Winery and Vineyard Law

For information on how to become a faculty member for one of our seminars, contact the Planning Department at the address below, by calling **(800) 777-8707,** or emailing us at speakerinfo@nbi-sems.com.

NBI, Inc.
PO Box 3067
Eau Claire, WI 54702

67379

Are you **maximizing** the **visibility** of your company?

Let us help you.

Savvy businesses know they need to take every opportunity to get their company and products in front of the right audience. NBI ***is*** that opportunity.

By sponsoring break times at NBI seminars, you're taking advantage of yet another way to establish relationships with new customers – and solidify your contact with those you already have.

Why pass up this opportunity when reaching our shared audience is so easy? Call us today to find out more about how you can become a sponsor for an NBI seminar.

800.777.8707

Laurie Johnston

Legal Product Specialist
laurie.johnston@nbi-sems.com

NBI NATIONAL BUSINESS INSTITUTE™

www.nbi-sems.com

IN-HOUSE TRAINING

Can training your staff be easy **and** individualized?

It can be with NBI.

Your company is unique, and so are your training needs. Let NBI tailor the content of a training program to address the topics and challenges that are relevant to you.

With customized in-house training we will work with you to create a program that helps you meet your particular training objectives. For maximum convenience we will bring the training session right where you need it…to your office. Whether you need to train 5 or 500 employees, we'll help you get everyone up to speed on the topics that impact your organization most!

Spend your valuable time and money on the information and skills you really need! Call us today and we will begin putting our training solutions to work for you.

800.930.6182

Jim Lau | Laurie Johnston

Legal Product Specialists
jim.lau@nbi-sems.com
laurie.johnston@nbi-sems.com

NBI | NATIONAL BUSINESS INSTITUTE

www.nbi-sems.com

Winery and Vineyard Law

Authors

David B. Albo
Albo & Oblon, L.L.P.
6367 Rolling Mill Place, Suite 102
Springfield, VA

Denise Gorrell
Samuels Yoelin Kantor LLP
111 SW 5th Avenue, Suite 3800
Portland, OR

Charles E. Harrell
Buckley Law P.C.
5300 SW Meadows Road, Suite 200
Lake Oswego, OR

Katie Hellebush
The Alliance Group
2201 West Main Street
Richmond, VA

E. Michael Paturis
E. Michael Paturis, Attorney at Law
431 N Lee Street
Alexandria, VA

Philip Carter Strother
Strother Law Offices, PLC
The Hillyard-Maury House
Richmond, VA

Lindsey A. Zahn
Lehrman Beverage Law, PLLC
2911 Hunter Mill Road, Suite 303
Oakton, VA

Presenters

DAVID B. ALBO is a partner in the Arlington law firm of Albo & Oblon, L.L.P. As a veteran legislative leader in the Virginia General Assembly, House of Delegates, he has helped write every change to Virginia's ABC ("Alcohol Beverage Control") laws for almost two decades. Mr. Albo authored laws dealing with alternate ways to calculate the food to alcohol ratio for restaurants that serve high end distilled spirits, Sunday sales of alcohol at ABC stores, advertising rules, specialty and banquet license changes, franchise act amendments, and some of the nation's toughest penalties for drunk driving, just to name a few. He is an accomplished litigator in both criminal and civil litigation. Mr. Albo earned his B.A. degree at the University of Virginia and his J.D. degree at the University of Richmond School of Law.

KATIE HELLEBUSH is the Vice President of Government Affairs for the Alliance Group. Ms. Hellebush brings experience in successfully advocating on a wide array of legislative and regulatory policy issues at the local, state and federal level in addition to association management of nonprofits. She currently serves as the Executive Director of the Virginia Grain Producers Association, and Director of Virginia Wine Council. Prior to joining The Alliance Group, Ms. Hellebush served as the Director of Government Relations for the Virginia Hospitality & Travel Association (VHTA), where she represented the multi-billion dollar tourism industry on a range of legislative and regulatory issues of importance to Virginia businesses and employers. Prior to her position with VHTA, she worked with the Virginia Chamber of Commerce. Ms. Hellebush enjoys working on a wide variety of policy issues and considers a day successful when she comes up with an innovative way to better serve her clients. She is a 2005 graduate of the University of Richmond where she majored in Political Science and French.

E. MICHAEL PATURIS J.D., C.P.A., is the principal of the law office of E. Michael Paturis, Attorney at Law in Alexandria. He also is a Certified Public Accountant in Virginia. Since 1959, Mr. Paturis has focused his practice in the areas of taxation, including: trusts and estates, estate planning, wills, probate, business law, corporate law, partnership law, limited liability company law, business estate planning, business formation, business organization, business planning, business succession planning, business taxation, business torts, business transfers, buy-sell agreements, closely held business law, closely held business taxation, professional practices, closely held corporations, corporate commercial law, nonprofit corporations, professional corporations, S corporations, estate and gift taxation, federal estate and gift taxation, federal income tax, federal tax controversies, tax appeals, tax law, and tax planning. He is a former Tax Specialist in the Chief Counsel's Office of the Internal Revenue Service and a former Senior Trial Attorney in Regional Counsel's Office of the Internal Revenue Service. Mr. Paturis is listed in: *Who's Who in American Law, Who's Who in the World, Who's Who in Finance and Industry,* and *Who's Who in America.* He is a member of the Alexandria, Fairfax County and Virginia Bar Associations; The District of Columbia Bar; North Carolina State Bar; Virginia State Bar; and the Virginia Society of Certified Public Accountants. Mr. Paturis earned his B.S. degree in Business at the University of North Carolina at Chapel Hill and his J.D. degree, with honors, at the University Of North Carolina School Of Law at Chapel Hill.

PHILIP CARTER STROTHER is the founder and managing partner of Strother Law Offices, PLC, with offices in Richmond. He serves as general counsel to many Virginia farm wineries. Mr. Strother has been instrumental in the development of legislation to promote the economic viability of the Virginia Wine Industry, including drafting legislation, testifying before General Assembly committees and serving as a participant of the Secretary of Agriculture and Forestry's Virginia Wine Industry Study Group. He also has successfully represented clients before the Virginia Alcoholic Beverage Control Board on numerous occasions. Mr. Strother has extensive experience with complex litigation, land use and zoning, alcoholic beverage control law, Virginia Wine Industry, and Business Law. Mr. Strother has been published and has lectured in numerous areas of the law. He earned his B.S. degree at Elon University, his J.D. degree, cum laude, at Thomas M. Cooley Law School and his L.L.M. in Environmental Graduate Honor Fellowship for academic excellence Law at The George Washington University Law School.

JARROD THOMAS is an attorney with the Strother Law Offices, PLC, in Richmond. His practice areas include Alcoholic Beverage Control Law, Virginia Wine Industry, business law, land use and zoning. Mr. Thomas served a judicial clerkship for the Honorable Cheryl V. Higgins in the Albemarle County Circuit Court. He earned his B.A. degree at the University of Virginia and his J.D. degree at Rutgers University School of Law.

LINDSEY A. ZAHN is an alcohol beverage attorney with the Oakton law firm Lehrman Beverage Law, PLLC. She has previously counseled wine, beer, and spirits producers; importers, wholesalers, and distributors on licensing and compliance; federal and state labeling; customs regulations; supplier agreements; and advertising and promotions. Ms. Zahn is an award winning author on wine law, publishes a leading wine law blog called On Reserve, and has traveled to over a dozen wine regions in the U.S. and Europe. She earned her B.S. degree from Cornell University and her J.D. degree from Brooklyn Law School. Ms. Zahn holds a University Diploma in Transnational Wine Trade Law from the Université de Reims Champagne-Ardenne.

Table Of Contents

Hot Topics in Local Government
Winery Regulations

Submitted by David B. Albo

I. Hot Topics in Local Government Winery Regulations: Conflict with Local Governments & Desire of Small Wineries to By-pass Wholesalers

A. **Conflict with Local Governments**.

Local governments want wineries to move in. A winery is inexpensive to take care of. (e.g. a 1,000 town house development requires sewage, police and schools, while a winery costs a local government nothing). However, many local governments don't want wineries to do anything but grow wine. The problem is that it is very difficult for a winery to make money just on selling their wine. To be able to even scrape by, wineries began engaging in tourism and entertainment to supplement their income. However, some wineries were extreme in their activities with balloon rides, rock shows, and huge events every weekend. Similarly, some local governments have taken the regulation of wineries over the top by trying to regulate the sound of car tires on gravel roads, limiting hours to ridiculous time frames, limiting the number of people allowed to visit, and passing rules that you cannot even play a stereo if any sound goes out of the boundaries of the winery.

Wineries countered local government regulations by citing a law known as the "Right To Farm Act" which limits local governments' ability to regulate farms. Conversely, local governments countered the wineries claims by saying that events such as wine dinners, tastings and weddings were not "farming."

Things came to a head in 2006, when Oasis Winery, according to Fauquier County, went "over the top" with live bands, festivals, and balloon rides. Fauquier's response, according to the wineries, was over the top. The wineries complained that new zoning and noise ordinances created such strict rules that they would go out of business. For example, the rules banned the times when a winery could have personal guests, and made any outdoor amplified music illegal. A hard fought bill was passed in 2006 and then updated in 2007 to establish the parameters as to what rules local governments can regulate with regard to activities on winery property.

But this did not solve the problem. Still, some wineries and some counties are at each others throats.

Here are summaries of the 2006 bill and a re-write of it in 2007.

> HB 1435 Farm wineries; local regulation thereof, report.
> David B. Albo | all patrons
>
> Zoning; agricultural districts; farm wineries. Provides that localities may not require that a special exception or special use permit be obtained for the processing of wine by licensed farm wineries. Also, no locality may adopt any requirements for special exceptions or special use permits

relating to licensed farm wineries that would be more restrictive than its requirements in effect as of January 1, 2006. Further, any special exception or special use permit in effect as of January 1, 2006, shall remain in effect until July 1, 2007, unless such exception or permit is either no longer required by the locality or is amended to be less restrictive. Other provisions are also included that are generally intended to temporarily preserve the status quo while the Secretary of Agriculture and Forestry undertakes a study of issues surrounding the farm winery industry. The results of such study are to be reported to the 2007 Session of the General Assembly.

HB 2493 Farm wineries; establishes criteria for local regulation thereof. David B. Albo | all patrons

Farm wineries. Provides that local restriction upon licensed farm wineries' activities and events to market and sell their products shall be reasonable and shall take into account the economic impact on the farm winery of such restriction and whether such activities and events are usual and customary for farm wineries throughout the Commonwealth. The bill further provides that no local ordinance regulating noise, other than outdoor amplified music, arising from activities and events at farm wineries shall be more restrictive than that in the general noise ordinance. This bill is identical to SB1205.

The current state of the law is set forth in VA Code §15.2-2288.3. I would advise each Virginia winery to know this statute inside and out and compare it to zoning, health and noise ordinances that your local government imposes. Provisions of the local government ordinances may very well be in violation of this statute.

§ 15.2-2288.3. Licensed farm wineries; local regulation of certain activities.

A. It is the policy of the Commonwealth to preserve the economic vitality of the Virginia wine industry while maintaining appropriate land use authority to protect the health, safety, and welfare of the citizens of the Commonwealth, and to permit the reasonable expectation of uses in specific zoning categories. Local restriction upon such activities and events of farm wineries licensed in accordance with Title 4.1 to market and sell their products shall be reasonable and shall take into account the economic impact on the farm winery of such restriction, the agricultural nature of such activities and events, and whether such activities and events are usual and customary for farm wineries throughout the Commonwealth. Usual and customary activities and events at farm wineries shall be permitted without local regulation unless there is a substantial impact on the health, safety, or welfare of the public. No local ordinance regulating noise, other than outdoor amplified music, arising from activities and

events at farm wineries shall be more restrictive than that in the general noise ordinance. In authorizing outdoor amplified music at a farm winery, the locality shall consider the effect on adjacent property owners and nearby residents.

B, C. [Expired.]

D. No locality may treat private personal gatherings held by the owner of a licensed farm winery who resides at the farm winery or on property adjacent thereto that is owned or controlled by such owner at which gatherings wine is not sold or marketed and for which no consideration is received by the farm winery or its agents differently from private personal gatherings by other citizens.

E. No locality shall regulate any of the following activities of a farm winery licensed in accordance with subdivision 5 of § 4.1-207 :

1. The production and harvesting of fruit and other agricultural products and the manufacturing of wine;

2. The on-premises sale, tasting, or consumption of wine during regular business hours within the normal course of business of the licensed farm winery;

3. The direct sale and shipment of wine by common carrier to consumers in accordance with Title 4.1 and regulations of the Alcoholic Beverage Control Board;

4. The sale and shipment of wine to the Alcoholic Beverage Control Board, licensed wholesalers, and out-of-state purchasers in accordance with Title 4.1, regulations of the Alcoholic Beverage Control Board, and federal law;

5. The storage, warehousing, and wholesaling of wine in accordance with Title 4.1, regulations of the Alcoholic Beverage Control Board, and federal law; or

6. The sale of wine-related items that are incidental to the sale of wine.

Note also that a separate VA Code provision §4.1-129 gives local governments the authority to regulate Sunday sales of wine and beer between house of 12 pm. Saturday and 6 a.m. Monday.

Unless you have a ton of money, you cannot effectively litigate against a local government. They essentially have paid lawyers on staff. Litigating a case

against someone who has free lawyers is an expensive journey. I suggest that you develop a personal relationship with your local government representative. Solving over burdensome restrictions is usually more easily done through the political process. And if you are not getting anywhere, run for office yourself! Wineries should be represented in our many "citizen legislatures" throughout the Commonwealth.

B. **Desire of Small Wineries to By-Pass Wholesalers**.

When Prohibition ended, over 80 years ago, Virginia created the "Three Tier System" (Also known as the "Tied House" statutes). Without going into every element of this system, the basic theme is that Manufacturing/Distribution/Sale should all be separated. Thus,

- Wineries/Breweries/Distilleries cannot be Wholesalers/Distributors nor sell directly to the public.
- Wholesalers/Distributors cannot make alcohol nor sell directly to the public.
- Retailers cannot make alcohol and cannot distribute alcohol.

Recently, the most common complaints by Retailers are that they can sometimes get better deals at big box retailers such as Costco, but because of the Three Tier System, they have to buy from wholesalers. Also, some Retailers complain that a simple task such as merely shifting wine from one location to another is barred by the Three Tier System. They have to hire a wholesaler to transfer the wine that they already own.

Recently, the most common protests by small Wineries are that they can't afford to hire a Wholesaler because they are not big enough to afford to eat the delivery costs. They would rather sell their wine directly to stores and restaurants, but they cannot because they have to use a wholesaler. (Note: later you will see a "work around" to this for some small wineries.) They also complain that Wholesalers don't seem to want to aggressively promote their wine or beer.

This issue NEVER seems to go totally away. Later we will see some changes in the laws that have tried to address these problems. Over the years, some exceptions have been made.

As for Virginia Wineries, the landmark bill was passed in 2007. It did not let small wineries bypass the Three Tier System. Rather, it had the VA ABC create a government approved wholesaler (the Virginia Wine Distribution Company which is managed by ABC itself) for the sole purpose of transporting small Farm Wineries wines.

> HB 2450 Alcoholic beverage control; creates new restricted wholesale wine license.

Christopher B. Saxman

Alcoholic beverage control; creates new wholesale wine license. Creates a new restricted wholesale wine license that authorizes the licensee to provide wholesale wine distribution services to winery and farm winery licensees, provided that no more than 3,000 cases of wine produced by a winery or farm winery licensee shall be distributed by the corporation in any one year. The bill requires the Commissioner of the Department of Agriculture and Consumer Services to form a nonprofit nonstock corporation that will hold this new license to promote, develop, and sustain markets for licensed Virginia wineries and farm wineries. The bill also allows certain licensees to deliver or ship beer or wine from one or more premises identified in the license. The bill sets the state license tax for this new license and requires the ABC Board to adopt emergency regulations to implement the provisions of the bill. This bill is identical to SB1413 and contains an emergency clause.

The law appears in VA Code §4.1-207.1. (See later in the outline for further discussion.)

Other changes have been made to address complaints. While they will be discussed later, a few examples are listed in VA Code §4.1-201 Conduct Not Prohibited By This Title; Limitation, and VA Code §4.1-201.1 Conduct Not Prohibited By This Title; Tastings By Manufacturers [e.g. winery] Notice that each of these are essentially exceptions to the Three Tier System. This list, as you will see, is not exhaustive of all the exceptions.

- Farm Wineries are allowed to sell wine at the winery. (See §4.1-201A(5))
- Wineries can receive of wine in closed containers from other wineries (See §4.1-201A(7))
- A Winery can ship its wine in closed containers to another Winery for the purpose of additional bottling and return of the wine the manufacturing Winery. (See §4.1-201A(9))
- A Winery can provide "to adult customers of licensed retail establishments information about wine being consumed on" the premises of a Retail establishment. In other words, Winery reps can help explain wine at a Retail shop. (See §4.1-201A(17))
- Wineries may conduct tastings of wine at hotels, restaurants, and clubs license for on-premises consumption under certain criteria. (See §4.1-201.1)

Hot Topics in Local Government
Winery Regulations

Submitted by Katie Hellebush

Virginia Wine Law CLE

1- Overview of Legislation 2014 that impacts Land Use/Farm Wineries: On Farm Activities/Limited Breweries
(10-15 minutes)

- On Farm Activities (HB268, HB71, SB51) http://lis.virginia.gov/cgi-bin/legp604.exe?ses=141&typ=bil&val=hb268
- Limited Brewery License (SB430) http://lis.virginia.gov/cgi-bin/legp604.exe?ses=141&typ=bil&val=sb430
- Zoning - Clarification of agricultural products (HB1089) http://lis.virginia.gov/cgi-bin/legp604.exe?ses=141&typ=bil&val=hb1089
- Right to Farm (SB5) http://lis.virginia.gov/cgi-bin/legp604.exe?ses=141&typ=bil&val=sb5

2- Overview of Local Approaches: Reaction to 2014 Legislation & Economic Development Strategies
(10-15 minutes)

- Albemarle County Local Ordinance Development: Winery, Brewery, Agricultural Operation http://www.albemarle.org/agenda.asp?department=bos&year=2014
- Rockingham County Board of Sense http://www.rockinghamcountyva.gov/index.aspx?NID=172
- Nelson County Article on Food Trucks http://www.newsadvance.com/nelson_county_times/news/agritourism-policy-needs-new-language-and-rules/article_2d0bad86-1d6d-11e4-b12b-001a4bcf6878.html
- Hanover County Article on Friendly Brewery Laws re: Zoning http://www.herald-progress.com/?p=17848

3- Overview of Developing Questions Going Forward: Enforcement? State, Local Patchwork…
(10-15 minutes)

- Enforcement
- Complaint Driven
- Cost to Enforce; Cost to Agribusiness; Cost to Community
- Locality vs State
- ABC vs VDH vs VDACS
- Rural Planning/Economic Development

4- As agriculture continues to grow and agribusinesses continue to find success with new models, how do we build strong relationships; how do we define “normal and customary” without limiting innovation? How do we position ourselves to continue to be the fastest growing ag sector in VA?
(10-15 minutes)

- Background: Fauquier County vs Albemarle County Local Ordinances
- King Family Vineyards – special permit for polo http://www.nbc29.com/story/26709009/county-requires-special-use-permit-for-free-sunday-polo-at-king-family

Wine Business Entity Selection

Submitted by Philip Carter Strother

WINERY BUSINESS ENTITY SELECTION

Entity selection is one of the first choices that an aspiring winery owner must make. Entity selection will influence nearly all of the early operations and actions of a winery, as well as those during the course of its life, and the discontinuing or transfer of its operations. The entity chosen by a winery owner will affect business management, liability, distribution of profits, raising of capital, and taxation, among other issues. This article will serve as a primer for winery entity selection by discussing common questions and issues that should be addressed before an entrepreneur decides on his choice of entity. Section A will begin with a discussion of basic questions that owners should consider when selecting an entity type, Section B will analyze the benefits and drawbacks to various types of entities, Section C will briefly discuss the use of multiple entities, and Section D will conclude by covering succession planning for wineries.

A. INITIAL QUESTIONS

There are a number of questions that a winery entrepreneur should consider before choosing a business entity. While an owner may alter the business' form later in the life of the winery, there may be additional obstacles and difficulties depending on individual circumstances; therefore, it is critical to consider a variety of business issues that may arise not only during initial formation, but also during the life of the winery.

1. *Is the Business involved in Production, Wholesaling, Retailing, or a Combination?*

Virginia utilizes a three-tier distribution system for alcoholic beverages, largely insulating production, wholesale, and retail operations from each other. Regardless of entity choice, if the proper license is not granted, a business will be limited in its ability to produce, distribute, or directly sell wine. The Virginia Alcoholic Beverage Control Board ("Board") issues different licenses for producers, wholesalers, and retailers of wine.[1] While the three-tier system seeks to stratify the alcoholic beverage industry by force of law, in reality many wine businesses will be engaged in a combination of these operations.[2] Indeed, in the earlier stages of their lives, most wineries, especially smaller operations, will likely be involved in a combination of

[1] *See* VA. CODE. ANN. § 4.1-207.

[2] There are exceptions to the strict division of production, wholesale, and retail operations. For example, a Farm Winery License allows certain businesses to both produce wine and sell it directly to consumers. VA. CODE ANN. § 4.1-207(5).

production and retail activity. Whatever the combination of activities engaged in by the business, basic concerns related to each sphere are briefly discussed below.

i. Production

A business involved in the production of wine may or may not grow its own grapes, and those grapes may or may not be grown in the Commonwealth.[3] If a winery is involved in only the production of grapes and/or wine, the business will likely be most interested in the ability to raise capital in order to acquire the land, fixtures, and equipment necessary to produce grapes and wine. Production oriented businesses that are not open to the public will not have as high a concern for tort liability as retail or combination businesses that must be concerned for the safety of invitees.

ii. Wholesale

A business involved in wholesale will be concerned mostly with the procurement, storage, transportation, and sale of wine. Similar to a production oriented winery, a wholesaler need not be as concerned over general tort liability for members of the general public. A wholesaler will, however, need to be keenly aware of contractual obligations between producers, itself, and retailers. Moreover, a wholesaler will likely want, or need, to maintain comprehensive insurance policies on its products and facilities. Therefore, an entity that facilitates the ability to enter into potentially complex contracts is ideal.

iii. Retail

Smaller winery operations, specifically Farm Wineries, rely largely on on-site retail sales to succeed.[4] Therefore, unlike the above businesses, a business involved in the retail sale of wine must be especially concerned for the potential of injury to invitees on-site. Retail

[3] A licensee holding a "Wine License" simply produces wine from grapes obtained elsewhere, either in-state or out-of-state. *See* VA. CODE ANN. § 4.1-207(1). Whereas a licensee holding a "Farm Winery License" produces wine from grapes grown by the licensee or obtained from other in-state farms. *See* VA. CODE ANN. §§ 4.1-207(5), 4.1-219.

[4] "To generate their revenue, '[t]he vast majority' of these wineries rely on the higher margins produced by sales made directly to the customer in the tasting room." Philip Carter Strother & Andrew E. Tarne, *The Grapes of Wrath: Encouraging Fruitful Collaborations Between Local Governments and Farm Wineries in the Commonwealth*, 48 U. RICH. L. REV. 235, 261 (2013) (quoting VIRGINIA WINE BOARD, THE ECONOMIC IMPACT OF WINE AND WINE GRAPES ON THE STATE OF VIRGINIA—2010, at 2 (2012)).

businesses must focus on bringing customers on-site to taste and make purchases. Retailers, therefore, should choose an entity that facilitates the development of a customer friendly atmosphere and limits the personal liability of owners to potential injuries sustained on-site.

2. *Will Land be Acquired?*

Generally speaking, the entity itself should perform any land acquisition. If the entrepreneur already owns land that is to be used for the winery, the entrepreneur should transfer the land to the winery. It is important for the business to own the land to further limit the business owner's potential personal liability for debts associated with the land or for injuries that occur on the land.

Land is expensive, especially if the entrepreneur is building the winery from the ground up. Real estate costs will accrue quickly, from the cost of undeveloped land, to site preparation, to planting, to construction, to equipment. The acquisition of land, therefore, can influence the choice of entity. The business owner should consider whether the business will assume debt or sell equity to outside investors to raise capital. If the business intends to debt finance land acquisitions, the owner should know that he could be required to act as a guarantor or co-signor for any loans, because lenders may be uneasy with lending to an unproven limited liability entity. On the other hand, if the business intends to raise capital through the sale of equity, the original owners' control over the company could be compromised.

3. *Who will Manage the Business?*

Management will likely be one of the more important and potentially contentious issues facing winery owners, not only at the formation of the business, but also throughout its life. The initial founders of the business will likely desire to retain some measure of control over the winery, including not only day-to-day operations, but also long term stewardship. While founding friends or family members may be amicable to each other during the formation of the winery, future disputes are all but inevitable. Management of the company, therefore, is something that must be discussed in-depth with any and all initial entrepreneurs looking to form the winery.

The possibilities for management of a winery are essentially boundless given the various business entities available. Generally, management is conducted by the general partner(s) in a

limited partnership, by the operating agreement procedures in an LLC, and by both a board of directors (overall management) and corporate officers (day-to-day management) in either S- or C-Corporations. Each entity type offers flexibility in the specifics of management, as the founders are free to limit or expand the powers of managers in the business' formative document.

An LLC likely offers the most flexibility of management options as it is not required to observe certain corporate formalities or maintain a board of directors in addition to corporate officers. The founders of an LLC may, for example, grant each other management rights equal to the percentage of their initial capital contribution to the company. In the alternative, the formative documents can name a sole managing member, or provide for the election of a managing member or a non-member manager.

Regardless of the entity form chosen, it is important for the formative documents to specify the management rights of individuals within the company. Prior to formation, the founders should consider whether they want control over day-to-day operations of the winery or if they simply want to manage the overall functions of the business. While there is a distinction between the two levels of management, in a small winery setting, these control groups may easily overlap.

So as to avoid disputes and potential gridlock over day-to-day operations, it may be useful to vest all day-to-day management power in one trusted individual, or to provide for the election of such an individual by the owners.[5] With this arrangement, the business' formative documents should specify what actions are substantial and not of a general day-to-day nature, requiring agreement among all or a majority of the owners of the business.[6]

4. *What are the Liability Concerns?*

[5] The LLC form offers the most flexibility to achieve this type of management arrangement. However, corporations can also be used to achieve this arrangement as the winery owners would elect a board of directors to control overall management and in turn to hire corporate officers to have responsibility over day-to-day management.

[6] Control issues may arise more frequently in an entity with only two owners, each with equal management rights. In that event, deadlock is especially possible, leading to an essential moratorium on operations. Therefore, if only two owners exist, they should agree and specify in the business' formative documents that a single owner has the sole authority to act on day-to-day and general operational matters, but that both owners must agree before the business undertakes a different sort of substantial action.

As with any industry, one of the most important reasons for a winery entrepreneur to formally create a separate business entity is to secure a measure of safety from personal liability for the debts and obligations of the business. There are a multitude of liabilities that a business can incur that owner(s) will want to avoid personally.

i. Sources of Liability

During the initial formation of the winery and throughout its life, the business will incur debts and assume voluntary obligations owed to third parties through contracts. Likewise, the business may incur involuntary obligations, such as the costs and damages associated with adverse judgments from personal injury or nuisance suits. The business will also be responsible for licensing fees and taxes. Moreover, especially if the winery is involved in the growth of grapes and direct production of wine, the business could incur costs associated with government environmental investigations of the site, for example those under the Clean Water Act[7] or CERCLA.[8]

While many of these occurrences may seem unlikely or avoidable, owner(s) should seek preemptive protection from them by choosing the proper business entity. A single bad crop or vintage could cause a winery to not only lose revenue, but also default on debts, fail to meet contractual obligations, and be unable to pay taxes and licensing fees. If a single invitee to a tasting room slips on a slick floor, the winery will likely incur substantial litigation costs, even if it ultimately prevails in court. Even if the winery inadvertently causes groundwater contamination or other adverse environmental impacts, it will be responsible for the costs of remediation. The only manner in which the winery's owner(s) can avoid personal liability for these occurrences is by choosing any limited liability entity discussed in more detail below.

[7] Federal Water Pollution Control Act Amendments of 1972, 33 U.S.C. §§ 1251-1387 (2006.)

[8] Comprehensive Environmental Response, Compensation, and Liability Act, 42 U.S.C. §§ 9601-9675 (2006).

ii. Virginia Agritourism Activity Liability Statute

If the new winery is licensed as a Virginia Farm Winery, or otherwise engages in agricultural operations open for public participation or observation, the Virginia Agritourism Activity Liability Statute may provide further protection from tort liability to the owners, employees, agents, and business itself, regardless of form.[9] With limited exceptions, the Agritourism Statute provides an affirmative defense to tort actions arising "from the inherent risks of agritourism activities."[10]

iii. Piercing the Veil

Due to the doctrine of "piercing the veil," personal liability for debts or judgments against even a limited liability entity can never be fully eliminated, and attorneys should always inform their clients as such. A full discussion of piercing the veil is beyond the scope of this article; however, it should be sufficient to note that Virginia courts are very hesitant to pierce the veil of Virginia businesses.

Noting that "a corporation is a legal entity separate and distinct from the shareholders or members who compose it," the Supreme Court of Virginia has stated that "immunity of stockholders is a basic provision of statutory and common law and supports a vital economic policy underlying the whole corporate concept."[11] A plaintiff who wishes to pierce the veil of a limited liability entity "must show that the corporate entity was the *alter ego*, alias, stooge, or dummy of the individuals sought to be charged personally and that the corporation was a device or sham used to disguise wrongs, obscure fraud, or conceal crime."[12]

5. *What about Urban Wineries?*

When most individuals picture a winery, they likely envision a pastoral setting, complete with rolling hills, neatly managed rows of vines, a barn, and a converted farm house serving as a tasting room. In other words, they are picturing a Farm Winery – an agricultural, wine producing

[9] VA. CODE ANN §§ 3.2-6400 to -6402.
[10] VA. CODE ANN. § 3.2-6401.
[11] Cheatle v. Rudd's Swimming Pool Supply Co., Inc., 234 Va. 207, 212, 360 S.E.2d 828, 831 (1987).
[12] *Id.*

and retailing enterprise. While less prolific, however, different types of wineries may exist. Specifically, a business located in an urban setting could exist solely to produce grapes purchased from elsewhere. In the alternative, the rural Farm Winery could conduct its own production, retail, or tasting operations in the city, away from the farm itself.

Urban wineries may encounter difficulties that rural wineries do not. For example, the closer proximity to neighbors could increase the potential for nuisance suits. Moreover, city zoning regulations may be more restrictive than those found in primarily rural communities. Further, urban wineries open to invitees may not enjoy the full protections of the Agritourism Liability Act. Finally, the current regulatory environment may not include a license that sufficiently applies to the operations of an urban winery.

Regardless of the exact function the urban winery will perform, the primary considerations involved for initial entity selection are largely the same as those discussed above. The first question for an urban winery entrepreneur to consider is whether the winery will primarily produce, distribute, or directly sell wine. The answer to that question will affect not only the licenses that the business must obtain, but also help to inform what entity form the business should take.

B. LIMITED LIABILITY ENTITY FORMS

Each entity has its own benefits and drawbacks. Some provide an easier ability to raise capital and grow, while others ensure that control remains firmly with the initial founders. Some receive more favorable tax treatment than others, and some require more stringent formalities and relatively more complex management. All of the entities discussed below provide limited personal liability to their owners, with the notable exception of general partners in an LP or FLP.

1. *Limited Partnership*[13]

A Limited Partnership ("LP") has an unlimited number of both general partners and limited partners. The general partner has sole control over management of the LP, and also has personal liability for the actions, debts, and obligations of the LP. Generally, limited partners have no personal liability for the LP, unless they engage in control of the LP. However, limited partners are not considered to be engaging in control of the LP by serving as an employee of LP,

[13] *See* VA. CODE ANN. §§ 50-73.1 to -73.78.

consulting with the general partner, acting as a surety for the LP, pursuing derivative actions in the right of the LP, requesting or attending meetings, or engaging in overall management decisions, such as the dissolution or sale of the LP.

An LP receives favorable tax treatment, as all profits and losses pass through the entity to the partners. An LP is also relatively simple to form, requiring registration and a partnership agreement.

Downsides to an LP include personal liability for the general partner and the potential difficulty in raising initial capital.

2. *Family Limited Partnership*

A Family Limited Partnership ("FLP") is essentially the same entity as an LP, except that it is comprised only of family members. As the name suggests, an FLP can be used to keep a winery and its assets completely within a single family.

3. *Limited Liability Company*[14]

A Limited Liability Company ("LLC") is comprised of an unlimited number of members. As discussed above, the management of an LLC can be accomplished in almost any means that its members desire. The formative documents can divide management among all members, name a single managing member, provide for the election of a managing member, or provide for the hiring of a third party manager. Generally, no member, managing or otherwise, has personal liability for the actions, debts, and obligations of the LLC.

An LLC receives favorable tax treatment, similar to that of an LP. The entity itself is untaxed, and all profits and losses pass through the entity to the members. Moreover, an LLC has the benefits of simple formation, requiring only articles of organization and an operating agreement, and flexibility in management arrangements, without the loss of limited liability. Furthermore, LLCs are generally not required to practice all the strict formalities and procedures required of corporations.

Like partnerships, an LLC may suffer from an initial difficulty in acquiring capital, without members guaranteeing debts of the company.

[14] *See* VA. CODE ANN. §§ 13.1-1000 to -13.1-1080.

4. *S-Corporation*[15]

An S-Corporation is a corporation that has a single class of stock and no more than 100 shareholders, who are natural persons (general) and either United States citizens or residents. A board of directors, elected by the shareholders, has control over the ultimate management of an S-Corporation, while corporate officers exercise control over day-to-day operations.

An S-Corporation receives the same favorable, pass-through tax treatment as LLCs and LPs. S-Corporations benefit primarily from the ability to raise capital through stock sales. As an S-Corporation can have 100 shareholders, capital can be raised relatively painlessly if equity investors are available.

The downside to S-Corporations in the small winery context is that an expansion of shareholders will dilute ownership of the winery. Moreover, because S-Corporations can only issue a single class of stock, the voting rights and profit rights of the original owners may decrease with each new shareholder. Furthermore, S-Corporations must strictly practice various corporate formalities, which could possibly prove too demanding on a small winery.

5. *C-Corporation*[16]

The primary difference between a C-Corporation and an S-Corporation is in its tax treatment. The earnings of a C-Corporation are taxed both at the corporate level and again when distributed to shareholders. However, because of this method of taxation, C-Corporations are not encumbered by the various special requirements for S-Corporations, discussed above. C-Corporations can have an unlimited number of shareholders and issue multiple classes of stock. Moreover, fictitious persons – LLCs, corporations, partnerships, etc. – may serve as shareholders of a C-Corporation. C-Corporations are managed in the same manner as S-Corporations.

Similar to S-Corporations, the primary benefit of C-Corporations is the ability to raise capital. Moreover, because a C-Corporation can issue different classes of stock, the issuance of new stock to new shareholders does not necessarily have to dilute the rights of existing shareholders.

[15] *See* VA. CODE ANN. §§ 13.1-601 to -792; *see also* I.R.C. §§ 1361 to 1379.
[16] *See* VA. CODE ANN. §§ 13.1-601 to -792; *see also* I.R.C. §§ 301 to 385.

The two largest downsides to C-Corporations are that corporate earnings suffer double taxation, and that the corporation must strictly practice all corporate formalities.

C. When to Use Multiple Entities

The use of multiple entities is beneficial to establish clearly delineated control groups, to limit tax liability, and to compartmentalize potential damages in lawsuits.[17] Multiple entities may be especially useful when the winery is engaged in a multitude of operations, perhaps at separate locations.

Most smaller wineries will likely not benefit from the use of multiple entities. In order to truly compartmentalize the liabilities of parent, subsidiary, and sister entities, fairly complex business practices may be required. In order to minimize the possibility of a potential plaintiff piercing the entity's veil, each entity would need to maintain separate accounts, hold separate meetings, and observe other formal distinctions among themselves. Such procedures will likely only be viable for a larger winery business, well beyond the point of initial entity selection and formation.[18]

D. Succession Planning

With every business, there inevitably comes a time when the initial owners will dissolve the business, sell it, or transfer it to family members. Though entrepreneurs starting a business may not naturally look ahead to the end of their involvement with that business, or that business itself, they should always consider an exit strategy in the beginning to avoid excessive future disputes.

1. *Dissolution and Sales to Third Parties*

Voluntary dissolution is relatively straightforward, generally requiring consent of the owners (as provided in the formative documents), a payment of outstanding debts, and a

[17] As discussed above, however, parent or sister entities could still be held accountable for debts and judgments through a piercing of the veil.

[18] If multiple entities are contemplated for the future, the use of the more formal corporate entity form is likely best.

distribution of assets to the owners. Selling or transferring the winery similarly requires consent of the existing owners and adoptions of certain obligations by the transferee(s).[19]

Assuming the winery is solvent, the actual dissolution, sale, or transfer will not likely present many problems. Problems are likely to arise internally over whose approval is required for such an action. Each entity form discussed herein has statutory default rules requiring certain levels of owner approval for dissolution or transfer; however, these rules can generally be altered in the formative documents of the winery. With some limitations depending on entity form, the original owners of the winery can choose exactly whose consent is needed for dissolution or transfer. To avoid unnecessary litigation when some, but not all, of the owners move to dissolve or transfer the business, the formative documents should clearly include provisions governing consent to dissolve or transfer. Furthermore, the original owners of the winery should be aware that whenever they add new owners, especially in the context of corporations, they are diluting their ownership interest in the winery. If the original owners are not careful in the issuance of new stock or acceptance of new partners, they could find the new owners forcing an unwanted transfer.

2. *Transferring the Business to Family Members*

If the original owners of a winery wish to retire and choose to transfer the winery to family members to continue its operations, they may accomplish those ends in a few ways, depending on the entity type.

- An LP or FLP could simply admit family members as new limited partners, and the partners could then vote on a new general partner.
- An LLC could similarly admit family members as new members of the LLC, and all the members could vote for a new managing member or members.
- Shareholders in either an S-Corporation or C-Corporation could simply gift or sell their shares to family members to transfer the corporation to them.

[19] For example, the purchaser of a winery generally has a statutory obligation to uphold all of the agreements that the selling winery had in place with wholesalers in effect on the date of purchase. VA. CODE ANN. § 4.1-405.

As with provisions for initial ownership and management, the founders of any of these entities have fairly broad discretion in choosing how to bring in new partners or members, or how to provide for the sale of stock. To make future transfers as painless as possible, it is crucial for the original owners of the winery, from the foundation of the business, to consider how they may wish to transfer their winery to family members in the future.

Wine Law in Virginia

Wine Business Entity Selection

Philip Carter Strother
Founder/Managing Partner of Strother Law Offices, PLC
CEO of Philip Carter Winery of Virginia

Introduction

One of the most basic, and yet most important decisions that an aspiring winery owner must make, is how to organize the winery as a registered business

Topics of Discussion

- Initial questions to ask before determining the best entity type
- Benefits and drawbacks to various types of entities
- When to use (or not use) multiple entities
- Exit Strategy

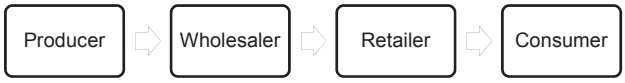
Initial Questions

- Is the business involved in production, wholesale, retail, or a combination?
- Will land be acquired?
- Who will run the day-to-day operations and who will control the overall management of the winery
- What are some liability concerns facing the winery and its owner(s)?
- What unique issues may face urban wineries?

Initial Questions

Production, wholesale, retail, or a combination?

- The Three-Tier Distribution System
  - General statutory separation of the production, wholesale, and retail of alcoholic beverages
  - Proper license required at each tier
  - Farm Wineries are an exception to the general rule



Initial Questions

Production

- Will the winery produce its own grapes, purchase grapes, or both produce and purchase?
- What kind of capital does a production operation require?
- Production only businesses that are closed to the public will have a smaller concern for tort liability

Wholesale

- Major operations
  - Procurement
  - Storage
  - Transportation
  - Sales
- Entity and its managers should have the ability to enter into potentially complex commercial and insurance contracts

Retail

- Is the retail operation on or off the site of the production operation?
- Limited liability is especially important as invitees will be on-site

Combined Operations

- Farm Wineries
  - Farm Wineries are permitted to produce alcohol and retail it directly to consumers (VA. CODE. ANN. § 4.1-207(5))
  - Farm Wineries are by far the most common wine businesses in Virginia
- Farm Winery entities should have
  - The ability to raise capital for production costs
  - Protect their owners from tort liability to invitees and others

Will Land be Acquired?

- Any land acquisitions should be done by the entity itself
- If the entity must acquire land from third parties, ability to raise capital is crucial
  - Debt financing
    - Owners may need to co-sign
  - Equity financing
    - Control of the winery could be compromised

Who will Manage?

- One of the most important, and potentially contentious, issues
- Control issues should be thoroughly discussed prior to formation
- Distinction between
  - Day-to-day operations
  - Overall management

Who will Manage?

- Day-to-day operations
  - Regular business transactions
  - Employee management
- Overall management
  - Substantial business decisions
    - E.g., selling all or substantially all of the business' assets
  - Hiring of managers

Who will Manage?

- What involvement do the owners want?
  - Running the day-to-day operations
  - Overall management
  - Both
- What kind of employees will be hired?
  - Managers with authority to conduct day-to-day operations
  - Employees with no authority over management

Who will Manage?

- Discuss these questions prior to formation
- Specific management responsibilities can be enumerated and divided in the winery's initial operating agreement (articles of incorporation, partnership agreement, etc.)
  - Flexibility to determine initially what is and isn't a management decision that requires consent of all, or a majority, of the owners

Initial Questions

What are the Liability Concerns?

- Sources of Liability
- Registration as a limited liability entity will protect the winery owners from personal liability
- Agritourism Activity Liability Statute
- Limited Liability and Piercing the Veil

Initial Questions

Sources of Liability

- Breach of Contract
- Personal Injury Suits
- Nuisance Suits
- Government Action
  - Licensing problems
  - Tax Liability
  - Environmental investigations

Limited Liability Entities

- Entities that protect against personal liability
  - Limited Partnerships
    - Family Limited Partnerships
  - Limited Liability Companies
  - Corporations
    - S-Corporations
    - C-Corporations

Agritourism Activity

- VA. CODE. ANN. § 3.2-6400 *et seq.*
  - Affirmative defense against personal injuries sustained by participants in agritourism activities
    - Essentially an assumption of risk defense
  - Owners must post a warning notifying invitees that they assume the risks of agritourism activities
  - May not reach all types of injuries sustained by invitees

Piercing the Veil

- Business owners may sometimes be held liable for the debts and obligations of the business
  - Piercing the veil of the entity
- Rare under Virginia Law
  - "must show that the corporate entity was the *alter ego*, alias, stooge, or dummy of the individuals sought to be charged personally and that the corporation was a device or sham used to disguise wrongs, obscure fraud, or conceal crime." *Cheatle v. Rudd's Swimming Pool Supply Co., Inc.*, 234 Va. 207, 212, 360 S.E.2d 828, 831 (1987).

Urban Wineries

- Considerations
  - Who grows the grapes?
  - Does the urban winery both produce and directly market wine?
  - There may be stricter zoning regulations
  - Lack of protection under the Agritourism Liability Act
  - Difficulty obtaining a license

Limited Liability Entities

- Limited Partnerships
  - Family Limited Partnerships
- Limited Liability Companies
- Corporations
  - S-Corporations
  - C-Corporations

Limited Partnerships

- Partners
  - General
    - Manage the partnership, but do not benefit from limited liability
  - Limited
    - No control over regular operations, but enjoy limited liability
- Profits and losses pass through to partners (favorable tax treatment)
- May experience difficulties raising capital

Family Limited Partnerships

- Substantially similar to Limited Partnerships
- Partnership is limited to family members
  - Can be a useful vehicle to ensure control remains in a single family

Limited Liability Companies

- Most popular choice for wineries
- Full limited liability for all members
- Great flexibility in organizing management in the initial Operating Agreement
- Profits are taxed at the member level only, as in Partnerships
- LLCs are generally not required to maintain all the formalities that a corporation must
- Limited ability to raise capital
  - Owners may need to guaranty any debts taken

Initial Questions

S-Corporations

- Requirements to elect S-Corp status, 26 I.R.C. § 1361(b)
  - Only one class of stock
  - No more than 100 shareholders
    - Generally, only natural persons can be shareholders
    - Shareholders must be U.S. citizens or residents
- S-Corp election grants tax benefits similar to those of LLCs and Partnerships

Initial Questions

S-Corporations

- Overall management exercised by a board of directors, elected by the shareholders
- Day-to-day operations are run by officers selected by the board
- S-Corps must strictly observe corporate formalities
  - Record keeping, formal meetings, etc…

S-Corporations

- S-Corps can raise capital relatively painlessly through outside equity investors
  - Given a single class of stock, however, each new shareholder will dilute the control of the original owners
- S-Corps can prove useful for smaller family businesses that choose a corporate form over an LLC or Partnership

C-Corporations

- Do not have the same restrictions as S-Corps
  - Unlimited number and type of shareholders
  - Ability to issue multiple classes of stock
    - Stock restrictions can be used to ensure that new equity investors do not dilute the control of the original owners

C-Corporations

- Management is organized in the same way as S-Corps
  - Shareholders
  - Board of Directors
  - Officers
- C-Corps must observe all corporate formalities

C-Corporations

- Largest downside to C-Corps is the double taxation of all earnings
  - The corporation must pay taxes on its income
  - The shareholders must pay taxes on the income distributed by the corporation
- Given their relative complexity and double taxation, C-Corps should be reserved for larger operations

Multiple Entities

- Potential Uses
  - Delineate control groups
  - Limit tax liability
  - Limit liability for debts and other obligations
- Most useful for larger operations
- Smaller operations may find the separation, operation, and management of parent or sibling entities burdensome

Exit Strategy

- Exit strategy should be discussed at formation
- The formative documents should specify whose consent is required for dissolution, sale, or transfer
- Discussing the exit strategy initially can mitigate future disputes and litigation
- Acceptance of new members/partners or the issuance of new stock can dilute the original owners' control

Initial Questions

Transfers to Family Members

- Partnerships can admit family members as new limited partners, who then vote on a new general partner
- LLCs can admit family members as new members of the LLC, who then vote for a new managing member or members.
- Shareholders in either an S-Corporation or C-Corporation could simply gift or sell their shares to family members

Any questions?

Contact information:

Philip Carter Strother
Strother Law Offices, PLC
The Hillyard-Maury House
15 East Franklin Street
Richmond, Virginia 23219
804.523.2000
pstrother@strotherlaw.com

Tax Considerations and Consequences

Submitted by E. Michael Paturis

The first topic confronting us is whether a principal investor ("investor") would be able to provide services to a winery in exchange for an ownership interest. To no one's surprise, this can be done. The real issue is how to accomplish this to the mutual satisfaction of the present winery owners and the investor.

While it is customary for winery owners (as with the business owners of most businesses) to be reluctant to reduce their ownership interest, they may be more receptive than most business owners to a reduction of their ownership interest because of the nature of the winery business. To explain why winery owners would be more receptive, the winery business is capital intensive. Thus, capital is required for real estate, equipment, roads permitting ingress to and egress from the vineyards, vehicles and necessary personnel.

The question then becomes what is the most satisfactory mean from all of the parties' standpoint for securing the services of the investor. One mean is to provide the investor only a profit sharing interest without the transfer of an accompanying capital interest. In this connection, see Rev. Proc. 93-27 and Rev. Proc. 2001-43 which permits such to be done without immediate tax consequences if there is no accompanying transfer of a capital interest,. The advantage to the investor is that the investor would only realize income at the time monies are received. If, on the other hand, a capital interest is also transferred, income would be realized by the investor at the time of the transfer of the capital interest if the interest is not subject to a substantial risk of forfeiture-a time the investor may not be able to pay the taxes the incurred. See Section 1.721-1(b)(1) of the Regulations.

Until now, we have assumed the winery business was owned by a partnership or an L.L.C., but if the business is owned by a corporation, the investor can be paid for his or her services by the corporation with its own stock. However, if the corporation is a Subchapter S Corporation, one should be cautious about such a transfer since subsequent action by the investor could result in a loss of Subchapter S treatment.

The issue of how contributions and distributions are to be handled is the next topic. In the case of a corporation, contributions to the corporation's capital by a shareholder increases that shareholder's stock basis, and distributions to a shareholder generally are treated as compensation or dividends. In the case of a partnership, no gain or loss is recognized by the partnership or by any of its partners as a result of a contribution of property to the partnership by a prospective partner in exchange for a partnership interest. See Section 721 (a). The basis of the contributing partner's interest in the partnership would be the amount of the money contributed plus the contributing partner's adjusted basis of the property contributed. See Section 722. Partnership distributions to a partner are generally not taxable except to the extent money or marketable securities distributed exceeds that partner's basis in the partnership. Loss is not recognized on a distribution to a partner unless the distribution

terminates the receiving partner's interest and consists solely of money, unrealized receivables and inventory. See Section 731 (a)(2). A very interesting case which includes a denied claim by the taxpayer of a tax-free distribution and a tax-free contribution is Goudas v. Comm'r., 137 F. 3rd 368 (1998). Mr. Goudas was a partner in two different partnerships, one of which sold a shopping center to the other partnership. Mr. Goudas sought to avoid capital gains taxes resulting from the sale by the original partnership owner of the shopping center on the ground Mr. Goudas was entitled to non-recognition of gain under Section 731(a) from a liquidation by the first partnership which claimed liquidation included his interest in the shopping center and that the transfer of his interest in the shopping center to the second partnership was also not taxable under Section 721 (a)(1). The Court took the position that the case did not involve a liquidation and contribution by a partner (Mr. Goudas) , but, instead , was a sale between two partnerships and that the claimed non-recognition provisions do not apply to transactions between a partnership and a partner when the partner is not acting in the capacity of a partner.

The next topic is how is the business is to be financed. Except for revenues generated by the business, capital must come from either the equity owners or from outside sources. Having discussed earlier equity contributions, present attention must be focused now on outside financing. In the case of a partnership or an L.L.C., it is important to recognize the distinction between recourse debts and non-recourse debts. Recourse debts are allocated in accordance with the partners' economic risk of loss. To illustrate, if there is a three (3) partner partnership in which the partners share losses equally, then absent a provision in the loan agreement to the contrary, the liability resulting from the recourse loan to the partnership is a liability with respect to which the partners are equally liable. That liability would be allocated equally to the three (3) partners' respective bases in the partnership See Section 752(a). A non-recourse loan is one in which none of the partners bears personal liability. However, a non-recourse debt may also increase the partners' bases. Thus, if there is a loan to the partnership secured only by a mortgage on a building owned by the partnership, then, again, the partners' bases in the partnership would be increased equally. See Section 752(c). However, the situation with respect to bases changes if one of the three (3) partners were to provide a personal guarantee in addition to the mortgage on the building. In such event, only the guarantor's basis in the partnership would be increased. See Section 1.752-2(b)(1) of the Regulations.

The next issue is how business operations are affected by taxes. Thus, would the business prefer to operate as a partnership, as an L.L.C. or as a corporation? Although Subchapter S Corporations today outnumber L.L.C.s , I believe most tax advisors today recommend L.L.C.s To minimize payroll taxes, some business owners of Subchapter S Corporations seek to minimize payroll taxes by taking dividend distributions. However, the IRS in recent years has increased its scrutiny of allocations between compensation and dividends. In this connection, your attention is invited to item 8 of IRS Information Release 2004-47 in which the IRS indicated it

viewed “dividend distributions” as constituting a fraudulent scheme if such distributions are determined to constitute compensation. Further with respect to dividend distributions, it should be remembered that The Affordable Care Act, as amended, provides for a 3.8 % tax on net investment income (admittedly, at present, a tax on high income taxpayers). As between an L.L.C. and a partnership, the L.L.C. has the clear advantage of limited personal liability exposure. However, this limited liability exposure can be reduced or lost completely by a provision commonly found in the governing documents of L.L.C.s providing the manager or governing committee of the L.L.C. with authority to demand and receive reimbursements from members for their share of the losses suffered by the L.L.C. An advantage that partnerships and L.L.C. have over corporations is that, generally speaking, the partners and members can allocate profits and losses in a manner other than by their equity ownership. However, in making decisions with respect to such allocations, you should be aware that the IRS has the authority under Section 1.701-2 of the Regulations to recast transactions purporting to use the partnership provisions of the Code for tax avoidance purposes.

With respect to payroll taxes, the wineries and their employees will each pay for 2014 6.2 % F.I.C.A. taxes on each of the employees’ earnings up to $117,000 and will each pay 1.45% Medicare taxes on each of the employees’ entire earnings. The partners in a partnership and the members in an L.L.C, in contrast, .will pay for 2014 12.4% F.I.C.A. taxes on their earnings up to $117,000 and 2.9% on their entire earnings. The Federal Unemployment taxes is imposed only on employees and the wage base for such is presently $7,000.

Real estate taxes will obviously constitute a significant expense for an operating vineyard. Thus, as stated at the outset, not only must there be acreage, there must be a facility or facilities for keeping equipment, all of which would be subject to real estate taxes.. However, the tax burden with respect to real estate continues after the death of the winery owners. In this connection, you should be aware that a substantial tax saving may be possible upon the death of a principal owner of the winery by utilizing the benefits of Section 2032A. Section 2032A is a relief provision designed to permit, under certain circumstances and conditions, the decedent’s heirs to value the real estate on the basis of the property’s actual use rather than on the basis of the real estate’s highest or best use. Prior to enactment of Section 2032A, heirs of a deceased farmer were often forced, because of estate taxes, to sell real estate used in farming operations, notwithstanding their desire to continue the farming operations. Under Section 2032A, it may be possible to reduce the value of the real property by as much as $1,090,000.However, a number of conditions must be met and a number of steps must be taken in order to take advantage of Section 2032A For example, the subject property must pass to a “qualified heir,” the property must have been devoted to a “qualified use” at the decedent’s death, a “recapture agreement” must be submitted for the IRS’ approval, etc. .

Principals in the winery (especially if the winery is held by an L.L.C.) can make gifts of part of their interests during their lives in an attempt to further reduce their ultimate estate tax burden. This is commonly done by gifts of such interests The donors of such interests establish a new L.L.C. and make gifts of their interest in such new L.L.C., attempting, of course, to claim valuation discounts for the gifts on the grounds of minority interest and lack of marketability. The IRS , in opposition to the valuation discounts, frequently look to the value of the underlying assets (for example, the land). With respect to the IRS' attitude toward such discounts, your attention is directed to Appeals Settlement Analysis: Family Limited Partnerships at www.irs.gov. you may also wish to review C. Lappo v. Comm'r, 86 TCM 333, Peracchio v. Comm'r., 86 TCM 412 and Pierre v Comm'r.99 TCM 1436. Another argument utilized by the IRS to challenge such life time gifts is based on Section 2036 of the Code. Unfortunately, the donors of the life time gifts frequently convey all of their assets to the new L.L.C., but continue to enjoy such assets for their lives (for example, their personal residences). Section 2036 places in the donors' estates assets transferred, irrespective if such transfers are irrevocable, if the donors retain the right to the enjoyment of such assets for their lives. With respect to life-time gifts for which discounts are sought, it is essential that the non-tax reasons for the new L.L.C. and the gifts be documented. Another mean for transferring equity ownership in the winery is by a GRAT. Under this approach, the grantor frequently creates a trust under the terms of which the grantor retains an annuity interest for a term of years, with the assets to be transferred to the remainder men after the expiration of the term of years. Unfortunately, if the grantor dies before expiration of the term of years, the IRS uses Section 2036 to place in the grantor's estate part of the trust's assets, thus defeating the purpose of the GRAT. You also should be aware the Administration has sought to lessen the advantages of GRATs.

The net income of a winery held by a Subchapter C Corporation will be taxed to the corporation. If there is a danger of an imposition of the accumulated earnings tax, the corporation may find it advantageous to make a Subchapter S election. If the winery is owned by a partnership or L.L.C., the net income will be taxed to the partners or to the members, as the case may be.

The 21st Amendment to the United States Constitution vested considerable authority in the states for regulating alcoholic beverages. In accordance with such authority, Virginia has enacted a number of statutes relating to the taxing of wineries . For example, Section 4.1-231 imposes a winery license fee, a wine shipper's license fee, a tasting fee, etc. Sections 4.1-212.1, 4.1-234, 4.1-235 and 4.1236 impose a sales tax on wine used or delivered in Virginia. Section 58.1-3703.1 provides rules relating to ordinances imposing a license fee for wineries and with respect to wineries' gross receipts tax. Sections 4.1-128 and 58.1 3706 restrict local jurisdictions in their imposition of sales and excise taxes on alcoholic beverages.

Virginia provides a credit of 25% against Virginia's income tax for all qualified expenditures up to $250,000 for a calendar year. However, this credit against Virginia's taxes cannot be claimed for expenditures deducted under Section 179 of the Code.

Wineries generally are entitled to a general business credit under the Code (Section 38) which credit is the sum of a number of other credits provided businesses (for example, see Section 49 of the Code providing the investment credit, Section 51 of the Code providing the work opportunity credit, Section 44 providing the disabled access credit, etc.) the general business credit is subject to income and tax limitations.

With respect to audits and the strategies for minimizing audits, I would be remiss if I did not warn you especially of the danger of forming a new L.L.C. and of later making discounted gifts of minority interests in the new L.L.C. The IRS has indicated it will contest vigorously such estate planning maneuvers, and they have had some success in this area. Moreover, if the IRS is successful in challenging the maneuver, the costs and expenses to the clients can be substantial. Thus, before taking such steps, you are urged to have a thorough discussion with the clients of the risks involved, including the possibility of a later challenge by the IRS of the good faith valuations which would be reflected on the gift and estate tax returns expected to be filed. The clients should be fully aware of the possible penalties and the interest charges which could follow a successful challenge by the IRS.

In conclusion, I would like to thank NBI for the opportunity to discuss this subject with you and to thank you for the courteous attention you, have afforded me.

Vineyard and Winery Land Use Issues

Submitted by Philip Carter Strother

Wine Law in Virginia

Effective Land Use Strategies for Vineyards and Wineries

Philip Carter Strother
Founder/Managing Partner of Strother Law Offices, PLC
CEO of Philip Carter Winery of Virginia

Introduction

The dynamic growth of the Virginia wine industry presents unique land use issues to winery owners, local governments, and neighboring citizens

Topics of Discussion

- What is a “Virginia Farm Winery?”
- Who regulates Virginia farm wineries?
- How is a Virginia farm winery regulated under Virginia Land Use Law?
- Hot Issues
- New Local Ordinances

The State of the Virginia Wine Industry, 2014

- 254 licensed Virginia farm wineries as of 10/8/14
- Approximately 3,500 acres under vine in Virginia

The State of the Virginia Wine Industry, 2014

- Economic contributions:
  - $747.1 million impact on Virginia economy
  - 4,700 jobs related to the VA Wine Industry
  - $27.8 million paid in wages to winery/vineyard employees

The State of the Virginia Wine Industry, 2014

- More economic benefits:
  - $130.6 million generated from agritourism
  - $42.7 million in state tax revenue
  - 23% growth in wine sales since 2010

The History of Virginia Wine

In the Beginning…

- **1608** – First English settlers planted vines and made wine at the Jamestown Colony
- **1619** – Law that required every householder to plant ten vines

The History of Virginia Wines

As Virginia grows…

- **1762** – Colonial Virginia produced first internationally recognized fines wines
- **1769** – An Act for the Encouragement of the Making of Wine

The History of Virginia Wine

As a nation is born…

- **1773** – Thomas Jefferson's first attempt to produce vinifera wines at Monticello
- The planting and growing of wine grapes continues past Independence
- A fledgling industry is given new life in 1975…

The 1975 Virginia Farm Winery Act

- Designed to Stimulate Industry growth:
  - ⋆ Tax incentives for wineries making wine from Virginia grapes
  - ⋆ Established monetary fund
    - Research
    - Education
    - Promotion

Further amendments to law:

- 1980 Amendments to the VA Farm Winery Act
  - Allowed farm wineries to act as wholesalers and retailers, as well as producers of Virginia wine
  - Significant legislation – 6 Virginia wineries in 1979

What is a "Virginia Farm Winery"?

- An establishment *located in the Commonwealth*
- with a *producing vineyard*, orchard, or similar growing area **or**
- agreements for *purchasing grapes* or other fruits from agricultural growers *within the Commonwealth*, and
- with facilities for *fermenting and bottling* wine on the premises
- *not more than 18 percent alcohol* by volume
- *Source: Va Code Ann. § 4.1-100*

What is a "Virginia Farm Winery"?

- ". . . or agreements for purchasing grapes . . . from agricultural growers within the Commonwealth"
  - *In re Paradise Springs Winery* (2009)
  - Zoning administrator's/BZA's determination contrary to ABC's statutory requirements "CANNOT STAND."
  - ABC ruled that it was *contrary to law* for a BZA to determine that "agricultural use" requires that all grapes be grown on the winery site itself.

What is a "Virginia Farm Winery"?

- A Farm Winery = agricultural land use.
  - Located on a farm with a fruit-producing growing area. § 4.1-100
  - Wine produced at a winery in the hands of the producer is an agricultural product. §§ 4.1-201(A)(10); 58.1-1101, 58.1-3505(A)(7) & (C)

What is a "Virginia Farm Winery"?

- VA Dept of Agriculture is responsible for fostering winery development. § 3.2-3001
- "Agricultural nature of such activities and events" § 15.2-2288.3 [2009 amend]
- "Agritourism activity" includes "any" activity at a winery § 3.2-6400

Who regulates Virginia farm wineries?

- Major
  - Federal – Alcohol and Tobacco Tax and Trade Bureau (TTB)
  - State – Virginia Alcoholic Beverage Control Act
  - Local – Zoning

Who regulates Virginia farm wineries?

- Federal – Alcohol and Tobacco Tax and Trade Bureau (TTB)
  - 21st Amendment
  - Main functions:
    - License approval to manufacture and warehouse wine
    - Collects excise taxes
    - Monitors labeling

Who regulates Virginia farm wineries?

- State – Virginia Alcoholic Beverage Control Act
- Exclusive regulatory control:
  - Manufacturing
  - Bottling
  - Possession
  - Sale
  - Distribution
  - Handling
  - Transportation
  - Drinking
  - Use
  - Advertising
  - Dispensing of alcoholic beverages
    - *Source: Va Code Ann. § 4.1-128*

Who regulates Virginia farm wineries?

- State – Virginia Alcoholic Beverage Control Act
  - "Except as provided in this section, all local . . . [laws] inconsistent with any of the provisions of this title, are repealed to the extent of such inconsistency." § 4.1-128(C)

Who regulates Virginia farm wineries?

- State – Virginia Alcoholic Beverage Control Act
- Regulatory authority to grant or deny license if the licensed premises "is so located with respect to any residence or residential area that the operation of the premises would adversely affect real property values or **substantially** interfere with the usual quietude and tranquility of such residence or residential area." § 4.1-222(2)(d)
  - Recent cases

How is a Virginia Farm Winery regulated under Virginia Land Use Law?

- Historically:
  - *City of Norfolk v. Tiny House*, 281 S.E.2d 836 (Va. 1981)
  - *County of Chesterfield v. Windy Hill, Ltd*., 559 S.E.2d 627 (Va. 2002)
    - A locality had the authority through zoning to regulate the LOCATION of alcoholic beverage sales

Land Use Considerations

- 2005 – Tensions between farm wineries and localities (85 wineries)
  - Agricultural business selling an agricultural product that is also an alcoholic beverage
    - Warren County (conditional use permit for winery in ag district)
    - Clarke County (permit for events)
    - Fauquier County (limited size and number of events, etc)

Land Use Considerations

- "We love vineyards, just not events at wineries"
- vs.
- "Vineyards cannot survive without wineries and wineries cannot survive without events, especially new ones"

Land Use Considerations

- 2006 – HB1435 (Albo, D.)
  - Intent to promote the growth of the Virginia farm wine industry by expressly restricting localities from regulating wineries through zoning
  - 2006 – Office of the Secretary of Agriculture and Forestry's Group Study
    - 11 "interested" agencies and organizations

Secretary of Agriculture's Group Study-- HB1435

- Virginia Department of Agriculture and Consumer Services,
- Virginia Department of Alcoholic, Beverage Control,
- Virginia Wineries Association,
- Virginia Vineyards Association,
- Virginia Wine Travel and Tourism Office,
- Virginia Hospitality & Travel Association,
- Virginia Farm Bureau,
- Virginia Agribusiness Council,
- Virginia Association of Counties,
- Virginia Municipal League, and
- Virginia Tourism Corporation.

Land Use Considerations

- § 15.2-2288.3 (2007)
- A. Policy of the Commonwealth to preserve the economic vitality of the Virginia wine industry,
- While maintaining appropriate land use authority . . .,
- And to permit the reasonable expectation of uses in specific zoning categories.

§ 15.2-2288.3

- Cannot be regulated:
  - Private gatherings (Oasis Winery – Fauquier County – *Granholm v. Heald,* 544 U.S. 460 (2005)
  - Production and harvesting of fruit
  - Manufacturing of wine (Winery at La Grange – Prince William County)
  - Sale, tasting or consumption of wine during regular business hours
    - § 4.1-129 - Local ordinances regulating time of sale of wine

§ 15.2-2288.3

- Cannot be regulated:
  - Direct shipments to customers – wine clubs
  - Sales and shipments to distributors
  - Storage & warehousing of wine
  - Sale of incidental wine-related items (cork screws yes, but what about local artwork?)

§ 15.2-2288.3

- Cannot be regulated:
  - Usual and customary activities and events, unless there is a substantial impact on the health, safety, or welfare of the public.
    - Versus "such restrictions bear a relationship to the health, safety, and general welfare of its citizens"
  - "shall be permitted without local regulation"
  - Burden of proof is on the locality

§ 15.2-2288.3

- What can be regulated?
  - "Very little" – Albemarle County
  - Non-private events and activities that are not usual and customary at farm wineries
  - Usual and customary events and activities with **substantial** impact
  - Outdoor amplified music
  - Non-wine related merchandise

§ 15.2-2288.3

- A. Local restrictions **shall**:
  - be reasonable
  - *take into account*
    - the economic impact on the farm winery – must preserve economic vitality
    - the agricultural nature of such activities and events (2009 – King Family – Albemarle County)
    - whether the activities and events are usual and customary for farm wineries throughout the Commonwealth
    - Outdoor amplified music -- Shall *consider* the effect on adjacent property owner and nearby residents

Additional Limitations on Localities

- Dillon's rule
  - A locality has only those powers expressly granted, those necessarily or fairly implied there-from, and those that are essential and indispensable." *Commonwealth v. County Bd. Of Arlington County*, 232 S.E.2d 30, 40 (Va. 1977)

Additional Limitations on Localities

- The Virginia Right to Farm Act
  - No county shall adopt an ordinance that requires a special exception or a special use permit for agricultural production in an agricultural district. § 3.2-301
  - Uniform Statewide Building Code
    - "farm buildings and structures (e.g., farm wineries) shall be exempt from the provisions of the Building Code, except . . . a restaurant § 36-99
    - AG Opinion "primary use" – 8/23/2010

Hot issues

- Outdoor amplified music
- Hours of operation
- Size of events
- Delegation though zoning to Health Department and VDOT
- Building Code requirements
  - When does a tasting room become a restaurant?
- Right to Onsite Farm Sales
- Conservation Easements

Local Ordinances

- Albemarle County
  - 2009
  - Collaborative effort by interested parities – Virginia Wine Council
  - "win/win"
  - Events of 200 or fewer attendees by right

Local Ordinances

- Loudoun County
  - Similar collaborative effort
  - Traditional areas of zoning regulation
    - Lot size, building area, access, lighting, noise, etc
  - Limits operational hours 10am – 10pm
  - "win/win" generally

Local Ordinances

- Fauquier County
  - Hostile environment
  - Directly regulates business activities
    - Administrative permits, event size to 35 people, hours of operation, staff training, 300 ft set backs, discretionary decision making to Zoning Administrator, etc.
  - Lawsuits
  - AG Opinion – "exceeds locality's zoning authority" 7-19-13

Local Ordinances

- The Effect – the Data
  - 2005 Licensed Farm Wineries
    - Albemarle – 10; Loudoun – 13; Fauquier 13
  - 2010 Licensed Farm Wineries
    - Albemarle – 20; Loudoun – 26; Fauquier – 24
  - 2012 Licensed Farm Wineries
    - Albemarle – 26; Loudoun – 39; Fauquier – 27
  - 2005-2012 Winery Growth
    - Statewide 151%
    - Albemarle 160%
    - Loudoun 200%
    - Fauquier 108%

Local Ordinances

- The Effect – the Data
  - 2005 Total Grape Production (tons)
    - Albemarle 904; Loudoun 709; Fauquier 418
  - 2010 Total Grape Production (tons)
    - Albemarle 1099; Loudoun 1036; Fauquier 383
  - 2012 Total Grape Production (tons)
    - Albemarle 1223; Loudoun 1342; Fauquier 443
  - 2005-2012 Total Grape Production (tons)
    - Statewide 35%
    - Albemarle 35%
    - Loudoun 89%
    - Fauquier 6%

Local Ordinances

- The Effect – the Data
  - 2005 Total Grape Acreage
    - Albemarle 490; Loudoun 342; Fauquier 213
  - 2010 Total Grape Acreage
    - Albemarle 562; Loudoun 543; Fauquier 205
  - 2012 Total Grape Acreage
    - Albemarle 557; Loudoun 602; Fauquier 242
  - 2005-2012 Total Grape Acreage
    - Statewide 32%
    - Albemarle 14%
    - Loudoun 76%
    - Fauquier 14%

What This Means

- Active, continuing attention to activities of planning commissions, Boards of Supervisors, and other local bodies / agencies is crucial
- Establish a positive dialogue with neighbors, residents, government
- Always emphasize and maintain the agricultural nature of activities

Other steps

- Keep in mind:
  - Virginia farm wineries are a community
  - Supported and encouraged and regulated by the Commonwealth itself
  - Ample state and local resources for information, guidance, and support.

Any questions?

Contact information:

Philip Carter Strother
Strother Law Offices, PLC
The Hillyard-Maury House
15 East Franklin Street
Richmond, Virginia 23219
804.523.2000
pstrother@strotherlaw.com

Vineyard and Winery Land Use Issues

Philip Carter Strother and Andrew E. Tarne

ESSAY

THE GRAPES OF WRATH: ENCOURAGING FRUITFUL COLLABORATIONS BETWEEN LOCAL GOVERNMENTS AND FARM WINERIES IN THE COMMONWEALTH

Philip Carter Strother *
Andrew E. Tarne **

> *"It must be a bad heart, indeed, that is not rendered more cheerful and more generous by a few glasses of wine."*[1]

The United States has a complicated history with wine, beer, and spirits. Indeed, the prohibition of alcohol is the only regulation directed personally at individuals that has ever made it into the Constitution, albeit for a relatively short period of time.[2] The

* Founding Partner, Strother Law Offices, PLC, Richmond, Virginia. LL.M, 1999, George Washington University Law School; J.D., 1997, Thomas M. Cooley Law School; B.S., 1991, The Love School of Business, Elon University.

** J.D., 2013, University of Richmond School of Law; M.U.R.P Candidate, 2014, Virginia Commonwealth University; B.A., 2010, University of Virginia.

The authors would like to thank the editorial board and staff of the *University of Richmond Law Review* for their dedicated help and support. Further thanks go to Delegate David Albo, Matthew Conrad, and Travis Hill of the Governor's Office and Stephen Mackey of the Loudoun Wineries Association for their invaluable insights and to Johnathan Newberry of the Albemarle Planning division, Kellie Boles of the Loudoun Department of Economic Development, Stacey Sheetz of Visit Loudoun, and Catherine Payne of the Fauquier County Department of Economic Development for their assistance in data collection.

1. Benjamin Rush, *Inquiry into the Effects of Spiritucus Liquors, in* 3 A SELECTION OF CURIOUS ARTICLES FROM THE GENTLEMAN'S MAGAZINE 456, 461 (John Walker ed., 1814).

2. NAT'L COMM'N ON LAW OBSERVANCE AND ENFORCEMENT, ENFORCEMENT OF THE PROHIBITION LAWS OF THE UNITED STATES, H.R. DOC. NO. 71-722, at 20 (1931) ("The Eighteenth Amendment represents the first effort in our history to extent [sic] directly by Constitutional provision the police control of the federal government to the personal habits

history of America's relationship with the fruit of the vine, however, is far more nuanced than national prohibition and repeal. Wine, for example, has been in Virginia's blood for over four centuries, ever since the first ships navigated the James River in 1607.[3] From the House of Burgesses' first decree for the cultivation of grape vines[4] to the modern Virginia Farm Winery Zoning Act,[5] wine has been a subject of lawmaking in the Old Dominion. The legal status of the wine industry and its product has changed over the years, traversing a wavelength that takes it, as Richard Mendelson describes, "from demon to darling."[6]

Many have already written on the subject of wine law in the United States and particularly in the Commonwealth of Virginia.[7] This essay will add to the growing corpus of wine law, with a scope roughly limited to discussing the relationship of wineries to the localities in which they are situated. With Virginia's wine industry growing at astounding rates, so too are regulations of that industry at all levels of government: federal, state, and local.

While there is fairly substantial federal regulation in the field of wine law, this essay's scope will be limited to the interplay of Virginia's state and local laws that affect wineries close to home.[8] Within that scope, this essay's purpose is threefold. First, it will

and conduct of the individual.").

3. Karen Page & Andrew Domenburg, *Virginia Vintages That Can Hold Their Own*, WASH. POST (May 9, 2007), www.washingtonpost.com/wp-dyn/content/article/2007/05/08/AR2007050800350.html. By 1762, Charles Carter of Virginia had earned international acclaim for the production of "excellent" wines in the Colony of Virginia. *See* Minutes, Meeting of the Royal Society of the Arts, 1762 (on file with the Royal Society of the Arts, London, United Kingdom). The very next year, Mr. Carter was recognized by Lieutenant Governor Fauquier in the first recordation of successfully cultivating a vineyard of European grapes in Virginia. *See* Certification of Charles Carter's European Grapes, Lieutenant Governor Francis Fauquier (Aug. 6, 1763) (on file with the Library of Virginia). *See also* Jennifer Heyns, *History Comes Full Circle at Philip Carter Winery in Hume*, THE WARRENTON LIFESTYLE MAGAZINE, May 2009, at 38.

4. WILLIAMSBURG WINERY, A BRIEFE HISTORY OF WINEMAKING IN WILLIAMSBURG, VIRGINIA 1 (1994).

5. VA. CODE ANN. § 15.2-2288.3 (Repl. Vol. 2012).

6. *See* RICHARD MENDELSON, FROM DEMON TO DARLING 3–5 (2009).

7. *See, e.g.*, WINE IN AMERICA: LAW AND POLICY (Richard Mendelson ed., 2011); CAROL ROBERTSON, THE LITTLE RED BOOK OF WINE LAW (2008); Philip Carter Strother & Robert Jackson Allen, *Wine Tasting Activities in Virginia: Is America's First Wine Producing State Destined to Wither on the Vine Due to Overregulation?*, 23 T.M. COOLEY L. REV. 221 (2006); Philip Carter Strother & Andrew E. Tarne, *Annual Survey of Virginia Law: Land Use and Zoning Law*, 47 U. RICH. L. REV. 223, 247–54 (2012).

8. For a helpful overview of federal issues implicated by wineries, including the three tiered system, interstate and international commerce, and intellectual property, see generally Richard Mendelson, *U.S. Wine Law: An Overview*, *in* WINE IN AMERICA, *supra* note 7, at 19–33.

highlight the key legislation and ordinances that affect farm wineries. Second, it will discuss the interplay between state and local level regulations, concluding that the General Assembly has intended to retain near exclusive regulatory powers over farm wineries. Third, it will briefly analyze the impact of the wine industry on three Virginia counties, concluding that a more temperate approach to local regulation of the wine industry in the Commonwealth is desirable for optimal growth and participation in one of Virginia's most vibrant economic sectors.

I. REGULATION OF VIRGINIA FARM WINERIES

A. *State Statutes*

In Virginia, there are three main statutes that affect the wine industry: the Virginia Farm Winery Zoning Act,[9] the Virginia Alcoholic Beverage Control Act ("ABC Act"),[10] and the Virginia Right to Farm Act.[11] Together, these pieces of legislation suggest that the General Assembly has intended to reserve most of the power to regulate the business of a farm winery unto itself.[12] Moreover, taken together, these acts indicate that the General Assembly has adopted a statewide policy to encourage growth and limit local restrictions on the Virginia farm winery industry. While the General Assembly granted localities the power to regulate land uses under the Zoning Enabling Act,[13] it did not grant localities the power to micromanage the affairs of either business or agricultural uses.[14] Nor did it grant localities the power to pass ordinances that conflict with the general statutory and policy frameworks set out elsewhere in the Code of Virginia.[15]

9. VA. CODE ANN. § 15.2-2288.3 (Repl. Vol. 2012).

10. *Id.* § 4.1-100 to -133 (Repl. Vol. 2010 & Cum. Supp. 2013). Portions of the Virginia ABC Act relating to the establishment of farm wineries have historically been known as the "Virginia Farm Winery Act." *See, e.g.*, Strother & Allen, *supra* note 7, at 232. Because this Article discusses title 4.1 of the Virginia Code broadly, rather than simply the provisions relating to farm wineries, the term "ABC Act" will be used for consistency.

11. *Id.* § 3.2-300 to -302 (Repl. Vol. 2008 & Cum. Supp. 2013).

12. The Office of the Attorney General of Virginia has reached a similar conclusion in a recent opinion, discussed *infra* in Part III.A.3.b.

13. VA. CODE ANN. § 15.2-2280 (Repl. Vol. 2012 & Cum. Supp. 2013).

14. *See id*.

15. *See id*.

1. Virginia Farm Winery Zoning Act

Originally passed in 2006 and situated in the zoning chapter of the Code of Virginia, the Virginia Farm Winery Zoning Act is the foundation for local regulation of Virginia farm wineries.[16] The opening lines of the act set forth that "[i]t is the policy of the Commonwealth to preserve the economic vitality of the Virginia wine industry while maintaining appropriate land use authority to protect the health, safety, and welfare of the citizens of the Commonwealth."[17] Moreover, the underlying impetus for the Act was to fight the "micromanaging rules" of local governments that were putting wineries out of business.[18] By passing the Farm Winery Zoning Act, the General Assembly intended to protect the burgeoning Virginia wine industry by preventing overregulation at the local level. Under the Act, localities were left with their basic power to regulate land use for the welfare of their residents; however, the General Assembly established a higher burden for regulations in addition to setting forth a clear statewide policy objective.[19]

Under the general zoning enabling statute, localities may regulate "[t]he use of land, buildings, structures, and other premises[;] . . . [t]he size, height, area, bulk, location, erection, construction, reconstruction, alteration, repair, maintenance, razing, or removal of structures; [and] [t]he areas and dimensions of land, water, and air space to be occupied by buildings."[20] Absent is the ability to directly regulate the operations of the business that occupies the land. Typically these local zoning regulations will be upheld so long as there is a rational basis for the regulation.[21]

16. *Id.* § 15.2-2288.3 (Repl. Vol. 2012).

17. *Id.* § 15.2-2288.3(A) (Repl. Vol. 2012).

18. Delegate David Albo, the sponsor of the Farm Winery Zoning Act, has stated the act grew from "a number of wineries who were being put out of business by micromanaging rules from local governments. Wineries *rarely* make a profit on just selling wine. Their volume and price point don't make it profitable alone. They rely on eco-tourism." E-mail from the Hon. David Albo, Member, Virginia House of Delegates, to author (Sept. 17, 2013, 10:25 PM) (on file with author).

19. The heightened burden is that localities may only regulate farm winery activities when they have a *substantial impact* on the public welfare. *See infra* notes 22–25 and accompanying text.

20. VA. CODE ANN. § 15.2-2280 (Repl. Vol. 2012 & Cum. Supp. 2013).

21. *See, e.g.*, Bd. of Supervisors v. McDonald's Corp., 261 Va. 583, 591, 544 S.E.2d 334, 339 (2001); Cnty. Bd. of Arlington v. Bratic, 237 Va. 221, 229–30, 377 S.E.2d 368, 372 (1989).

Under the Farm Winery Zoning Act, however, the standard for regulating wineries is higher than that for the typical zoning statute. First, a locality must consider the economic impact of any proposed restrictions on the licensed farm winery impacted by such restrictions.[22] Second, a locality may only regulate "usual and customary" activities at a farm winery if they cause a "substantial impact on the health, safety, or welfare of the public."[23] While this statute leaves localities free to regulate the traditional size, area, and type of land use, it specifically forbids them from regulating the activities of farm wineries absent a "substantial impact" on the public.[24] Any regulations, therefore, that purport to regulate the actual business activities of a farm winery which do not have an identifiable "substantial impact" on the public welfare will likely be void as ultra vires.[25]

The Virginia Farm Winery Zoning Act establishes a relatively simple legal test to determine if a local regulation is ultra vires. First, localities are forbidden from regulating certain activities. Specifically, localities may not regulate (1) "[t]he production and harvesting of fruit" or the "manufacturing of wine;" (2) "[t]he on-premises sale, tasting, or consumption of wine during regular business hours"; (3) "[t]he direct sale and shipment of wine" to customers, wholesalers, or the ABC Board; (4) the storage and wholesale of wine; or, (5) "[t]he sale of wine-related items that are incidental to the sale of wine."[26] As these activities are specifically exempted from local regulation, any ordinance that attempts to regulate them will be void as ultra vires.

Second, localities may only regulate certain activities at farm wineries in the same manner that they generally regulate other citizens. Specifically, localities may not regulate (1) "private personal gatherings held by the owner of a licensed farm winery differently from private personal gatherings [held] by other citizens," and (2) "noise, other than outdoor amplified music" differently than noise regulated "in the general noise ordinance."[27] When deciding to authorize "outdoor amplified music" at farm

22. VA. CODE ANN. § 15.2-2288.3(A) (Repl. Vol. 2012).

23. *Id.* The statute specifically provides that "usual and customary" activities are those that are usual and customary for farm wineries throughout the entire Commonwealth, not simply those that are usual and customary for a particular county, region, or farm winery. *Id.*

24. *See id.*

25. *See infra* Part II.B.

26. VA. CODE ANN. § 15.2-2288.3(E)(1)–(6) (Repl. Vol. 2012).

27. *Id.* § 15.2-2288.3(A), (D) (Repl. Vol. 2012).

wineries, a locality is required to "consider the effect on adjacent property owners and nearby residents."[28] If any locality seeks to regulate these activities differently from other citizens or businesses, such action is void as ultra vires.

Third, localities must permit "usual and customary" events at farm wineries "without . . . regulation unless there is a substantial impact on the health, safety, or welfare of the public."[29] By mandating that events be permitted "without local regulation," the statute essentially places the heightened burden of proof on the locality to show that an event will have a "substantial impact" on the public.[30]

Fourth, any other local regulations on events and activities at farm wineries must "be reasonable and shall take into account the economic impact on the farm winery . . . , the agricultural nature of such activities and events, and whether such activities and events are usual and customary for farm wineries throughout the Commonwealth."[31]

Condensed, the test under section 15.2-2288.3 is essentially: (1) has the locality attempted to regulate a specifically protected activity; (2) has the locality regulated private gatherings or general noise differently from the rest of the public; (3) has the locality failed to show that a usual and customary event has a substantial impact on the general welfare; and (4) are regulations on activities and events other than those covered in steps (1) through (3) unreasonable, or do they fail to consider the economic impact on the farm winery, their agricultural nature, or their customary nature? If the response to any of these questions is "yes," the locality has acted contrary to the Virginia Code and, therefore, ultra vires.

2. Virginia Alcoholic Beverage Control Act

Under the Code of Virginia, the Virginia Alcoholic Beverage Control Board ("ABC Board" or "the Board") exercises exclusive control over the regulation of alcoholic beverages in the Commonwealth.[32] Included within this grant is the exclusive authority

28. *Id.* § 15.2-2288.3(A) (Repl. Vol. 2012).
29. *Id.*
30. *Id.*
31. *Id.*
32. *Id.* § 4.1-103 (Repl. Vol. 2010).

and discretion to license farm wineries for operation in Virginia.[33] Before the ABC Board decides to issue or deny a license, the interested parties may petition for an internal hearing within the agency.[34] The Board will then determine whether to issue a license, and that determination is final, subject only to an appeal taken to the Court of Appeals of Virginia.[35]

Final regulations of the ABC Board have the effective force of law.[36] Moreover, reiterating that the laws of the Commonwealth are supreme and preempt local ordinances, the ABC Act further states that no locality shall "adopt any ordinance or resolution which regulates or prohibits the manufacture, bottling, possession, sale, wholesale distribution, handling, transportation, drinking, use, advertising or dispensing of alcoholic beverages in the Commonwealth."[37]

The ABC Board recently and unequivocally upheld these provisions in the Virginia Code in *In re Paradise Springs Winery, LLC*.[38] In that hearing, the ABC Board determined that a local ordinance could not be used to prohibit a farm winery from opening in Fairfax County because that ordinance was inconsistent with the ABC Act.[39] The ordinance essentially established a higher burden on farm wineries for obtaining a zoning permit than the ABC Board required for obtaining a farm winery license.[40] Because this ordinance presented a situation wherein the county could potentially deny a farm winery the ability to operate after that farm winery was already licensed to operate by the Commonwealth, it was invalid in this instance.[41] As the Supreme Court of Virginia would later hold in an unrelated case, a locality may not "forbid what the legislature has expressly licensed, authorized, or required."[42]

33. *Id.* § 4.1-207, 4.1-222 (Repl. Vol. 2010 & Cum. Supp. 2013).

34. *Id.* § 4.1-103(11) (Repl. Vol. 2010).

35. *Id.* § 4.1-224(A) (Repl. Vol. 2010). Appeals from decisions of the ABC Board are taken in accordance with the Virginia Administrative Process Act. *Id.*

36. *Id.* § 4.1-111(A) (Cum. Supp. 2013).

37. *Id.* § 4.1-128(A) (Repl. Vol. 2010 & Supp. 2013). This prohibition is subject to two minor exceptions involving taxation and regulating hours between 12:00 PM on Saturday and 6:00 AM on Monday. *See id.* § 4.1-205 (Repl. Vol. 2010); *Id.* § 4.1-129 (Repl. Vol. 2010).

38. *In re* Paradise Springs Winery, LLC, Appl. #056973 Alcoholic Beverage Control Bd. (Sept. 3, 2009).

39. *Id.* at 25–26.

40. *Id.* at 8–9, 25–26.

41. *See id.* at 25–26.

42. Blanton v. Amelia Cnty., 261 Va. 55, 64, 540 S.E.2d 869, 874 (2001) (quoting King

3. Virginia Right to Farm Act

In addition to the Farm Winery Zoning Act and the ABC Act, the Right to Farm Act is further evidence of a statewide policy to foster the growth of Virginia farm wineries. While the Right to Farm Act does not affect the processing and retail operations of farm wineries, as the other acts do, it does protect production activities at farm wineries. Quite simply, the Right to Farm Act's goal is "to limit the circumstances under which agricultural operations may be deemed to be a nuisance."[43] In relevant part, the Act defines agricultural operation as "any operation devoted to the bona fide production of crops, . . . including the production of fruits."[44] The Act achieves its goal of limiting nuisance status for agricultural operations by prohibiting localities from adopting ordinances or regulations that would require special permits for "any production agriculture . . . in an area that is zoned as an agricultural district or classification."[45] Moreover, the Act states that so long as agricultural operations follow "existing best management practices and comply with existing laws and regulations of the Commonwealth," those operations cannot be deemed a nuisance.[46]

The Act does, however, still allow localities to adopt the customary setback and area requirements that apply to land.[47] This distinction between general regulatory power and the power to specifically regulate land is critical. As discussed below, the Supreme Court of Virginia has consistently recognized that the General Assembly intended for localities to have the power to identify where types of land uses may be located, but not to regulate the operations undertaken on the land.[48]

v. Cnty. of Arlington, 195 Va. 1084, 1091, 81 S.E.2d 587, 591 (1954)) (internal quotation marks omitted); *see also infra* notes 77–81 and accompanying text.

43. VA. CODE ANN. § 3.2-301 (Repl. Vol. 2008 & Cum. Supp. 2013).

44. *Id.* § 3.2-300 (Repl. Vol. 2008 & Cum. Supp. 2013). The Act further defines agricultural operation to include a number of production activities irrelevant to the scope this article. *See id.*

45. *Id.* § 3.2-301 (Repl. Vol. 2008 & Cum. Supp. 2013).

46. *Id.* § 3.2-302 (Repl. Vol. 2008).

47. *See id.* § 3.2-301 (Repl. Vol. 2008 & Cum. Supp. 2013). *But see infra* notes 62–64 and accompanying text (discussing the requirement that setback and other zoning regulations must be reasonable and not deny landowners the legitimate use of their property).

48. *See infra* notes 91–100 and accompanying text. The New York Court of Appeals recently reached a similar decision, holding that "zoning power is not a general police power, but a power to regulate land use." Sunrise Check Cashing v. Town of Hempstead,

While not a section of the Virginia Right to Farm Act, an important provision in the Virginia Uniform Statewide Building Code also protects agriculture operations in the Commonwealth. Specifically, "farm buildings and structures [are] exempt from the provisions of the Building Code."[49] A "farm building or structure" is defined as a building or structure that is "primarily" used for any of a variety of agricultural purposes, including "storage, handling, production, display, *sampling or sale* of agricultural . . . products produced in the farm."[50] In an advisory opinion, the Virginia Attorney General opined that these provisions "indicate[] that the General Assembly contemplated that some non-specified uses would be made of these buildings."[51] That is, if a farm building is occasionally used for an event, such as a wedding reception, that building would still primarily serve as a farm building, and be exempt from the Building Code.[52]

These code provisions are particularly important to farm wineries which derive such a substantial portion of their profits from on-site tastings, sales, and agritourism activities.[53] Furthermore, they reinforce the notion that the General Assembly has actively promoted a statewide policy of encouraging the growth and success of Virginia farm wineries.

B. *Local Regulation*

Localities regulate land uses through various mechanisms, but most notably through the use of zoning ordinances. These ordinances are established not because the localities possess the inherent power to zone, but rather because the General Assembly has granted localities that power.[54] Virginia localities possess only

986 N.E.2d 898, 900 (N.Y. 2013).

49. VA. CODE ANN. § 36-99(B) (Repl. Vol. 2011).

50. *Id.* § 36-97 (Repl. Vol. 2011 & Cum. Supp. 2013) (emphasis added). Other uses include animal shelters, business offices, and storage structures. *See id.* § 36-97(1)–(5) (Repl. Vol. 2011 & Cum. Supp. 2013).

51. 2010 Op. Va. Att'y Gen. 10-071, *2, http://www.oag.state.va.us/Opinions%20and%20Legal%20Resources/OPINIONS/2010opns/10-071-Burke.pdf

52. *See id.*

53. *See* VIRGINIA WINE BOARD, THE ECONOMIC IMPACT OF WINE GRAPES ON THE STATE OF VIRGINIA—2010, at 7 (2012), *available at* http://www.virginiawine.org/system/docs/47/original/virginia_2010_EI_update_Draft_3.pdf?1328208264; e-mail from the Hon. David Albo, *supra* note 18.

54. VA. CODE ANN. § 15.2-2280 (Repl. Vol. 2012 & Cum. Supp. 2013).

those powers which the General Assembly grants to them; any step beyond those granted powers is invalid.[55]

Local governments are the governing bodies closest to the citizens of Virginia. They, therefore, have an important role to play in the regulation of that ultimately local concern—land and its use. For this reason, localities have the power to regulate land and land uses within their borders.[56] Local citizens and local governments have the most interest in the use of their land and the first-hand knowledge necessary to effectively regulate their land. Numerous cases have reinforced the power of localities to zone; however, this power is not without its limits.[57] While a locality does have the power to regulate the use of land, it cannot warp that power into a general regulatory power over individuals and businesses—such a power, within reasonable limits, is reserved to the state under its general police power.[58]

Virginia courts have consistently held that local ordinances must fall when they conflict with state law. While ordinances may regulate within an area that state law regulates, they "must not . . . contravene the general law, nor . . . be repugnant to the policy of the [s]tate as declared in general legislation."[59] As Virginia follows the Dillon Rule, whenever a locality enacts an ordinance that goes beyond those powers granted by the General Assembly, that ordinance is void.[60] In other words, the baseline for local power in Virginia is established by the Code of Virginia. If the locality exercises a power that the Code of Virginia has not expressly granted, that cannot be reasonably implied from express powers, or is not essential and indispensable, that locality has acted ultra vires and its actions are invalid.[61]

55. *See, e.g.*, City of Richmond v. Confrere Club of Richmond, 239 Va. 77, 80, 387 S.E.2d 471, 473 (1990).

56. *See, e.g.*, City of Norfolk v. Tiny House, Inc., 222 Va. 414, 423, 281 S.E.2d 836, 841 (1981).

57. *See, e.g.*, *id*. at 422–24, 281 S.E.2d at 841 ("Local governments have been granted the authority to adopt and enforce zoning ordinances to ensure the orderly use of land.").

58. *See, e.g.*, Loudoun Cnty. v. Pumphrey, 221 Va. 205, 207, 269 S.E.2d 361, 362 (1980); Allen v. City of Norfolk, 196 Va. 177, 180–81, 83 S.E.2d 397, 399–400 (1954).

59. City of Lynchburg v. Dominion Theatres, Inc., 175 Va. 35, 42, 7 S.E.2d 157, 160 (1940) (quoting 43 C.J.S. *Municipal Corporations* § 219 (1927)) (internal quotation marks omitted).

60. *See City of Richmond*, 239 Va. at 79–80, 387 S.E.2d at 473.

61. *See, e.g.*, Ticonderoga Farms v. Cnty. of Loudoun, 242 Va. 170, 173–74, 409 S.E.2d 446, 448 (1991) ("The Dillon Rule . . . [provides that] 'local governing bodies have only

Furthermore, the Supreme Court of Virginia has stated that local ordinances, specifically zoning ordinances, must be reasonable in scope. In *Board of Supervisors of James City County v. Rowe*, the Supreme Court of Virginia emphasized an earlier holding that "[t]he mere power to enact an ordinance . . . does not carry with it the right arbitrarily or capriciously to deprive a person of the legitimate use of his property."[62] Specifically, the landowners in *Rowe* argued that building area setback requirements enacted by James City would severely restrict their ability to develop and utilize their land.[63] The Court agreed, noting that collectively the setback requirements deprived the landowners the legitimate use of their property.[64] In short, even though a locality may enact zoning ordinances, those ordinances must not unreasonably curtail the owner's use of his land.

II. STATE SUPREMACY IN THE FIELD OF WINERY REGULATION

A common problem that threatens farm wineries is overregulation at the local level. Such overregulation causes uncertainty as to the valid scope of local ordinances and raises the threat that government bodies may become micromanagers. This threat is not merely perceived, but is in fact very real. Utilizing their power to zone, Virginia localities have at various times attempted to specifically regulate the business activities of farm wineries.[65] Most recently, and quite controversially, Fauquier County passed amendments to its winery ordinance ("Fauquier Ordinance").[66] While the Fauquier Ordinance is nominally a zoning ordinance, it regulates the business operations of farm wineries by establish-

those powers that are expressly granted, those that are necessarily or fairly implied from expressly granted powers, and those that are essential and indispensable.'" (quoting Tabler v. Bd. of Supervisors, 221 Va. 200, 202, 269 S.E.2d 358, 359 (1980))).

62. 216 Va. 128, 140–41, 216 S.E.2d 199, 210 (1975) (second alteration in original) (quoting Bd. of Supervisors v. Carper, 200 Va. 653, 662, 107 S.E.2d 390, 396 (1959)) (internal quotation marks omitted).

63. *See id*.

64. *See id*.

65. *See* Strother & Allen, *supra* note 7, at 237–42.

66. *See, e.g.*, Susan Svrluga, *Winery Rules Passed After Much Debate in Fauquier*, WASH. POST, Jul. 15, 2012, at C12; Richard Leahy, *Fauquier Wineries Reflect on New Restrictive County Ordinance*, RICHARD LEAHY'S WINE REPORT (July 15, 2012), http://www.richardleahy.com/2012/07/15/fauquier-wineries-reflect-on-new-restrictive-county-ordinance/.

ing operating hours, requiring various administrative licenses, and prohibiting certain functions.[67]

Following the Dillon Rule, Virginia courts have consistently held that where local ordinances and state legislation come into conflict, the local ordinances must fall.[68] As localities are considered administrative departments of the state, the laws of the Commonwealth are supreme, preempting local regulations and ordinances.[69] This preemption covers not only state legislation, but also state level regulations and decisions promulgated by state agencies.[70] While localities have a broad range of powers, when the General Assembly has shown intent to control a given field of law, its word is final.

As discussed below, the General Assembly has shown an intent that the state, not localities, should occupy the central role in regulating farm wineries in Virginia. Farm wineries are affected primarily by three sectors of law and regulation at the state level: zoning, alcoholic beverage control, and agriculture. In each of these fields, the General Assembly has shown its intent for the state, rather than the localities, to control farm wineries.

A. *Preemption, Generally*

As Virginia adheres to the Dillon Rule, whenever a local regulation has not been expressly granted, cannot be reasonably implied from express grants, or is not an essential and indispensable local action, that regulation is invalid. Moreover, if a locality attempts to adopt a regulation that is in conflict with the Code of Virginia or general state policy, that regulation is preempted and, therefore, invalid.[71]

67. FAUQUIER COUNTY, VA., ZONING ORDINANCE §§ 3-318, 5-1810.1, 6-102, 6-400, 15-300, *available at* http://www.fauquiercounty.gov/documents/departments/commdev/pdf/zoningordinance/Amends_FarmWineryOrd_07-12-12.pdf.

68. *See supra* Part I.B.

69. *See* VA. CODE ANN. § 1-248 (Repl. Vol. 2011); *see also* City of Winchester v. Redmond, 93 Va. 711, 713, 25 S.E.2d 1001, 1001–02 (1986).

70. *See* Dail v. York Cnty., 259 Va. 577, 585, 528 S.E.2d 447, 451 (2000) ("A local ordinance may be invalid because it conflicts with a state regulation if the state regulation has 'the force and effect of law.'" (quoting Bd. of Supervisors v. Pumphrey, 221 Va. 205, 207, 269 S.E.2d 361, 362–63 (1980))).

71. *See* City of Lynchburg v. Dominion Theatres, 175 Va. 35, 42-43, 7 S.E.2d 157, 160 (1940).

In *Tabler v. Board of Supervisors of Fairfax County*, the Supreme Court of Virginia held that a local ordinance establishing a cash refund for non-alcoholic beverage containers was invalid.[72] In this case, the court found the General Assembly did not intend to convey the power to establish cash refunds to localities.[73] Finding no language in the Code of Virginia that specifically allowed localities to establish a cash refund, the court looked to proposed legislation to determine if such a power was implicitly granted.[74] The court noted that bills banning or taxing nonrefundable beverage containers were rejected by the General Assembly over the course of several years.[75] Finding no explicit language conveying a refund power to localities and a general state policy disfavoring the ban or taxation of nonrefundable containers, the court refused to "imply powers that the General Assembly clearly did not intend to convey."[76]

In *Blanton v. Amelia County*, the Supreme Court of Virginia held that a local ordinance banning the use of biosolids was in direct conflict with state level regulations that explicitly licensed businesses within Amelia County to use biosolids on their land.[77] The court noted that if an ordinance is not in direct conflict with state law or policy, it is the duty of the courts to harmonize local and state regulations and uphold the ordinance.[78] The court went on to state, however, that "local government may not forbid what the legislature has expressly licensed, authorized, or required."[79] The court found that the Code of Virginia and State Board of Health regulations specifically governed, authorized, and licensed the general use of biosolids on land in the Commonwealth.[80] As the local ordinance prohibited the use of biosolids, it had to be nullified because it stood in direct conflict with state law, regulations, and policy.[81]

72. 221 Va. 200, 204, 269 S.E.2d 358, 361 (1980).
73. *Id.*
74. *Id.* at 202–04, 269 S.E.2d at 359–61.
75. *Id.* at 203–04, 269 S.E.2d at 360–61.
76. *Id.* at 202, 204, 269 S.E.2d at 360–61.
77. 261 Va. 55, 65–66, 540 S.E.2d 869, 875 (2001).
78. *Id.* at 64, 540 S.E.2d at 874.
79. *Id.* (quoting King v. Cnty. of Arlington, 195 Va. 1084, 1091, 81 S.E.2d 587, 591 (1954)) (internal quotation marks omitted).
80. *Id.* at 64–66, 540 S.E.2d at 874.
81. *Id.* at 65–66, 540 S.E.2d at 875.

In *City of Lynchburg v. Dominion Theatres, Inc.*, the Supreme Court of Virginia held that a local ordinance prohibiting the exhibition of indecent movies was in conflict with state licenses authorizing the exhibition of such movies.[82] In that case, Dominion Theatres had obtained a license from the Division of Motion Picture Censorship for the State of Virginia for showing a film titled *The Birth of a Baby*.[83] Lynchburg, however, attempted to prohibit the theater from showing the film as a city ordinance prohibited the exhibition of indecent movies.[84] The court recognized that the state had codified laws relating to movie censorship and granted the power to issue licenses to the Division of Motion Picture Censorship.[85] As the state had occupied this field of law, the court moved to the conflicts analysis.[86] Stating that "what the legislature permits the city cannot suppress without express authority therefor," the court held that the local ordinance was in direct conflict with state law and policy.[87] The General Assembly, the court found, intended for the Division of Motion Picture Censorship to determine what films may or may not be shown in the Commonwealth.[88] Any ordinance that attempted to prohibit showings in contravention of the Division's permits was therefore in conflict with state law and void.[89]

The Supreme Court of Virginia has rigorously applied this preemption analysis whenever local ordinances and regulations come into conflict with the Code of Virginia or with policy set forth by the General Assembly. Whenever a local ordinance of any kind is irreconcilable with the Code of Virginia, the ordinance must fall.

B. *Preemption in the Farm Winery Field*

Where the General Assembly has shown an interest in exclusive regulation, localities cannot overregulate. The explicit language of statutes is indicative of legislative intent for either the

82. 175 Va. 35, 43, 7 S.E.2d 157, 160 (1940).
83. *Id.* at 37, 7 S.E.2d at 158.
84. *Id.*
85. *Id.* at 40–43, 7 S.E.2d at 159–60.
86. *Id.* at 42, 7 S.E.2d at 160.
87. *Id.* at 42–43, 7 S.E.2d at 160.
88. *Id.* at 43, 7 S.E.2d at 160.
89. *Id.*

state or localities to control an area of law. Furthermore, courts will not confer implied powers on localities that "the General Assembly clearly did not intend to convey."[90] Virginia statutes, regulations, and case law all suggest that the General Assembly clearly intended to exercise near exclusive control over all matters affecting the farm winery business in the Commonwealth.

In *City of Norfolk v. Tiny House*, the Supreme Court of Virginia held that the General Assembly, in passing the ABC Act, did not intend to usurp the power of localities to regulate the *location* of establishments selling alcoholic beverages through valid zoning permits.[91] The court began its analysis by noting that the Code of Virginia specifically grants localities the power to adopt zoning ordinances.[92] The court found that this grant of power was not displaced by the ABC Act, which granted the ABC Commission the authority to regulate matters concerning alcoholic beverages.[93] The court held that the zoning power allowed localities to regulate the *location and concentration* of establishments selling alcoholic beverages, the ABC Act notwithstanding.[94] The court noted, however, that "[t]he General Assembly intended to grant the ABC Commission exclusive authority to control the 'manufacture, bottling, possession, sale, distribution, handling, transportation, drinking, use, advertising or dispensing of alcoholic beverages in Virginia.'"[95] Further emphasizing this point, the court noted that Norfolk's ordinance was "not a prohibition measure," but rather merely an attempt to prevent the clustering of "adult uses."[96] Norfolk's ordinance was "not designed to prevent or control the use of alcohol or *to regulate the business of those who dispense it*."[97] That power, the court noted, "is the exclusive province of the ABC Commission."[98] As the Norfolk ordinance only sought to regulate the location of establishments selling alcoholic beverages, it was a valid exercise of the city's zoning power.[99] In short,

90. Tabler v. Bd. of Supervisors, 221 Va. 200, 202, 269 S.E.2d 358, 359–60 (1980).

91. 222 Va. 414, 422, 281 S.E.2d 836, 841 (1981).

92. *Id.* at 417, 281 S.E.2d at 838 (citing VA. CODE ANN. §§ 15.1-427 to -503.2 (Repl. Vol. 1981).

93. *Id.* at 421, 281 S.E.2d at 840.

94. *Id.* at 422, 281 S.E.2d at 841.

95. *Id.* (quoting VA. CODE ANN. § 4-96 (Repl. Vol. 1979)).

96. *Id.* at 424, 281 S.E.2d at 842.

97. *Id.* (emphasis added).

98. *Id.*

99. *Id.*

a zoning ordinance that regulates the business of alcohol distribution is invalid. The scope of a zoning ordinance is limited to the regulation of land, not to the regulation of business itself.[100] Any local ordinance, therefore, that purports to regulate the business activities of a farm winery is likely void as ultra vires.

Moreover, similar to the ordinance at issue in *Tabler*,[101] there is no direct language in the Code of Virginia that explicitly authorizes localities to have general regulatory power over wineries. That power has been reserved to the ABC Board whose regulations "have the effect of law."[102] The explicit language of the Code of Virginia denies localities the general power to regulate businesses dispensing alcoholic beverages. Section 4.1-128 recognizes only two instances in which a locality may directly regulate businesses dispensing alcoholic beverages. First, localities may issue licenses for taxation purposes.[103] Second, localities may prohibit the sale of beer or wine between noon on Saturday and 6:00 a.m. on Monday.[104] By the Code's explicit language, these are the only instances that localities may directly regulate businesses dispensing alcoholic beverages.[105] These specifically enumerated exceptions and the general grant of authority to the ABC Board show that the General Assembly intended for the ABC Board, not localities, to have the general authority to regulate businesses dispensing alcoholic beverages. As the General Assembly enumerated exceptions to this general power, it clearly did not intend for localities to have full regulatory power over such businesses.

Furthermore, *Tabler* rejects any notion that the courts, absent a specific intent by the General Assembly, should imply powers for localities that go beyond grants in the Code of Virginia.[106] As there is no specific intent granting localities a general regulatory power over businesses dispensing alcoholic beverages, localities lack that power. Indeed, in *Tiny House*, the Supreme Court of

100. *Id.*

101. *See supra* notes 72–76 and accompanying text.

102. VA. CODE ANN. § 4.1-111(A) (Cum. Supp. 2013); *see also id.* § 4.1-128(A) (Repl. Vol. 2010 & Cum. Supp. 2013) (explicitly stating that no locality shall "adopt any ordinance or resolution which regulates or prohibits the manufacture, bottling, possession, sale, wholesale distribution, handling, transportation, drinking, use, advertising or dispensing of alcoholic beverages in the Commonwealth").

103. *Id.* § 4.1-205 (Repl. Vol. 2010).

104. *Id.* § 4.1-129 (Repl. Vol. 2010).

105. *Id.* § 4.1-128 (Repl. Vol. 2010 & Cum. Supp. 2013).

106. *See supra* notes 72–76 and accompanying text.

Virginia specifically recognized that the general power "to prevent or control the use of alcohol or *to regulate the business of those who dispense it* . . . is the exclusive province of the ABC Commission."[107] Any local zoning ordinance that would not simply govern the clustering and location of farm wineries is therefore likely void.[108]

The Code of Virginia explicitly denies localities a general regulatory power over businesses dispensing alcoholic beverages, and the Supreme Court of Virginia has recognized the ABC Board's exclusive authority over such regulations. The Commonwealth, therefore, has shown clear intent to reserve for itself the general authority to regulate farm wineries—establishments that are in the businesses of dispensing alcoholic beverages.

III. COMPARATIVE ANALYSIS

Despite the General Assembly's intent to control the farm winery industry, the treatment of wineries in Virginia varies quite substantially from county to county. Some counties adopt a very laissez-faire approach, while others opt to more tightly control the day-to-day operations of farm wineries. In addition to the legal problems raised by strict local control over wineries, data suggests that there may be a correlation between burdensome regulations and decreased wine production. This data suggests that localities experimenting with more onerous regulations suffer from decreased participation in one of the most vibrant aspects of Virginia's economy.

107. City of Norfolk v. Tiny House, Inc., 222 Va. 414, 424, 281 S.E.2d 836, 842 (1981) (emphasis added).

108. The Supreme Court of Virginia later revisited the issue addressed in *Tiny House*. *See* Cnty. of Chesterfield v. Windy Hill, 263 Va. 197, 204–06, 559 S.E.2d 627, 631–32 (2002) ("We hold that the ABC Commission's exclusive authority to license and regulate the sale and purchase of alcoholic beverages in Virginia does not preclude a municipality from utilizing valid zoning ordinances to regulate the location of an establishment selling such alcoholic beverages." (quoting *Tiny House*, 222 Va. at 423, 281 S.E.2d at 841) (internal quotation marks omitted)).

A. *The Ordinances*[109]

1. Albemarle County

Central Virginia's Albemarle County has a very detailed farm winery ordinance that is one of the most supportive of agribusiness in the Commonwealth. Passed in 2009, the Albemarle ordinance was a response to the Virginia Farm Winery Act of 2006.[110] Following the passage of the Farm Winery Zoning Act, Albemarle sought to revise its winery ordinance, which had become unenforceable under the new legislation.[111] Original drafts saw the county attempting to define what a farm winery is, to regulate operational hours at farm wineries, and to define usual and customary events as those involving at most fifty individuals.[112] Concerned that these attempts were in violation of the Farm Winery Zoning Act, the Virginia Wine Council proposed an alternative ordinance that sought to strike a balance between the concerns of the county, local citizens, and farm wineries.[113] After working with the Virginia Wine Council, the county redrafted the ordinance, dropping the provisions governing business hours and redefining farm wineries.[114] The final ordinance, dubbed a "win-win"

109. Ordinances discussed in Part III are generally those ordinances currently in force as of the date of publication. With the exception of the 2012 Fauquier County Wine Ordinance, no major changes have been made to these localities' treatment of farm wineries since approximately 2010. Given the historical treatment of farm wineries by these counties, it is likely safe to discuss data largely in the context of current ordinances. Both Albemarle and Loudoun County have a pattern of loosely regulating farm wineries, while Fauquier County has a history of stricter regulation dating to at least 2005. *See* e-mail from Travis Hill, Deputy Secretary of Agriculture & Forestry, Office of the Governor of Virginia, to author (Sept. 19, 2013, 5:11 PM) (on file with author) (discussing Albemarle's "growing pains" with its farm winery ordinance but noting that both Albemarle and Loudoun work well with the wine industry). For a discussion on historic regulation of farm wineries in Fauquier County, see Strother & Allen, *supra* note 7, at 239–42. *See also* Linda Jones McKee, *A Tale of Two Lawsuits*, WINES & VINES (Feb. 26, 2013), http://www.winesandvines.com/template.cfm?section=news&content=112418; Susan Svrluga, *Fauquier County to Vote on Rules for Farm Wineries*, WASH. POST, Sept. 7, 2011, at C12.

110. Telephone Interview with Matthew Conrad, Deputy Chief of Staff & Deputy Counselor to the Governor, Office of the Governor of Virginia (Sept. 4, 2013). *See also* e-mail from Travis Hill, *supra* note 109 ("Albemarle went through some growing pains initially where wineries were finding it hard to operate under the rules the County was trying to set, but now, for the most part, what I'm hearing is that the County found the proper balance between the wineries and the County's interest in protecting public health, safety and welfare after working collaboratively with winery owners.").

111. *See* Interview with Matthew Conrad, *supra* note 110.

112. *See id*.

113. *See id*.

114. *See id*.

for all interested parties was the product of fruitful collaboration among local planning officials, a business friendly board of supervisors, and the Virginia Wine Council.[115]

Albemarle's ordinance specifically allows a variety of land uses by right, including: the uses expressly provided for by the Virginia Code;[116] the sale, tasting, and consumption of wine within the winery's normal course of business;[117] and events with two hundred or fewer attendees.[118]

Quite notably, Albemarle County also specifically provides for agritourism uses and uses related to wine sales.[119] Specific allowance for both of these potentially expansive uses were not given in either the Loudoun County or Fauquier County ordinance.[120] For two hundred or fewer attendees, the agritourism provision explicitly allows by right not only picnics, catering activities, and tours, but also hayrides, museums, and weddings.[121] Moreover, wineries are allowed to host more than two hundred guests at a time, provided they first obtain a special use permit.[122]

Albemarle only narrowly restricts wineries by regulating sound and yard sizes consistent with the other portions of its zoning ordinance.[123] The only uses that are expressly prohibited are restaurants and helicopter rides.[124]

As discussed below, Albemarle's very accommodating winery ordinance has seemingly contributed to a vibrant local wine industry.[125] In the words of Matthew Conrad, former director of the

115. *Id*.

116. These uses include: the production and harvesting of grapes; the sale, wholesale, shipment and storage of wine in accordance with Title 4.1; and private personal gatherings held by the winery's owner. *See* ALBEMARLE COUNTY, VA., CODE ch. 18, § 5.1.25(a) (2013); *see also* VA. CODE ANN. § 15.2-2288.3(E) (Repl. Vol. 2012).

117. Note that this seems to be a subjective element defined by a particular winery's business operations. *See* ALBEMARLE COUNTY, VA., CODE ch. 18, § 5.1.25(a)(2) (2013).

118. *Id.* ch. 18, § 5.1.25(b)(2).

119. *Id.* ch. 18, § 5.1.25(b).

120. FAUQUIER COUNTY, VA., CODIFIED ORDINANCES § 6-401 to -403 (2013), *available at* http://www.fauquiercounty.gov/government/departments/commdev/index.cfm?action=zoningordinance1; LOUDOUN COUNTY, VA., ZONING ORDINANCES § 5-625 (2013).

121. ALBEMARLE COUNTY, VA., CODE ch. 18, § 5.1.125(b) (2013).

122. *Id*. ch. 18, § 5.1.25(c). Contrast this broad allowance to the narrow allowance provided in the Fauquier County Ordinance. FAUQUIER COUNTY, VA., CODIFIED ORDINANCES §§ 5-1810.2, 6–401 (2013), *available at* http://www.fauquiercounty.gov/government/departments/commdev/index.cfm?action=zoningordinance1.

123. ALBEMARLE COUNTY, VA., CODE ch. 18, § 5.1.25(e),(f).

124. *Id.* ch. 18 § 5.1.25(g).

125. *See infra* Part III.B.

Virginia Wine Council, "the Albemarle Ordinance is a model ordinance that should be adopted for the interests of both wineries and local government."[126]

2. Loudoun County

Similar to Albemarle's ordinance, northern Virginia's Loudoun County has a rather brief winery ordinance that leaves farm wineries quite free to manage their own affairs. Most of Loudoun's winery ordinance is dedicated to regulating lot size, building area, landscape buffers, access, parking, and lighting.[127] These regulations are akin to traditional zoning practices, burdening the land on which a farm winery is situated, rather than its business operations.

The only regulation that directly regulates the operations of wineries is a provision that limits operational hours to between 10:00 a.m. and 10:00 p.m.[128] Despite serving as a limitation, the twelve hour time period is still rather broad, likely conforming to the usual and customary hours of wineries throughout the Commonwealth.[129]

Moreover, Loudoun County, as well as Albemarle, is lauded as having promoted an environment that encourages collaboration among the local government, agriculture in general, and farm wineries specifically. Such collaboration has "promote[d] economic development and attract[ed] various agricultural operations" to those counties.[130] As Travis Hill, the Deputy Secretary of Agriculture, has stated:

> Obviously, the growing conditions need to be there in order to grow high quality grapes, something both Albemarle and Loudoun have, but having the right regulatory environment is also necessary to keep things going. . . . [G]rape growers and winemakers are going to want to know that they and their businesses are welcome additions to the community. If they see areas that make it more difficult to succeed as a going concern, . . . they'll avoid those areas, despite good growing conditions.[131]

126. Interview with Matthew Conrad, *supra* note 110.

127. LOUDOUN COUNTY, VA., ZONING ORDINANCES § 5-625 (2013).

128. *Id*. § 5-625(A)(3).

129. The Farm Winery Zoning Act generally prohibits regulations that disallow usual and customary activities at farm wineries. *See* VA. CODE ANN. § 15.2-2288.3(A) (Repl. Vol. 2012).

130. E-mail from Travis Hill, *supra* note 109.

131. *Id.* Furthermore, "Loudoun also has some terrific promotion programs that en-

3. Fauquier County

a. The Ordinance

Northern Virginia's Fauquier County has an incredibly detailed set of ordinances related to farm wineries that was recently updated in July of 2012.[132] Unlike the ordinances in Albemarle and Loudoun, the Fauquier ordinance seeks to directly regulate the business activities of farm wineries.

The Fauquier ordinance specifically allows the by right uses established by the Virginia Farm Winery Zoning Act, but only during county-defined business hours.[133] It also expressly allows light food service during defined business hours and two special events per month, during defined business hours and limited to thirty-five attendees.[134] Unlike Albemarle County, Fauquier County does not permit, by right, uses related to agritourism or wine sales.

Like the ordinances in Albemarle and Loudoun, the Fauquier ordinance attempts to regulate lighting, setbacks, parking, and land area.[135] Again, these regulations are essentially traditional zoning regulations which simply affect the land, not the business on the land.[136]

Unlike the ordinances in Albemarle and Loudoun, however, Fauquier's ordinance also attempts to establish a number of explicit restrictions that directly regulate the business operations of farm wineries. For example, the ordinance establishes regular business hours for the wineries as 10:00 a.m. to 6:00 p.m.[137] Ex-

courage development of agricultural operations." *Id.*

132. FAUQUIER COUNTY, VA., CODIFIED ORDINANCES §§ 3-318, 5-1810, 6-102, 6-400, 15-300 (2013), *available at* http://www.fauquiercounty.gov/documents/departments/commdev/pdf/zoningordinance/Amends_FarmWineryOrd_07-12-12.pdf.

133. *Id.* § 6-401(1)–(7).

134. *Id.* § 6-401(8)-(9).

135. *Id.* § 6-402.

136. While these regulations may be considered traditional zoning regulations, they could still suffer from an important legal deficiency: The extent to which they regulate setbacks, parking, and buildable areas could likely be considered unreasonable. When enacting zoning ordinances, local governments must always remember the Supreme Court of Virginia's admonition that "[t]he mere power to enact an ordinance . . . does not carry with it the right arbitrarily or capriciously to deprive a person of the legitimate use of his property." Bd. of Cnty. Supervisors v. Carper, 200 Va. 653, 662, 107 S.E.2d 390, 396 (1959); *see also* Bd. of Supervisors v. Rowe, 216 Va. 128, 140–41, 216 S.E.2d 199, 210 (1975) (quoting Bd. of Cnty. Supervisors, 200 Va. at 662, 107 S.E.2d at 396.

137. FAUQUIER COUNTY, VA., CODIFIED ORDINANCES § 15-300, *available at* http://www.

tended hours are permissible in certain months if the winery first obtains an administrative permit from the county.[138] The Fauquier ordinance also expressly prohibits a number of accessory uses at farm wineries,[139] and strictly regulates the hosting of events.[140] Unlike Albemarle County, which allows up to two hundred attendees at winery events by right, the Fauquier ordinance generally allows an absolute maximum of two hundred attendees at events, eighteen times per year, and only with a special use permit.[141]

Not only does this ordinance likely suffer from legal problems regarding state control and preemption, but it has also likely contributed to Fauquier County's increasingly smaller impact on the Virginia wine industry.[142] Indeed, as of publication, The Virginia Governor's Secretary of Agriculture and Forestry "is aware of one potential corporate investor in the Virginia wine industry that has stricken Fauquier County from the county listing of where it would consider buying or building a winery . . . due, at least in part, to the passage of the winery ordinance in that County."[143]

b. A Continuing Controversy

The current Fauquier ordinance and its predecessors have been the subject of intense controversy from approximately 2005 to today.[144] Most recently, the Virginia Attorney General issued an ad-

fauquiercounty.gov/documents/departments/commdev/pdf/zoningordinance/Amends_FarmWineryOrd_07-12-12.pdf.

138. *Id.* § 5-1810.1.

139. *Id.* § 6-403.

140. *Id.* § 5-1810.2.

141. *Id.* § 5-1810.2(6). Larger wineries are permitted to have up to 250 guests 24 times a year as well as one event with 500 guests once a year. *Id.*

142. *See infra* Part III.B.

143. E-mail from Travis Hill, *supra* note 109.

144. *See, e.g.*, Susan Svrluga, *Fauquier County Passes Rules After Contentious Debate Over Wineries*, WASH. POST (July 14, 2012), http://articles.washingtonpost.com/2012-07-14/local/35489743_1_winery-owners-three-wineries-rural-area; *see also* Mckee, *supra* note 109 ("By 2005, the farm wineries in Fauquier County, Va., west of Washington, D.C., were limited by local regulations that threatened to stifle their ability to grow . . . . Fauquier County officials began to discuss a revised farm winery ordinance as early as 2008, and county supervisors have held numerous work sessions and public hearings on different versions of a potential ordinance."). In the days leading up to the passage of the Fauquier Ordinance, the Virginia Secretary of Agriculture & Forestry sent a letter to the Fauquier Board of Supervisors discussing his concern that the proposed ordinance would hamper the wine industry in Fauquier and that provisions of the ordinance were in conflict with state law. *See* Letter from Todd P. Haymore, Sec. of Agric. & Forestry, Office of the Gover-

visory opinion finding that, in part, the ordinance was "an invalid exercise of local authority because it exceeds the locality's delegated zoning authority and is preempted by state law governing alcoholic beverages."[145]

The opinion begins by first recognizing that localities have broad powers to zone, but that the Commonwealth follows the Dillon Rule, requiring that ordinances conflicting with state law be deemed invalid.[146] While conceding that certain provisions in the Fauquier Ordinance *may* be consistent with the Virginia Farm Winery Zoning Act, the Attorney General determined that significant portions of the ordinance went beyond the scope of power delegated to the county.[147] Specifically, the Attorney General stated:

> To the extent that the process of obtaining a Zoning Permit imposes obligations and burdens, including fees, upon the farm winery applicant and allows Fauquier County the ability to restrict through its review and potential denial of the zoning permit application those activities, the Fauquier County Zoning Ordinance exceeds the locality's zoning authority.[148]

In essence, the opinion reinforces existing case law by declaring that localities cannot expand their specifically delegated power to zone into a general police power over businesses.[149]

The concession that some provisions of the ordinance *may* be consistent with state law should not be read as inherent approval of those provisions. This concession was made without undergoing any of the factual questions posed by the Farm Winery Zoning Act.[150] The Attorney General specifically states that his office does not offer opinions to resolve factual disputes such as those posed by certain sections of the Fauquier ordinance.[151] This opinion,

nor of Va., to Holder Trumbo, Jr., Chairman, Fauquier Cnty. Bd. of Supervisors (July 10, 2012) (on file with author).

145. 2013 Op. Va. Att'y Gen. 12-063, *1 http://www.oag.state.va.us/Opinions%20and%20Legal%20Resources/OPINIONS/2013opns/12-063%20Peace.pdf.

146. *See id.* at *1–2.

147. *See id.* at *2–3.

148. *Id.* at *3.

149. *See id.* at *2; City of Norfolk v. Tiny House, Inc., 222 Va. 414, 414, 424, 281 S.E.2d 826, 841 (1981).

150. For example, the Farm Winery Zoning Act requires that localities first consider the economic impact of ordinances on farm wineries and if the winery operations have a substantial impact on the public welfare. *See* VA. CODE ANN. § 15.2-2288.3(A) (Repl. Vol. 2012); *see also supra* Part I.A.1.

151. 2013 Op. Va. Att'y Gen. 12-063, *supra* note 145, at *1.

therefore, leaves the door open to litigation and dispute over the application of much of the Fauquier ordinance.

B. *The Data*

1. Actively Licensed Farm Wineries

Actively Licensed Farm Wineries[152]					
County	2005	2010	2011	2012	Growth, 2005-2012
State Total	85	165	191	213	151%
Albemarle	10	20	24	26	160%
Loudoun	13	26	29	39	200%
Fauquier	13	24	26	27	108%

The table above shows the growth rates of licensed farm wineries in the counties discussed in Part III.A. Data is listed for the three most recent growing years as well as 2005, prior to the passage of the Virginia Farm Winery Zoning Act. The data suggest that, in the years following its passage, the Virginia Farm Winery Zoning Act initially had an extremely positive impact on the growth of Virginia wineries. Four years after the Act was passed, the number of farm wineries in Virginia had nearly doubled. Albemarle, Loudoun, and Fauquier saw similar growth patterns, with the number of farm wineries in those counties doubling, or nearly doubling by 2010. From 2010 through 2012, growth continued modestly in Albemarle and Fauquier; however, growth in Loudoun County was quite substantial.

Overall, the number of farm wineries in Virginia grew by approximately 151% from 2005 through 2012. In that same period, growth rates in Albemarle and Loudoun were higher than the statewide rate. Loudoun County, whose ordinance could be considered the most relaxed, enjoyed a considerable growth rate of

152. County figures were derived from information available at the Virginia Department of Alcoholic Beverage Control's website. *Retail License Search*, VIRGINIA DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL, http://www.abc.virginia.gov/licenseesearch/welcome.do. To obtain the figures for each year, the author (1) sorted the entries by date of origin; (2) removed any entries that were surrendered or withdrawn prior to January 1 of the subsequent year; and (3) removed any duplicate entries within that range. The winery counts, therefore, are as of December 31 of the year reported. State totals were obtained from the Virginia Wine Board Marketing Office. E-mail from Annette Boyd, Director, Virginia Wine Board Marketing Office, to author (Sept. 9, 2013, 12:18 PM) (on file with author).

200%, far outpacing the statewide rate. Fauquier County, on the other hand, which has a history of more strictly regulating farm wineries, experienced a growth rate of only 108%, well below the statewide rate.

2. Grape Production and Acreage

Total Grape Production (Tons)					
County	2005[153]	2010[154]	2011[155]	2012[156]	Growth 2005-2012
State Total	5600	6557	7728	7532	35%
Albemarle	904	1099	971	1223	35%
Loudoun	709	1036	1296	1342	89%
Fauquier	418	383	479	443	6%

Total Grape Acreage					
County	2005[157]	2010[158]	2011[159]	2012[160]	Growth 2005-2012
State Total	2560	3123	3158	3376	32%
Albemarle	490	562	461	557	14%
Loudoun	342	543	565	602	76%
Fauquier	213	205	238	242	14%

In 2005, Virginia produced a total of 5600 tons of grapes, grown on approximately 2560 total acres of land. With an average price of $1360 per ton, Virginia farm wineries generated $7,616,000

153. VIRGINIA WINE BOARD MARKETING OFFICE, VIRGINIA 2005 COMMERCIAL GRAPE REPORT [hereinafter 2005 GRAPE REPORT], *available at* http://www.virginiawine.org/system/datas/197/original/2005CommercialGrapeReport.pdf?1248124239.

154. VIRGINIA WINE BOARD MARKETING OFFICE, VIRGINIA 2010 COMMERCIAL GRAPE REPORT [hereinafter 2010 GRAPE REPORT], *available at* http://www.virginiawine.org/system/datas/320/original/2010_Commercial_Grape_Report.pdf?1312838511.

155. VIRGINIA WINE BOARD MARKETING OFFICE, VIRGINIA 2011 COMMERCIAL GRAPE REPORT [hereinafter 2011 GRAPE REPORT], *available at* http://www.virginiawine.org/system/datas/356/original/2011_Commercial_Grape_Report.pdf?1340900266.

156. VIRGINIA WINE BOARD MARKETING OFFICE, VIRGINIA 2012 COMMERCIAL GRAPE REPORT [hereinafter 2012 GRAPE REPORT], *available at* http://www.virginiawine.org/system/datas/376/original/Grape_Report_2012.pdf?1363691676.

157. 2005 GRAPE REPORT, *supra* note 153.

158. 2010 GRAPE REPORT, *supra* note 154.

159. 2011 GRAPE REPORT, *supra* note 155.

160. 2012 GRAPE REPORT, *supra* note 156.

from grape production in 2005.[161] By 2012, Virginia was producing a total of 7532 tons of grapes. At a weighted average price of $1669 per ton, the Virginia Wine Industry generated a total of $12,570,908 from grape production in 2012.[162] These grapes were produced on a total of 3376 acres of land in the Commonwealth.

In total, Virginians produced approximately 35% more grapes in 2012 than they did in 2005. Wine producers in Albemarle County kept pace with the statewide growth rate, while production in Fauquier grew at the substantially slower rate of 6%. During the same period, production in Loudoun County soared. Grape production in Loudoun grew by the considerable rate of approximately 89% from 2005 through 2012.

From 2005 to 2012, acreage dedicated to grape planting increased by 32% in Virginia. Both Albemarle and Fauquier saw acreage increase by a lower rate of approximately 14%. Loudoun County, by comparison, enjoyed 76% more land dedicated to grape production in 2012 than in 2005. As with the growth of licensed establishments and production, the increase of cultivated acreage in Loudoun is substantially larger than in either Albemarle or Fauquier. These figures further indicate a positive correlation between growth and relaxed regulations and a negative correlation between growth and strict regulations.

3. Economic Impact

In 2010, the Virginia Wine Industry as a whole had an estimated impact of $747.1 million on the Virginia economy.[163] In addition to the $10.6 million from grape production, this figure includes, among other items, $27.8 million paid in wages to winery and vineyard employees, $130.6 million generated from agritourism, and nearly $42.7 million in state tax revenue.[164]

Ninety-five percent of the wineries in Virginia contributing to this $747.1 million industry are classified as "small producers, producing less than 10,000 cases."[165] To generate their revenue,

161. *See* 2005 GRAPE REPORT, *supra* note 153.

162. *See* 2012 GRAPE REPORT, *supra* note 156.

163. THE ECONOMIC IMPACT OF WINE AND WINE GRAPES ON THE STATE OF VIRGINIA—2010, *supra* note 53, at 2.

164. *Id.* at 3.

165. *Id.* at 3, 7.

"[t]he vast majority" of these wineries rely on the higher margins produced by sales made directly to the customer in the tasting room.[166] With such a reliance on actual on-site sales, the majority of farm wineries rely on the least restrictive regulations possible in order to effectively conduct their businesses. When local governments have attempted to exercise strict control over the actual day-to-day operations of farm wineries, data suggests that those businesses are not able to thrive as readily as under less burdensome regulations. A weaker participation in the Virginia wine industry hurts not only the wineries themselves, but also the localities in which they are located. Wineries experience more difficulty providing products to their customers, leading to a smaller potential for growth, stymieing the growth of the local economy.

Moreover, in addition to the positive economic impact that farm wineries have, they serve as vehicles for preserving open space. Indeed, "[t]he best way in Virginia, or anywhere, to preserve farmland for agricultural uses is to keep agriculture profitable."[167] Each acre devoted to grape production is an acre that remains conserved for agricultural use. So long as farm wineries are able to effectively profit from their operations, land within these counties will continue to be preserved as rural.

Unsurprisingly, both Albemarle and Loudoun enjoy a substantial share of participation in Virginia's wine economy.[168] Overall, their regulations are less burdensome and leave farm wineries relatively free to manage their own affairs. On the contrary, Fauquier County's participation in the wine economy is quite small by comparison.[169]

In fact, by the end of the period of the most recent economic impact study, 2010, both Albemarle and Loudoun were producing more grapes on more acres than they had been in 2005; Fauquier, however, was producing fewer grapes on fewer acres.[170] Production levels in Fauquier have since risen above the 2005 levels.[171]

166. *Id.* at 8. Delegate Albo has also remarked that agritourism is vital to securing profits for farm wineries. *See* Albo, *supra* note 18.

167. Interview with Matthew Conrad, *supra* note 110.

168. *See* 2012 GRAPE REPORT, *supra* note 156.

169. *Id.*

170. *Compare* 2005 GRAPE REPORT, *supra* note 153, *with* 2010 GRAPE REPORT, *supra* note 154.

171. *Compare* 2005 GRAPE REPORT, *supra* note 153, *with* 2012 GRAPE REPORT, *supra* note 156.

An uncertain regulatory environment, however, could severely threaten this renewed growth in Fauquier. The current Fauquier ordinance has been a subject of controversy from around 2008 when it was first being debated, and it is possible that such controversy and uncertainty has since contributed to slower growth in Fauquier.[172] From 2011 to 2012, grape production again fell in Fauquier County.[173]

While it is impossible to state that stricter regulations implemented in Fauquier in 2012 were the sole cause of a downward trend in production, data released in 2013 indicates that grape production in Fauquier decreased from 2011 to 2012 whereas production in both Albemarle and Loudoun increased during the same period.[174]

Overall, the data for 2005 through 2012 indicates a correlation between higher regulation and lower output. More traditional land use regulations, such as those adopted in Albemarle and Loudoun, that largely allow farm wineries to establish their own business procedures and operations, correspond with higher outputs and, therefore, higher revenue (both for the winery and for the government through taxation). More onerous regulations, however, such as those in Fauquier County, that regulate the actual business of farm wineries, thereby limiting their ability to operate freely, correspond with lower outputs and, therefore, lower revenue.[175]

172. *See supra* notes 109 & 144 (discussing the history of the Fauquier ordinance and the public controversy surrounding it).

173. *Compare* 2011 GRAPE REPORT, *supra* note 155, *with* 2012 GRAPE REPORT, *supra* note 156.

174. 2012 GRAPE REPORT, *supra* note 156.

175. This data should not be read to show that stricter regulations are the *only* factor that leads to lower outputs. There are a variety of factors that could contribute to lower county-wide production of wine: the economic climate, individual business acumen, and weather patterns, among others. Nonetheless, the data does show a negative correlation between the strictness of regulations and the overall productiveness of farm wineries. Though a comprehensive geographical, geological, and soil analysis is beyond the scope of this article, it is useful to note at least a few general similarities between two of the studied counties, Loudoun and Fauquier. Both counties are geographically located within the Washington D.C. Metropolitan Statistical Area, allowing both access to similar markets. Both counties also have similar soil and geological conditions, indicating that both perhaps have similar positive potential for grape cultivation. *Cf.* e-mail from Tony Wolf, Director, AHS Jr. Agricultural Research and Extension Center, to author (Sept. 24, 2013, 7:28 PM) (on file with author) ("[A] given variety subjected to comparable management practices, including pest management, and grown at similar site conditions, would be expected to perform comparably between the two counties. . . . This is not the same as saying 'all other

IV. CONCLUSION

As the Supreme Court of Virginia has stated, the purpose of zoning is to "strike a deliberate balance between private property rights and public interests."[176] Government, of course, must be permitted to make laws governing its citizens and industries; however, these laws must not be so oppressive as to threaten the existence of the industry they purport to regulate. Virginia's great wine connoisseur, Thomas Jefferson, once stated that while restraining men from injuring each other, a wise government should "leave them otherwise free to regulate their own pursuits of industry and improvement."[177] Virginia's lawmakers should strive to follow Mr. Jefferson's advice and always remember that the public interest must be balanced against the rights of farm wineries and all businesses to conduct their operations as they deem best.

things being equal,' as there will be small climatic and other site-specific differences between the two counties. But in the broader sense of your [question regarding growing conditions], I think it would be extremely difficult to discern differences in grapes grown well in Loudoun County from those grown well in Fauquier County."). These general similarities further suggest that local regulations play a chief role in affecting viticultural production within a given county. Although further study is needed on these physical conditions, the general similarities between the counties do help to reinforce the conclusion that there is a negative correlation between strict regulation and grape production.

176. Bd. of Supervisors v. Snell Constr. Corp., 214 Va. 655, 657, 202 S.E.2d 889, 892 (1974).

177. Thomas Jefferson, *First Inaugural Address* (Mar. 4, 1801), *in* THOMAS JEFFERSON: WRITINGS 492, 494 (Merrill D. Peterson ed., 1984).

Licenses, Permits and Regulations

Submitted by David B. Albo

V. Licenses Permits and Regulations

A. State Specific Laws for Wineries. As stated, Virginia has a "Three Tier System" which is also known as "Tied House." It is a system where alcohol is made, delivered and sold by three different groups or "Houses" -- Manufacturers [e.g. wineries, brewers, distillers], Wholesalers/Distributors, and Retailers [e.g. 7-11, grocery stores or restaurants]. And each of these groups or "Houses" cannot have anything to do with the other group/"House." In other words, there can be no *ties* between the groups/*"Houses."* Thus, the term "Tied House" statute. This CLE is about wineries. Thus, I am not going to discuss beer or distilled spirits. Also, as for issues related to Wholesalers/Distributors and Retailers, I will only discuss as it relates to the role wineries may play in those "tiers." (Also, it is of no use for me just to re-print the code. These are my basic summaries of relevant Code and Regulations. Consult the Code and the Regulations *all* the rules and details.)

1. **Limitations on Wineries being able to sell as a Retailer or distribute as a Wholesaler**. "Tied House" VA Code §4.1-215 is the General Ban and §4.1-216 is the Financial Interest Ban (Regulations are 3 VAC 5-30-10 to 5-30-90).
    a. **VA Code §§4.1-215. General "Tied House" / "Three Tier System" law.** Sub-section C is the general ban: "*The General Assembly finds that it is necessary and proper to require a separation between manufacturing interests, wholesale interests and retail interests in the production and distribution of alcoholic beverages in order to prevent suppliers from dominating local markets through vertical integration and to prevent excessive sales of alcoholic beverages caused by overly aggressive marketing techniques. The exceptions established by this section to the general prohibition against tied interests shall be limited to their express terms so as not to undermine the general prohibition and shall therefore be construed accordingly*." Also, in VA Code §4.1-111, the Board is given power to implement regulations that "Maintain the reasonable separation of retailer interests from those of manufacturers, bottlers, brokers, importers and wholesalers…" This then lists exceptions. It says that the "Tied House" ban shall not apply to:
        i. Corporations operating dining cars, buffet cars, club cars or boats;
        ii. Brewery, distillery, or winery licensees engaging in selling wine at the Winery (See § 4.1-201 A (5));
        iii. Farm winery licensees engaging in conduct authorized by subdivision 5 of § 4.1-207. Activities in this section include selling wine at the Farm Winery or at up to 5 approved off site retail locations;
        iv. Manufacturers, bottlers or wholesalers of alcoholic beverages who do not (i) sell or otherwise furnish, directly or indirectly, alcoholic beverages or other merchandise to persons holding a retail license or banquet license as described in subsection A and (ii) require, by agreement or otherwise, such person to exclude from sale at his establishment alcoholic beverages of other manufacturers, bottlers or wholesalers;
        v. Wineries, farm wineries engaging in conduct authorized by § 4.1-209.1

(direct shipment) or 4.1-212.1 (home delivery for personal consumption); or

vi. One out-of-state winery, not under common control or ownership with any other winery, that is under common ownership or control with one restaurant licensed to sell wine at retail in Virginia, so long as any wine produced by that winery is purchased from a Virginia wholesale wine licensee by the restaurant before it is offered for sale to consumers.

b. **VA Code §4.1-216. Ban on financial ties between Wineries, Wholesalers and Retailers.** While §215 is the general "Tied House" ban, §216 is the "financial" ban, stating that no Manufacturer [eg. winery] or Wholesaler shall acquire or hold any financial interest, direct or indirect, in the business that has a retail license or on the premises where a business has a retail licensee. However the "on premises" restriction does not apply if the winery does not sell wine or other merchandise to such retail licensee and such retail licensee is not required by agreement to exclude from sale at his establishment alcoholic beverages of other wineries or wholesalers. (See §4.1-216B) Also take note that no manufacturer [e.g. winery] shall make an agreement with a retail licensee where products sold by another winery are excluded. (See §4.1-216 B (5)) In addition, No winery shall induce or coerce or attempt to induce or coerce (1) wholesaler to accept delivery of any wine which has not been ordered by wholesaler, (2) a wholesaler to do an illegal act by any means including threatening to amend, cancel or refuse to renew the wine/wholesaler contract, or (3) limit the wholesaler to to sell products any other winery.

2. **Getting a license in the first place.** * *The terms get confusing because in the code it uses "winery" to mean regular wineries and farm wineries. And then "winery" when it means just regular winery. To try and make sense of this, I will use the term "Winery" when I mean both types, and the term "Regular Winery" for larger wineries that are not Farm Wineries and the term "Farm Winery." In Virginia, a Winery can be one to two types, a "Regular Winery" or a "Farm Winery."*

   a. To apply for a Regular Winery or Farm Winery License, oddly enough, you use the form marked "Retail." Form 805-52. (See ABC web site page "Forms and Reports" http://www.abc.virginia.gov/enforce/forms/enfforms.htm) This application is tricky because it does not say "farm winery" on it. Its title is "Retail," but it is really a "one size fits all" application. At the bottom of the form there is a note which says if you don't find your type of license here, call the ABC. The ABC agents tell me that they always answer "use form 805-52."

   b. Grounds for Which Board May Refuse to Grant License. VA Code §4.1-222. The list is long, but includes applicants who are (a) under 21, (b) convicted of a felony or crime of moral turpitude, (c) … (d) not of good moral character, (e) has not demonstrated financial responsibility, (f) … (g) has maintained a noisy, lewd, disorderly or unsanitary establishment, (h) … (i) is unable to speak, understand, read and write English I a reasonably satisfactory manner…

3. **Production/Manufacturing/Sale. Types of Licenses for Manufacturing Wine**. Basically, a person who wants to manufacture and sell wine in Virginia has two choices,

a "Regular Winery" license or a "Farm Winery license." (A Farm Winery license can be either a Class A or Class B license.) In short, a Regular Winery license is for a big winery that can produce enough that it needs a wholesaler. It can get its grapes from anywhere, but it cannot sell retail on site without a special license. Farm Wineries are small wineries that are usually too small to be able to have enough volume or reliability for a Wholesaler. (Note: Wholesalers want to know that there will be enough of the winery's wine to be able to keep the shelves stocked at Giant or Safeway). In order to help foster a "wine economy" in Virginia and create jobs, Farm Wineries are given special rights which we hope will help them grow and prosper. For example, embedded in the Farm Winery license is the ability to sell retail at the farm. In addition, a special state sponsored distributor was created to help Farm Wineries get their wine to stores and restaurants.

a. **Regular Winery License.** VA Code §4.1-207 (1). This license authorizes a Regular Winery to manufacture wine and to sell and deliver or ship the wine in accordance with the Code and ABC Regulations in closed containers to wholesalers and to persons outside of VA for resale outside VA. In addition, it allows:
    i. Operation of distilling equipment on promises in making wine,
    ii. Make other wineries win under a "contract winemaking" arrangement, and
    iii. Store wine in bonded warehouses on or off the winery premises.
b. **Farm Winery License**. VA Code §4.1-207 (5). This authorizes the winery to manufacture wine containing 18% or less of alcohol, deliver or ship the wine in closed containers to either the ABC Board, wholesalers, or persons outside the Commonwealth. The Farm Winery can:
    i. **Sell to a wholesaler OR to the ABC Board**. Note the difference here from a winery license. A Winery can only sell to wholesalers. A Farm Winery can sell to a wholesaler OR the ABC Board.
        1. This is a result of the bill which allowed small wineries to use a government approved wholesaler approved by the ABC. This state sponsored Wholesaler is called The Virginia Wine Distribution Company (VDWC). As you will recall from earlier discussions, small wineries complained that the cost of using a wholesaler at their level was too expensive. So the state created a government approved wholesaler for lower cost distribution for small wineries. (See also VA Code §3.2-102 B (2))
        2. VDWC can be used only by Farm Wineries. A Farm Winery applies for this ability to ship via the VDWC through the ABC. Basically, when a Farm Winery wants to deliver wine in the role of a wholesaler (e.g. to a grocery store or restaurant) it must file the transaction with the ABC/VDWC. The VDWC basically allows the winery to act as its own wholesaler, but certain formalities must be followed.
        3. Confused? Maybe an example would help. A restaurant places an order to Farm Winery X to buy 3 cases of wine. Farm Winery X submits an invoice electronically through VWDC, a wholesale invoice is created. An employee of the Farm Winery, who

temporarily is acting as a representative of the VWDC, will deliver the wine to the restaurant, and VWDC invoices to the restaurant. Payment is made to VWDC not directly to the Farm Winery. VWDC then reimburses the Farm Winery. We designed this so that the Three Tier System is maintained, but it does operate in a fashion where the Farm Winery employee is temporarily working as an employee of both the farm winery and the VWDC.

ii. **Operate a contract winemaking facility** (e.g. Take grapes from other wineries and under contract, make wine for them. This allows wineries to share resources so each winery does not have to, for example, buy expensive stainless steel tanks.)

iii. **Store wine in bonded warehouses** located on or off the winery premises.

iv. **Class A vs. Class B License.** VA Code §4.1-219 designates the difference:

1. Class A: At least 51% of fruit *must be grown or produced on the farm* and no more than 25% of the fruit shall be grown or produced outside of VA.
2. Class B: 75% of the fruit *must be grown in VA* and no more than 25% of fruit shall be grown outside VA. No Class B farm winery licensee shall be issued to any person who has not operated under an existing Virginia farm winery license for at least 7 years
3. There is a petition system for exceptions to the rules if unusually severe weather or disease conditions cause a significant reduction in fruit.

4. **Exceptions to "Three-Tier System/Tied House."** As discussed above, it is the statutory policy of the Virginia Code that there be a complete division between Manufacturers [wineries], Retailers and Wholesalers. But here is a list of licenses, allow for exceptions to the "Three-Tier System/Tied House." (Note, these are in addition to rights that a winery has listed above to sell on premises).

a. Exceptions allowing wineries to distribute/wholesale. <u>There are no exceptions</u>. While it may be semantics, the provision in the Farm Winery law that allows a Farm Winery to sell directly to the Board through the VWDC is really not an exception. They are still selling to a wholesaler, but it happens to be a wholesaler operated by the ABC that is meant to be "user friendly" to these small Farm Wineries.

b. Exceptions allowing wineries to sell retail.

i. **Retail Off-Premises Winery License**. VA Code §4.1-207 (4). This section applies to Regular Wineries, not Farm Wineries. Farm Wineries are allowed to sell at their wine as part of their initial license. This is essentially an add-on license to a Regular Winery license that allows the winery to sell directly to customers at the Regular Winery for off-premises consumption. [e.g. Buy a bottle of our Merlot to take with you and drink at home] Under 3 VAC 5-60-90, wine offered for sale by a retail off-promises Regular Winery shall be procured on order forms prescribed by the Board. The wine for sale at retail must be segregated from all other

wine and stored only at the location on the promises approved by the board.

ii. **Farm Wineries can sell at their wine under the Farm Winery License itself.** The Farm Winery statute itself gives the Farm Winery the right to sell retail at the Farm Winery, and at no more than five additional retail establishments of the licensee for on-premises consumption and in closed containers for off-premises consumption. (Note that a Regular Winery licensee has to get the "add-on" license to sell on-premises. The Farm Winery license incorporates the retail sale on premises and at up to five other locations, with the permission of the ABC Board, of course).

iii. ***NOTE: How Wineries Must Conduct Retail/Sales****. This CLE is about the "manufacturing" tier of the Three Tier/Tied-House system. If I made this outline about the retail side also, it would be twice as long. Suffice it to say, if your winery wants to sell retail under one of the exceptions, KNOW ALL THE RULES. To start with, look at 3 VAC 5-50-10 through 3 VAC 5-50-240. I would also suggest that all managers and employees take the free courses offered by the ABC. (See the Virginia ABC website for ABC Licensee Training and Resources. Not only will it help you and your staff learn the rules, IF anything happens, such as a mistake in selling to someone under 21, having taken these courses can help alleviate the severity of the punishments.*
http://www.abc.virginia.gov/licensing/licensee_edu.htm)

iv. Internet Wine Retailer License. VA Code §4.1-207(6) and Direct Direct Shipment of Wine and Beer; Shipper's License. Under VA Code §4.1-209.1.

1. **Internet Wine Retailer License**. VA Code §4.1-207(6) Allows person in or outside of VA to sell and ship wine in closed containers to persons in VA *via* the internet. (No monthly food sales are required for this.) This section refers to the rules set forth in the Direct Shipment of Wine and Beer; Shipper's License. (see below)
2. **Direct Shipment of Wine and Beer**; Shipper's License. Under VA Code §4.1-209.1. Wine shipper's licenses may sell and ship not more than 2 cases of wine per month to people in VA for their personal consumption.
    a. The shipment must be by "common carrier" [e.g. Fed Ex, UPS] and there are rules that must be followed to make sure it is not delivered to people under 21.
    b. Subsection E talks about "Wine-of-the Month" clubs and allows this type of contract where a customer agrees to buy a certain amount of wine per month.
    c. Subsection F states that instead of the winery doing all the packaging and mailing itself, it can use a "fulfillment warehouse." (These fulfillment warehouses are not wineries, so they are not discussed here, but it is a separate license)

d. Subsection G allows sale of wine through the use of the services of an approved marketing portal, [a business organized as an agricultural coop association soliciting and receiving orders for wine or beer and processing payment as the agent of a wine shipper.

3. **Specific Rules for Internet and Direct Shipment**: 3 VAC 5-70-220. This regulation is two pages single spaced. So if you do this, memorize the rules. Some of the highlights include:
   a. Must apply for such license by submitting form 805-52 application. (See ABC web site page "Forms and Reports" http://www.abc.virginia.gov/enforce/forms/enfforms.htm)
   b. Records of number, volume and brand of containers shipped, and the names and addresses of recipients must be kept for two years and made available for inspection at reasonable hours.
   c. Reports must be made by the 15th of every month.
   d. Shipments must be by common carrier.
   e. When attempting to deliver the recipient must demonstrate he is at least 21 and sign form acknowledging receipt.
   f. The licensee must affix in 16 point font "CONTAINS ACLOHOLIC BEVEAGES; SIGNATURE OF PERSON AGED 21 YEARS OR OLDER REQUIRED FOR DELIVERY."
4. **Rules for Sale of Wine Outside the Commonwealth**. There is no statute or regulation which authorizes the sale to a customer in another state. That is because the sale is done under that state's rules. So if a Winery wants to mail wine to a person in State X, it must look at State X's laws. However, there is one limitation. VA Code §4.1-214 states that no deliveries or shipments of alcoholic beverages to persons outside of VA for resale outside VA, shall be made into any state "… the laws of which prohibit the consignee from receiving or selling the same." Obviously this is a reciprocity rule.

v. **Tasting Licenses**. A manufacturer of wine (e.g. Regular Winery and Farm Winery) can do off site tastings, but there are many rules to follow. A winery would usually conduct its tastings pursuant to VA Code §4.1-201.1 under its Manufacturer license.
   1. Under VA Code § 4.1-201.1,
      a. Manufacturers of alcohol [Wineries] may conduct tastings of wine within hotels, restaurants and clubs license for on-premises consumption provided:
      b. Tasting are done by an employee of the Winery or an authorized representative of the Winery which such authority person obtained a permit in accordance with VA Code§4.1-212 A (15),
      c. Such person is present at the tasting,

d. The retail establishment must be licensed to sell wine,
e. The tasting is served to the customer by employees of the retail establishment,
f. No more than 5 oz. of wine can be served and all the wine must be purchased from the retail establishment,
g. No more than $100 may be expended during an 24 hour period.

2. All tastings done other than under the VA Code §4.1-201.1 outlined above have different rules under §4.1-221.1. Samples given or sold by a licensee can not be more than 2 oz per person of each product tested provided that:
    a. No more than four products shall be offered
    b. No more than four tasting licenses issue annually to any person.
    c. Provisions of this do not apply to tastings under §4.1-201.1 for tastings by a manufacturer.

5. State Requirements for Product Approval

a. **Procedures for qualifying and disqualifying wine**. 3-VAC-40-20. All wine sold in VA shall first be approved by the Board as to content, container and label.
    1. Must conform with all federal regulations.
    2. Winery must submit application form to the Board for each new brand and type of wine. (However a "gift package" where the label had been previously granted does not need additional approval.)
    3. Board *shall* withhold approval of any wine with greater than 21% alcohol volume
    4. Board *may* withhold approval of any label which:
        a. Implies or indicates the product contains spirits,
        b. Has the word "fortified" or implies that it contains spirits,
        c. Contains anything obscene,
        d. Contains subject matter designed to induce minors to drink,
        e. Contains anything misleading,
        f. Implies it is government endorsed,
        g. Implies it enhances athletic prowess or includes any reference to any athlete (unless allowed under the advertising exceptions 3 VAC-5-20-10).

b. **Wine Containers Sizes and Types** 3 VAC 5-40-30. Wine may be sold at retail only in its original containers in sizes approved by federal agency, except that Farm Winery may conduct barrel tastings. Wine cannot be removed from a Retailer except in original containers and cannot be sold if the closure has been broken. But you can get a special permit for novel or unusual containers

6. **Other permits**. Permits Required in Certain Instances. VA Code §4.1-212. This is a miscellaneous section. Some of the other permits that apply to Regular Wineries and/or Farm Wineries are:

a. **Sale of wine in kegs** (See VA Code §4.1-212(12).
b. **Storage of wine by a license Winery under internal revenue bond in warehouses located in VA** (See VA Code§4.1-212(14).
c. **For any person to conduct tastings** in accordance with §4.1-201.1 (See VA Code §4.1-212(15).
d. **Delivery of wine and beer** (See VA Code §4.1-212.1). Also, see 3 VAC 5-70-225. (The rules are very similar to the Internet and Direct Shippers rules.) Any Winery in VA or outside VA that is authorized for retail sale of wine or off-premises consumption may apply to the Board for a delivery permit that will allow the delivery of wine in closed containers to consumers in VA for personal consumption. (Cannot be re-sold)
    i. The application is on form 805-52 (See the ABC website page "Forms and Reports" http://www.abc.virginia.gov/enforce/forms/enfforms.htm)
    ii. Specific Rules listed in both the code §4.1-212.1 and the regulation 3 VAC 5-70-225. This regulation is one page single spaced. So if you do this, memorize the rules. Some of the highlights are:
        1. Must apply for such license by submitting form 805-52 application. (See ABC web site page "Forms and Reports" http://www.abc.virginia.gov/enforce/forms/enfforms.htm)
        2. Records number, volume and brand of containers shipped, and names and addresses of recipients. Records must be kept for two years and made available for inspection at reasonable hours.
        3. Reports must be made by the 15th of every month.
        4. Shipments must be by common carrier.
        5. When attempting to deliver the recipient must demonstrate he is at least 21 and sign form acknowledging receipt.
        6. The licensee must affix n 16 point font "CONTAINS ACLOHOLIC BEVEAGES; SIGNATURE OF PERSON AGED 21 YEARS OR OLDER REQUIRED FOR DELIVERY."
        7. The Delivery of the wine must be performed by the owner, agent of employee of the Winery.
        8. No more than four cases of wine may be delivered at any one time. (Can get permission to deliver more if notify Dept. one day in advance.)
        9. In addition, there are certain things that must be done to make sure no one under 21 gets the wine and you must have a signed acknowledgment of delivery.

7. **Traditional Advertising, Social Media Advertising and Promotion** See S4.1-111B(13)
    a. **Selected rules in VA Regulations.** (Check them all. These are just the ones I thought were more relevant to this CLE.)
        i. **Inducements to Retailers**. 3 VAC 5-30-60 lists what "Inducements to retailers" can be given. For example, any Winery may sell, rent or give wine knobs containing advertising, refrigeration equipment, and bottle

openers. The rule is, don't give retailers anything not listed in this regulation.

ii. **Routine Business Entertainment**. 3 VAC 5-30-60 explains what "routine business entertainment" that a Winery can provide to a Retailer.

iii. **Advertising Materials Provided by Winery to Retailer**. 3 VAC 5-30-80 explains advertising materials that may be provided by a Winery to a Retailer.

1. Firstly, with exceptions, there can be no cooperative advertising with a wholesaler or retailer.
2. Subsection G creates a complete ban on selling, renting, lending, buying for, or giving any Retailer any unlawful advertising material and bans any Retailer from inducing any Winery to give any advertising. While this section does not say "except as provided herein," the term unlawful would mean that the only things that can be given or sold to a retailer are listed in this regulation. So, don't give or sell anything to a retailer unless you see it in the Code or regulation.
3. Subsection F says that all advertising obtained by a Retailer from a Winery or Wholesaler that is allowed can be installed in the *interior* of the retailer. The Retailer must keep a list of everything it gets.
4. Things that can be *given*, include:
    a. Non-illuminated ads made of paper, cardboard, canvas, rubber foam or plastic if it has a wholesale value of $40 or less.
    b. Napkins or coasters with the winery logo if they promote moderation and responsible drinking.
    c. Wine brochures relating to the manufacturing process, vineyard geography and history.
    d. With the consent of the retailer, point-of-sale entry blanks relating to contests and sweepstakes if such is offered to all retail licensees.
    e. Refund coupons.
5. Winery can *sell* to a retailer articles of tangible personal property normally used to serve alcoholic beverages such as glasses, napkins, buckets and coasters.

b. **Internet/Web Sites**. This has been controversial. As a guide, unless otherwise stated, make sure your website only has things on it that are allowed outside the restaurant. Restaurants want to be able to put their "specials" or "happy hour times" on the internet, but the regulations did not allow it. The restaurants say their internet site should be governed like the interior of their restaurant. I agree and put in a bill to implement this. However, groups fighting underage drinking disagreed. They fought vigorously against allowing website advertising of alcohol specials. These groups and I had a difference of opinion. I pointed out that even if a person under 21 saw the information on the internet, they could not get into the restaurant to take advantage of it. As a compromise, I struck my bill

and allowed the ABC to do regulations which allowed for public comment and a more collaborative process.) Recently, the Happy Hour regulation was rewritten. (See 3 VAC 5-50-160.) It now says that advertising happy hour anywhere other than within the interior of a license promises is barred, except that a licensee may use the term "Happy Hour" or "Drink Specials" and the time period of the happy hour or drink special. So your internet site can have "Happy Hour 5 p.m. – 9 p.m." but cannot describe the wine or the prices.

8. Miscellaneous

a. **Setting the Price**.
   i. Under 3 VAC 5-70-150 A, no Winery shall require a Wholesaler to discount the price at which the Wholesaler shall sell any wine nor can a Winery in any other way fix or maintain the price at which a Wholesaler can sell the wine.
   ii. Under 3 VAC 5-70-150 B, no Winery can increase the price charged to any Wholesaler without 30 days advanced written notice to the Wholesaler containing the amount and effective date of the increase.
   iii. Under 3 VAC 5-70-150 C, no Winery can discriminate as to price between different Wholesalers unless the price charged is due to a bona fide difference in the cost of sale or delivery, or where a lower price was charged in good faith to meet an equally low price charged by a competing Winery on a brand and packaging of like grade and quality. If there is a price difference, the Board may ask for a written "substantiation"

b. **Certain Transactions Must Be For Cash**. 3 VAC 5-30-30: Sales of wine between wholesale and retail shall be for cash at the time of delivery or prior to, except where payment made by electronic fund transfer.

c. **Solicitation of Licensees By Wine Solicitor Salesmen or Representatives.** 3 VAC 5-30-50: A permit is <u>not</u> required to solicit or promote wine to Wholesaler or Retailer by a wine solicitor salesman who represents any Winery licensed in VA. But, a permit <u>is</u> required to solicit or promote wine sold by a wine solicitor salesman or representative of any out-of-state Wholesaler.

d. **Reporting**. 3 VAC 5-60-25: There is a LOT of reporting to the government when you sell alcohol. On or before the 15th of each month each Winery shall file a report of its sales. 3 VAC 5-60-50 states that a Winery must comply with keeping complete and accurate records at the place of business for two years. The records must be available during reasonable hours for inspection. This section lists all the information that must be recorded.

Federal and State Licenses Permits and Regulations

Submitted by Denise Gorrell

NBI LICENSING PRESENTATION

OCTOBER 16, 2014

FEDERAL AND STATE LICENSES, PERMITS AND REGULATIONS

A. ALCOHOL AND TOBACCO TAX AND TRADE BUREAU

Establishing a winery under federal law requires compliance with two sets of laws, the Federal Alcohol Administration Act (FAA) and the Internal Revenue Code (IRC).[1] The Alcohol and Tobacco Tax and Trade Bureau (TTB) is the agency responsible for administering these laws. In administering these laws, the TTB is responsible for the collection of taxes on alcohol and alcohol permitting, labeling, and marketing requirements.

1. Applying as a Bonded Winery, Alternating Proprietorship or Custom Crush

Any company that wishes to produce wine for commercial purposes, store, blend or bottle untaxpaid wine, or wholesale or import wine products must file and application with TTB and receive approval before starting operations.[2] The permit a company receives cannot be sold or transferred. In order to obtain a permit, a wine making operation should first determine which type of operation they would like to run. The TTB has established approximately four types of wine operations associated with wine making:

a. Types of Winery Operations

"Stand Alone" Bonded Winery: This is a traditional winery. Sometimes called a "stand alone" or "brick-and-mortar" winery, this type of operation is responsible for all production activities as well as the recordkeeping and filing associated with onsite production. This includes label approval for the wine prior to bottling and the payment of excise tax on the wine.

Alternating Proprietor: This form of operation is used when two or more wine companies agree to share the use of a bonded wine premises. The wine company that owns or controls the premises is known as the "host" winery while the companies that use the premises are known as "tenants" or "alternators." In this case each company will be fully responsible for their own production, bottling, storage and management. Additionally, each company must separately keep appropriate records, follow labeling and reporting guidelines, and pay taxes. This is common among new entrants to wine making who can lease excess space and capacity from a larger more established winery thereby defraying startup costs.

Custom Crush: This operation generally occurs when a currently operating winery is approached by a customer or start-up winery who would like to have wine produced. There are

---

[1] *See* 27 CFR §§ 24.100-.117 (IRC regulations) and 27 CFR §§ 1.24-.31 (FAA Act regulations).
[2] 27 CFR § 24.100.

two pieces of this operation: the party producing the wine (Producer) and the party for whom the wine is produced (Client).

Producer: The winery responsible for making the wine in a custom crush arrangement is known either as the "custom crush winery" or the "producer" and must qualify as a fully bonded winery. Generally, the producer will be responsible for making the wine as well as all associated taxes, records, labeling & reporting requirements. If, however, there is an arrangement which provides for different premises in different steps of the process, the premises that bottles the wine will be responsible for obtaining approval from the TTB for the labels and the wine premises that removes the wine from bond is required to pay the Federal excise tax on the wine.3

Client (Wholesaler): The customer for whom the wine is being produced is called the "customer" or "client" and they will be licensed under the TTB's wholesaler category. The Client will receive taxpaid wine from the producer and has fairly minimal compliance requirements. The customer is not responsible for labeling, tax, or reporting responsibilities and has only minimal record keeping requirements.4 A custom crush arrangement will often arise when the customer has access to the grapes or other raw material (e.g. a vineyard might be a client); however, the client does not need to provide the wine making materials.

Bonded Wine Cellar: These operations generally store already made wine under bond, but then they can include bottling or blending operations. The more a Wine Cellar's operation includes, the more responsibility they will incur in regards to labeling and reporting requirements.

Company Type[5]	Wine Premises Expenses	Recordkeeping	Label Approval	Excise Tax	Operations Reports
Stand-Alone Bonded Wine Premises	Yes	Yes	Yes	Yes	Yes
Alternating Proprietor Host	Yes	Yes	Yes	Yes	Yes
Alternating Proprietor Tenant	Minimal	Yes	Yes	Yes	Yes
Custom Crush Producer	Yes	Yes	Yes	Yes	Yes
Custom Crush Client	No	Minimal	No	No	No

b. Required Documents

When a company determines what type of entity they want to run, the company then must apply to the TTB. The TTB has numerous and varied requirements depending on the type of operation. The following is a description of some of the basic required forms:[6]

---

[3] *See* http://www.ttb.gov/wine/regulatory_reponsibilities.shtml
[4] *See* 27 CFR § 31.222
[5] http://www.ttb.gov/wine/regulatory_reponsibilities.shtml

[6] See appendix A for a checklist of required forms from the TTB & see chart below for which forms are required for each entity.

1) **Application to Establish and Operate Wine Premises TTB F 5120.25:** This is one of the basic forms the TTB requires before an application can be processed. This form needs to be filled out by every operation which produces or stores wine. These include: Bonded Wineries, Alternating Proprietorships, and Wine Cellars.

2) **Application for Basic Permit under the FAA Act TTB F 5100.24:** Every application, other than storage only applicants, must include this form. The TTB will not begin to process your application until they receive this form. This form includes a source of funds section, supporting documentation must be attached to this form.[7]

3) **Personnel Questionnaire TTB F 5000.9:** This form is used by the TTB to determine the eligibility, suitability, and/or qualifications of an applicant. It requests information about applicant's background. It will only be used where applicable.

4) **Wine Bond TTB F 5120.36:** Two original bonds must be filed; the TTB will not accept photocopies. This form is required for every operation which produces or stores untaxpaid wine and the TTB will not begin to process your application until they have received this form. The TTB has worksheets and instructions to determine the sum of the bond.[8]

5) **Environmental Information TTB F 5000.29:** This form gathers information on the environmental impact wine making operations will have.

6) **Supplemental Information on Water Quality Considerations TTB F 5000.30:** This form gathers information to determine if a certification or waiver by the applicable State Water Quality Agency (DEQ in Oregon) is required by the Clean Water Act.

7) **Power of Attorney Form 5000.8, or Signing Authority for Corporate and LLC Officials TTB F 5100.1, or Signing Authority in Organizational Documents:** The appropriate form must be chosen based upon applicable business entity. This form informs the TTB who has authority to sign for a company. If you are filing as a sole owner you only need to file Form 5000.8, if someone will sign documents on your behalf.

8) **Special Tax Registration TTB F 5630.5 (Registration only – No Tax Due):** In 2005, the "Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users," was signed into law.9 This law repealed the special (occupational) taxes on all alcohol occupations effective July 1, 2008. However, the registration requirement for producers and marketers of alcohol beverages remains (this includes all wine making operations). Thus, for wine operations, registration is still required but no tax will be due.

9) **Trade Name Registration** for the company's Operating Trade Name and any additional Bottling Trade Names.

---

[7] See appendix B for more information.
[8] See appendix C*; see also* 27 CFR § 24.148.
[9] *See* Public Law 109-59.

10) **Diagram of bonded wine premises:** this document is only required if there will be alternating proprietor hosts and tenants. The TTB does, however, state that it is quite helpful in processing all applications.

11) **Alternating Proprietor agreement or contract:** required for all operations where there will be alternating proprietor hosts and tenants.

12) **Lease agreement**: only required if a lease exists

13) **Organizational Documents**: depending on the type of business entity the operation is, the TTB requires different documents:

For Limited Liability Companies:

Copy of the Articles of Organization;

Copy of Operating Agreement;

List of members/managers, including addresses, and their percentage of interest; and

Copy of the certificate of organization executed by an officer of the state in which organized.

For Corporations:

Copy of Articles of Incorporation;

Copy of Bylaws;

List of officers, directors, and anyone holding more than 10 percent stock, including addresses and showing the number of shares held; and

Copy of the certificate of incorporation executed by an officer of the state in which incorporated.

For Partnerships:

Copy of the Partnership Agreement;

List of the partners,
Copy of the certificate of partnership where required to be filed by any State, county, or municipality;

If there is a verbal agreement rather than written partnership agreement, provide a written statement to that effect signed by all partners. If no one is given signing authority on behalf of the partnership, all partners must sign all forms sent to the TTB.

	"Stand Alone" Bonded Winery	Alternating Proprietor	Custom Crush Client	Bonded Wine Cellar

Application to Establish and Operate Wine Premises Form 5120.25	YES	YES	NO	YES
Application for Basic Permit Under the FAA Act Form 5100.24	YES	YES	YES	ONLY IF BLENDING
Wine Bond Form 5120.36	YES	YES	NO	YES
Environmental Information Form 5000.29	YES	YES	NO	YES
Supplemental Information on Water Quality Considerations Form 5000.30	YES	YES	NO	YES
Power of Attorney Form 5000.8, or Signing Authority for Corporate and LLC Officials Form 5100.1, or Signing Authority in Organizational Documents	YES	YES	YES	YES
Special Tax Registration Form 5630.5 (Registration only – No Tax Due)	YES	YES	YES	YES
Trade Name Registration for the company's Operating Trade Name and any additional Bottling Trade Names	YES	YES	YES	YES
Diagram of bonded wine premises from all alternating proprietor hosts and tenants.	OPTIONAL (but recommended)	YES	NO	OPTIONAL (but recommended)
Alternating Proprietor agreement or contract	NO	YES	NO	NO
Lease agreement	YES (if applicable)	YES (if applicable)	NO	YES (if applicable)
Organizational documents (articles of incorporation, partnership agreement, etc.), as applicable	YES	YES	NO	YES
Copy of the Driver's License or official State ID card of the primary contact person who will be interviewed by TTB regarding application	YES	YES	YES	YES

c. Excise Taxes and Bonded Facilities

Part of the TTB's responsibility is to ensure that all applicable taxes are paid on wine products. One of the ways the government ensures that taxes are paid is to require wine making facilities that store untaxpaid wine to obtain a bond to cover potential tax liability. The bond secures the payment of excise taxes. Wine is considered "under bond" as long as the wine remains on or in transit between "bonded wine premises."

Excise taxes on wine will be determined at the time wine is removed from bonded wine premises for consumption or sale. The amount of tax owed is determined and paid on the volume of wine (see chart[10]).

If ½ of 1% to not over 14% alcohol	$1.07 per gallon
If more than 14% and not over 21% alcohol	$1.57 per gallon
If more than 21% and not over 24% alcohol	$3.15 per gallon
Artificially Carbonated	$3.30 per gallon
Sparkling	$3.40 per gallon

The TTB provides a credit for Small Domestic Producers who produce less than 250,000 gallons of wine annually. [11] In Oregon, all but the very largest wineries will qualify for this credit. This grants a credit of up to $.90 per gallon on the first 100,000 gallons of wine (other than sparkling) taxably removed per calendar year. Removals beyond 100,000 gallons are taxed at the different tax rates.[12] According to the TTB this credit may even be taken on wine a small producer did not make, so long as the small producer produces some wine and there is no benefit to any winery which would not otherwise be entitled to credit.

2. Labeling Regulations and Procedures

The TTB, as part of their goal of protecting consumers, regulates labels for wine and must approve all labels. The wine premise that is responsible for bottling the wine must also obtain a Certificate of Label Approval ("COLA") before bottling.[13] 24 CFR § 4.32 et. seq. contains the regulations for labeling wine. These regulations outline the form and content of a wine label.[14]

1) Mandatory Items of Information:[15]

a. Brand labels:

a) Brand name, in accordance with 27 CFR § 4.33.

b) The brand name cannot mislead consumer as to the age, origin, identity, or other characteristic of the wine

c) Class, type, or other designation.

d) Alcohol Content

e) Must be in terms of percentage of alcohol by volume (ABV) and is required if wine is more than 14% ABV. If the wine is less than 14% ABV it must be type designated as "table" wine ("light" wine) or the alcoholic content shall be stated.[16]

---

[10] 25 U.S.C. § 5041 (b).
[11] 27 CFR § 24.278(a).
[12] *See* 26 U.S.C. § 5041 and 27 CFR §24.278(d)(1)(2).
[13]This can be done online here: https://www.ttbonline.gov/. Some products are subject to pre-COLA product evaluations. *See* http://www.ttb.gov/industry_circulars/archives/2007/07-04.html for more information.
[14] Appendix D outlines most of the elements of a wine label.
[15] 27 CFR § 4.32.
[16] *See* 27 CFR § 4.36 for information on required form and accuracy.

f) Appellation (under certain circumstance[17])

g) On blends consisting of American and foreign wines, if any reference is made to the presence of foreign wine, the exact percentage by volume is required.

b. Any Label:

a) Name and address, in accordance with 27 CFR § 4.35.
b) Net contents, in accordance with 27 CFR § 4.37. If the net contents is a standard of fill other than an authorized metric standard of fill as prescribed in 27 CFR § 4.72, the net contents statement shall appear on a label affixed to the front of the bottle.
c) Declaration of sulfates[18]
d) Declaration of certain coloring materials[19]
e) Government Warning[20]

3. Identifying Wine

1) 24 CFR §§ 20 through 25 provide ways of identifying wine. According to 27 CFR § 4.32(a)(2) a wine label must include a designations of class, type or other designation in accordance with §4.34. Generally, the class of wine must be used but there are a number of notable exceptions:

a) "table" ("light") and "dessert" wines do not need a class type.[21]

b) Still grape wine may use, in lieu of the class designation:

i. any varietal (grape type) designation[22]

ii. type designation of varietal significance[23]

iii. semigeneric geographic type designation[24]; or

iv. geographic distinctive designation[25]

a) In the case of champagne, or crackling wines, the type designation "champagne" or "crackling wine" ("petillant wine", "frizzante wine") may appear in lieu of the class designation "sparkling wine".

b) In the case of wine which has a total solids content of more than 17 grams per 100 cubic centimeters the words "extra sweet", "specially sweetened", "specially sweet" or "sweetened with excess sugar"[26] shall be stated as a part of the class and type designation.

c) If the class of the wine is not defined in subpart C or the class or type is altered so that is does not fall within any other class or type, a truthful and adequate statement

---

[17] *See* 27 CFR § 4.34(b).
[18] 27 CFR § 4.32(e).
[19] *See* 27 CFR § 4.32.
[20] 27 CFR § 16.
[21] *See* 24 CFR § 4.21(a)(2) & (3).
[22] 27 CFR § 4.23.
[23] 27 CFR § 4.28.
[24] 27 CFR § 4.24.
[25] See id..
[26] This phrase is required in some cases. *See* 27 CFR § 24.

of composition shall appear upon the brand label of the product in lieu of a class designation.

i. Alteration of Class - 27 CFR § 4.22 details what constitutes alteration of a class. Some examples include blending wines of different classes, use of substances foreign to such wine, use of excess sugar or water, etc.

2) **Wine Classes (the standards of identity):** wine is divided into classes. Under each respective class there are specific allowed designations (e.g. Class 1 Table Wine can be designated "light wine," "red table wine," "light white wine," "sweet table wine," etc.).[27] 27 CFR § 4.21 gives specific criteria in regards to taste, production method, and composition in order for a wine to qualify for a specific designation. The general classes are as follows. [28]

a) Class 1; grape wine
b) Class 2; sparkling grape wine
c) Class 3; carbonated grape wine.
d) Class 4; citrus wine.
e) Class 5; fruit wine.
f) Class 6; wine from other agricultural products.
g) Class 7; aperitif wine.
h) Class 8; imitation and substandard or other than standard wine.
i) Class 9; retsina wine.

3) Varietal (grape type) Labeling

a) If an operation chooses to use a varietal for labeling in lieu of a class the wine must also be labeled with an appellation of origin as defined by 27 CFR § 4.25.[29] Additionally, only the names approved by the TTB may be used as a type designation.[30]

i. **Single Grape Variety:** the name of a single grape variety may be used as the type designation if not less than 75 percent of the wine is derived from grapes of that variety, the entire 75 percent of which was grown in the labeled appellation of origin area.

b) There are exceptions for Vitis Labrusca and other species found by the TTB to be too strongly flavored at the 75% minimum. If this is the case the wine still needs to contain a minimum of 51% of the labeled variety and label must include a statement to that effect.

---

27 See 27 CFR § 4.21.

28 See id.

29 27 CFR § 4.23(a).

30 See 27 CFR § 4.91.

ii. **Multiple Grape Varieties**: names of two or more grape varieties may be used as the type designation if all the grapes varieties are approved. The percentage of the wine derived from each variety must be shown on the label and if the appellation is multicounty or multistate those percentages must be shown as well.

4) **Designations of geographic significance**: Some wines have become known by their geographic location which has over time become that style's designation of class or type of wine; a well-known example is "champagne" which originated from the Champagne Valley in France, but now is used to describe sparkling wine. Champagne is an example of a semi-generic designation, the TTB has determined it is commonly used but not so common that it has lost all of it original reference to the region. There are certain designations which the administrator has deemed generic or semi-generic.

   a) **Generic**: are designations that are so common they have lost all of their original significance. Examples include: Vermouth, Sake. These can be used regardless of the actual location the grapes are grown.

   b) **Semi-generic**: are designations which still retain some of their inference to a geographic region but are also commonly used to simply describe a style of wine. Examples include: Angelica, Burgundy, Claret, Chablis, Champagne, Chianti, Malaga, Marsala, Madeira, Moselle, Port, Rhine Wine (syn. Hock), Sauterne, Haut Sauterne, Sherry, Tokay. These can be used if the wine conforms to the standard identity of such wine (based on regulation, if applicable, or trade understanding) and an appropriate appellation of origin disclosing the true place of origin appears on the label.

   c) **Non-generic**: There are two types of non-generic designations, those that are associated with a distinctive wine style and those that simply indicate the wines origin but are not associated with a style of wine. Distinctive designations may be used as in lieu of the class in labeling while those that indicate origin may not. The TTB designates distinctive designations.

      i. Examples of nongeneric names which are not distinctive designations of specific grape wines are: American, California, Lake Erie, Napa Valley, New York State, French, Spanish.[31]

      ii. Examples of nongeneric names which are also distinctive designations of specific grape wines are: Bordeaux Blanc, Bordeaux Rouge, Graves, Medoc, Saint-Julien, Chateau Yquem, Chateau Margaux, Chateau Lafite, Pommard, Chambertin, Montrachet, Rhone, Liebfraumilch, Rudesheimer, Forster, Deidesheimer, Schloss Johannisberger, Lagrima, and Lacryma Christi.[32]

5) **Appellations of origin:** this is a designation of where the dominant grapes used in the wine were grown and is based on state or county boundaries in the United States. If the wine has

31 Additional examples of foreign nongeneric names are listed in 27 CFR § 12.21.

32 See 27 CFR § 12.31.

multiple appellations of origin the percentage of the wine derived from fruit or other agricultural products grown in each place must be shown on the label. At least 75% of the wine must be derived from fruit or agricultural products grown in the appellation area indicated. The wine must also be fully finished[33] within:

a) the in the United States, if labeled "American";
b) if labeled with a State appellation, within the labeled State or an adjacent State (or within one of in one of the labeled appellation States if multiple states are listed) ;
c) if labeled with a county appellation, within the State in which the labeled county is located
d) **American wine.** An American appellation of origin is:

The United States;

i. a State;
ii. two or no more than three States which are all contiguous;
iii. a county (which must be identified with the word "county", in the same size of type, and in letters as conspicuous as the name of the county);
iv. two or no more than three counties in the same State(the percentage of the wine derived from fruit or other agricultural products grown in each county must be shown on the label); or
v. a viticultural area (as defined in paragraph (6).

e) **Imported wine.** An appellation of origin for imported wine is:

i. A country;
ii. A state, province, territory, or similar political subdivision of a country equivalent to a state or county;
iii. Two or no more than three states, provinces, territories, or similar political subdivisions of a country equivalent to a state which are all contiguous; or
iv. A viticultural area (as defined in paragraph (6).

6) Viticultural Areas:

i. **American Viticultural Areas ("AVA"):** the TTB has established delimited grape-growing regions known as AVAs.34 An American AVA is defined as a delimited place or region the boundaries of which have been recognized and defined by the country of origin for use on labels of wine available for consumption within the country of origin. AVAs are predistinguised geographical features, as opposed to by state or county boundaries.

ii. **Foreign Viticultural Areas:** the TTB will recognize foreign viticultural areas as long as it is a delimited place or region the boundaries of which have been recognized and defined by the country of origin for use on labels of wine available

---

33 (except for cellar treatment pursuant to § 4.22(c), and blending which does not result in an alteration of class or type under § 4.22(b)

34 See 27 CFR Part 9 for a list of currently recognized areas.

for consumption within the country of origin. The wine must also conform to the requirements of the foreign laws and regulations governing the composition, method of production, and designation of wines available for consumption within the country of origin.

iii. **Requirements for use.** A wine may be labeled with a viticultural area if:

a) The viticultural area has been approved by the TTB or by the appropriate foreign government;

b) Not less than 85% of the wine is derived from grapes grown within the boundaries of the viticultural area; and

c) In the case of American wine, it has been fully finished within the State, or one of the States, within which the labeled viticultural area is located (except for cellar treatment pursuant to 27 CFR § 4.22(c), and blending which does not result in an alteration of class and type under 27 CFR § 4.22(b)).

7) **Estate bottled:** this phrase (and no other) may be used on a label where the growing of the grapes and the bottling occurred in the same viticulture area. To qualify for this designation:

a) Wine must be labeled with a viticultural area appellation of origin

b) The bottling winery must be located in the labeled viticultural area;

c) All of the grapes used to make the wine must be grown on land owned or controlled by the winery within the boundaries of the labeled viticultural area; and

d) The bottling winery must crush the grapes, ferment the resulting must, and finish, age, and bottle the wine in a continuous process (the wine at no time having left the premises of the bottling winery).[35]

8) **Vintage wine**: this indicates the year of harvest of the grapes, if used it must also show an appellation of origin smaller than a country.

a) **Viticultural area appellation of origin:** If a viticultural area appellation of origin is used at least 95% of the wine must have been derived from grapes harvested in the labeled calendar year

b) **Other appellation of origin:** For all other appellation of origins at least 85% percent of the wine must have been derived from grapes harvested in the labeled calendar year.

9) **Type designations of varietal significance:** if the wine is an American wine and an appellation of origin in compliance with 27 CFR § 4.25 is used one of the following designations of varietal significance may be used:

35 27 CFR § 4.26.

a) **Muscadine**. An American wine which derives at least 75 percent of its volume from Muscadinia rotundifolia grapes.

b) **Muscatel**. An American wine which derives its predominant taste, aroma, characteristics and at least 75 percent of its volume from any Muscat grape source, and which meets the requirements of 27 CFR § 4.21(a)(3) ("dessert wine").
c) **Muscat or Moscato**. An American wine which derives at least 75 percent of its volume from any Muscat grape source.
d) **Scuppernong**. An American wine which derives at least 75 percent of its volume from bronze Muscadinia rotundifolia grapes.

10) Use of the Term "Organic"

"In 2000, the United States Department of Agriculture (USDA) finalized the regulations relating to the National Organic Program (NOP) at 7 CFR Part 205. These rules provide new standards for the production, handling, processing, labeling, and marketing of products labeled with organic claims. While these rules were not written or implemented by TTB, they do apply to alcohol beverages. For this reason, TTB has worked closely with USDA to ensure that the alcohol beverage industry has current and accurate information regarding organic claims on labels."[36]

4. Requirements for Importing

a) Application - Importer's Basic Permit

1) This is the Application for Basic Permit Under the FAA Act Form 5100.24
2) Must also fill out the Alcohol Dealer Registration Form TTB F 5630.5(d), but will owe no special occupational tax
3) If the importer plans on selling wine other than that which they import they must also apply for a Wholesaler's Basic Permit
4) Importers must also obtain a COLA for each unique product/label.

b) Certification requirements

1) Section 5382(a) of the IRC37
   a) **International agreement or treaty:** In the case of wine produced and imported subject to an international agreement or treaty, proper cellar treatment of natural

---

36 http://www.ttb.gov/alfd/alfd_organic.shtml. See http://www.ttb.gov/pdf/organic-wine.pdf , a guide on how to label organic wine from USDA.

37 26 USC § 5382(a) sets forth standards regarding what constitutes proper cellar treatment of natural wine. A natural wine is the product of the juice or must of sound, ripe grapes or other sound, ripe fruit (including berries) made with any cellar treatment authorized by subparts F and L of 27 CFR part24, containing not more than 24 percent alcohol by volume and containing not more than 21 percent by weight (21 degrees Brix de-alcoholized wine) of total solids

wine includes those practices and procedures acceptable to the United States under the agreement or treaty.

b) **Certification Requirement:** Wine imported from those countries not under such an agreement requires a certification regarding production practices and procedures for imported natural wine produced after December 31, 2004.

   i. Certification is a statement that the practices and procedures used to produce the imported wine constitute proper cellar treatment. Certification may consist of a statement from the producing country's government, or government-approved entity having oversight or control of enological practices. This form of certification includes the results of a laboratory analysis of the wine performed by either a government laboratory or a laboratory certified by the government of the producing country. Certification may also be in the form of a statement from the importer, that is, a self-certification.[38]

   ii. If an importer or its affiliate owns or controls a winery operating under a basic permit issued under the Federal Alcohol Administration Act, that importer may certify that the practices and procedures used to produce the wine constitute proper cellar treatment (self-certification). An importer who self-certifies does not need to obtain a producing country certification and laboratory analysis.

c) Duties, Taxes, and Fees

1) **Duty:** A duty is a payment due and enforced by law or custom, in particular a payment levied on the import, export, manufacture, or sale of goods. Check the Harmonized Tariff System for current rates.[39]

2) Excise Tax Rates for Alcoholic Beverages[40]

38 See appendix E for example certification.
39 http://www.cbp.gov/trade/trade-community/duty-tariff-rates/determining-duty-rates
40 http://www.ttb.gov/applications/pdf/tax_and_fee_rate.pdf

PRODUCT	TAX	TAX PER PACKAGE (usually to nearest cent)
Beer	**Barrel (31 gallons)**	**12 oz. can**
Regular Rate	$18	$0.05
Reduced Rate	$7 on first 60,000 barrels for brewer who produces less than 2 million barrels. $18 per barrel after the first 60,000 barrels.	$0.02
Wine	**Wine Gallon**	**750ml bottle**
14% Alcohol or Less	$1.07[1]	$0.21
Over 14 to 21%	$1.57[1]	$0.31
Over 21 to 24%	$3.15[1]	$0.62
Naturally Sparkling	$3.40	$0.67
Artificially Carbonated	$3.30[1]	$0.65
Hard Cider	$0.226[1]	$0.04
([1] $0.90 credit, or for hard cider $0.056, may be available for the first 100,000 gallons removed by a small winery producing not more than 150,000 w.g. per year. Decreasing credit rates for a winery producing up to 250,000 w.g. per year.)		
Distilled Spirits	**Proof Gallon ***	**750ml Bottle**
All	$13.50 less any credit for wine and flavor content.	$2.14 (at 80 proof)
* A proof gallon is a gallon of liquid that is 100 proof, or 50% alcohol. The tax is adjusted, depending on the percentage of alcohol of the product.		

5. Requirements for Exporting

a) Exportation of Taxpaid or Tax Determined Wine

1) Anyone other than a qualified proprietor of a bonded wine cellar who plans to engage in the business of exporting taxpaid wine out of the United States must first obtain a basic permit under the Federal Alcohol Administration Act.

2) Taxpaid or tax determined wine produced in the United States may be removed from bonded wine premises for:

   a. Exportation to a foreign country;

   b. Use as supplies on the Vessels of the United States[41] and aircraft; or

41 Vessels of the United States are "employed in the fisheries or in the whaling business, or actually engaged in foreign trade or trade between the Atlantic and Pacific ports of the United States or between the United States and any of its possessions, or between Hawaii and any other part of the United States, or between Alaska and any other part of the United States. 19 USC § 28.21.

c. Transfer to and deposit in a foreign-trade zone for exportation or storage pending exportation

b) Export marks

1) Producers are also required to mark the word "Export" on each container or case of wine, before removal for export, for use on Vessels or aircraft, or for transfer to a foreign-trade zone.

c) Drawback notice and claim for taxpaid wine

2) To obtain a refund of excise taxpaid on wine that has been exported, or otherwise removed as listed above, bonded wine premises proprietors must file TTB F 5120.24, in accordance with the instructions on that form.

d) Proof of exportation

3) In conjunction with submitting TTB F 5120.24, the bonded wine premises proprietor must submit appropriate and acceptable proof of exportation, which may vary depending on the purpose for the export and final destination of the product.[42]

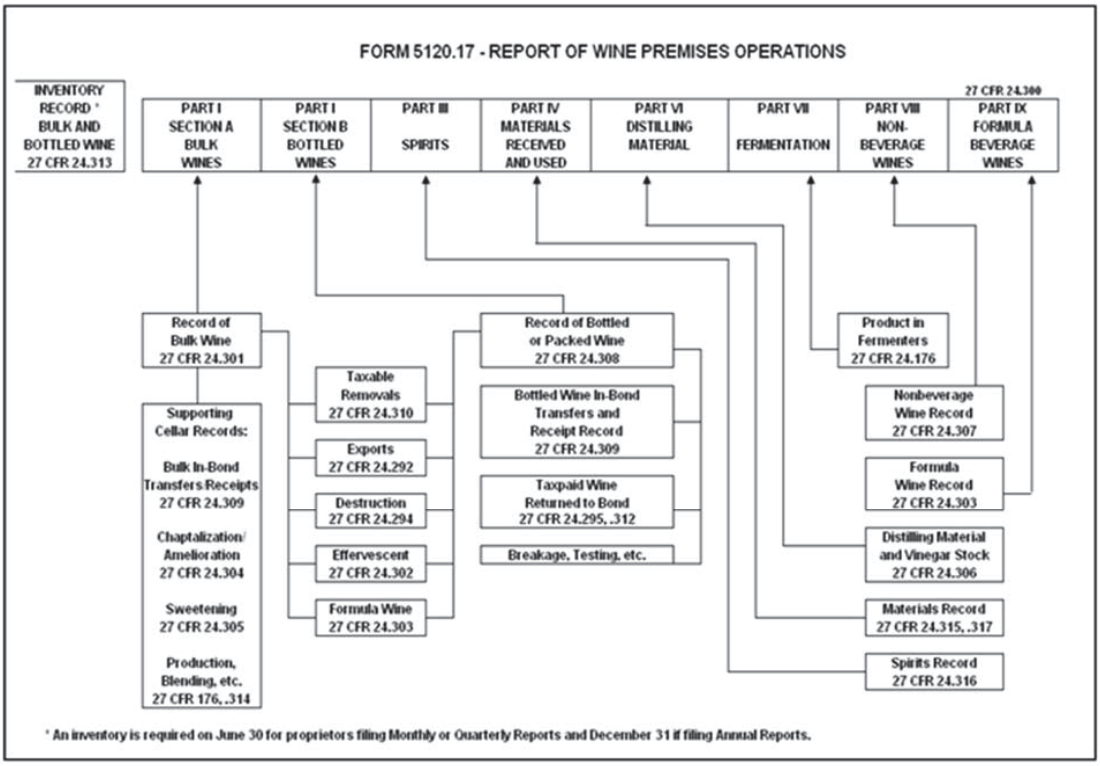
6. Records

The TTB requires the maintenance and reporting of certain records. Most of these are requirements for bonded facilities. These records are generally reported on Report of Wine Premises Operations TTB F Form 5120.17 but are also required if you are subject to a TTB excise tax audit. The most common compliance issues bonded wineries or bonded cellars face is inaccurate or incomplete records. It is important to review what records are required which can be found at 27 CFR § 24.300-.323. These regulations detail the type and contents of records required. Although most of these regulations only apply to bonded wineries and bonded wine cellars, custom crush clients are also required to maintain some records under 27 CFR § 31.222.[43] All record requirements for bonded facilities are detailed below.

---

42 For details on acceptable proof of exportation, see 27 CFR §§ 28.40, 28.41, and 28.42.

4343 All retail dealers must keep at their place of business complete records showing the quantities of all distilled spirits, wines, and beer received, from whom the distilled spirits, wines, and beer were received, and the dates of receipt. Records of receipts shall consist of all purchase invoices or bills covering distilled spirits, wines, and beer received, or, at the option of the retail dealer, a book record containing all of the required information.
27 CFR § 31.191.



a) Receipt of Materials and Production[44]

1) A proprietor who produces wine shall maintain a record showing the receipt and use or other disposition of basic winemaking materials received on wine premises. Must include:

   a) Date of receipt;

   b) The quantity received (weigh tag) or quantity used or produced if juice;

   c) The name and address from whom received; and

   d) The date of use or other disposition of the materials.

2) Additional Materials & Production Records:

Record	Required By

44 27 CFR § 24.315.

Spirits record	27 CFR § 24.316
Sugar record	27 CFR § 24.317
Acid record	27 CFR § 24.318
Chemical records	27 CFR § 24.320
Effervescent wine record	27 CFR § 24.302
Formula wine record	27 CFR § 24.303
Chaptalization, amelioration	27 CFR § 24.304
Sweetening record	27 CFR § 24.305
Distilling material, vinegar stock	27 CFR § 24.306
Nonbeverage wine record	27 CFR § 24.307
Carbon dioxide record	27 CFR § 24.319
Decolorizing material record	27 CFR § 24.321
Allied products record	27 CFR § 24.322

3) Bulk Still[45] Wine Records[46]

   a) A summary record maintained by tax class

   b) Documents wine production, receipts, removals, blending operations, losses

   c) Can contain information about sugar, acids, chemicals, etc.

b) Bottling and Bottled Wine[47]

1) If wine is bottled or packed on site the facility must maintain a record, by tax class of:

   a) The volume of wine received, bottled, and removed. (e.g., taxpaid removals, in bond removals, dumped to bulk or destroyed, breakage, used for tasting.)

   b) Certificate of Label Approval (COLA) serial numbers (see Labeling below for more information)

45 Wine containing not more than 0.392 gram of carbon dioxide per 100 milliliters.
46 27 CFR § 24.301.
47 27 CFR § 24.308.

c) The fill tests and alcohol tests.[48]

2) This record is especially important as it will be used to determine eligibility for the Small Domestic Producers credit.

c) Removals and Receipts

1) Taxpaid Removals from Bond Record[49]

a) A record must be kept when wine is removed from bond for consumption or sale on determination of tax.[50] An invoice can be used as a record but whatever its form the record must show:

i. Date of removal;

ii. Name/address of person to whom shipped; and

iii. Volume, kind of wine (class and type), alcohol content.

iv. All records of taxpaid removals must be summarized daily to the nearest tenth of a gallon.

2) Taxpaid Wine Record

a) If a wine premises stores taxpaid wine a running inventory must be kept of the taxpaid wine on the premises including:

i. Record of receipt

ii. Record of removals

iii. Record of cases or containers filled

3) Taxpaid Wine Returned to Bond

a) A proprietor shall maintain a record of any unmerchantable taxpaid wine returned to bond as follows:

i. The kind, volume, and tax class of the wine;

ii. With regard to each tax class, the amount of tax previously paid or determined;

iii. The location of the wine premises at which the wine was bottled or packed and, if known, the identity of the bonded wine premises from which removed on determination of tax;

iv. The date the wine was returned to bond;

---

48 See 27 CFR § 24.255.
49 27 CFR § 24.310.
50 There are number of removals which are considered untaxpaid removals, these require different record keeping. See Appendix F for a list of untaxpaid removals.

v. The serial numbers or other identifying marks on the cases or containers in which the wine was received; and

vi. The final disposition of the wine.

4) Transfer in Bond Record

a) Transfers in Bond are the most common removal which is untaxpaid and one of the most common records which lack required information.[51] When you are setting up the format for your transfer in bond records (bills of lading) consult the list given in 27 CFR § 24.309 (see below), making sure everything that is requested by the regulation is included. A shipping document can be sufficient for this record but regardless of its form the record must contain:

i. The name, address and registry number of the proprietor;

ii. The name, address and registry number of the consignee;

iii. The shipping date;

iv. The kind of wine (class and type);

v. The alcohol content or the tax class;

vi. The number of containers larger than four liters and cases;

vii. The serial numbers of cases (if any) or containers larger than four liters;

viii. Any bulk container identification marks;

ix. The volume shipped in gallons or liters;

x. The serial number of any seal used;

xi. For unlabeled bottled or packed wine, the registry number of the bottler or packer;

xii. Information necessary for compliance with 27 CFR § 24.315, e.g., the varietal, vintage, appellation of origin designation of the wine or any other information that may be stated on the label; and

xiii. Information as to any added substance or cellar treatment for which a label declaration is required for the finished product, or any other cellar treatment for which limitations are prescribed in this part, e.g., amount of decolorizing material used and kind and quantity of acid used.

d) Inventories

1) When are the reports due?

a) **Annual Report:** If you have not more than 20,000 gallons of wine on hand at any time AND you will file an annual federal excise tax return, your Annual Report of Wine Premises Operations TTB F 5120.17 is due on January 15th of the following year.

---

51 http://www.ttb.gov/wine/common_compliance_tax_issues.shtml#record_2

b) **Quarterly Reports:** If you have not more than 60,000 gallons of wine on hand at any time AND you file quarterly federal excise tax returns, your Quarterly Reports of Wine Premises Operations TTB F 5120.17 are due on April 15th, July 15th, October 15th and January 15th (15 days after the close of each calendar quarter).

c) **Monthly Reports:** If you have more than 60,000 gallons of wine on hand at any time OR pay more than $50,000 in Federal Excise tax each year, Report Forms 5120.17 must be submitted by the 15th day after the close of any month in which you conducted reportable operations.

2) Results are reported on TTB F 5120.17 only when a complete inventory is taken

3) Dated, signed by person with signature authority, under Penalty of Perjury (This is commonly forgotten)

    1) "Under penalties of perjury, I declare that I have examined this inventory record and to the best of my knowledge and belief, it is a true, correct and complete record of all wine and spirits require to be inventoried."

4) Although the inventory is due January 15, the inventory must be taken on June 30. If it is not taken on June 30 a premises must immediately notify the TTB of the alternate date.

Drafting and Negotiating Wine Industry Contract and Agreements

Submitted by Charles E. Harrell

V. DRAFTING AND NEGOTIATING WINE INDUSTRY CONTRACTS AND AGREEMENTS.

A. GRAPE PURCHASE AGREEMENTS.

Most wineries either crush grapes grown on their own vineyards or they purchase some portion of their grape supply from outside growers. The contracts that govern the purchase and sale of wine grape purchases can be greatly varied, but the primary negotiating points generally focus on issues of control, quality, price, and term.

It can be generally stated that grape growers are farmers who would rather tend their land than deal with lawyers and contracts. Historically, many agreements for the purchase of grapes were handshake deals or bare-bones contracts with few details flushed out before the parties' committed themselves to the relationship. Now, as Oregon's wine industry flourishes and more money is invested in the wine industry, the parties are becoming more sophisticated and the stakes are becoming higher, resulting in complicated business structures are devised to own and manage the industry's assets.

The basic elements of the grape purchase agreement are the term, pricing mechanisms, viticultural practices (including farming, picking and delivery), quality standards and dispute resolution mechanisms. The "boilerplate" terms governing assignment, force majeure and events of default also require special attention when structuring long-term contractual relationships in an industry characterized by regular changes in control and subject to the will of weather.

1. The Parties.

As with many contracts, unsophisticated parties may enter into agreements as individuals even when the individual owns and operates under an entity structure. It is important that the grape grower and the winery purchaser enter into grape purchase agreements as the correct legal entities that own and control the vineyard producing the grapes to be purchased or will take title to the grapes and bear the full legal responsibility for payment of the grapes, respectively. As with any contract negotiation, the contracting parties (or their attorneys) should verify the authority of the signatories to bind the entity parties or, at minimum, require representations and warranties that the signatories are endowed with the required authority. Failure to verify the

legal status of the parties entering the agreement may significantly affect the enforceability of the agreement.

2. Term of the Grape Purchase Agreement.

The term provisions in grape purchase agreements can range from short fixed terms, as in the case of single harvest agreements with no renewal rights, to multi-year contracts in which pricing formulas, crop control and quality standards, and relationship-building become a vital part of the grape purchase contract. When grapes are destined for premium wine and quality is a significant issue, it is not uncommon for the winery to negotiate a 'probationary' period of a relatively short term, and provide the winery with the right to renew for a longer term or terminate at the end of the probationary period if the vineyard and grapes do not meet the winery's quality standards.

Evergreen provisions, which allow for the repeated, automatic renewal of the contract (subject to either party's ability to terminate on a specified amount advance notice) can be common in grape purchase agreements. Language governing the termination of an evergreen contract should provide clear mechanisms for notice and termination, the timing of termination, and the length of time the contract will continue post termination notification. The benefit of an evergreen contract for the grower is the time to modify or change its growing practices to meet the needs of the buyer. Particularly in the case of long-term contracts, the grower may adapt its viticultural practices to serve the particular purchaser even to the extent of planting or grafting to particular varietals or clones. The termination delay that generally accompanies an evergreen term allows the grower to search for a new purchaser with similar viticultural requirements or to adapt its practices to appeal to a new purchaser. When considering the use of an evergreen provision and negotiating the period between delivery of the notice of termination and the actual termination of the agreement, the parties should weigh the consequences of holding parties to a contract after one or both of the parties have become discontented with the arrangement against the benefits of continuing the contractual relationship through additional harvests.

3. Identification of the Grapes.

Grape purchase agreements must identify the grapes that are to be sold to the winery, generally both as to quantity and varietal. The description of the grapes can vary in detail from

the broadest classification, perhaps described as "all the grapes sold at _____ vineyard," to a more specific description of varietal, clone, sugar level and vineyard block, including tonnages, among other possible criteria.

Wineries that are particularly concerned about quality may prefer to include a more detailed description of the grapes intended for purchase. For the grower, a clearer description of the winery's expectations may provide lead-time to line up alternate buyers for the grapes in the anticipation that the crop will not meet the winery's quality criteria and will be rejected. As discussed herein, the responsibility for testing the physiological ripeness of the grapes may be assigned to either the grower or the winery. In addition, the winery may have varying levels of control to trigger harvest. In cases where the winery has particular quality requirements, the grower may consider shifting viticultural control to the winery in an effort to deflect some of the risk associated with production.

4. Pricing.

A fixed price per ton pricing mechanism is most typically used in short-term "spot" contracts. If a fixed price per ton is used in longer term agreements, the fixed price may be tied to indexes, such as the Consumer Price Index or to percentage shifts in the Final Grape Crush Report published by the California Department of Food and Agricultural for the particular varietal and geographical area. In evergreen contracts, it is common for pricing per ton to be determined by reference to the price reported in the Final Grape Crush Report for the year prior to the harvest. Those formulas often refer to the weighted average price as reported in the Final Grape Crush Report, or to higher percentile levels, or the weighted average level plus a stated percentage, depending upon the quality of the grape, the term of the contract and the outcome of other negotiated elements in the contract.

Price adjustments can be capped to prevent a decrease in per ton pricing under any circumstances or to limit any increase or decrease to a certain maximum percent change. In addition, the grower and purchaser may consider a fixed percentage increase for the price of grapes. The fixed percentage may not capture all market trends and requires a certain degree of speculation but the parties will realize greater certainty in their contracting and avoid the often time consuming process of calculating adjustments based on the grape crush report.

Because pricing is most often calculated on a "per ton" basis, accurate weight measurements are critical to a fair and accurate total purchase price calculation. Accurate weight measurements require not only a precise, usually certified, scale and qualified weigh master to prepare the weigh tags but also, for the benefit of the grower, the grapes should be weighed as close to harvest as possible. Transportation of harvested grapes, exposure to heat and further ripening after harvest may result in desiccation of the grapes and a drop in weight of the crop. Timely weight measurements will benefit the grower.

If the grower's fruit is destined for a varietal brand of the winery to be sold at premium wine prices, bottle pricing formulas may provide a method for the grower to participate in the growth of a successful product. Bottle pricing formulas are typically structured to determine a price per ton based on a multiplier of the bottle price as of a pre-harvest or post-harvest date.[1]

While the most common pricing mechanisms tend to revolve around a determination of a price per ton, the winery may also negotiate a price per acre by which the winery agrees to purchase all of the wine grapes grown on a given acreage notwithstanding the level of production, though often subject to negotiated protections. Pricing per acre is not uncommon where quality is paramount and the winery retains significant control over viticultural practices. Pricing per acre is typically coupled with price adjustments in the event of reduction of grape production due to environmental factors or reductions in the acreage of healthy and producing vines due to replanting or disease. In general, a fixed price per acre contract will provide for minimum production requirements with adjustments in price through various mechanisms if production falls below the stated minimum.

5. Timing of Payment.

The timing of payments from the winery to the grower is a key provision of the grape purchase agreement. Though it seems obvious, it is important for the grape purchase agreement to address and state the time for payment. The parties may use the payment provisions as a means of managing revenues and expenses for tax purposes by, among other options, scheduling

[1] For example, 85, 95, 125 multiplied by the retail bottle price as of [date prior to harvest] or as of [release date].

payments to coincide with the end of the harvest year (the current tax year) and the beginning of the following tax year.

6. Farming and Viticultural Practices and Quality Standards.

In the world of premium wine production and increased prices, the winery has more interest in being involved in the farming process. Many grape purchase agreements provide for winery input into viticultural practices, including planting location, selection and spacing of vines, pruning, thinning and harvest. Other agreements may require the grower to adhere to winery-dictated viticultural practices specified in the agreement and may prohibit the grower from varying from the practices in the absence of the winery's consent. The negotiation of viticultural control balances the interests of the winery in assuring high quality grapes for premium wine production against the grower's desire to retain control of farming. The distribution of control and labor can also be used to shift the risk associated with the farming process. The distribution of responsibilities can shift either to the grower or the winery or can be a cooperative effort of the parties. The resolution of these issues tends to depend upon the basic goals of the relationship, including the goal to satisfy long-term business needs reflected in the winery's business plan and the goal of the parties to develop a brand for their grapes or wine.

The more viticultural control that rests with the grower, the more emphasis the winery may place on negotiating quality standards such as freedom from defects (mold, rot, or mildew), MOG standards (material other than grapes), winery retention of the right to trigger the harvest and reservation by the winery of a right to reject the crop or the grapes that do not comply with the quality standards otherwise set forth in the agreement.

On occasion, the winery will negotiate for the ability to make subjective determinations of quality as a criterion separate from allowable defects. If the grapes do not meet the winery's quality standards, the winery may reject the grapes entirely. This provision will necessarily create uncertainty for the grower because the determination of quality will rest with the subjective judgment of the winery. If the determination of quality is not made until after harvest, the grower will have a very limited alternate market for its grapes, if any. When quality is paramount, the grower may consider relinquishing additional control over its viticultural practices so that the winery will bear responsibility for the quality of the product. Generally, as

the winery plays a greater role in defining or controlling viticultural practices, the emphasis on compliance with objective and subjective quality standards tends to relax. The issue of winery viticultural control is more heavily negotiated in contracts where grapes are sold by the block or by the acre and may become important if a winery attempts to qualify the wine for "Estate Bottled" labeling.

The issue of "hang time" and grape weight loss is a regular and often tense debate between grower and winery. For any number of reasons, not the least of which is the market trend towards riper high-alcohol wines, wineries prefer or require harvest to occur later in the season when the grapes have reached high sugar levels. The increase in sugars can also mask flaws inherent in certain grape varietals. For the grower, however, higher sugar content and riper fruit means less water in the grapes, a lower weight and lower purchase price. One mechanism used to mitigate this tension is the payment of bonuses to the grower based on the production of high-sugar grapes. By incorporating bonuses into the contract terms, the winery may still trigger the harvest based upon its processing needs and winemaking style but a disincentive will be created for triggering a late harvest for the sake of reducing the weight of the harvest and, therefore, the purchase price.

7. The Agricultural Produce Lien and Grower Security.

Disputes over the payment for grower's grapes can be simplified for the grower due to the availability of the agricultural produce lien, often referred to as a "grower's lien." The agricultural produce lien is a specific and noteworthy statutory creation, which provides a lien in favor of the producer or grower without initially requiring the grower to take any affirmative act to perfect its security. The authority for the creation of the lien is provided by ORS Chapter 87.705 and provides as follows:

> (1) An agricultural producer that delivers or transfers agricultural produce for consideration to a purchaser has a lien for the contract price of that produce, or for the reasonable value of the produce if there is no contract price. The lien created by this section attaches to all agricultural produce, whether in a raw or processed condition, delivered or transferred to the purchaser by any agricultural producer and to all other inventory of the purchaser. The lien also attaches to proceeds received by the purchaser from the sale by the purchaser to a third party of any raw or processed agricultural produce. If the agricultural produce that an agricultural producer delivers to the purchaser consists of meat

animals, the lien also attaches to all accounts receivable by the purchaser from the sale of any agricultural produce to a third party. The lien on the agricultural produce, inventory, proceeds or accounts receivable attaches on the date physical possession of the agricultural produce is delivered or transferred by the agricultural producer to the purchaser or an agent of the purchaser.

(2) An agricultural producer that claims a lien under subsection (1) of this section need not file any notice in order to perfect the lien. The agricultural producer must file a notice of lien as provided in ORS 87.710 or a notice of claim of lien as provided in ORS 87.242 to extend the lien beyond the normal expiration date.

(3) The lien created by this section is subject to the provisions of ORS 79.0320 (1).

(4) An agreement by an agricultural producer purporting to waive the right to file notice under ORS 87.242 or 87.710 of a lien created by this section is void as contrary to public policy.

The grape purchase agreement does need not include any specific provisions for the grower to assert the lien. However, as provided in ORS 87.710, the agricultural produce lien is only initially valid for 45 days after the last date that last payment is due from the purchaser, but the lien may be extended for an additional 225 days by filing a Notice of Agricultural Produce Lien with the Oregon Secretary of State.

The agricultural produce lien attaches to the product and all processed or manufactured forms of the product without the need for segregation. The agricultural produce lien extends to the accounts receivable of the winery even after the finished wine is no longer in the winery's possession.

The agricultural produce lien is just one tool to ensure payment and the grower may consider requiring personal guarantees, UCC liens against purchaser's inventory or business assets or other collateral as security for payment.

8. Vineyard Designation.

It is the grower, not the winery, which possesses the rights in the vineyard name. If a grower sells wine grapes under a vineyard name to a winery, the winery may fairly use that vineyard name on the wine produced from those grapes to designate origin so long as such use

complies with the vineyard designation labeling requirements of the TTB,[2] even absent grower consent. If the grower wishes to control the winery's ability to use the vineyard name on the wine, the grower should insert language in the grape purchase agreement prohibiting use absent the prior consent of the grower.

If vineyard designation is intended at the time of contract negotiation, the contract should specifically authorize the winery to use the name on its label as a vineyard designation and specify that upon termination of the contract, the winery's right to continue to use the vineyard names ceases. A grower holding a trademark of a vineyard name should consider licensing the name to the winery intending to use the name as a vineyard designation on the winery's label.[3] Such an arrangement would more likely be used in a long term relationship, providing the winery with clear rights to use the name and the grower with additional economic value associated with the vineyard. Such arrangements should be documented carefully to reflect that the licensing of the mark or name is a separate and distinct transaction from the grape purchase agreement in order to avoid any argument that royalties paid under the licensing agreement are disguised grape purchase payments, particularly where the royalties are tied to a bottle release some years after the harvest.

Growers hoping to create value in their vineyard designation and build a brand around that designation should consider the level of control they wish to maintain over the quality of the wine produced, whether as a result of a bad crop or flawed processing, and the marketing of wine bearing the designation.[4] The grower may consider tying provisions of a licensing agreement to the termination provisions of the grape purchase agreement in the event that the winery fails to add value to the grower's brand.

The winery, however, may not want to establish brand equity in a vineyard name owned by the grower alone without some assurance that competitors may not also benefit from the brand equity when purchasing grapes from the same vineyard owner even if the winery may also

---

2 "…Additionally, the name of a vineyard, orchard, farm or ranch shall not be used on a wine label, unless 95 percent of the wine in the container was produced from primary winemaking material grown on the named vineyard, orchard, farm or ranch." *27 C.F.R. § 4.39(m)*.

3 A new vineyard owner may file a trademark application on a reserved rights basis pending vineyard maturation and sufficient use of the name in interstate commerce to qualify for trademark status.

4 A provision regarding quality control should be included in every license in order to preserve trademark protections.

use the vineyard designation for its own product. In some situations, a winery owner and vineyard owner may agree to adopt a unique vineyard name and jointly own the name as a vineyard designation for as long as the vineyard supplies the grapes for the wine carrying the vineyard designation. This fosters a unified effort to build the brand and, should the relationship end, the party with a greater interest in the brand may buy out the other party's interest in the mark. In other situations, instead of using a vineyard designation, the winery may adopt a unique sub-brand that it can retain ownership in and source grapes from different locations and make any reference to the vineyard name or the vineyard owner on the "romance" section of the back label.

Wineries licensing a name for vineyard designation purposes may also want to label the wine as "Estate Bottled." An open question exists as to whether or not a winery may retain sufficient viticultural control so that the resulting wine may be labeled as "Estate Bottled" under federal law. The term "Estate Bottled" may be used by a bottling winery only where 100 percent of the grapes were grown within the named viticultural area in which the bottling winery is also located, where that winery crushed the grapes, fermented and processed the wine, and bottled it, without the wine ever leaving that winery's bonded premises, and where the grapes are grown on land owned or controlled by the winery.[5] The regulation defines "controlled" as the performance of all acts common to viticulture under the terms of a lease or similar agreement with at least three years' duration. The estate bottled designation is premised on the notion that the named winery, that is, the estate, has direct involvement in, and complete control over, the production of the bottled wine from the grape growing stage through the bottling process. Thus, 27 C.F.R. §4.26 requires that the bottling winery grow the grapes on land it owns or controls and, in the case of land controlled by the winery, that the winery actually performs the acts common to viticulture. Wineries should rely on fee ownership or long-term agricultural leases to assure compliance with federal "Estate Bottled" regulations.

9. Assignments, Sales and Changes in Control.

When entering into long-term grape purchase agreement, the parties should appreciate the relatively high turnover of vineyard properties and winery businesses and consider the impact that changes in ownership will have on the future performance of the agreement. Free

[5] *See* 27 C.F.R. § 4.26.

assignability of the agreement to the winery's successors may create a credit risk for the grower. If trademark licensing or vineyard designation issues are in play, the grower may also be particularly invested in the purchaser of the grapes. For the winery, free assignability of the agreement to grower's successors may impact the standard of care used in viticultural practices. On the other hand, assignable contracts may create an asset for winery and grower that may increase the overall value of the parties' holdings. When a winery plays a large role in viticultural practices and the grapes have become the staple of a longstanding production of a premium quality wine identified by a vineyard designation in the context of a long-term purchase agreement, the winery may require that the grape purchase agreement bind successors and assigns and run with the land. Such a concession by the grower needs to be reflected in the economic benefit to the grower in the form of a higher price paid for the grapes or in continuing royalties paid by the winery under the agreement for licensing the vineyard name. In these situations, the winery will often require the recordation of a Memorandum of Grape Purchase Agreement in the public records of the county in which the vineyard is located.

Most parties resort to the fallback position of agreeing to some level of restriction on assignments so that they will not be forced to perform agreements with unknown entities. Options for restrictive assignment language are as follows.

10. Termination and Default.

Many grape purchase agreements provide basic terms for establishing default and termination, such as failure to pay for the grapes according to the agreed upon payment schedule or a substantial change in a party's financial condition. Because many grape purchase agreements are for extended terms, the parties may also consider other contract performance issues that will impact the working relationship to such a degree that early termination may be appropriate. For example, it may not be economical for a grower to stay in contract with a winery which repeatedly refuses grape deliveries for alleged quality reasons. Conversely, if there are substantial quality problems, the winery may require remedies beyond its ability to

reject grapes.[6] A failure of performance in even one year of the contract term may have substantial financial impacts on one or both of the parties.

Also, in the context of long-term contracts, the parties may be subject to substantial damages in the event of a default occurring early in the contract term. As with any contractual relationship, the non-breaching party will have an obligation to take reasonable steps to mitigate its damages, however, depending on the specific nature of the agreement, mitigation may not effectively eliminate the contract damages. In addition, it may fall to the court to determine what actions the grower must take to mitigate its damages. For example, is it reasonable to require a grower to replant or graft an entire vineyard to a more broadly marketable grape variety? These issues should be addressed in the specific context of the proposed contractual relationship. The issue of damages will be more pronounced in the case of long-term contracts or contracts that require the grower to plant a rare varietal or perform specific viticultural practices that will impact the future development of the vines.

11. Force Majeure.

Force majeure provisions, which usually fall into contracts as "boilerplate," can play an important role in grape purchase agreements. The parties can, to a certain extent, define certain events as force majeure events, which will relieve, in whole or in part, the parties' obligations to perform.

It is also possible that a catastrophic or unforeseen event will not result in a total inability to perform but will greatly reduce crop yield beyond the parties' expectations. When a grower has multiple grape purchase agreements obligating its delivery of grapes to multiple parties, the grower must consider how it will distribute a reduced yield among the various contracting parties. Grape purchase agreements defined by the production of tons of grapes rather than for the production of grapes within a given block of the vineyard will complicate this circumstance. The parties may find greater predictability by incorporating some version of the following provision into their agreement.

/ / /

[6] The parties may also want to consider whether or not the grower's failure to deliver grapes meeting the winery's quality standards is itself a breach of the agreement giving rise to a claim by the winery to collect damages or resulting in the termination the agreement.

B. CUSTOM CRUSH AGREEMENTS.

Custom crush arrangements and alternating premises/proprietor arrangements can appear to be very similar, but legally, the effects and consequences of custom crush arrangements and alternating premises/proprietor arrangements are significant and substantial. Legally, a custom crush facility is just a winery that makes wine to order for grape-grower clients, and the winery sells the finished wine to the grape-grower clients who then resell the wine under their own label. The custom crush winery can use the customers' grapes or procure them elsewhere. The grape-grower clients do not have their own winery license and have no ownership interest in the winery and have limited control over the production of the wine. The custom crush facility owns all of the equipment involved and, unless otherwise agreed upon by the parties, is solely responsible for all costs of production, recordkeeping, labeling of bottles and payment of taxes. Of course, the custom crush winery passes on a share of these costs to the grape-grower clients. The custom crush winery contracts with the grape-growing clients to produce the grape-growing clients' grapes into wine, and the clients receive finished, tax-paid wines.

The distinction between custom crush arrangements and alternating premises/proprietorship arrangements is especially significant to Alcohol and Tobacco Tax and Trade Bureau ("TTB"). The TTB treats the custom crush clients the same as wholesalers. The custom crush clients have minimal recordkeeping requirements, and don't have to file reports to the TTB. The custom crush clients take no responsibility for production, recordkeeping, reporting, labeling or taxes, and they don't make any investment in winemaking equipment or premises. However, the custom crush clients have to apply to the TTB under the Federal Alcohol Administration Act ("FAAA") as a wholesaler, as well as obtain a winery license from the Oregon Liquor Control Commission ("OLCC") and maintain supporting documents. Custom crush agreements are a simple way for smaller vineyards to have their own wine, and therefore they understandably popular.

Due to the legal and tax differences between custom crush agreements and alternating premises/proprietorship agreements, it is very important that the parties have a written agreement that provides enough detail, and addresses the legal specificities, that are necessary to differential a custom crush agreement from an alternating premises/proprietorship agreement. The key elements of a custom crush agreement are as follows:

1. Responsibilities of the Parties.

As with any contract, the custom crush client and the custom crush operator need to specifically define the roles and responsibilities of each party, especially any responsibilities that are unusual or not in the ordinary custom for the local industry. Is the custom crush operator responsible for every single aspect of the wine production, or will the custom crush client take on some responsibilities, such as bottling and/or labeling? Will the custom crush operator also store (in bond) the custom crush client's wine after it is bottled? If there is going to be any allocation of responsibilities between the custom crush operator and the custom crush client, then it is absolutely vital that the parties have a clear and unambiguous written agreement regarding the parties' responsibilities.

2. Representations and warranties by the custom crush operator.

At the beginning of the day and at the end of the day, wine quality is the key element of any Oregon wine. And because wine quality is usually the core issue at the heart of many custom crush disputes, the custom crush client will want the custom crush agreement to address the quality of the wine produced by the custom crush operator. Custom crush clients may choose a custom crush operator based upon the reputation of the custom crush operator's winemaker alone, and the custom crush client may require that the wine produced by the custom crush operator have certain key characteristics.

If the custom crush operator is going to agree to any quality guarantees, they should be as definite and quantifiable as possible. The custom crush operator should require that all representations and warranties regarding the wine's quality be agreed to in writing by the parties. Note that if a dispute arises regarding the delivered product, a court may read a number of provisions of the Uniform Commercial Code ("UCC") into the custom crush contract, including the UCC's warranty of the wine's "merchantability" or its "fitness for a particular purpose." The only way to avoid this is to expressly and explicitly disclaim the UCC's warranties in the written custom crush contract.

3. Delivery of the grapes.

Most custom crush operators produce their own wine as well as wine a number of custom crush clients at the custom crush operator's facility. And since Oregon's grape harvest season can occur at varied times (weather is major factor in this. Harvest this year occurred in mid-September, whereas the harvest in 2011 occurred after Halloween) and in a short period of time, the demand for the custom crush operator's facility can be very time-sensitive. Therefore, the custom crush agreement should provide specific requirements regarding delivery of the dates, including provisions regarding how much advance notice needs to be provided to the custom crush operator, as well as facility-specific delivery procedures and requirements.

4. Payment and security.

As we discussed previously, the custom crush operator owns the facility and all of the production equipment and is generally responsible for all costs of production, recordkeeping, labeling of bottles and payment of taxes. These costs are obviously passed on to the custom crush clients. However, the payment provisions of the custom crush agreement should address how the payment due to the custom crush facility is calculated. For example, the custom crush operator may choose to charge the custom crush client by an hourly rate or by a price-per-case. Additionally, the payment provisions of the custom crush contract should provide specific detail about what services and products are included in the price, such as wine making, wine aging and bottling, packaging, taxes, bottles and labels.

The prudent custom crush operator will also seek to have some form of security to ensure payment by the custom crush client. In that case, the custom crush contract should contain a provision granting the custom crush operator a security interest in the custom crush client's personal property related to the custom crush agreement, including the grapes delivered to the custom crush facility, the juice and wine, and any other personal property and goods procured on behalf of the custom crush client (barrels, bottles, labels, etc.).

5. Dispute resolution.

A dispute resolution process should also be included in the custom crush agreement. The dispute resolution procedure should address how the parties can efficiently and promptly resolve disputes, such as a complaint by the custom crush client about the wine's quality. Consider including a date certain by which the custom crush client must notify the custom crush operator

of any perceived quality problems and providing the custom crush operator with a period of time during which the custom crush operator can fix the alleged problem.

The custom crush operator may also want to try to limit the amount of damages available to the custom crush client. Typical damage limitation language will either limit the damages to the amount of the contract price or, if the custom crush client pushes back, the amount of the operator's insurance limits. The custom crush operator should push to disclaim special, incidental and consequential damages and should make certain the custom crush agreement limits the operator's liability to money damages only.

C. ALTERNATING PROPRIETOR AGREEMENTS.

The alternating premises/proprietor arrangement is considerably more complex than a custom crush agreement. Under an alternating premises/proprietorship agreement, two or more wineries share (alternate) use of part of a bonded winery's facility. The host is a bonded winery, but the alternating proprietors are also bonded wineries. The host and the alternating proprietors take turns using the equipment for a 24-hour minimum period. The exception to this arrangement is winery's crushing equipment not on the bond. The crushing equipment is normally owned by the host, who used the equipment to crush its own grapes and to crush grapes for its custom crush clients (the grapes aren't yet wine in this case). The host winery is responsible for all its records and filing, but the host winery is not responsible for the records and filings of the other alternating proprietors.

Each of the alternating proprietors must qualify as a winery on their own standing, however. Though each of the alternating proprietors has lower investment in equipment and premises, they are each responsible for all their own production, records, reporting, labeling and taxes. Wineries deal with two different federal laws, the Internal Revenue Code (IRC) and the Federal Alcohol Administration Act ("FAAA"). The IRC is responsible for the qualification of the premises, and the payment of taxes and production, and is enforced by the Internal Revenue Service. The FAAA defines the basic permits for qualified applicants, truthful labeling and advertising, and fair trade practices, and is enforced by the TTB. Both the IRS and the TTB are division of the Department of the Treasury.

Stand-alone or custom crush wineries are responsible for their own IRC application and FAAA and OLCC application as a wine producer, and must obtain a bond and maintain the supporting documents. If a winery is also operating as an alternating premises/proprietorship, then each of the entities operating under the alternating proprietorship has the same responsibilities and requirements, plus they are required to submit a diagram describing the parts of the winery allocated to each proprietor.

The basic application to establish and operate wine premises, IRC Form 5120.25, is required from all winery applicants. It describes the bonded premises and operations. The application for a basic permit under the FAAA, Form 5100.24, is required from wineries and wholesalers, and provides information about ownership of the operation.

Winery applicants are also required to obtain a wine bond, Form 5120.36, in order to ensure that required taxes will be paid. The amount of the bond is based on the winery's tax liability. The supporting documents that each of the alternating proprietors must maintain include environmental forms from all bonded wine premises applicants, signature authority, trade name registration and a diagram from bonded premises if the space is shared.

The legal issues that are unique to an alternating proprietorship agreement include language that provides that: (1) the operations and record keeping of the host winery and each of the alternating proprietors must be separated and that the separation must be maintained; (2) that each of the alternating proprietors has sufficient and reasonable access to the winery and to their wine; (3) certain areas of the winery are being exclusively maintained for each of the alternating proprietors. Additionally, the TTB usually needs to review and approve the alternating proprietorship agreement.

The legal issues that should be addressed in the alternating proprietorship agreement that are similar to custom crush agreements include: (1) identification and separation of responsibilities among the host winery and the alternating proprietors; (2) identification of the exclusive space being maintained for the alternating proprietor(s); (3) who has wine making and record keeping responsibilities; (4) payment of taxes; (5) price and payment calculations; (6) delivery, crush and fermentation schedules; (7) indemnification and insurance requirements; (8)

representations regarding condition of the host winery; and (9) termination and dispute resolution.

D. DISTRIBUTORSHIP AGREEMENTS.

The system for distribution of alcohol in the United States, established after the repeal of Prohibition, is set up as a three-tiered system. The three tiers are producers, distributors, and retailers. The basic structure of the system is that producers can sell their products only to wholesale distributors who then sell to retailers, and only retailers may sell to consumers. Producers include brewers, wine makers, distillers and importers.

Some states, including Oregon, elected to become alcoholic beverage control jurisdictions after Prohibition. In these states, part or all of the distribution tier, and sometimes also the retailing tier, are operated by the state government itself (or by contractors operating under its authority) rather than by independent private entities.

The basic provisions of a distribution agreement include the term (time period for which the contract is in effect), terms and conditions of supply and exclusivity or non-exclusivity. An exclusivity agreement, for example, stipulates that the specified distributor will be the only one with the right to sell the product within a particular geographic area.

Additionally, governing law, venue and jurisdiction clauses are generally much more significant in distribution agreements. Generally speaking, grape purchase agreements, custom crush agreements and alternating proprietor agreements will involve parties that are located within the same state and within the same, or adjacent counties. In those situations, governing law is not an issue and venue may be inconvenient, but not an obstacle. However, if a McMinnville winery enters into a distribution agreement with a New York distributor, the governing law, venue and jurisdiction provisions will become critical if a dispute arises. If the distribution agreement provides that venue and jurisdiction are in New York, the McMinnville winery will be reluctant to asset any claims if it must travel to New York to enforce the agreement.

Following is a checklist of agreements to be considered when drafting a distribution contract:

- Terms and conditions of sale.
- Term for which the contract is in effect.
- Marketing rights.
- Trade mark licensing.
- Exclusivity or non-exclusivity.
- The geographical territory covered by the agreement.
- Non-competition.
- Performance.
- Reporting.
- Circumstances under which the contract may be terminated.

E. WINE CLUB CONTRACTS.

Generally, wine club contracts are really not contracts at all. For most wineries, the wine club contract is just an agreement between the winery and the consumer that the winery will ship a certain number of bottles or cases of wine to the consumer at regular calendar intervals. Simply put, the wine club contract is nothing more than an agreement by the winery to sell wine to the consumer and an agreement by the consumer to pay for the wine. The winery may offer different levels of membership and different types of product, but generally the "contract" usually just provides a selection for type/level of membership, a mailing or delivery address and a method of payment by the consumer.

Some higher-end wineries may offer greater benefits to the wine club members, such as exclusive use of the winery for private events, the opportunity to participate in winery or vineyard activities, such as harvest or crush, or the opportunity to produce a limited-edition wine labelled specifically for the club member. In those situations, the winery will want to prepare enhanced agreements with the wine club members. For example, if the wine club member is able to use the winery for a private event, then the winery will need to prepare a standard event-style agreement complete with the appropriate representations and warranties, waivers and indemnification provisions. If the winery is going to provide a limited-edition wine for the customer with a customer-specific label, the winery will essentially enter into a custom crush agreement with the customer.

Drafting and Negotiating Wine Industry Contract and Agreements

Submitted by Charles E. Harrell

V. DRAFTING AND NEGOTIATING WINE INDUSTRY CONTRACTS AND AGREEMENTS.

A. GRAPE PURCHASE AGREEMENTS.

Most wineries either crush grapes grown on their own vineyards or they purchase some portion of their grape supply from outside growers. The contracts that govern the purchase and sale of wine grape purchases can be greatly varied, but the primary negotiating points generally focus on issues of control, quality, price, and term.

It can be generally stated that grape growers are farmers who would rather tend their land than deal with lawyers and contracts. Historically, many agreements for the purchase of grapes were handshake deals or bare-bones contracts with few details flushed out before the parties' committed themselves to the relationship. Now, as Oregon's wine industry flourishes and more money is invested in the wine industry, the parties are becoming more sophisticated and the stakes are becoming higher, resulting in complicated business structures are devised to own and manage the industry's assets.

The basic elements of the grape purchase agreement are the term, pricing mechanisms, viticultural practices (including farming, picking and delivery), quality standards and dispute resolution mechanisms. The "boilerplate" terms governing assignment, force majeure and events of default also require special attention when structuring long-term contractual relationships in an industry characterized by regular changes in control and subject to the will of weather.

1. The Parties.

As with many contracts, unsophisticated parties may enter into agreements as individuals even when the individual owns and operates under an entity structure. It is important that the grape grower and the winery purchaser enter into grape purchase agreements as the correct legal entities that own and control the vineyard producing the grapes to be purchased or will take title to the grapes and bear the full legal responsibility for payment of the grapes, respectively. As with any contract negotiation, the contracting parties (or their attorneys) should verify the authority of the signatories to bind the entity parties or, at minimum, require representations and warranties that the signatories are endowed with the required authority. Failure to verify the

legal status of the parties entering the agreement may significantly affect the enforceability of the agreement.

2. Term of the Grape Purchase Agreement.

The term provisions in grape purchase agreements can range from short fixed terms, as in the case of single harvest agreements with no renewal rights, to multi-year contracts in which pricing formulas, crop control and quality standards, and relationship-building become a vital part of the grape purchase contract. When grapes are destined for premium wine and quality is a significant issue, it is not uncommon for the winery to negotiate a 'probationary' period of a relatively short term, and provide the winery with the right to renew for a longer term or terminate at the end of the probationary period if the vineyard and grapes do not meet the winery's quality standards.

Evergreen provisions, which allow for the repeated, automatic renewal of the contract (subject to either party's ability to terminate on a specified amount advance notice) can be common in grape purchase agreements. Language governing the termination of an evergreen contract should provide clear mechanisms for notice and termination, the timing of termination, and the length of time the contract will continue post termination notification. The benefit of an evergreen contract for the grower is the time to modify or change its growing practices to meet the needs of the buyer. Particularly in the case of long-term contracts, the grower may adapt its viticultural practices to serve the particular purchaser even to the extent of planting or grafting to particular varietals or clones. The termination delay that generally accompanies an evergreen term allows the grower to search for a new purchaser with similar viticultural requirements or to adapt its practices to appeal to a new purchaser. When considering the use of an evergreen provision and negotiating the period between delivery of the notice of termination and the actual termination of the agreement, the parties should weigh the consequences of holding parties to a contract after one or both of the parties have become discontented with the arrangement against the benefits of continuing the contractual relationship through additional harvests.

3. Identification of the Grapes.

Grape purchase agreements must identify the grapes that are to be sold to the winery, generally both as to quantity and varietal. The description of the grapes can vary in detail from

the broadest classification, perhaps described as "all the grapes sold at _____ vineyard," to a more specific description of varietal, clone, sugar level and vineyard block, including tonnages, among other possible criteria.

Wineries that are particularly concerned about quality may prefer to include a more detailed description of the grapes intended for purchase. For the grower, a clearer description of the winery's expectations may provide lead-time to line up alternate buyers for the grapes in the anticipation that the crop will not meet the winery's quality criteria and will be rejected. As discussed herein, the responsibility for testing the physiological ripeness of the grapes may be assigned to either the grower or the winery. In addition, the winery may have varying levels of control to trigger harvest. In cases where the winery has particular quality requirements, the grower may consider shifting viticultural control to the winery in an effort to deflect some of the risk associated with production.

4. Pricing.

A fixed price per ton pricing mechanism is most typically used in short-term "spot" contracts. If a fixed price per ton is used in longer term agreements, the fixed price may be tied to indexes, such as the Consumer Price Index or to percentage shifts in the Final Grape Crush Report published by the California Department of Food and Agricultural for the particular varietal and geographical area. In evergreen contracts, it is common for pricing per ton to be determined by reference to the price reported in the Final Grape Crush Report for the year prior to the harvest. Those formulas often refer to the weighted average price as reported in the Final Grape Crush Report, or to higher percentile levels, or the weighted average level plus a stated percentage, depending upon the quality of the grape, the term of the contract and the outcome of other negotiated elements in the contract.

Price adjustments can be capped to prevent a decrease in per ton pricing under any circumstances or to limit any increase or decrease to a certain maximum percent change. In addition, the grower and purchaser may consider a fixed percentage increase for the price of grapes. The fixed percentage may not capture all market trends and requires a certain degree of speculation but the parties will realize greater certainty in their contracting and avoid the often time consuming process of calculating adjustments based on the grape crush report.

Because pricing is most often calculated on a "per ton" basis, accurate weight measurements are critical to a fair and accurate total purchase price calculation. Accurate weight measurements require not only a precise, usually certified, scale and qualified weigh master to prepare the weigh tags but also, for the benefit of the grower, the grapes should be weighed as close to harvest as possible. Transportation of harvested grapes, exposure to heat and further ripening after harvest may result in desiccation of the grapes and a drop in weight of the crop. Timely weight measurements will benefit the grower.

If the grower's fruit is destined for a varietal brand of the winery to be sold at premium wine prices, bottle pricing formulas may provide a method for the grower to participate in the growth of a successful product. Bottle pricing formulas are typically structured to determine a price per ton based on a multiplier of the bottle price as of a pre-harvest or post-harvest date.[1]

While the most common pricing mechanisms tend to revolve around a determination of a price per ton, the winery may also negotiate a price per acre by which the winery agrees to purchase all of the wine grapes grown on a given acreage notwithstanding the level of production, though often subject to negotiated protections. Pricing per acre is not uncommon where quality is paramount and the winery retains significant control over viticultural practices. Pricing per acre is typically coupled with price adjustments in the event of reduction of grape production due to environmental factors or reductions in the acreage of healthy and producing vines due to replanting or disease. In general, a fixed price per acre contract will provide for minimum production requirements with adjustments in price through various mechanisms if production falls below the stated minimum.

5. Timing of Payment.

The timing of payments from the winery to the grower is a key provision of the grape purchase agreement. Though it seems obvious, it is important for the grape purchase agreement to address and state the time for payment. The parties may use the payment provisions as a means of managing revenues and expenses for tax purposes by, among other options, scheduling

[1] For example, 85, 95, 125 multiplied by the retail bottle price as of [date prior to harvest] or as of [release date].

payments to coincide with the end of the harvest year (the current tax year) and the beginning of the following tax year.

6. Farming and Viticultural Practices and Quality Standards.

In the world of premium wine production and increased prices, the winery has more interest in being involved in the farming process. Many grape purchase agreements provide for winery input into viticultural practices, including planting location, selection and spacing of vines, pruning, thinning and harvest. Other agreements may require the grower to adhere to winery-dictated viticultural practices specified in the agreement and may prohibit the grower from varying from the practices in the absence of the winery's consent. The negotiation of viticultural control balances the interests of the winery in assuring high quality grapes for premium wine production against the grower's desire to retain control of farming. The distribution of control and labor can also be used to shift the risk associated with the farming process. The distribution of responsibilities can shift either to the grower or the winery or can be a cooperative effort of the parties. The resolution of these issues tends to depend upon the basic goals of the relationship, including the goal to satisfy long-term business needs reflected in the winery's business plan and the goal of the parties to develop a brand for their grapes or wine.

The more viticultural control that rests with the grower, the more emphasis the winery may place on negotiating quality standards such as freedom from defects (mold, rot, or mildew), MOG standards (material other than grapes), winery retention of the right to trigger the harvest and reservation by the winery of a right to reject the crop or the grapes that do not comply with the quality standards otherwise set forth in the agreement.

On occasion, the winery will negotiate for the ability to make subjective determinations of quality as a criterion separate from allowable defects. If the grapes do not meet the winery's quality standards, the winery may reject the grapes entirely. This provision will necessarily create uncertainty for the grower because the determination of quality will rest with the subjective judgment of the winery. If the determination of quality is not made until after harvest, the grower will have a very limited alternate market for its grapes, if any. When quality is paramount, the grower may consider relinquishing additional control over its viticultural practices so that the winery will bear responsibility for the quality of the product. Generally, as

the winery plays a greater role in defining or controlling viticultural practices, the emphasis on compliance with objective and subjective quality standards tends to relax. The issue of winery viticultural control is more heavily negotiated in contracts where grapes are sold by the block or by the acre and may become important if a winery attempts to qualify the wine for "Estate Bottled" labeling.

The issue of "hang time" and grape weight loss is a regular and often tense debate between grower and winery. For any number of reasons, not the least of which is the market trend towards riper high-alcohol wines, wineries prefer or require harvest to occur later in the season when the grapes have reached high sugar levels. The increase in sugars can also mask flaws inherent in certain grape varietals. For the grower, however, higher sugar content and riper fruit means less water in the grapes, a lower weight and lower purchase price. One mechanism used to mitigate this tension is the payment of bonuses to the grower based on the production of high-sugar grapes. By incorporating bonuses into the contract terms, the winery may still trigger the harvest based upon its processing needs and winemaking style but a disincentive will be created for triggering a late harvest for the sake of reducing the weight of the harvest and, therefore, the purchase price.

7. The Agricultural Produce Lien and Grower Security.

Disputes over the payment for grower's grapes can be simplified for the grower due to the availability of the agricultural produce lien, often referred to as a "grower's lien." The agricultural produce lien is a specific and noteworthy statutory creation, which provides a lien in favor of the producer or grower without initially requiring the grower to take any affirmative act to perfect its security. The authority for the creation of the lien is provided by ORS Chapter 87.705 and provides as follows:

> (1) An agricultural producer that delivers or transfers agricultural produce for consideration to a purchaser has a lien for the contract price of that produce, or for the reasonable value of the produce if there is no contract price. The lien created by this section attaches to all agricultural produce, whether in a raw or processed condition, delivered or transferred to the purchaser by any agricultural producer and to all other inventory of the purchaser. The lien also attaches to proceeds received by the purchaser from the sale by the purchaser to a third party of any raw or processed agricultural produce. If the agricultural produce that an agricultural producer delivers to the purchaser consists of meat

animals, the lien also attaches to all accounts receivable by the purchaser from the sale of any agricultural produce to a third party. The lien on the agricultural produce, inventory, proceeds or accounts receivable attaches on the date physical possession of the agricultural produce is delivered or transferred by the agricultural producer to the purchaser or an agent of the purchaser.

(2) An agricultural producer that claims a lien under subsection (1) of this section need not file any notice in order to perfect the lien. The agricultural producer must file a notice of lien as provided in ORS 87.710 or a notice of claim of lien as provided in ORS 87.242 to extend the lien beyond the normal expiration date.

(3) The lien created by this section is subject to the provisions of ORS 79.0320 (1).

(4) An agreement by an agricultural producer purporting to waive the right to file notice under ORS 87.242 or 87.710 of a lien created by this section is void as contrary to public policy.

The grape purchase agreement does need not include any specific provisions for the grower to assert the lien. However, as provided in ORS 87.710, the agricultural produce lien is only initially valid for 45 days after the last date that last payment is due from the purchaser, but the lien may be extended for an additional 225 days by filing a Notice of Agricultural Produce Lien with the Oregon Secretary of State.

The agricultural produce lien attaches to the product and all processed or manufactured forms of the product without the need for segregation. The agricultural produce lien extends to the accounts receivable of the winery even after the finished wine is no longer in the winery's possession.

The agricultural produce lien is just one tool to ensure payment and the grower may consider requiring personal guarantees, UCC liens against purchaser's inventory or business assets or other collateral as security for payment.

8. Vineyard Designation.

It is the grower, not the winery, which possesses the rights in the vineyard name. If a grower sells wine grapes under a vineyard name to a winery, the winery may fairly use that vineyard name on the wine produced from those grapes to designate origin so long as such use

complies with the vineyard designation labeling requirements of the TTB,[2] even absent grower consent. If the grower wishes to control the winery's ability to use the vineyard name on the wine, the grower should insert language in the grape purchase agreement prohibiting use absent the prior consent of the grower.

If vineyard designation is intended at the time of contract negotiation, the contract should specifically authorize the winery to use the name on its label as a vineyard designation and specify that upon termination of the contract, the winery's right to continue to use the vineyard names ceases. A grower holding a trademark of a vineyard name should consider licensing the name to the winery intending to use the name as a vineyard designation on the winery's label.[3] Such an arrangement would more likely be used in a long term relationship, providing the winery with clear rights to use the name and the grower with additional economic value associated with the vineyard. Such arrangements should be documented carefully to reflect that the licensing of the mark or name is a separate and distinct transaction from the grape purchase agreement in order to avoid any argument that royalties paid under the licensing agreement are disguised grape purchase payments, particularly where the royalties are tied to a bottle release some years after the harvest.

Growers hoping to create value in their vineyard designation and build a brand around that designation should consider the level of control they wish to maintain over the quality of the wine produced, whether as a result of a bad crop or flawed processing, and the marketing of wine bearing the designation.[4] The grower may consider tying provisions of a licensing agreement to the termination provisions of the grape purchase agreement in the event that the winery fails to add value to the grower's brand.

The winery, however, may not want to establish brand equity in a vineyard name owned by the grower alone without some assurance that competitors may not also benefit from the brand equity when purchasing grapes from the same vineyard owner even if the winery may also

---

2 "…Additionally, the name of a vineyard, orchard, farm or ranch shall not be used on a wine label, unless 95 percent of the wine in the container was produced from primary winemaking material grown on the named vineyard, orchard, farm or ranch." *27 C.F.R. § 4.39(m)*.

3 A new vineyard owner may file a trademark application on a reserved rights basis pending vineyard maturation and sufficient use of the name in interstate commerce to qualify for trademark status.

4 A provision regarding quality control should be included in every license in order to preserve trademark protections.

use the vineyard designation for its own product. In some situations, a winery owner and vineyard owner may agree to adopt a unique vineyard name and jointly own the name as a vineyard designation for as long as the vineyard supplies the grapes for the wine carrying the vineyard designation. This fosters a unified effort to build the brand and, should the relationship end, the party with a greater interest in the brand may buy out the other party's interest in the mark. In other situations, instead of using a vineyard designation, the winery may adopt a unique sub-brand that it can retain ownership in and source grapes from different locations and make any reference to the vineyard name or the vineyard owner on the "romance" section of the back label.

Wineries licensing a name for vineyard designation purposes may also want to label the wine as "Estate Bottled." An open question exists as to whether or not a winery may retain sufficient viticultural control so that the resulting wine may be labeled as "Estate Bottled" under federal law. The term "Estate Bottled" may be used by a bottling winery only where 100 percent of the grapes were grown within the named viticultural area in which the bottling winery is also located, where that winery crushed the grapes, fermented and processed the wine, and bottled it, without the wine ever leaving that winery's bonded premises, and where the grapes are grown on land owned or controlled by the winery.[5] The regulation defines "controlled" as the performance of all acts common to viticulture under the terms of a lease or similar agreement with at least three years' duration. The estate bottled designation is premised on the notion that the named winery, that is, the estate, has direct involvement in, and complete control over, the production of the bottled wine from the grape growing stage through the bottling process. Thus, 27 C.F.R. §4.26 requires that the bottling winery grow the grapes on land it owns or controls and, in the case of land controlled by the winery, that the winery actually performs the acts common to viticulture. Wineries should rely on fee ownership or long-term agricultural leases to assure compliance with federal "Estate Bottled" regulations.

9. Assignments, Sales and Changes in Control.

When entering into long-term grape purchase agreement, the parties should appreciate the relatively high turnover of vineyard properties and winery businesses and consider the impact that changes in ownership will have on the future performance of the agreement. Free

[5] *See* 27 C.F.R. § 4.26.

assignability of the agreement to the winery's successors may create a credit risk for the grower. If trademark licensing or vineyard designation issues are in play, the grower may also be particularly invested in the purchaser of the grapes. For the winery, free assignability of the agreement to grower's successors may impact the standard of care used in viticultural practices. On the other hand, assignable contracts may create an asset for winery and grower that may increase the overall value of the parties' holdings. When a winery plays a large role in viticultural practices and the grapes have become the staple of a longstanding production of a premium quality wine identified by a vineyard designation in the context of a long-term purchase agreement, the winery may require that the grape purchase agreement bind successors and assigns and run with the land. Such a concession by the grower needs to be reflected in the economic benefit to the grower in the form of a higher price paid for the grapes or in continuing royalties paid by the winery under the agreement for licensing the vineyard name. In these situations, the winery will often require the recordation of a Memorandum of Grape Purchase Agreement in the public records of the county in which the vineyard is located.

Most parties resort to the fallback position of agreeing to some level of restriction on assignments so that they will not be forced to perform agreements with unknown entities. Options for restrictive assignment language are as follows.

10. Termination and Default.

Many grape purchase agreements provide basic terms for establishing default and termination, such as failure to pay for the grapes according to the agreed upon payment schedule or a substantial change in a party's financial condition. Because many grape purchase agreements are for extended terms, the parties may also consider other contract performance issues that will impact the working relationship to such a degree that early termination may be appropriate. For example, it may not be economical for a grower to stay in contract with a winery which repeatedly refuses grape deliveries for alleged quality reasons. Conversely, if there are substantial quality problems, the winery may require remedies beyond its ability to

reject grapes.[6] A failure of performance in even one year of the contract term may have substantial financial impacts on one or both of the parties.

Also, in the context of long-term contracts, the parties may be subject to substantial damages in the event of a default occurring early in the contract term. As with any contractual relationship, the non-breaching party will have an obligation to take reasonable steps to mitigate its damages, however, depending on the specific nature of the agreement, mitigation may not effectively eliminate the contract damages. In addition, it may fall to the court to determine what actions the grower must take to mitigate its damages. For example, is it reasonable to require a grower to replant or graft an entire vineyard to a more broadly marketable grape variety? These issues should be addressed in the specific context of the proposed contractual relationship. The issue of damages will be more pronounced in the case of long-term contracts or contracts that require the grower to plant a rare varietal or perform specific viticultural practices that will impact the future development of the vines.

11. Force Majeure.

Force majeure provisions, which usually fall into contracts as "boilerplate," can play an important role in grape purchase agreements. The parties can, to a certain extent, define certain events as force majeure events, which will relieve, in whole or in part, the parties' obligations to perform.

It is also possible that a catastrophic or unforeseen event will not result in a total inability to perform but will greatly reduce crop yield beyond the parties' expectations. When a grower has multiple grape purchase agreements obligating its delivery of grapes to multiple parties, the grower must consider how it will distribute a reduced yield among the various contracting parties. Grape purchase agreements defined by the production of tons of grapes rather than for the production of grapes within a given block of the vineyard will complicate this circumstance. The parties may find greater predictability by incorporating some version of the following provision into their agreement.

/ / /

[6] The parties may also want to consider whether or not the grower's failure to deliver grapes meeting the winery's quality standards is itself a breach of the agreement giving rise to a claim by the winery to collect damages or resulting in the termination the agreement.

B. CUSTOM CRUSH AGREEMENTS.

Custom crush arrangements and alternating premises/proprietor arrangements can appear to be very similar, but legally, the effects and consequences of custom crush arrangements and alternating premises/proprietor arrangements are significant and substantial. Legally, a custom crush facility is just a winery that makes wine to order for grape-grower clients, and the winery sells the finished wine to the grape-grower clients who then resell the wine under their own label. The custom crush winery can use the customers' grapes or procure them elsewhere. The grape-grower clients do not have their own winery license and have no ownership interest in the winery and have limited control over the production of the wine. The custom crush facility owns all of the equipment involved and, unless otherwise agreed upon by the parties, is solely responsible for all costs of production, recordkeeping, labeling of bottles and payment of taxes. Of course, the custom crush winery passes on a share of these costs to the grape-grower clients. The custom crush winery contracts with the grape-growing clients to produce the grape-growing clients' grapes into wine, and the clients receive finished, tax-paid wines.

The distinction between custom crush arrangements and alternating premises/proprietorship arrangements is especially significant to Alcohol and Tobacco Tax and Trade Bureau ("TTB"). The TTB treats the custom crush clients the same as wholesalers. The custom crush clients have minimal recordkeeping requirements, and don't have to file reports to the TTB. The custom crush clients take no responsibility for production, recordkeeping, reporting, labeling or taxes, and they don't make any investment in winemaking equipment or premises. However, the custom crush clients have to apply to the TTB under the Federal Alcohol Administration Act ("FAAA") as a wholesaler, as well as obtain a winery license from the Oregon Liquor Control Commission ("OLCC") and maintain supporting documents. Custom crush agreements are a simple way for smaller vineyards to have their own wine, and therefore they understandably popular.

Due to the legal and tax differences between custom crush agreements and alternating premises/proprietorship agreements, it is very important that the parties have a written agreement that provides enough detail, and addresses the legal specificities, that are necessary to differential a custom crush agreement from an alternating premises/proprietorship agreement. The key elements of a custom crush agreement are as follows:

1. Responsibilities of the Parties.

As with any contract, the custom crush client and the custom crush operator need to specifically define the roles and responsibilities of each party, especially any responsibilities that are unusual or not in the ordinary custom for the local industry. Is the custom crush operator responsible for every single aspect of the wine production, or will the custom crush client take on some responsibilities, such as bottling and/or labeling? Will the custom crush operator also store (in bond) the custom crush client's wine after it is bottled? If there is going to be any allocation of responsibilities between the custom crush operator and the custom crush client, then it is absolutely vital that the parties have a clear and unambiguous written agreement regarding the parties' responsibilities.

2. Representations and warranties by the custom crush operator.

At the beginning of the day and at the end of the day, wine quality is the key element of any Oregon wine. And because wine quality is usually the core issue at the heart of many custom crush disputes, the custom crush client will want the custom crush agreement to address the quality of the wine produced by the custom crush operator. Custom crush clients may choose a custom crush operator based upon the reputation of the custom crush operator's winemaker alone, and the custom crush client may require that the wine produced by the custom crush operator have certain key characteristics.

If the custom crush operator is going to agree to any quality guarantees, they should be as definite and quantifiable as possible. The custom crush operator should require that all representations and warranties regarding the wine's quality be agreed to in writing by the parties. Note that if a dispute arises regarding the delivered product, a court may read a number of provisions of the Uniform Commercial Code ("UCC") into the custom crush contract, including the UCC's warranty of the wine's "merchantability" or its "fitness for a particular purpose." The only way to avoid this is to expressly and explicitly disclaim the UCC's warranties in the written custom crush contract.

3. Delivery of the grapes.

Most custom crush operators produce their own wine as well as wine a number of custom crush clients at the custom crush operator's facility. And since Oregon's grape harvest season can occur at varied times (weather is major factor in this. Harvest this year occurred in mid-September, whereas the harvest in 2011 occurred after Halloween) and in a short period of time, the demand for the custom crush operator's facility can be very time-sensitive. Therefore, the custom crush agreement should provide specific requirements regarding delivery of the dates, including provisions regarding how much advance notice needs to be provided to the custom crush operator, as well as facility-specific delivery procedures and requirements.

4. Payment and security.

As we discussed previously, the custom crush operator owns the facility and all of the production equipment and is generally responsible for all costs of production, recordkeeping, labeling of bottles and payment of taxes. These costs are obviously passed on to the custom crush clients. However, the payment provisions of the custom crush agreement should address how the payment due to the custom crush facility is calculated. For example, the custom crush operator may choose to charge the custom crush client by an hourly rate or by a price-per-case. Additionally, the payment provisions of the custom crush contract should provide specific detail about what services and products are included in the price, such as wine making, wine aging and bottling, packaging, taxes, bottles and labels.

The prudent custom crush operator will also seek to have some form of security to ensure payment by the custom crush client. In that case, the custom crush contract should contain a provision granting the custom crush operator a security interest in the custom crush client's personal property related to the custom crush agreement, including the grapes delivered to the custom crush facility, the juice and wine, and any other personal property and goods procured on behalf of the custom crush client (barrels, bottles, labels, etc.).

5. Dispute resolution.

A dispute resolution process should also be included in the custom crush agreement. The dispute resolution procedure should address how the parties can efficiently and promptly resolve disputes, such as a complaint by the custom crush client about the wine's quality. Consider including a date certain by which the custom crush client must notify the custom crush operator

of any perceived quality problems and providing the custom crush operator with a period of time during which the custom crush operator can fix the alleged problem.

The custom crush operator may also want to try to limit the amount of damages available to the custom crush client. Typical damage limitation language will either limit the damages to the amount of the contract price or, if the custom crush client pushes back, the amount of the operator's insurance limits. The custom crush operator should push to disclaim special, incidental and consequential damages and should make certain the custom crush agreement limits the operator's liability to money damages only.

C. ALTERNATING PROPRIETOR AGREEMENTS.

The alternating premises/proprietor arrangement is considerably more complex than a custom crush agreement. Under an alternating premises/proprietorship agreement, two or more wineries share (alternate) use of part of a bonded winery's facility. The host is a bonded winery, but the alternating proprietors are also bonded wineries. The host and the alternating proprietors take turns using the equipment for a 24-hour minimum period. The exception to this arrangement is winery's crushing equipment not on the bond. The crushing equipment is normally owned by the host, who used the equipment to crush its own grapes and to crush grapes for its custom crush clients (the grapes aren't yet wine in this case). The host winery is responsible for all its records and filing, but the host winery is not responsible for the records and filings of the other alternating proprietors.

Each of the alternating proprietors must qualify as a winery on their own standing, however. Though each of the alternating proprietors has lower investment in equipment and premises, they are each responsible for all their own production, records, reporting, labeling and taxes. Wineries deal with two different federal laws, the Internal Revenue Code (IRC) and the Federal Alcohol Administration Act ("FAAA"). The IRC is responsible for the qualification of the premises, and the payment of taxes and production, and is enforced by the Internal Revenue Service. The FAAA defines the basic permits for qualified applicants, truthful labeling and advertising, and fair trade practices, and is enforced by the TTB. Both the IRS and the TTB are division of the Department of the Treasury.

Stand-alone or custom crush wineries are responsible for their own IRC application and FAAA and OLCC application as a wine producer, and must obtain a bond and maintain the supporting documents. If a winery is also operating as an alternating premises/proprietorship, then each of the entities operating under the alternating proprietorship has the same responsibilities and requirements, plus they are required to submit a diagram describing the parts of the winery allocated to each proprietor.

The basic application to establish and operate wine premises, IRC Form 5120.25, is required from all winery applicants. It describes the bonded premises and operations. The application for a basic permit under the FAAA, Form 5100.24, is required from wineries and wholesalers, and provides information about ownership of the operation.

Winery applicants are also required to obtain a wine bond, Form 5120.36, in order to ensure that required taxes will be paid. The amount of the bond is based on the winery's tax liability. The supporting documents that each of the alternating proprietors must maintain include environmental forms from all bonded wine premises applicants, signature authority, trade name registration and a diagram from bonded premises if the space is shared.

The legal issues that are unique to an alternating proprietorship agreement include language that provides that: (1) the operations and record keeping of the host winery and each of the alternating proprietors must be separated and that the separation must be maintained; (2) that each of the alternating proprietors has sufficient and reasonable access to the winery and to their wine; (3) certain areas of the winery are being exclusively maintained for each of the alternating proprietors. Additionally, the TTB usually needs to review and approve the alternating proprietorship agreement.

The legal issues that should be addressed in the alternating proprietorship agreement that are similar to custom crush agreements include: (1) identification and separation of responsibilities among the host winery and the alternating proprietors; (2) identification of the exclusive space being maintained for the alternating proprietor(s); (3) who has wine making and record keeping responsibilities; (4) payment of taxes; (5) price and payment calculations; (6) delivery, crush and fermentation schedules; (7) indemnification and insurance requirements; (8)

representations regarding condition of the host winery; and (9) termination and dispute resolution.

D. DISTRIBUTORSHIP AGREEMENTS.

The system for distribution of alcohol in the United States, established after the repeal of Prohibition, is set up as a three-tiered system. The three tiers are producers, distributors, and retailers. The basic structure of the system is that producers can sell their products only to wholesale distributors who then sell to retailers, and only retailers may sell to consumers. Producers include brewers, wine makers, distillers and importers.

Some states, including Oregon, elected to become alcoholic beverage control jurisdictions after Prohibition. In these states, part or all of the distribution tier, and sometimes also the retailing tier, are operated by the state government itself (or by contractors operating under its authority) rather than by independent private entities.

The basic provisions of a distribution agreement include the term (time period for which the contract is in effect), terms and conditions of supply and exclusivity or non-exclusivity. An exclusivity agreement, for example, stipulates that the specified distributor will be the only one with the right to sell the product within a particular geographic area.

Additionally, governing law, venue and jurisdiction clauses are generally much more significant in distribution agreements. Generally speaking, grape purchase agreements, custom crush agreements and alternating proprietor agreements will involve parties that are located within the same state and within the same, or adjacent counties. In those situations, governing law is not an issue and venue may be inconvenient, but not an obstacle. However, if a McMinnville winery enters into a distribution agreement with a New York distributor, the governing law, venue and jurisdiction provisions will become critical if a dispute arises. If the distribution agreement provides that venue and jurisdiction are in New York, the McMinnville winery will be reluctant to asset any claims if it must travel to New York to enforce the agreement.

Following is a checklist of agreements to be considered when drafting a distribution contract:

- Terms and conditions of sale.
- Term for which the contract is in effect.
- Marketing rights.
- Trade mark licensing.
- Exclusivity or non-exclusivity.
- The geographical territory covered by the agreement.
- Non-competition.
- Performance.
- Reporting.
- Circumstances under which the contract may be terminated.

E. WINE CLUB CONTRACTS.

Generally, wine club contracts are really not contracts at all. For most wineries, the wine club contract is just an agreement between the winery and the consumer that the winery will ship a certain number of bottles or cases of wine to the consumer at regular calendar intervals. Simply put, the wine club contract is nothing more than an agreement by the winery to sell wine to the consumer and an agreement by the consumer to pay for the wine. The winery may offer different levels of membership and different types of product, but generally the "contract" usually just provides a selection for type/level of membership, a mailing or delivery address and a method of payment by the consumer.

Some higher-end wineries may offer greater benefits to the wine club members, such as exclusive use of the winery for private events, the opportunity to participate in winery or vineyard activities, such as harvest or crush, or the opportunity to produce a limited-edition wine labelled specifically for the club member. In those situations, the winery will want to prepare enhanced agreements with the wine club members. For example, if the wine club member is able to use the winery for a private event, then the winery will need to prepare a standard event-style agreement complete with the appropriate representations and warranties, waivers and indemnification provisions. If the winery is going to provide a limited-edition wine for the customer with a customer-specific label, the winery will essentially enter into a custom crush agreement with the customer.

Protecting Brand Identity Through Trademarks and Copyrights

Submitted by Charles E. Harrell

VI. PROTECTING BRAND IDENTITY THROUGH TRADEMARKS AND COPYRIGHTS.

A brand, as defined by the American Marketing Association, is a "Name, term, design, symbol, or any other feature that identifies one seller's good or service as distinct from those of other sellers." In short, the brand is how the public views and feels about the values, products and/or services and personality of the seller's goods or services. So, exactly how important is a brand's identity? What do you think of and feel when you hear the brand names BMW or Mercedes? Would Nike be the same without its Swoosh and "Just Do It" tagline?

Understanding the importance or brand identity is one thing. Actually developing and putting it into action is a completely different task. And once a vineyard or winery has taken the time and incurred the considerable expense to establish a brand, the vineyard or winery is going to need to take steps to protect that brand. Perhaps the best way to protect your brand is to make sure you aren't stealing someone else's. Although certain visual elements wax and wane in popularity, in general, a unique brand consists of a specific tagline or a logo with a consistent set of colors, fonts and graphics. So before building equity in a brand, the business needs to perform adequate due diligence to make sure it isn't accidentally adopting an existing, protected logo or mark. Some very large companies, such as Starbucks, have been known to fire both legal barrels at very small companies on the mere allegation of brand infringement. Upfront research is the best defense against being accused of infringement.

United States law requires that every wine label must display a brand name. See, 27 C.F.R. § 4.32. A wine brand may start out as a simple identifying aspect for the wine, but over time, the brand can gain value by earning a reputation for a certain quality or style. The obvious legal aspect of branding is the need to protect the trademark represented by the brand. Note that the TTB process for label approval is not directly related to, and does not provide any form of, trademark protection.

When evaluating potential trademarks for a winery, vineyard or bottle label, be aware that there is a spectrum of protection in trademarks. The more distinctive that a trademark is, the stronger the trademark is and the more protection that the trademark can receive. The strongest trademarks, for purposes of protection, are coined or fanciful terms that have no meaning in the common English language. Examples of coined or fanciful marks are KODAK or XEROX.

Arbitrary trademarks are commonplace terms that are used out of normal context. Apple computers is an example of an arbitrary mark.

Suggestive trademarks require some imagination, thought, or perception in order to reach a conclusion as to the nature of the product or service. In other words, the trademark hints or suggests something about the product or service. An example of a suggestive mark may be Blu-ray, denoting a new technology of high-capacity storage.

When properly used, coined/fanciful, arbitrary and suggestive trademarks are immediately protectable. Descriptive marks convey some aspect or feature of a good or service. However, descriptive marks will only be protected trademarks if they acquire distinctiveness. Methven Family Vineyards is an example of a descriptive mark and will only become fully protected if it can obtain a certain distinctiveness over time.

A. LOGO DESIGN TRADEMARK.

In its simplest terms, a trademark is anything that tells a consumer the origin of a particular product or service. In the world of marketing and advertising, trademarks are everywhere. Every major commercial brand that you can think of has a trademark associated with it. Over time, trademarks have taken on many forms. There are traditional word marks (names), design marks (logos), and slogans or taglines. There are also non-traditional marks, such as sound marks (think of the three-tone chime associated with NBC) and trade dress (the distinctive share of the COCA-COLA bottle). Incredibly, certain scents can also be a protected mark. For example, the smell of fresh-cut grass for tennis balls is a registered trademark.

As discussed above, a brand logo can be a protectable design mark. Ideally, the brand logo should be a visual representation of everything that the winery wants the wine to represent. A good logo can build loyalty between your business and your customers, establish a brand identity, and provide the professional look of an established enterprise.

1. Logo Types.

There are basically three kinds of logos. Font-based logos consist primarily of a type treatment. The logos of IBM, Microsoft and Sony, for instance, use type treatments with a twist that makes them distinctive. There are logos that literally illustrate what a company does, such as when a house-painting company uses an illustration of a brush in its logo. And finally, there are abstract graphic symbols-such as Nike's swoosh-that become linked to a company's brand.

Look at the logos of other wineries. Do your competitors use solid, conservative images, or flashy graphics and type? Think about how you want to differentiate your logo from those of

your competition. The logo should work as well on wine label as on a business card and on the side of a truck. A good logo should be scalable, easy to reproduce, memorable and distinctive. Icons are better than photographs, which may be indecipherable if enlarged or reduced significantly.

2. Registration Formats.

Three possible mark registration formats are available: (1) standard character format; (2) stylized/design format; or (3) sound mark. The standard character format should be used to register word(s), letter(s), number(s) or any combination thereof, without claim to any particular font style, size, or color, and absent any design element. Registration of a mark in the standard character format will provide broad rights, namely use in any manner of presentation.

The stylized/design format, on the other hand, is appropriate if you wish to register a mark with a design element (logo) and/or word(s) and/or letter(s) having a particular stylized appearance that you wish to protect. **Note that registration of a mixed standard character format and stylized/design format is note available.** In other words, do not submit for registration a representation of a mark that attempts to combine a standard character format and a stylized/design format.

B. NEGOTIATING TRADEMARK LICENSES.

A trademark license is an agreement between a trademark owner (the "licensor") and another person (the "licensee") in which the licensor permits the licensee to use its trademark in commerce. Usually, a trademark license is expressed in a written contract specifying the scope of the license.

There are many factors that go into a trademark license negotiation. Some are common to all license negotiations and some are specific to trademark licensing deals. It is important to prepare for a negotiation like you would prepare for any negotiation, doing research to understand the different issues that will be negotiated, determining your own position on each of those issues and how important that position is to you, and trying to understand what the other side's position is.

Trademark licensing is widespread in the consumer product field. Sometimes trademark licensing is obvious, like when it connects two vastly different brands (e.g. Dora the Explorer on Colgate Toothpaste for Kids), and sometimes it is more subtle, like when a trademark is placed on a complementary product line (e.g. Mr. Coffee brand coffees). One thing that is common to all kinds of trademark licensing deals is that each deal started from a license negotiation.

One of the biggest issues with regard to trademark licensing is maintaining control over the trademark. Control is needed because a trademark represents the trademark owner's reputation for goods and services of a certain level of quality, and consumers tend to rely on this reputation in making purchasing decisions. If a licensor does not exercise sufficient control over the quality of the goods and services offered by the licensee, the trademark may, in some countries (for example, the United Kingdom and Canada), become vulnerable to attack by the licensee or a third party. In other countries, such as the United States, the trademark may be deemed abandoned.

A license will provide for quality control by the licensor by including provisions such as:

- **Trademark Usage** - The licensor may specify the manner in which the trademark will be used on or in connection with the goods and services of the licensee and on advertising and promotional materials. The licensee may be required to obtain the licensor's permission before using any new presentation of the trademark.

- **Quality Control Monitoring** - A licensor may require access to a licensee's facilities, raw materials, finished products, personnel and records to monitor the licensee's adherence to the licensor's quality standards.

- **Royalty** - When a licensor grants a trademark license in return for royalty payments from its licensee, a royalty amount is usually stated explicitly in the license.

- **License Term** - A trademark license usually sets a fixed term for the license and the conditions under which the license may be (a) renewed for an additional period of time or (b) terminated for breach of the license conditions.

- **Exclusivity** - A trademark may be licensed exclusively to a single licensee or licensed non-exclusively to more than one licensee. In a non-exclusive licensing arrangement,

the licensor retains rights to use the trademark itself, to license it to others, or both. A license may also be "sole," meaning that only the licensee may use the trademark.

In some countries, for example, the United States, there is no legal requirement that trademark licenses be recorded with the national trademark office. Such recording will simply provide notice to the public of the existence of the license agreement. In other countries, however, a license must be recorded to be effective against third parties.

C. REGISTERING TRADEMARKS AT THE STATE, FEDERAL AND INTERNATIONAL LEVEL.

1. Registering Trademarks with the United States Patent and Trademark Office.

Federal registration of trademarks is done through the United States Patent and Trademark Office ("USPTO") with an online system called the Trademark Electronic Application System (TEAS). The trademark application fee is a processing fee that is not refunded, even if ultimately no registration certificate issues. In other words, not all trademark applications will ultimately result in a valid trademark registration.

After the USPTO determines that you have met the minimum filing requirements, an application serial number is assigned and the trademark application is forwarded to an examining attorney with the USPTO. This process may take a number of months. The examining attorney reviews the application to determine whether it complies with all applicable rules and statutes, and includes all required fees. As noted above, filing fees will not be refunded, even if the application is later refused registration on legal grounds. A complete review includes a search for conflicting marks, and an examination of the written application, the drawing, and any specimen.

If the examining attorney decides that a mark should not be registered, the examining attorney will issue a letter (called an Office action) explaining any substantive reasons for refusal, and any technical or procedural deficiencies in the application. If only minor corrections are required, the examining attorney may contact the applicant by telephone or e-mail (if the applicant has authorized communication by e-mail). If the examining attorney sends an Office action, the applicant's response to the Office action must be received in the USPTO office within

six (6) months of the mailing date of the Office action, or the application will be declared abandoned.

If the applicant's response does not overcome all objections, the examining attorney will issue a final refusal. To attempt to overcome a final refusal, the applicant may, for an additional fee, appeal to the Trademark Trial and Appeal Board (TTAB), an administrative tribunal within the USPTO.

If the examining attorney raises no objections to registration, or if the applicant overcomes all objections, the examining attorney will approve the mark for publication in the *Official Gazette*, a weekly publication of the USPTO. The USPTO will send a notice of publication to the applicant stating the date of publication. After the mark is published in the *Official Gazette*, any party who believes it may be damaged by registration of the mark has thirty (30) days from the publication date to file either an opposition to registration or a request to extend the time to oppose. An opposition is similar to a proceeding in a federal court, but is held before the TTAB. If no opposition is filed or if the opposition is unsuccessful, the application enters the next stage of the registration process.

A certificate of registration will issue for applications based on use, on a foreign registration under Section 44 of the Trademark Act, or an extension of protection of an international registration to the United States under Section 66(a). If the mark is published based upon the actual use of the mark in commerce, or on a foreign registration, and no party files an opposition or request to extend the time to oppose, the USPTO will normally register the mark and issue a registration certificate about eleven (11) weeks after the date the mark was published. After the mark registers, the owner of the mark must file specific maintenance documents to keep the registration live. The maintenance document is a Section 8 Declaration of Continued Use. A Section 8 Declaration of Continued Use is a sworn statement, filed by the owner of the trademark registration, that the mark is in use in commerce, and is based upon Section 8 of the Trademark Act, 15 U.S.C. §1058. If the owner is claiming excusable nonuse of the mark, a §8 Declaration of Excusable Nonuse may be filed. The purpose of the §8 Declaration is to remove marks no longer in use from the register.

If the mark is published based upon the applicant's bona fide intention to use the mark in commerce and no party files either an opposition or request to extend the time to oppose, the USPTO will issue a notice of allowance about eight (8) weeks after the date the mark was published. The applicant then has six (6) months from the date of the notice of allowance to either: (1) use the mark in commerce and submit a statement of use (SOU); or (2) request a six-month extension of time to file a statement of use (extension request).

A notice of allowance is a written notification from the USPTO that a specific mark has survived the opposition period following publication in the *Official Gazette*, and has consequently been allowed; it does not mean that the mark has registered yet. Receiving a notice of allowance is another step on the way to registration. Notices of allowance are only issued for applications that have been filed based on an intent-to-use a mark in commerce under Trademark Act Section 1(b).

As noted previously, the trademark applicant has six (6) months from the mailing date of the notice of allowance in which to either file a statement of use or file an extension request. If the trademark applicant is not using the mark in commerce on all of the goods/services listed in the notice of allowance, the applicant must file an extension request and the required fee(s) to avoid abandonment. Because extension requests are granted in six (6) month increments, applicant must continue to file extension requests every six (6) months. A total of five (5) extension requests may be filed. The first extension request must be filed within six (6) months of the issuance date of the notice of allowance and subsequent requests before the expiration of a previously granted extension.

If the applicant is using the mark in commerce on all of the goods/services listed in the notice of allowance, the applicant must submit an statement of use and the required fee(s) within six (6) months from the date the notice of allowance issued to avoid abandonment. The applicant cannot withdraw the statement of use; however, the applicant may file one extension request with the statement of use to provide more time to overcome deficiencies in the statement of use. No further extension requests may be filed.

If the trademark applicant does not file a statement of use or extension request within six (6) months from the date the notice of allowance issued, the application is abandoned (no longer

pending/under consideration for approval). To continue the application process, the trademark applicant must file a petition to revive the application within two (2) months of the abandonment date.

If the minimum filing requirements are met, the statement of use is forwarded to the examining attorney. The examining attorney conducts a review of the statement of use to determine whether federal law permits registration. The applicant cannot withdraw the statement of use and the filing fee(s) will not be refunded, even if the application is later refused registration on legal grounds. If no refusals or additional requirements are identified, the examining attorney approves the statement of use.

If refusals or requirements must still be satisfied, the examining attorney assigned to the application issues a letter (Office action) stating the refusals/requirements. This is the same process that occurs prior to publication of the mark if the examining attorney determines that legal requirements must be met. The process and timeframes remain the same, except that if issues are ultimately resolved and the statement of use is approved, the USPTO issues a registration within approximately two (2) months. If all issues are not resolved, the application will be abandoned.

Within approximately two (2) months after the SOU is approved, the USPTO will issue a trademark registration. Again, in order to keep the registration "live," the registrant must file specific maintenance documents. The maintenance document is a Section 8 Declaration of Continued Use. A Section 8 Declaration of Continued Use is a sworn statement, filed by the owner of the trademark registration, that the mark is in use in commerce, and is based upon Section 8 of the Trademark Act, 15 U.S.C. §1058. If the owner is claiming excusable nonuse of the mark, a Section 8 Declaration of Excusable Nonuse may be filed. The purpose of the §8 Declaration is to remove marks no longer in use from the register. Failure to make these required filings will result in cancellation and/or expiration of the registration.

The applicant can monitor the progress of its trademark application through the online Trademark Status and Document Retrieval (TSDR) system. It is important to check the status of the trademark application every 3-4 months after the initial filing of the application, because otherwise you may miss a filing deadline.

2. Registering Trademarks with the Oregon Secretary of State.

Registration of a trademark at the Oregon state level is significantly less complicated than federal registration, but also offers significantly less protection than a federal registration. Whereas an applicant can file an intent-to-use application at the federal level, Oregon requires that the trademark actually be in use in commerce before a registration can be made. Unlike the federal registration, Oregon does not generally examine the trademark application for competitive issues, but Oregon will reject a trademark application if the application is not fully and accurately completed. The trademark registration fee in Oregon is a mere fifty dollars ($50).

3. Registering Trademarks at the International Level.

The Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks (Madrid Protocol) is an international treaty that allows a trademark owner to seek registration in any of the countries that have joined the Madrid Protocol by filing a single application, called an "international application." The International Bureau of the World Intellectual Property Organization, in Geneva, Switzerland administers the international registration system.

The Madrid Protocol is one of two treaties comprising the Madrid System for international registration of trademarks. The Madrid Protocol is a filing treaty and not a substantive harmonization treaty. The Madrid Protocol provides a cost-effective and efficient way for trademark holders to ensure protection for their marks in multiple countries through the filing of one application with a single office, in one language, with one set of fees, in one currency. Additionally, no local agent is needed to file the application.

While an International Registration may be issued, it remains the right of each country or contracting party designated for protection to determine whether or not protection for a mark may be granted. Once the trademark office in a designated country grants protection, the mark is protected in that country just as if that office had registered it. The Madrid Protocol also simplifies the subsequent management of the mark, since a simple, single procedural step serves to record subsequent changes in ownership or in the name or address of the holder with World Intellectual Property Organization's International Bureau. The International Bureau administers

the Madrid System and coordinates the transmittal of requests for protection, renewals and other relevant documentation to all members.

The resulting "international registration" serves as a means for seeking protection in member countries, each of which apply their own rules and laws to determine whether or not the mark may be protected in their jurisdiction. Neither the Madrid Protocol nor the Madrid Agreement provide for registration of an "internationally effective" trademark.

Any trademark owner with an application filed in or a registration issued by the USPTO and who is a national of, has a domicile in, or has a real and effective industrial or commercial establishment in the United States can submit an international application through the USPTO.

In order to file an international application through the USPTO, an applicant must have a U.S. application, called a "basic application" or a U.S. registration, called a "basic registration." The mark and the owner of the international application must be the same as the mark and the owner of the basic application or registration. The international application may be based on more than one USPTO application or registration provided the mark and the owner are the same for each basic application and/or registration.

The international application must include a list of goods and services that is identical to or narrower than the list of goods or services in the basic application or registration. The international applicant must pay the U.S. certification fee(s) at the time of submission and identify at least one Contracting Party in which an extension of protection (that is, registration in a Contracting Party) is sought.

The international application must be filed through the USPTO. The USPTO must certify (review and confirm) that certain information in an international application based on a U.S. basic application or registration is the same as the information contained in the basic application or registration. The USPTO will then forward the international application to the International Bureau.

An international applicant must pay fees to the USPTO and to the International Bureau. The USPTO charges a fee for certifying international applications and transmitting them to the International Bureau, called a "certification fee." The certification fee is $100.00, per class, if the

international application is based on a single U.S. application or registration. The certification fee is $150.00, per class, if the international application is based on more than one U.S. application or registration. An international application may be filed electronically using the TEAS system for International Applications.

If the international application meets the requirements of 37 C.F.R. §7.11(a), then the USPTO will certify that certain information in the international application is the same as the information in the U.S. basic application or registration and forward the international application to the International Bureau.

If the international application does not meet the requirements of 37 C.F.R. §7.11(a), then the USPTO will not certify the international application. The USPTO will notify the international applicant of the reasons why the international application cannot be certified. The certification fee is not refundable. The international applicant may promptly resubmit a corrected international application based on the same U.S. application or registration. The certification fees must be included with the new submission.

Note that certification by the USPTO is only to ensure that the international application is properly based on a U.S. application or registration and to validate the date of receipt of the international application by the USPTO. The International Bureau must still review the international application to determine whether it meets the Madrid Protocol filing requirements. If the requirements are met and the fees paid, the International Bureau will then register the mark, publish it in the *WIPO Gazette of International Marks* (WIPO Gazette), send a certificate to the international applicant, now called "holder of the international registration", and notify the Offices of the Contracting Parties designated in the international application.

If the Madrid Protocol filing requirements have not been met, the International Bureau will send a notice to both the USPTO and the international applicant that explains the problems with the application. These notices are referred to as "Notices of Irregularity." Responses to irregularity notices must be received by the International Bureau within the time period indicated in the irregularity notice. Certain irregularities may require remedy by the USPTO as the office of origin. In such cases, the applicant must respond to the irregularity and submit the response to

the USPTO. The response will be reviewed, and if acceptable, forwarded to the International Bureau.

The date of the international registration is the date of receipt of the international application in the USPTO provided that the International Bureau receives the international application within two (2) months of the date of receipt in the USPTO. If the International Bureau does not receive the international application within two (2) months of the date of receipt in the USPTO, the date of the international registration will be the date of receipt by the International Bureau.

A claim of priority in an international application may be based on a U.S. application in accordance with Article 4 of the Paris Convention even if the filing date of the basic application precedes the implementation date of the Madrid Protocol in the United States. The international application must both: (1) assert a claim of priority; and (2) be filed in the USPTO within six (6) months after the filing date of the basic application that forms the basis of the priority claim.

Once the International Bureau registers the mark, the International Bureau will notify each Contracting Party designated in the international registration of the request for an extension of protection to that country. Each designated Contracting Party will then examine the request for an extension of protection the same as it would a national application under its laws. If the application meets the requirements for registration of that country, then the Contracting Party will grant protection of the mark in its country.

There are strict time limits for refusing to grant an extension of protection (a maximum of 18 months). If a Contracting Party does not notify the International Bureau of any refusal of an extension of protection within the time limits set forth in Article 5(2) of the Madrid Protocol, the holder of the international registration is automatically granted protection of its mark in that country. The holder of an international registration may designate additional Contracting Parties in a subsequent designation. A subsequent designation is a request by the holder of an international registration for an extension of protection of its international registration to additional Contracting Parties. A subsequent designation may also be used to extend protection to goods or services that were not originally extended to the previously designated Contracting Parties. For example, if a trademark owner sought international registration of five classes of

goods and services, but limited the initial designation to only one class of goods to the identified Contracting Parties, the holder of the international registration can later designate any or all of the goods/services covered by the international registration to both those countries previously identified or to new countries designated in the subsequent designation.

An international registration lasts for ten years from the date of registration and may be renewed for additional 10-year periods by paying a renewal fee to the International Bureau.

D. LABEL DESIGN AND ARTWORK COPYRIGHT.

Wineries and vineyards should take steps to secure copyright ownership in their design marks. While a distinctive design mark merits protections under trademark law, it also can be protected by copyright law if it contains the requisite originality and creativity. Obtaining and registering copyrights in design marks can provide a company with a powerful tool against infringers.

A design mark is any symbol or device that identifies a company's goods or services and distinguishes them from those offered by others, such as the Nike Swoosh, the Starbucks green siren logo and the Morton Salt Girl. A design mark may be subject to copyright protection if it possesses at least a modicum of creativity. Mere variations of typographic ornamentation, lettering or coloring, for example, are not copyrightable.

Trademark and copyright protections differ in scope. Copyright owners have the exclusive right to control reproduction and other exploitation of the copyrighted artwork for a set period of time—generally, the life of the author plus 70 years. Unlike copyright protection, trademark protection in a distinctive mark lasts as long as it is used in commerce. Copyright law allows a copyright owner to prevent intentional copying of its work in any medium; whereas, a trademark owner may only prevent use of its trademarks in more limited circumstances, such as when that use creates a likelihood of confusion as to source or affiliation. Simply reproducing a trademark does not constitute trademark infringement.

In some cases, a copyright claim may be a company's only course of action against an infringer. For example, a company that abandons use of its design mark may not have grounds for a trademark infringement claim against an infringer; however, if it owns the copyright in the

design, it may have a claim for copyright infringement. Copyright law may also be used to prevent copying of a company's designs in international territories where trademark law is less developed or where a company has not made use of the mark. And in cases where both copyright and trademark rights are infringed in a single act, a party may be entitled to monetary relief under both statutes.

While copyright protection in design marks has many benefits, the first step is securing ownership and registration. A company generally owns the copyright to artwork designed by its employees within the scope of employment. Oftentimes, however, companies hire independent contractors to create the artwork. Absent a written agreement to the contrary, simply commissioning an outside designer to design artwork does not give a company copyright ownership in that work.

Why? Because under the 1976 Copyright Act, copyright vests in the author *at the moment* the "original work of authorship" is "fixed in any tangible medium of expression." Thus, as a general rule, the owner of the copyright is the party who actually creates the work. While copyright law provides some exceptions to this rule through the "work made for hire" doctrine those exceptions are limited and do not apply where a company commissions an independent contractor to create artwork for branding purposes. Thus, absent a written agreement to the contrary, copyright in the artwork vests in the independent contractor—not the company that commissioned the artwork.

The fact that the designer still owns the copyright in the work does not necessarily preclude a company from using it. A nonexclusive license to use the artwork is generally implied if the parties' conduct indicates an intent to grant such permission. But the implied license may be limited in scope and, since it's nonexclusive, it will not prevent the designer from licensing the image to another company. Moreover, nonexclusive licensees do not have standing to sue for copyright infringement. Obtaining all of the exclusive rights in the artwork afforded under copyright law ensures control over how often and in what manner the artwork is used.

A company should enter into a consulting agreement with the designer before any work begins. The consulting agreement should outline the scope of the project and the parties' expectations. The agreement should transfer and assign to the company and its successors the

entire right, title and interest to all works (including drawings and drafts) created in performing the project. The designer also should agree to execute all documents necessary to secure the company's rights in the commissioned work. If you are working with a sophisticated design firm, it may have its own general contract. Be sure to review it closely to ensure that the entire copyright is assigned to your company, and that it includes the appropriate representations and warranties. Once the work is completed, it is good practice to have a separate simple copyright assignment executed that specifically details the works that are the subject of the copyright assignment.

While registration is not necessary for copyright protection, it is required for a U.S. copyright owner to bring a suit for copyright infringement in U.S. federal courts. Moreover, there are substantive advantages for early registration. If registration is made within five years after first publication of the work, the registration constitutes *prima facie* evidence of the validity of the copyright and the facts contained in the registration certificate. Another incentive for early registration is that copyright owners may seek to recover statutory damages or attorney's fees for any infringement that occurs after registration, but not before. If the designer already filed for copyright registration in the design, be sure to record the executed assignment with the Copyright Office.

Copyright protection can offer brand owners another weapon against infringers. Don't wait until an infringer comes along to find out that your company does not own the copyrights in its design marks.

E. UNIQUE TRADE DRESS.

Trade dress is the overall commercial image (look and feel) of a product or service that indicates or identifies the source of the product or service and distinguishes it from those of others. Trade dress may include the design or configuration of a product, the labeling and packaging of goods, and/or the décor or environment in which services are provided. Trade dress can consist of such elements as size, shape, color and texture, to the extent such elements are not functional.

Trade dress in both products and services is protectable to varying degrees. Trade dress was traditionally viewed as applicable to products, and trade dress for product packaging is

generally more readily recognized as being distinctive and entitled to protection. More recently, however, in the United States, trade dress protection has expanded applies to the "total visual image" where services are concerned.

In the United States, trade dress may be protected via common-law rights (acquired through use in commerce) and/or by registration (discussed below). It is advisable for trade dress owners to include in marketing materials an explicit notice of their trade dress claim.

In the Asia-Pacific (APAC) countries and the European Union (except in common-law countries), trade dress is, as a rule, protected only by registration as a trademark and is protected specifically through an action for passing off. Unfair competition and parasitism indirectly provide a basis for additional protection, in particular in continental Europe and in general in the APAC countries.

An application to register trade dress with the U.S. Patent and Trademark Office (USPTO) must include all of the same content as any other trademark application, including a description of the trade dress, identification of the products and/or services to be covered and payment of the appropriate fee. Substantively, the trade dress must be both distinctive (i.e., recognizable to consumers as source identifying) and nonfunctional (i.e., not be essential to the use or purpose of the product or service and not affect the cost or quality of the product or service). Functional trade dress is not registrable even if it is distinctive.

With regard to distinctiveness, the USPTO distinguishes between product packaging trade dress, which may in some circumstances be inherently distinctive, and product design trade dress, which is not inherently distinctive. When in doubt as to whether the trade dress is product packaging or product design, the USPTO will hold it to be product design trade dress and thus not inherently distinctive. Trade dress that is not inherently distinctive may be registered on the U.S. Supplemental Register or, upon a showing of secondary meaning, on the U.S. Principal Register. Even if the trade dress is found sufficiently distinctive, its scope of protection often is limited to avoid protecting a genre.

In the United States, trade dress, like a trademark, is protectable under the federal Trademark Act (the Lanham Act). If the trade dress is unregistered, the first hurdles that the trade dress owner must clear are articulating which aspects of its product or packaging constitute trade

dress and establishing that the trade dress is protectable. The trade dress owner must then establish that there is a likelihood of confusion. Similarity would be evaluated by considering the similarity of the respective trade dress designs. All other likelihood-of-confusion factors are generally the same as in a case comparing traditional trademarks or logos. Trade dress rights may be enforced through a federal district court action or through an opposition or cancellation proceeding before the USPTO's Trademark Trial and Appeal Board (TTAB).

F. DOMAIN NAME AND OTHER INTERNET-RELATED ISSUES.

If a winery or vineyard owner is not adequately prepared, there are a number of common mistakes which can result in the permanent loss of their domain name. Owners of multiple domain names are particularly at risk of loss.

The first risk of loss scenario is the inadvertent expiration of the domain name registration. In this situation, the legitimate owner of the domain name does not renew the name in time and it is snatched up by a domain speculator. This is often caused by failure to receive renewal notices because of out of date contact information. Most domain name registrars and hosts send notice by email only, so if the owners e-mail address is out of date, you will not receive renewal notices. This problem is further compounded by your registrar's inability to warn you that your domain is about to be deleted.

Once deleted, domain names are commonly snatched up within seconds by speculators running automated programs. Some speculators offer to sell them back to the original owners for greatly inflated prices, others point the domain name to a money making web site hoping to capitalize on the domain name's traffic.

The second risk of loss is domain name hijacking or theft. In this situation, a domain hijacker effectively 'steals' the domain by submitting a fraudulent registrar transfer request and tricking an unsophisticated domain owner or registrar into giving them control of the name. Once the hijacker has control of the name, they will usually assume ownership of the domain and start redirecting it to their own web sites. It is also quite common for hijackers to ransom off domain names and redirect traffic to explicit web sites (both for profit and shock value). At this point, legal options can be expensive and time consuming. Since the domain has been transferred away from the domain owner's original registrar, this registrar is often powerless in assisting.

Domain hijackers are aware of this and commonly transfer domains to countries far away from the original owner, making legal recourse cost prohibitive.

The third risk of loss scenario is due to inaccurate contact information. Under Section 3.7.7.2 of ICANN's Registrar Accreditation Agreement, a domain name can be cancelled if the domain name information is not accurate and the owner of the domain name fails to respond to a registrar's inquiries within fifteen days.

Simply put, internet domain name owners can protect themselves by keeping accurate track of their domain names' expiration dates and keep their contact information up to date. As previously discussed, most inadvertent domain expirations and many fraudulent transfers are due to out of date contact information.

If the winery or vineyard has more than one domain name, consider consolidating the domain names with a registrar who offers domain name portfolio management features. This will allow the owner to use one master account to see all of their domain names (and their expiration dates) at a glance, as well as make changes to all of their domains at once. Some registrars are now offering free options such as automatic expiration date tracking and auto-renewal as additional safeguards.

The second level of protection is to be careful and deliberate in who is listed in the contact information for the domain name. The winery or vineyard owner, or the owning entity should always be listed as the organization and administrative contact for the domain name. Along these lines, when registering corporate domain names, make sure that the company name is listed as the owner of the domain. Do not allow an outside web site designer or host to be listed as either the domain owner or administrative contact. Whenever possible, the business owner or a senior executive should be listed as administrative contact since this person will be authorized to modify or change ownership of company domain names.

Additionally, the domain name owner should check with the host or registrar to see if a registrar lock is available. This will lock the domain name record at the registry level and prevent it from being transferred, modified or deleted by a third party. This feature is very helpful in protecting the domain name against unauthorized transfers and hijacking. If the owner's current registrar does not offer this feature, consider transferring your domains to one

who does**.** Since a 'registrar lock' can also make it more difficult for the domain name owner to transfer away from a registrar, the domain name owner should look for a registrar that gives them the ability to automatically unlock their domain names at any time without having to call or e-mail them.

As with any level of internet security, be wary of potential phishing scams. This is done, primarily, by not replying to, or clicking on any links, in any domain name-related email correspondence from an email address that is unknown. Also be careful not to reply to any 'official looking' renewal notices received in the mail from companies not recognized. Domain hijackers and unscrupulous registrars have been known to submit mass amounts of transfers hoping that a small percentage of confused registrants will accidentally confirm the transfers. When in doubt, contact your original registrar to verify any suspicious messages. At this level, it is prudent to make sure that the registrar's domain name is added to the spam filter's 'approved sender' list. If you (or your ISP) are using a spam blocking service, you run the risk of not receiving domain renewal notices from your registrar if they are incorrectly categorized. You can prevent this from occurring by adding your registrar to your list of 'approved senders'. This will automatically bypass any filtering and ensure that all renewal notices make it straight to your inbox.

Finally, if your domain name is critical to your business and is one you will want for years to come**,** consider renewing your domain registration in five year increments. This will avoid yearly registration hassles and prevent your domain from accidentally expiring.

Ethics

Submitted by Lindsey A. Zahn

Section 1: Jurisdictional Issues

(a) *Advising Clients from Multiple States on Individual State Laws*

Many attorneys who advise across state lines face Unauthorized Practice of Law issues when applying or advising on laws of states in which they are not licensed.[1] Much of this is attributed to an increasingly global economy and the use of technology to remove geographical barriers from clients and their attorneys.[2] These concerns are particularly acute in the wine industry.

In the wine industry, it is not uncommon for larger wine companies to engage in highly regulated activities in states where they have no physical presence. For example, many wineries choose to directly ship their wines to consumers in one of the many states allowing direct shipment of wine. Often, these wineries seek legal advice on direct shipment of these products to consumers, *i.e.*, what the legal relationship is of the state where the consumer is located; the type of contractual agreement to pursue; whether the winery needs to be licensed within that particular state to ship wine; the reporting requirements for tax and other liability purposes and so on. Most wineries or vineyards do not have in house counsel and instead look to outside counsel to spearhead multi-jurisdictional issues or projects. The abovementioned issues require the lawyer to review local and state Alcohol Beverage Laws, as well as draft, negotiate, and review contracts involving multistate parties.

Another example that is particularly prevalent in the wine industry is advising clients on state licensing and labeling. Often, a federal label approval or federal basic permit is the

[1] To view the Unauthorized Practice Rules of Virginia, see *Unauthorized Practice Rules*, VIRGINIA STATE BAR, *available at* http://www.vsb.org/pro-guidelines/index.php/unauthorized-practice-rules/. For full text of Virginia State Bar UPL Opinions, see *UPL Opinions On-Line, Numeric Index*, VIRGINIA STATE BAR, *available at* http://www.vsb.org/site/regulation/upl-opinions-on-line-numeric-index.

[2] *See generally* Bruce A. Green, *Assisting Clients with Multi-State and Interstate Legal Problems: The Need to Bring the Professional Regulation of Lawyers into the 21st Century*, AM. BAR ASSOC., *available at* http://www.americanbar.org/groups/professional_responsibility/committees_commissions/commission_on_multijurisditional_practice/mjp_bruce_green_report.html#Introduction (discussing the expansion and evolution of law practice).

absolute minimum for winery licensing and labeling compliance. Most states require that a winery (or a wine company) to also be licensed on the state level. In addition, many states require that a wine label be approved by the state Alcohol Beverage Control Agency if the wine is to be sold within that state.

In these states, a federal approval of a wine label is a necessary but not a sufficient condition. The issue thus arises whether a lawyer admitted in one state can advise a client on labeling, licensing, and distribution issues of another state. Perhaps the distinction here is that lawyers need not be retained when a wine business seeks a license in one state or needs a label approval from one state; non-lawyers can actually perform the aforementioned tasks with respect to licensing and the filing of label approvals. A federal winery basic permit, like many other aspects of federal or (some) state compliance, need not be filed by an attorney.

Traditionally, it has been assumed that a lawyer licensed in one state will—generally speaking—be better qualified to serve a client on state matters than an attorney licensed in a foreign state.[3] Followers of this belief reason that the attorney licensed within the state is more likely to have studied the state law prior to admission, as well as gained experience in practice as an attorney.[4] However, others believe that eliminating geographic limits, with respect to jurisdictional practice, can promote the interest of clients and that the regulatory concerns that warrant such limitations can be upheld without jurisdictional practice limitations.[5] For an example, it is believed that an attorney admitted to practice in one state will only pursue work in another jurisdiction which he or she is competent to handle, just as the attorney would not handle in-state matters he or she was not capable of handling.[6] As with practicing within his or her admitted state, the

[3] *See Client Representation in the 21st Century: Report of the Commission on Multijurisdictional Practice*, AM. BAR ASSOC. CENTER FOR PROF. RESPONSIBILITY, *available at* http://www.americanbar.org/content/dam/aba/migrated/final_mjp_rpt_121702_2.authcheckdam.pdf.
[4] *Id.* at 15.
[5] *Id.* at 14.
[6] *Id.*

lawyer would be subject to disciplinary actions, as well as risk corroding his or her reputation, should the attorney handle the matter incompetently.[7]

The takeaway is that, before taking on a multijurisdictional project, an attorney should review the laws of both the state in which the attorney is admitted and practicing as well as the state in which the attorney is looking to extend his or her practice. Review local laws and regulations to obtain a more adequate understanding of what is expected in your jurisdiction.

(b) *The Growth of Virtual Law Offices*

A virtual law office is a lawyer or a group of lawyers who meet the legal needs of clients through use of a secure Internet portal, e-mail, and technological tools.[8] Operating a virtual law office involves issues that are present in regular law offices with a physical presence: confidentiality, competence, communication with clients, and other ethical issues impacting the practice of law. However, when operating a virtual law office, such lawyers should pay particular attention to two jurisdictional issues: (1) where the lawyer is physically located and (2) where the lawyer is providing legal services. While some may argue a virtual office is not a physical office established within the state,[9] the safer and more ethical practice is to ensure one is barred in the state where he or she is physically located if operating a virtual law office.

Virtual law offices are not exclusive to law practices dedicated to serving the wine industry. However, such offices may be more common when servicing businesses across multistate lines, such as with wine clients, especially when the attorney does not actually meet with the client as his or her desk. Depending on the wine lawyer's practice, it may

---

[7] *Id.*

[8] For more information on Virginia's stance on virtual offices and executive office suites, see Virginia State Bar, Virtual Office and Use of Executive Office Suites, Legal Ethics Op. 1872 (2013), *available at* http://www.vacle.org/opinions/1856.htm.

[9] *See generally What Everyone's Missing in the Virtual Law Office Debate*, STUART TEICHER, Feb. 7, 2014, *available at* http://www.stuartteicher.com/Trends/?p=468 (discussing the opinion of various states with respect to maintaining a physical office address in the context of virtual law offices).

be common to have clients from a variety of states or even countries. This is especially true with larger clients who have interest in national distribution, engage in contractual relationships with businesses in several states, offer direct shipping to consumers in multiple states, or have businesses or property physically located in several states. The issues of such wine clients will likely cross state lines and involve multistate legislation, and the physical presence of the attorney may not necessarily be within the client's state or any of the states in which the client is engaging in business with these types of clients. Some attorney think it easier to offer an online portal to stimulate discussions and transfer of documents and materials, especially when such cannot occur in an actual office. As a result, it is important for an attorney to understand the ethical considerations and concerns if practicing on a virtual level.

We see shades of this issue in a recent disciplinary order on behalf of the Virginia State Bar. A Virginia disciplinary panel determined that lawyer Atchuthan Sriskandarah should be reprimanded for advertising and operating his virtual law firm in violation of Virginia's Rules of Professional Conduct.[10] The attorney was licensed to practice in Virginia and represented his firm to contain multiple attorneys in at least six offices in three different states.[11] In actuality, the attorneys associated with his firm were independent contractors for tax purposes. Further, the Bar found the firm to have a single office in Fairfax, Virginia and the remaining offices to be virtual.[12] The Bar raised the concern that Mr. Sriskandarah's law firm was not, in fact, a firm comprised of attorneys employed by him, but rather a group of independent contractors that were not under his control or supervision.[13] The Virginia panel decided that Mr. Sriskandarah's conduct violated the Rules of Professional Conduct.

[10] *See* Virginia State Bar v. Sriskandarah, Case No. CL 2012-4137 (VSB Docket 10-022-081527) (Cir. Ct. Fairfax County, June 28, 2012), *available at* http://www.vsb.org/docs/Srisk-082712.pdf.
[11] *Id.*
[12] *Id.*
[13] *See generally*, *id.* at 2–7 (detailing the fact findings of the Mr. Sriskandarah's website and advertisements).

Mr. Sriskandarah was issued a public reprimand for violating Rule 7.4, Communication of Fields of Practice and Certification.[14] The failure to honestly advertise or communicate office locations, relationships with staff attorneys, and the staff attorneys' practices seems to be the predominant reason why the Virginia hearing panel recommended the attorney be reprimanded.[15]

* * *

The above are just several examples of what an attorney practicing across state lines should be aware. There are other, relevant issues to be concerned about, but the aforementioned are most pertinent to a wine industry practice.

[14] *See* Virginia State Bar v. Sriskandarah at 7.
[15] *See generally id.* at 7 (discussing Rule 7.4 of the Rules of Professional Conduct as the primary violation).

Section 2: Engagement Agreements and Scope of Representation

I. Engagement Agreements

An engagement agreement, also called a retainer, is good legal practice for all clients. Generally speaking, these contracts should be written and they should clearly and carefully define the range and capacity of the relationship. As noted by Marian C. Rice, this written agreement not only limits the attorney's duty to the client, but can also avoid misconception on behalf of the attorney or the client, as well as limit the possibility of a dispute between the parties.[16] To reduce confusion or misunderstandings, the attorney-client relationship should include (inter alia):

- Client's identity;[17]
- A description of the work covered by the fee or hourly rate (scope of the representation);[18]
- The amount of the fee or hourly rate;[19]
- Out-of-pocket costs (generally, the lawyer will want to represent that additional out-of-pocket costs may apply on top of the lawyer's hourly rate or fee);[20]
- Agreement of the client to cooperate and be truthful;[21]
- Either party's right to terminate services;[22]
- Consequence of non-payment;[23]
- No guarantee of particular results on behalf of the attorney;[24] and

[16] *See* Marian C. Rice, *Engagement Letters: Beginning a Beautiful Relationship*, 39 LAW PRAC. MGMT., no. 3, 2013, *available at* http://www.americanbar.org/publications/law_practice_magazine/2013/may-june/ethics.html.
[17] *Id.*
[18] *Id.*
[19] *Id.*
[20] *Id.*
[21] *Id.*
[22] *Id.*
[23] *Id.*
[24] *Id.*

- Signature (of both the attorney and the client).[25]

Some of the more important aspects of the engagement agreement are discussed in the following section. Note that lawyers should consult local rules before drafting an engagement agreement.

II. Scope of Representation

(a) *Defining the Scope of Representation*

The scope of representation is one of the most important—if not, the most important—concept in the engagement agreement with clients. Malpractice suits often arise over disagreement as to the attorney's scope of representation.[26] At times, a client may assume the attorney's representation will cover other aspects that have not necessarily been discussed or agreed upon. Alternatively, the client may have limited objectives for the lawyer's representation.

This issue frequently arises for wine lawyers. Working as a wine lawyer is an industry-specific practice and generally entails a particular area of training—such as trademark law, litigation, corporate law, licensing and compliance, real estate, etc. Wine clients are businesses that have general business needs (*i.e.,* business formation, contractual agreements, trademarks, licensing) from attorneys, but their products are also subject to specific regulations (*i.e.*, federal or TTB regulations, state regulations, local regulations) that play a significant role in how their businesses survive and thrive.

---

[25] For more information and discussion, see *id.*

[26] For example, the Crews law firm was hired by a client and sued for malpractice. "The Court reviewed the engagement letter and found that the letter was clearly drafted, providing a successful defense to the allegation of a duty of due diligence . . . . The Court also rejected the client's assertion that the law firm had invalidly limited its representation without consent, finding instead that the law firm had properly created a narrow and clear scope of representation in the engagement letter." A Clearly Drafted Engagement Letter Can Limit the Scope of Attorney's Duties, Hinshaw & Culbertson, Jan. 19, 2012, *available at* http://www.hinshawlaw.com/newsroom-publications-alerts-109.html (discussing *SCB Diversified Municipal Portfolio et. al. v. Crews & Associates et. al.*, 2012 WL 13708 (E.D. La. Jan. 4, 2012)) (emphasis added).

While "wine law" itself may be a very specialized and specific practice of law, the practice also incorporates general legal skills. Whereas most wine attorneys in the U.S. focus on a specific area that affects wine industry clients, it is important to keep in mind that many wine attorneys do not practice—and thus cannot represent clients—in all areas of law. In fact, many law firms that cater specifically to alcohol beverage clients do not offer a full range of legal services. For example, the winery may have zoning needs and require a real estate or zoning attorney, but the firm hired may not focus on or have experience in this area. Thus, it is particularly important to craft a written agreement with wine clients that carefully outlines the scope of representation because the range of services on behalf of the attorney or the firm can also be limited themselves. As mentioned above, lawyers should consult local rules before limiting the scope of representation.

Additionally, another important aspect to note is the general level of client sophistication. When working with wine clients—who tend to be smaller businesses—their level of sophistication may be limited. In other words, such clients generally do not have an in house counsel and may instead rely on your firm for all legal matters. If the firm can offer a full range of legal services, working with these wineries and vineyards may be a great way to maximize client relationships to a great benefit to the firm. On the downside, the client may also think the firm is covering all aspects of legal representation, which can be troublesome if the firm is not full service and/or if the scope of representation was limited by an agreement. Be sure to review local rules, as mentioned above, for more commentary.

(b) *Tips on Defining the Scope of Representation and Ethical Considerations*

Defining Scope of Representation Tips

- Define the scope of legal representation clearly in writing with an engagement letter. The engagement letter is the most common way to define the scope of representation of a client.[27]
- Make sure the written agreement limits the degree of the attorney's obligation and can avoid disputes as to whether a specific service was within the capacity of representation or collateral to the attorney's undertaking.[28]
- An engagement letter should outline the matters or issues that are being addressed—such as why the attorney is being engaged by the client—as well as identify non-contracted or unconsented matters in which the attorney will not be involved.[29] Collateral matters must be reviewed and discussed with the client at the outset of representation.[30]
- The engagement letter should advise the client to obtain additional or other legal representation on non-contracted or unconsented to matters.[31]
- The client must consent to the scope of representation and the exclusion of the collateral matters from the outset of representation.[32]
- If the attorney cannot fulfill the client's objectives of legal representation, the lawyer should decline representation.[33]
- The agreement need not be long; if anything, the aim is for the client to *read* and *understand* the context of the agreement. It should be easily read in one sitting.[34]

ABA Model Rule of Professional Conduct 1.2(c)

---

[27] *See generally* James R. Kahn, Esq. and James M. Prahler, Esq., *Defining the Scope of Representation is a Necessary Element of Any Attorney-Client Relationship*, THE HARMONIE GROUP, *available at* https://www.harmonie.org/user_documents/AJGLegalMalArticle7.pdf (discussing steps for defining the scope of an attorney-client relationship).
[28] *Id.* at 1.
[29] *Id.* at 3.
[30] *Id.*
[31] *Id.* at 3 –4.
[32] *Id.* at 4.
[33] *Id.*
[34] *See generally* Brian Tannebaum, *The Practice: Do You or Your Client Understand the Scope of Representation? (Part I)*, ABOVE THE LAW, Jan. 23, 2012, *available at* http://abovethelaw.com/2012/01/the-practice-do-you-or-your-client-understand-the-scope-of-representation-part-i/ (discussing clarity and length of an attorney-client engagement letter).

The ABA Model Rule of Professional Conduct 1.2 applies to the limitation in scope of representation between a client and lawyer.

> **Rule 1.2**. Scope Of Representation And Allocation Of Authority Between Client And Lawyer. Section (c). A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent.[35]

Commentary on Rule 1.2(c)

According to commentary on Rule 1.2(c), the scope of representation can be limited by agreement with the client *or* by the terms under which the lawyer's services are made available to the client.[36]

The model rule provides the client and the lawyer with great latitude to define the scope of representation. However, the Rule itself does not provide a definition for or clarity to the rather subjective term "reasonable under the circumstances." What does "reasonable under the circumstances" mean? Limited scope is not appropriate for every matter, every issue, every attorney, nor every client. This type of relationship should be discussed with the client from the outset to analyze the client's needs and whether a limited scope relationship makes sense when representing the specific client. See local rules and commentary to implement workloads.

(c) *Offering Discrete Task or Unbundled Representation (Types of Limited Representation)*

One type of limited scope representation is discrete task or unbundled representation. Unbundling is a means by which the lawyer:

---

[35] MODEL RULES OF PROF'L CONDUCT R. 1.2, *available at* http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/rule_1_2_scope_of_representation_allocation_of_authority_between_client_lawyer.html.

[36] MODEL RULES OF PROF'L CONDUCT R. 1.2 cmt., *available at* http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/rule_1_2_scope_of_representation_allocation_of_authority_between_client_lawyer/comment_on_rule_1_2.html

> [B]reaks down the tasks associated with a client's legal matter and provides representation only pertaining to a clearly defined portion of the client's legal needs. The client accepts responsibility for doing the footwork for the remainder of the legal matter until reaching the desired resolution.[37]

This model has become increasingly popular as some clients try to cut costs to meet their business needs. In discrete task representation, responsibilities for a legal matter are divided between the attorney and client on an issue-by-issue basis or—more frequently—projects or tasks are allocated between the attorney and client.[38]

If offering discrete task representation, an attorney must still be mindful of his/her legal and professional or ethical obligations. The attorney should also make sure the client is not biased if offered only unbundled representation. Be clear with the client as to what services will be offered and what services will not be offered in discrete task representation. Further, the attorney is still obligated to comply with the same fiduciary duties, such as those of loyalty and confidentiality, as attorneys providing full service legal representation.[39] Review local rules for further information.

Discrete task representation is common in the wine industry, especially as law firms shift to focus on specific areas of practice. Often, the client prefers a discrete task relationship because the client may not need to hire the lawyer for a full range of services normally offered by the lawyer's firm. In some ways, this helps the client pick and choose and

---

[37] Stephanie L. Kimbro, *Law a la Carte: The Case for Unbundling Legal Services*, 29 LAW PRAC. MGMT., no. 5, 2012, *available at* http://www.americanbar.org/publications/gp_solo/2012/september_october/law_a_la_carte_case_unbundling_legal_services.html.

[38] *Id.*

[39] For a very broad overview, *see generally*, *Virginia State Bar Council To Review Proposed Amendments To Rules 1.2 & 4.2 Of The Rules Of Professional Conduct And Rule 1:5 Of Rules Of Supreme Court Of Virginia*, VA LAWYER, Apr. 2005 at 17, *available at* http://www.vsb.org/publications/valawyer/apr05/prop_rules.pdf. *See also* VIRGINIA STATE BAR PROFESSIONAL GUIDELINES R. 1.2 (2011), *available at* http://www.vsb.org/pro-guidelines/index.php/rules/client-lawyer-relationship/rule1-2/.

customize services to meet his or her individual needs. Effectively, this helps to offer increased access to affordable legal services.

A discrete task relationship can also benefit the client with respect to billings. Often, a firm may choose to offer discrete task representation at flat rates as opposed to the traditional billable hour. Flat rates can help a client feel he or she is attaining the most value for work completed and can also strike the fear that a client might be charged for every communication with the lawyer. In other words, offering a flat rate where the client knows and expects a particular price can help to stimulate conversation between the client and lawyer, which can be beneficial to both parties. This practice can also be beneficial to firms for smaller projects with shorter timelines. In the wine law, flat rates for discrete tasks are often seen when representing clients in matters like licensing, labeling, and formulation in front of the federal or state alcohol beverage agency, as well as with trademark registration and even business formation.

This type of service is also often beneficial to wine industry clients because it provides affordable access to legal services. Clients in the wine industry are often small businesses—sometimes even startup businesses—who may (at times) make it a priority to control external costs (especially legal fees). Flat fee services or unbundled legal representation can be beneficial to wine clients for this very reason.

Offering unbundled services can also help a smaller firm to focus its practice in a particular area and to maximize its potential as opposed to offering a full range of services. Further, offering this type of service can help the firm expand its client base and gain a client the firm may not have otherwise had access to if the firm charged an hourly rate for its services or did not offer a discrete task service. If the client is smaller in size, there is also potential to grow and expand the attorney-client relationship as the client's business grows and expands. To be cost effective to the firm, however, it is important to

maintain the scope of the work and set up controls should the client request an extension of the services or should the client's needs step outside of the pre-defined scope.[40]

* * *

A wine lawyer must be aware that working with industry clients often means catering to the needs of smaller—and sometimes startup—businesses. Alas, the business structure of the attorney's firm and services should be designed to best match the necessities of these very unique companies. Often, such entails limiting the scope of the relationship or of the attorney's services, or offering discrete task services. An attorney who models his practice to include a limited scope relationship should consider the above, as well as local or jurisdictional, ethical concerns.

[40] David L. Hudson Jr., *What Ethics Issues to Consider When Offering Unbundled Legal Services*, ABA JOURNAL, June 1, 2013, *available at* http://www.abajournal.com/magazine/article/lawyers_offering_unbundled_legal_services_must_consider_the_ethics_issues/.

Section 3: Avoiding Problems During Client Representation

The alcohol beverage industry is an extremely small industry. As such, one of the caveats of working with clients from such an intricate network is that a lawyer can and will run into problems. Problems can range from conflict of interest issues where one client may wish to sue another client that the lawyer represents (this issue appears frequently in trademark infringement instances) or revealing confidential information to the wrong party.

(a) *Revealing Confidential Information to the Wrong Party*

Getting an alcohol product to the shelves will often involve many parties. For example, parties can include a bottler or a distiller and a brand owner. The brand owner and the bottler are usually two discreet entities that share the same interests, *i.e.*, to get the product to market on schedule. But, the brand owner and the bottler do have competing interests as well. For example, the brand owner often lacks access to the product's formula, or the product's recipe, because the bottler owns the formula. The distiller or bottler may not want to release the formulation to the brand owner for fear that the brand owner may take the formulation and ask another, competing company with lower prices or quicken turn around time to produce and bottle the product for the brand owner. In such a case, the bottler does not want to reveal the formulation to the brand owner for fear of losing business and/or giving the brand owner more leverage.

The lawyer's predicament is clear: In a relationship like the above, a lawyer will often work with both the bottler to overcome legal or regulatory compliance hurdles and get the product to market and there is a possibility for confusion. Formula approvals on behalf of the TTB are private and confidential information, and formulas—unlike label approvals—are not accessible by the public through a public database. To access the formula, a company or an individual needs to have a specific account login on TTB's formula portal that will link the account to the formula approval, which includes details

about the formula's "recipe." This prevents the public (or even the brand owner) from easily accessing a product's formulation and copying it for their own benefit or to produce a competing product.

Be aware of nondisclosure agreements or conflict provisions between parties. If a lawyer receives a formula approval from TTB, the lawyer must be conscious of which party to send the formula approval. TTB's formal approval of formulas includes the specific ingredients that are found in the product, along with their percentages, and the instructions on how to create the product based on those ingredients. See sample on provided.[41] Therefore, the approval itself contains a significant amount of proprietary information that can instruct the holder of the approval of how to reproduce the product exactly. If the bottler does not want the brand owner to access the formulation, the lawyer must be aware of this and must perform due diligence to make sure that an e-mail or correspondence containing the formula or other proprietary information is never sent to the wrong party. Sending the formula to the wrong party can be a substantial problem, and one that can cause the lawyer to breach his or her duty of confidentiality to the client.

What are the lawyer's ethical obligations in this type of relationship? The duty of confidentiality for all lawyers is outlined in ABA Model Rule 1.6.[42] Rule 1.6 indicates that a lawyer shall not reveal information relating to representation of a client without the client's informed consent.[43] When transmitting communication to a client that includes information relative to the client's representation, the lawyer is required to take reasonable precautions to prevent information from coming into the hands of unintended recipients.[44] In a pre-digital age, sending formula approvals with the exact recipe on how to produce a particular product may have been significantly easier—sending information

[41] Note, however, that this sample is a paper-based formula provided by TTB; currently, most formulas are completed through TTB's online formula system but still experience similar issues. We have refrained from including an online formula approval to protect client information.
[42] MODEL RULES OF PROF'L CONDUCT R. 1.6, *available at* http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/rule_1_6_confidentiality_of_information.html.
[43] *Id.*
[44] *Id.*

via regular mail or discussing on the phone may have been simpler forums through which to convey information. However, in a digital age, when e-mails often have multiple recipients, a lawyer must exercise utmost discretion when sending out confidential information. While this mantra likely applies with respect to all privileged, confidential, or otherwise private information gained through the representation of a client, it is certainly most prominent when secret formulas or recipes are involved. As discussed above, a beverage alcohol lawyer must be particularly aware of differing relationships and interests during representation of a client and pursue all measures possible to avoid sending confidential or propriety information to the wrong party.

Rule 1.6 does not require that the lawyer use a special security measure or measures if the method of communication affords a reasonable expectation of privacy.[45] In the above example, there is a likelihood that—without additional security measures enacted—sending such highly confidential information through e-mail may not meet this burden. Factors to be considered in determining the reasonableness of the lawyer's expectation of confidentiality include the following:

- The sensitivity of the information;[46] and
- The extent to which the privacy of the communication is protected by law or by a confidentiality agreement.[47]

Without a doubt, a company's recipe or formulation is sensitive information. Generally speaking, it is not known to the public and, in the case of alcohol beverages, probably not known to the brand owner. A lawyer should consider whether sending such information through encrypted e-mail is advantageous to his or her practice. To further good practice, the attorney should also review local rules and regulations to obtain clarity on the jurisdiction's view and preferences.

[45] *Id.*
[46] *Id.*
[47] *Id.*

Still, this does not explain the overarching and more important issue: What happens if the attorney inadvertently includes an unauthorized party in the communication when sending a highly confidential formula via e-mail? Even if unintentional, this is doubtlessly a breach of the attorney-client confidentiality duty, and one that may be considered malpractice. As mentioned previously, a small mistake, such as unintentionally sending formula approvals to the wrong party, can cause significant misfortune for the client, especially if the formulation is mistakenly sent to the brand owner. It is worthwhile for an attorney to consider whether unencrypted e-mail is a more ideal means of communication when dispersing confidential information like recipes and formulations. Likely, there are alternative means, such as password protecting the attachment with an access code only the intended recipient knows. Alternatively, regular mail (while not the fastest) may have its advantages. Lawyers should be advised or on notice to check local rules or regulations.

Perhaps use of e-mail signatures with a confidentiality notice or disclaimer can help when a party reveals confidential information to the wrong party. The confidentiality notice varies but generally contains statements similar to, "This e-mail is confidential and intended for the addressed recipient only," and, "If you received this e-mail in error, please contact the system manager." However, Greg Siskind, immigration attorney and first legal blogger, notes the legal effectiveness of such disclaimers is dubious.[48] An attorney should be mindful to check local rules and regulations governing e-mail signature requirements, as such may vary by jurisdiction.

In litigation, this may be most closely associated with clawback agreements, enforceable in some situations when privileged material is inadvertently produced during discovery.[49]

(b) *Representing Clients in a Small Industry*

---

[48] *See* Greg Siskind, The Do's and Don'ts of Email Signature Blocks, 39 LAW PRAC. MGMT., no. 5, 2013, *available at* http://www.americanbar.org/publications/law_practice_magazine/2013/september-october/marketing.html.

[49] *See* Anthony Valiulis, E-discovery: Be sure to "claw back" your privileges, INSIDE COUNSEL, Sept. 4, 2012, *available at* http://www.insidecounsel.com/2012/09/04/e-discovery-be-sure-to-claw-back-your-privileges.

Representing multiple clients within the same, highly competitive industry can cause problems for the attorney and between the attorney and the client. This paradigmatic example is represented when clients have adverse trademark interests. Examples include working two different wines with "Duck" in the brand name.[50] In instances generally involving contractual matters, there is a potential for disputes to arise between both parties and for both parties to request representation. For example, when a firm represents one client for labeling and the second for trademark, and an adverse interest develops between the two, can the firm still represent both clients?

What are the ethical obligations here? ABA Model Rule 1.7 Conflict of Interest: Current Clients notes that an attorney may not represent a client if the representation entails a concurrent conflict of interest.[51] Rule 1.7(a) notes that a concurrent conflict of interest exists if the representation would be "directly adverse to another client," or if "there is significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer."[52] The commentary to Rule 1.7 provides additional insight to the Model Rule.[53] To maximize prudence, attorneys should see local rules and regulations for further clarification.

(c) *Perjury Statements on COLAs*

---

[50] This refers specifically to multiple lawsuits filed on behalf of Duckhorn Vineyards. *See, e.g*., *One "Duck" Too Many? Duckhorn Sues Over Wine Brand*, NAPA VALLEY REGISTER, Jan 12, 2014, *available at* http://napavalleyregister.com/news/local/one-duck-too-many-duckhorn-sues-over-wine-brand/article_face459c-7bdf-11e3-a5ed-001a4bcf887a.html; *see also Duckhorn Asks NY Winery to Modify Label and Sales*, NAPA VALLEY REGISTER, Jan. 24, 2013, *available at* http://napavalleyregister.com/lifestyles/food-and-cooking/wine/duckhorn-asks-n-y-winery-to-modify-label-and-sales/article_d4ccdbca-669a-11e2-b6a1-001a4bcf887a.html.

[51] MODEL RULES OF PROF'L CONDUCT R. 1.7, *available at* http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/rule_1_7_conflict_of_interest_current_clients.html

[52] *Id.*

[53] MODEL RULES OF PROF'L CONDUCT R. 1.7 cmt., *available at* http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/rule_1_7_conflict_of_interest_current_clients/comment_on_rule_1_7.html

Generally speaking, all wines, beers, and spirits within the regulatory jurisdiction of TTB are required to have labels formally approved by the agency. Although not a requirement, a client may ask a lawyer to submit labels to TTB for approval. When submitting these labels—better known as COLA applications—there is a perjury statement at the bottom of the application. The perjury statement reads as follows:

> Under the penalties of perjury, I declare; that all statements appearing on this application are true and correct to the best of my knowledge and belief; and, that the representations on the labels attached to this form, including supplemental documents, truly and correctly represent the content of the containers to which these labels will be applied. I also certify that I have read, understood and complied with the conditions and instructions which are attached to an original TTB F 5100.31, Certificate/Exemption of Label/Bottle Approval.[54]

When submitting a label to TTB for review, the submitter affirms that all statements on the label are true and correct and that the representations on the label truly and correctly represent the content of the wine containers that will bear these labels. This includes the vintage year, the percentage of grape varietals, the wine appellation, and the alcohol by volume percentage. Ethically speaking, how does an attorney know—without chemically testing the wine or obtaining documents that speak for its chemical composition—that what is stated on the label the attorney submits is actually truthful?

Part of the confusion arises from the fact that the regulatory regime assumes non-lawyer filings for labels and formulations. But in practice, it is most often the case that lawyers serve as intermediaries to complete the filings. We see this role conflict in the recent Brunello di Montalcino scandal.

[54] Application for and Certification/Exemption Label/Bottle Approval, Alcohol and Tobacco Tax and Trade Bureau, *available at* http://www.ttb.gov/forms/f510031.pdf.

In 2008, many Italian wine producers were accused of fraudulently bottling Brunello di Montalcino wines using grapes other than the Sangiovese varietal required by Italian law. Italian authorities investigated the claim that many winemakers in the region adulterated their wines by using foreign grape varietals, in violation of the Italian DOCG law. By law, to label a wine as Brunello di Montalcino—one of the most coveted wines among oenophiles and generally sells for well over $50 a bottle—the wine must be produced from 100% Sangiovese grapes. During the 2008 scandal, many wineries in the region were using cheaper varietals, such as merlot and cabernet sauvignon, to cut costs as well as to accommodate the palates of Americans and wine critics. As a result, Sangiovese grapes usually have a flavor profile of sour red cherries with earthy aromas and tea leaf notes. Sangiovese wines usually have medium to high tannins and are highly acidic. Adding other varietals can help "soften" the wine, or assist in creating a wine more acceptable to the palate (and to wine critics). Winemakers in Italy found that Americans preferred a blend of the Sangiovese grapes with softer varietals like merlot or cabernet sauvignon. However, if the winemakers chose to blend the Sangiovese grapes with other varietals, the winemakers could not legally label the wines as Brunello di Montalcino under Italian law.[55]

Irrespective, many winemakers flouted these requirements and labeled the blends as Brunello di Montalcino and exported these wines to the U.S. to accommodate the tastes of the American market. Wines imported into the U.S. are required to have a COLA prior to admission to the U.S., and the Brunello wines were no exception. The U.S. placed an embargo on wines imported from the region for a period of time until the turmoil subsided.[56] It is unclear if the parties who filed the label approvals for these wines were

[55] For more information on the 2008 Brunello di Montalcino scandal, see Eric Asimov, *Fraudulent Brunellos? Shocking!*, NYTIMES, April 3, 2008, *available at* http://dinersjournal.blogs.nytimes.com/2008/04/03/fraudulent-brunellos-shocking/?_php=true&_type=blogs&_r=0; Eric Asimov, *Washington Takes on Brunello*, NYTIMES, May 13, 2008, *available at* http://dinersjournal.blogs.nytimes.com/2008/05/13/brunello-di-montalcino/; and Elisabetta Povoledo, *'Bolt From the Blue' on a Tuscan Red*, NYTIMES, April 23, 2008, *available at* http://www.nytimes.com/2008/04/23/dining/23brunello.html.

[56] *See, e.g.*, TTB Industry Circular Number: 2008-2: Brunello di Montalcino Wine, Alcohol and Tobacco Tax and Trade Bureau, June 20, 2008, *available at* http://www.ttb.gov/industry_circulars/archives/2008/08-

ever sanctioned or reprimanded. If no individuals in the U.S. were prosecuted or held accountable about the label approvals for the Brunello wines, this indicates that, perhaps, the perjury statement is not enforced as strongly as the statement would otherwise suggest.

Still, if a lawyer had filed the labels with TTB in this example, the lawyer might be held responsible, under penalty of perjury, for ensuring that the containers actually held 100% Sangiovese grapes. This might have ethical repercussions or merit bar sanctions.

Perhaps one way to understand this requirement in light of the fact that lawyers do file labels with TTB is to consider the meaning of the statement, "I declare . . . to the best of my knowledge and belief" on Form 5100.31. The phrase, "to the best of my knowledge and believe" appears on many TTB-related forms, such as the excise tax form, formula submissions, application for a federal basic permit, and the application to amend a federal basic permit. Intrinsically, it seems that this statement may be enough to cover a submitter of a label application if the wine does not actually contain what the label presents. In the above example with Brunello di Montalcino, if any lawyers representing the winemakers in Italy filed the label approvals with TTB, perhaps the attorneys could argue that they believed the wines to be unaltered from previous vintages and their submission was based on their belief and knowledge, to the best of the ability. In practice, it may be within the lawyer's best interest to always ask a client to confirm or declare in writing that the wine label for submission is an accurate and truthful representation of what is within the container. This is a process that could be incorporated into the engagement or retainer agreement, or even asked each time a label is filed.

(d) *The Ethics of Choosing Clients*

An interesting issue for consideration, and one on which counsel should review the laws of his or her jurisdiction, pertains to choosing clients with potentially offensive products.

02.html; and TTB Industry Circular Number: 2010-3, Brunello di Montalcino Wine, Alcohol and Tobacco Tax and Trade Bureau, March 29, 2010, *available at* http://www.ttb.gov/industry_circulars/archives/2010/10-03.html.

27 CFR 4.39(a)(3) prohibits any statement, design, device, or representation on a wine label from being obscene or indecent[57] and 4.64 prohibits an advertisement of a wine from being obscene or indecent.[58]

"Obscene or indecent" is a subjective standard. However, the beverage alcohol industry tends to contain entrepreneurs who are often times more creative than the law and constantly seek to push the boundaries of the law, TTB, and federal and state agencies. Our firm actively reviews label approvals and keeps track of some of the most risqué approvals and often discusses such approvals on our blog. Some label approvals we found to be "obscene or indecent," yet passed the eyes of TTB label specialists, include labels not just containing but outwardly displaying profanity,[59] pornographic images,[60] or otherwise alluding to sexual behavior.[61]

There is no clear standard; instead, whether or not a label is "obscene or indecent" seems to be determined on a case-by-case basis as interpreted by the TTB reviewer. It is a standard that seems to be invariably enforced. Many examples are detailed in our firm's blog, referenced *supra*.

How do we represent clients with different moral interests, especially when we personally or ethically feel labels or advertisements are wrong or immoral? An important point to consider is that a lawyer can choose not to represent a client, particularly if the lawyer feels personally offended or whose beliefs are violated by a client's brand or product. Additionally, the lawyer should consider if his or her representation of a particular client—in extreme instances where the potential client may be unpopular,

---

[57] 27 CFR 4.39(a)(3) (1960).
[58] 27 CFR 4.64 (2003).
[59] *See Shelton F's with Beer, Art, and Commercial Speech*, BEVLOG, Jan. 3, 2013, *available at* http://www.bevlaw.com/bevlog/malt-beverage/shelton-fs-with-beer-art-and-commercial-speech; *Poor, Unprintable Stu*, BevLog, Dec. 31, 2011, *available at* http://www.bevlaw.com/bevlog/wine/6396. For more general overview on risqué labels, see our firm's blog category here: http://www.bevlaw.com/bevlog/tag/risque/.
[60] *See, e.g.*, *Big Nose Kate's*, BEVLOG, Jan. 27, 2011, *available at* http://www.bevlaw.com/bevlog/wine/big-nose-kates.
[61] *See, e.g.*, *Panties on the Ground*, BEVLOG, Jan. 13, 2011, *available at* http://www.bevlaw.com/bevlog/wine/panties-on-the-ground.

reprehensible, or scandalous—may affect the attorney's representation of other clients. ABA Model Rule 1.16 details instances when an attorney may withdraw from representation of a client, one of which is if a client insists on pursuing a matter that the lawyer finds "repugnant" or with which the lawyer had a "fundamental disagreement."[62] Virginia carries a similar view, adding "imprudent" in the place of "fundamental disagreement."[63] Again, lawyers should review local rules and commentary to see what their options are in situations similar to the above.

(e) *Wineries or Vineyards Who Offer Tours*

Wineries are unique clients insofar as they frequently offer tours of their manufacturing properties to guests visiting the winery or the vineyard. If a vineyard clients offers tours, there is one specific issue that comes to mind: personal liability of the vineyard should a guest be injured.

If advising winery clients with respect to tours that involve alcohol or limousine transportation to multiple vineyards, a waiver may help reduce the vineyard's exposure to personal injury liability of the vineyard.[64] However, the waiver may "help" depending on the circumstance and how well the waiver is writer. Note that a waiver can often be invalidated by a court where the waiver is too broad or violates public policy.[65]

(f) *Issues in a Digital Age: When You Don't Meet with Clients in Your Office*

---

[62] MODEL RULES OF PROF'L CONDUCT R. 1.16, *available at* http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/rule_1_16_declining_or_terminating_representation.html.

[63] VIRGINIA STATE BAR PROFESSIONAL GUIDELINES R. 1.16 (2009), *available at* http://www.vsb.org/pro-guidelines/index.php/rules/client-lawyer-relationship/rule1-16/.

[64] *See* Doyice J. Cotton, *Liability Waivers 101*, SPORTRISK, April 8, 2011, *available at* http://www.sportrisk.com/2011/04/08/liability-waivers-101/; and Gregory Boop, *Business Release Forms: Release Forms May Lower Risk*, About.com, *available at* http://businessinsure.about.com/od/insurancepoliciesandlaw/a/relforms.htm.

[65] *See, e.g.*, Timothy D. Fenner, *Waivers of Liability: Are They Worth the Paper They Are Written On?*, AXLEY, May 30, 2013, *available at* http://www.axley.com/publication_article/waivers-of-liability-are-they-worth-the-paper-they-are-written-on/ (noting a waiver was found unenforceable for several reasons, including that the waiver violated public policy and was too broad).

Today's technology affords us a great opportunity to work with global clients without ever leaving our desk. While this presents the ability to network at higher levels and develop relationships with clients that may not have otherwise been presented, such opportunities are not without their qualms. Increased use of technology also increases our dependency on computers, the Internet, e-mail, and the ease of attaching documents or privileged materials and sending it virtually. This augmented dependency on technology brings about issues such as the risk of hacking or unintended parties reading or gaining access to confidential materials. In addition, dealing with clients in foreign countries with limited security can also raise questions and cause issues, limiting the privacy between attorneys and their clients.

A lawyer should take reasonable steps to prevent unauthorized third party access to email communication between attorney and client. This is most significantly addressed in Rule 1.6. The model rule indicates that a lawyer "shall make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client."[66]

Comments on Rule 1.6 indicate that unauthorized access to or the inadvertent or unauthorized disclosure of information pertaining to client representation does not violate Rule 1.6 if the lawyer made reasonable attempts to thwart the access or disclosure.[67] Factors considered in determining the reasonability of the efforts made on behalf of the lawyer include, but are not limited to, the following factors:

- The sensitivity of the information;[68]
- The likelihood of disclosure if supplementary safeguards are not engaged;[69]
- The cost of adding or using additional safeguards;[70]

---

[66] *See supra* note 42.
[67] MODEL RULES OF PROF'L CONDUCT R. 1.6 cmt., *available at* http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/rule_1_6_confidentiality_of_information/comment_on_rule_1_6.html
[68] *Id.*
[69] *Id.*
[70] *Id.*

- The difficulty of implementing these safeguards;[71] and
- The "extent to which these safeguards negatively affect the lawyer's ability to represent clients."[72]

There are many ways a lawyer can avoid inadvertent access of client information by a third party. Some examples include using software or hardware that acts to encrypt data and avoid third-party interception. A lawyer should also take steps to encrypt e-mails to clients—especially those containing privileged or confidential information. However, taking such steps to maintain privacy in a digital age can cause client frustrations and also generates the issue of whether the receiving end will send an encrypted response back to the original sender (i.e., clients tend not to send back encrypted responses, which can often defeat the entire purpose of encryption from the start). The lawyer has no control over whether the client will respond with an encrypted response, which can ultimately defeat the purpose of encrypting the e-mail chain to begin with.

Alternative solutions where the lawyer-client relationship occurs over telephone conversations include taking measures to secure verbal conversations with hardware technology. One great example of how lawyers can protect conversations on their mobile devices is through the Vysk QS1 case, which provides data encryption for phone calls, text messages, and pictures.[73] The case also provides dual shutters, microphone, and an internal processor that delivers hardware encryption for secure calling. Products like the Vysk QS1 may help the attorney take reasonable measures to provide a forum for secure communications, and may even be the future of business worldwide.

* * *

Often, when representing wine clients, a lawyer must be mindful that multiple parties may be involved in order to get a product to market. At times, these parties may have differing or diverse interests, of which the attorney should be aware. Many issues, such as

[71] *Id.*
[72] *Id.*
[73] Introducing the Vysk QS1, Vysk, *available at* https://www.vysk.com/product/qs1.

breach of client confidentiality or conflict of interest, can arise when representing companies in such an interconnected industry.

Shelton F's with Beer, Art, and Commercial Speech

January 3rd, 2013

TTB | ALCOHOL AND TOBACCO TAX AND TRADE BUREAU
U.S. Department of the Treasury

COLA Registry

ALCOHOL AND TOBACCO TAX AND TRADE BUREAU

TTB F 5100.31: Application For and Certification/ Exemption of Label/Bottle Approval

Search Public COLA Registry
COLAs Online FAQs
Contact Us
Public COLA Registry Manual
Download Public COLA Registry Manual
COLAs Online Logon

Search Results: COLAs

Printable Version
Save Search Results To File
1 to 4 of 4 (Total Matching Records: 4)

TTB ID	Permit No.	Serial Number	Completed Date	Fanciful Name	Brand Name	Origin	Class/Type
12346001000013	MA-I-15079	12FAAD	12/19/2012	FUCK ART THIS IS ADVERTISING	TO OL	65	952
12356001000008	MA-I-15079	12FARC	12/30/2012	FUCK ART THIS IS ARCHITECTURE	TO OL	65	952
12356001000009	MA-I-15079	12FADV	12/30/2012	FUCK ART THIS IS ADVERTISING	TO OL	65	952
12356001000011	MA-I-15079	12DART	12/30/2012	FUCK ART LET'S DANCE	TO OL	65	956

Printable Version
1 to 4 of 4 (Total Matching Records: 4)

Way back in mid-December of 2012 I would have considered this Shelton Brothers COLA to be, perhaps, an aberration. But upon checking it again, today, I see a few more COLAs with the same word — arguably in need of the fig leafs above.

It is hard to believe that the government did not see the word at issue. On the above-linked COLA it appears no less than three times. This may signal that, as social mores liberalize and budgets shrink, the government has bigger (or fewer) fish to fry. Clearly, it signals that Daniel Shelton does not mind pushing the envelope, or many. The Amherst College magazine unabashedly explains that, after graduating from Amherst, Shelton:

> went to a prestigious law school … then clerked for a judge (on a tropical Pacific isle, of all places) and finally secured a position at a venerable firm in Washington, D.C. (but convinced Shea & Gardner that he needed to spend a year bumming around Africa before starting.) … "My Amherst education has not been wasted at all. I use it more in this business than I ever did in lawyering. I never was completely comfortable with the idea of being a lawyer, anyway."

This creaky old regulation still prohibits any beer labeling that is "obscene or indecent." At this rate, however, it is difficult or uncomfortable to imagine something that goes too far — or too far for Dan. Many thanks to Mark for showing me these labels.

Category: malt beverage | **Tags:** policy, risqué, speech

Related Posts:

- Raging Beer Controversy in Michigan (4)
- Good Beer No Shi* (7)
- F-Words, F-Bombs and Booze, Part 3 (4)

2 Comments so far

Tags: policy, risqué, speech

This entry was posted on Thursday, January 3rd, 2013 at 8:55 am and is filed under malt beverage . You can follow any responses to this entry through the RSS 2.0 feed. You can leave a response, or trackback from your own site.

2 Responses to "Shelton F's with Beer, Art, and Commercial Speech"

1. January 3rd, 2013 at 2:29 pm

   Peter Egelston says:

   I think this is less an indication of shifting social standards and more an indication of how drastically reduced the TTB's budget is. I spoke on the phone to a TTB formula specialist a few months back who confided that he was now one of only two people reviewing formulations for the entire country.

   And at some point in the last year I noticed this curious language appearing on our approved COLA's:

   "TTB has not reviewed this label for type size, characters per inch or contrasting background. The responsible industry member must continue to ensure that the mandatory information on the actual labels is displayed in the correct type size, number of characters per inch, and on a contrasting background in accordance with the TTB labeling regulations, 27 CFR parts 4, 5, 7, and 16, as applicable."

   Are label approvals now based on the honor system? These are the very same folks who used to reject applications based on type sized off by fractions of a pica point. I wonder sometimes if a real human reviews these applications at all any more!

   p-

2. January 4th, 2013 at 4:49 pm

   Mark says:

   I was amazed these labels were approved. I'm not offended by them but to see that the government either does not mind them or somehow overlooked all three labels sure does seem like a big change. I wonder if some states will take offense to them?

Leave a Reply

Name (required)

Mail (will not be published) (required)

Website

Submit Comment

Notify me of followup comments via e-mail

Search Bevlog

Search

Subscribe to the RSS feed

Get bevlog via email.
Delivered by FeedBurner

Formulas Online

Uniform

Main

Submission ID: [redacted] **TTB Formula ID:** [redacted] **Date Submitted:** 01-06-2012 04:55 PM

Status: Closed **Disposition:** Approved

◉ Create New Formula ○ Supersede Existing Formula

TTB Formula ID: [redacted] **Company Formula #:** [redacted]

Company ID: [redacted] **Company Name:** [redacted]

Commodity: Distilled Spirits **Product Source: Domestic**

Product Name: [redacted] HONEY FLAVORED VODKA

	Submitted	Approved
Class/Type:	FLAVORED VODKA	FLAVORED VODKA
* Type Description:	HONEY FLAVORED VODKA	HONEY FLAVORED VODKA

Contacts

Address Type	Name	Telephone	E-mail Address

Entered by: [redacted] **Submitted by:** [redacted]

Created Date: 01-06-2012 04:50 PM

We collect this information to verify your compliance with Federal laws and regulations that TTB administers. The information collected on this form must be considered confidential tax information under 26 U.S.C. 6103, and must not be disclosed to any unauthorized party under 26 U.S.C. 7213.

FONL 1.5.28

Formula

Submission ID: [redacted] **TTB Formula ID:** [redacted] **Date Submitted:** 01-06-2012 04:55 PM

Status: Closed **Disposition:** Approved

Summary

Measurement Type: Volume/Weight

Measurement Units: Metric

Total Yield: [redacted]

	Low	High	Unit
Alcohol Content of Finished Product:	[redacted]	[redacted]	Proof

Ingredients

Fermentable Ingredients	---------Quantity---------

LEGAL ETHICS OPINION 1872 VIRTUAL LAW OFFICE AND USE OF EXECUTIVE OFFICE SUITES

This opinion is an examination of the ethical issues involved in a lawyer or firm's use of a virtual law office, including cloud computing, and/or executive office suites. These issues include marketing, supervision of lawyers and nonlawyers in the firm, and competence and confidentiality when using technology to interact with or serve clients.

A virtual law practice involves a lawyer/firm interacting with clients partly or exclusively via secure Internet portals, emails, or other electronic messaging.[1] This practice may be combined with an executive office rental, where a lawyer rents access to a shared office suite or conference room. This space is generally either unstaffed or staffed by an employee of the rental company who provides basic support services to all users of the space, rather than by an employee of the lawyer. The space is also not exclusive to the lawyer – even if she has exclusive access to a particular office or conference room, the suite is open to all other "tenants." Lawyers who maintain a virtual practice, who work from home, or who wish to expand their geographic profile without the higher costs of exclusive office space and staff all use these spaces as client meeting locations. In other words, virtual law offices and executive office suites do not always go together, but they frequently do.

APPLICABLE RULES AND OPINIONS

The applicable Rules of Professional Conduct are Rules 1.1[2], 1.6(a)[3], 5.1(a) and (b)[4], 5.3(a) and (b)[5], and 7.1[6]. The relevant legal ethics opinions are LEOs 1600, 1791, 1818, and 1850. Finally,

---

[1] Stephanie Kimbro, a practitioner and scholar of virtual law offices, defines a virtual law practice as one where "[t]he use of an online client portal allows for the initiation of the attorney/client relationship through to completion and payment for legal services. Attorneys operate an online backend law office as a completely web-based practice or in conjunction with a traditional law office." http://virtuallawpractice.org/about/, accessed Jan. 22, 2013.

[2] **Rule 1.1 Competence**
A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.

[3] **Rule 1.6 Confidentiality of Information**
(a) A lawyer shall not reveal information protected by the attorney-client privilege under applicable law or other information gained in the professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client unless the client consents after consultation, except for disclosures that are impliedly authorized in order to carry out the representation, and except as stated in paragraphs (b) and (c).
(b) To the extent a lawyer reasonably believes necessary, the lawyer may reveal:
***
(6) information to an outside agency necessary for statistical, bookkeeping, accounting, data processing, printing, or other similar office management purposes, provided the lawyer exercises due care in the selection of the agency, advises the agency that the information must be kept confidential and reasonably believes that the information will be kept confidential.

[4] **Rule 5.1 Responsibilities of Partners and Supervisory Lawyers**
(a) A partner in a law firm, or a lawyer who individually or together with other lawyers possesses managerial authority, shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that all lawyers in the firm conform to the Rules of Professional Conduct.

Regulation 7 Governing Applications for Admission to the Virginia Bar Pursuant to Rule 1A:1 of the Supreme Court of Virginia applies to lawyers who are admitted or seeking admission by motion to the Bar of Virginia[7].

ANALYSIS

Virtual law offices involve issues that are present in all types of law offices – confidentiality, communication with clients, and supervision of employees – but that manifest themselves in a new way in this context. *See also* LEO 1850 (exploring similar concerns in context of outsourcing legal support services).

A lawyer must always act competently to protect the confidentiality of clients' information, regardless of how that information is stored/transmitted, but this task may be more difficult when the information is being transmitted and/or stored electronically through third-party software and storage providers. The lawyer is not required, of course, to absolutely guarantee that a breach of confidentiality cannot occur when using an outside service provider. Rule 1.6 only requires the lawyer to act with reasonable care to protect information relating to the representation of a client. When a lawyer is using cloud computing or any other technology that involves the use of a third party for the storage or transmission of data, the lawyer must

---

(b) A lawyer having direct supervisory authority over another lawyer shall make reasonable efforts to ensure that the other lawyer conforms to the Rules of Professional Conduct.

[5] **Rule 5.3 Responsibilities Regarding Nonlawyer Assistants**
With respect to a nonlawyer employed or retained by or associated with a lawyer:
(a) a partner or a lawyer who individually or together with other lawyers possesses managerial authority in a law firm shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that the person's conduct is compatible with the professional obligations of the lawyer;
(b) a lawyer having direct supervisory authority over the nonlawyer shall make reasonable efforts to ensure that the person's conduct is compatible with the professional obligations of the lawyer; and…

[6] **Rule 7.1 Communications Concerning a Lawyer's Services**
(a) A lawyer shall not, on behalf of the lawyer or any other lawyer affiliated with the lawyer or the firm, use or participate in the use of any form of public communication if such communication contains a false, fraudulent, misleading, or deceptive statement or claim.
***

[7] **7. Intent to Practice Full Time in Virginia**. An applicant must intend, promptly after being admitted to practice in Virginia without examination, to establish his or her office in Virginia and to practice full time from such Virginia office. Full time is defined as being engaged in the active practice of law (as defined above) as one's primary occupation for at least thirty-five (35) hours weekly and having an office where clients can be seen on the premises. The Board shall not approve an application unless the applicant has verifiable plans to practice in Virginia (*i.e.*, a job offer from a Virginia firm, a relocation to the Virginia office of the applicant's firm, an executed lease for office space in Virginia, etc.). Practice from one's residence shall not constitute satisfactory evidence of intent to practice law full time unless the applicant's residence is in a zoning classification which permits seeing clients on the premises and displaying an exterior sign identifying the law office. Virtual offices or shared occupancy arrangements shall not be acceptable. In addition, an applicant shall not divide his or her time between an office within Virginia and one in another jurisdiction. An applicant who is a member of or associated with a firm which has offices outside Virginia must be resident at such firm's Virginia office, shall not maintain an office at a location outside Virginia, and may work at one of his or her firm's other offices only on an occasional and not on a regular basis. The Court will monitor to determine whether an applicant maintains his or her Virginia office.

follow Rule 1.6(b)(6) and exercise care in the selection of the vendor, have a reasonable expectation that the vendor will keep the data confidential and inaccessible by others, and instruct the vendor to preserve the confidentiality of the information. The lawyer will have to examine the third party provider's use of technology and terms of service in order to know whether it adequately safeguards client information, and if the lawyer is not able to make this assessment on her own, she will have to consult with someone qualified to make that determination. [8]

Similarly, although the method of communication does not affect the lawyer's duty to communicate with the client, if the communication will be conducted primarily or entirely electronically, the lawyer may need to take extra precautions to ensure that communication is adequate and that it is received and understood by the client. The Committee previously concluded in LEO 1791 that a lawyer could permissibly represent clients with whom he had no in-person contact, because Rule 1.4 "in no way dictates whether the lawyer should provide that information in a meeting, in writing, in a phone call, or in any particular form of communication. In determining whether a particular attorney has met this obligation with respect to a particular client, what is critical is *what* information was transmitted, not *how*." On the other hand, one of the aspects of communication required by Rule 1.4 is that a lawyer must "explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation." Use of the word "explain" necessarily implies that the lawyer must take some steps beyond merely providing information to make sure that the client actually is in a position to make informed decisions. A lawyer may not simply upload information to an Internet portal and assume that her duty of communication is fulfilled without some confirmation from the client that he has received and understands the information provided.

Finally, the technology that enables a lawyer to practice "virtually" without any face-to-face contact with clients can also allow lawyers and their staff to work in separate locations rather than together in centralized offices. As with other issues discussed in this opinion, a partner or other managing lawyer in a firm always has the same responsibility to take reasonable steps to supervise subordinate lawyers and nonlawyer assistants, but the meaning of "reasonable" steps may vary depending upon the structure of the law firm and its practice. Additional measures may be necessary to supervise staff who are not physically present where the lawyer works.

The use of an executive office/suite rental or any other kind of shared, non-exclusive space, either in conjunction with a virtual law practice or as an addition to a "traditional" office-based practice, raises a separate issue. A non-exclusive office space or virtual law office that is advertised as a location of the firm must be an office where the lawyer provides legal services. Depending on the facts and circumstances, it may be improper under Rule 7.1 for a lawyer to list or hold out a rented office space as her "law office" on letterhead or other public communications. Factors to be considered in making this determination include the frequency with which the lawyer uses the space, whether nonlawyers also use the space, and whether

[8] *See* LEO 1818, where the Committee concluded that a lawyer could permissibly store files electronically and destroy all paper documents as long as the client was not prejudiced by this practice, but noted that the lawyer may need to consult outside technical assistance and support for assistance in using such a system.

signage indicates that the space is used as a law office. In addition, a lawyer may not list alternative or rented office spaces in public communications for the purpose of misleading prospective clients into believing that the lawyer has a more geographically diverse practice and/or more firm resources than is actually the case. As discussed above in the context of Internet-based service providers, a lawyer must also pay careful attention to protecting confidentiality if any client information is stored or received in a shared space staffed by nonlawyers who are not employees of the law firm and may not be aware of the nature or extent of the duty of confidentiality.

For lawyers who are licensed to practice in Virginia by motion rather than by bar exam, Regulation 7 of the Regulations Governing Applications for Admission to the Virginia Bar Pursuant to Rule 1A:1 of the Supreme Court of Virginia creates an additional difficulty in using an executive office rental or virtual office. This Regulation requires that a lawyer who is seeking admission, or who is already admitted, by motion maintain an office in Virginia where clients can be seen on the premises, and specifically provides that virtual office or shared occupancy arrangements are not acceptable for purposes of satisfying the office requirement.[9] Accordingly, a lawyer who is admitted by motion should first ensure that any office space arrangement complies with Regulation 7 before there is any need to consider the ethics issues raised.

This opinion is advisory only and is not binding on any court or tribunal.

Committee Opinion
March 29, 2013

[9] *But see* Proposed Amendments to Rules 1A:1 and 1A:3, proposed October 22, 2012, available at http://courts.state.va.us/news/draft_revisions_rules/2012_rules_1_3_draft.pdf (proposing change to requirements for admission by waiver from "full-time" practice requirement to "predominant" practice requirement).

VIRGINIA:

IN THE CIRCUIT COURT OF THE COUNTY OF FAIRFAX

JUN 28 2012

VIRGINIA STATE BAR EX REL.
SECOND DISTRICT COMMITTEE

Complainant

v. Case No. CL 2012-4137
(VSB DOCKET NO. 10-022-081527)

ATCHUTHAN SRISKANDARAJAH

Respondent

MEMORANDUM ORDER

This cause came to be heard via teleconference hearing on June 5, 2012 by a duly convened, three-judge court consisting of the Honorable Donald M. Haddock, Retired Judge, the Honorable Horace A. Revercomb, III, Retired Judge, and the Honorable H. Thomas Padrick, Jr., Chief Judge Designate. The Virginia State Bar appeared by its Assistant Bar Counsel, Paul D. Georgiadis. The Respondent, Atchuthan Sriskandarajah, was present and was represented by counsel, Bernard Joseph DiMuro, who also was present.

This matter came before the Court pursuant to Respondent's February 28, 2012 demand that the proceedings certified to the Disciplinary Board by the Second District Committee Section II, be terminated and that this matter proceed before a three judge circuit court panel pursuant to §54.1-3935 of the Code of Virginia. On March 21, 2012, the Circuit Court of the County of Fairfax issued a Rule to Show Cause against the Respondent, returnable on June 20, 2012.

By order entered on March 29, 2012, the Supreme Court of Virginia appointed the members of this three judge panel, the Honorable Donald M. Haddock, Retired Judge, the Honorable Horace A. Revercomb, III, Retired Judge, and the Honorable H. Thomas Padrick, Jr., Chief Judge Designate.

Pursuant to §54.1-3935 (B) of the Code of Virginia and Pt. 6, §IV, ¶13-6 H, the parties tendered an Agreed Disposition to the Court on May 29, 2012.

Upon review of the tendered Agreed Disposition and upon consideration of the arguments of counsel, the Court ACCEPTS the tendered Agreed Disposition and thereby makes the following findings of fact and findings of a violation of a Rule of Professional Conduct and imposes the sanction of Public Reprimand without Terms. The Court notes that the parties reached the Agreed Disposition based upon the following considerations:

1. This matter raises a number of issues of first impression given the burgeoning use of the internet for advertising and marketing and to create "virtual" law offices.

2. It is recognized by both the Virginia State Bar ("the Bar") and the Respondent that the application of the Rules of Professional Conduct to advertising and marketing via the internet and to "virtual" offices poses difficulties and those traditional concepts of professional conduct may not translate easily when applied to electronic communications and/or "virtual" offices.

3. Over the course of two years the Bar has raised certain issues with the Respondent. The Respondent in turn has responded to the Bar's concerns and sought guidance from the Bar.

4. It is recognized that the Bar's overriding concern is the protection of the public. It is further recognized that the Respondent and others like him have rights to engage in commercial speech under the First Amendment.

5. It is with these principles in mind that the Bar and the Respondent have reached an agreed disposition as to the Bar's pending concerns about Respondent's marketing and advertising efforts and his use of "virtual" offices.

6. Both parties have compromised on their positions for purposes of a resolution of this matter and reserve their rights for further disputes.

I. FINDINGS OF FACT

7. At all times relevant hereto, Atchuthan Sriskandarajah, "Respondent", has been an attorney licensed to practice law in the Commonwealth of Virginia.

8. Respondent is the sole principal and owner of the SRIS Law Group, P.C., and "the firm."

9. In various law firm public communications including his website, srislawyer.com, representation agreements, letterhead, and business cards, Respondent makes the representation that the firm, the SRIS Law Group, P.C., is a law firm of multiple attorneys, including but not limited to the following instances:

   i. "Stop worrying . . . and Let the lawyers of SRIS, P.C. Start Taking "Care of You!" 2/22/10 website.

   ii. The **SRIS Law Group** is a NATIONAL LAW FIRM that primarily focuses on three areas of law. 11/7/11 website.

   iii. "when you hire a SRIS, P.C. Virginia, Maryland or Massachusetts Adoption Lawyer, you receive personal attention of a lawyer who has the backing of a firm that has a statewide presence. 11/8/11 website.

iv. ". . . you have sought the assistance of the Law Offices of Sris, P.C. and its counsel and associates . . ." 12/15/08 Representation Agreement with Toni Shank.

v. "SRIS Law Group, P.C. "Offices in Manassas, Virginia, Richmond, Virginia, Virginia Beach, Virginia, Lynchburg, Virginia, Fredericksburg, Virginia, Rockville, Maryland, Baltimore, Maryland, Boston, Massachusetts, Chenai, India. Letterhead.

vi. SRIS Law Group, P.C., listing multiple offices. Business Card.

10. In his correspondence to the Bar dated April 15, 2010 concerning this bar complaint, in his interview with the bar's Investigator on September 2, 2011, and at other times, Respondent has represented that the firm attorneys are independent contractors only for tax purposes, but otherwise are fully part of the firm.

11. The Bar has raised the concern with the Respondent that his law firm is, in fact, not a law firm of attorneys employed by him but rather a collection of independent contractors that are not under his supervision and control. The Bar takes the position that until October 19, 2011, the SRIS Law Group consisted of a single attorney – the Respondent, with his so-called associates being independent contractor attorneys paid on a commission basis.

12. Since October 19, 2011, Respondent has hired two newly admitted associates as employees of SRIS Law Group, P.C., with the majority of the firm's attorneys still being independent contractors.

13. The Bar claims that notwithstanding his public communications and representations of having a law firm, Respondent's private communications consistently define his attorneys as independent contractors.

i. In applications for insurance submitted in 2009 and 2011 Respondent listed the law firm's attorneys (other than himself) as independent contractors.

ii. With the exception of the two attorneys hired as employees on October 19, 2011 and November 3, 2011, all of the firm attorneys have and have had employment contracts describing the relationship of each attorney as "an independent contractor and as Counsel to the law firm." The contracts not only define the relationship as one of independent contractor, but also set out a functional framework as such to include shifting to the attorneys as independent contractor's key responsibilities including: overseeing client accounts; assuming sole responsibility for client matters upon the attorney departing the firm; and indemnifying the firm for any uninsured loss.

iii. In the firm's Employee and Attorney Handbook, Respondent designates the attorneys as "Independent Contractors":

"**Attorney Schedules**: Attorneys will be considered to be

NTP

"Independent Contractors." Therefore they make their own hours."

14. The Respondent has countered with evidence (including documentary evidence and emails) that he directly supervises and controls the work of the attorneys in his firm and that daily he is aware of the work of his attorneys. He asserts that there is nothing improper with having a law firm comprised of attorneys who are independent contractors and at the same time representing that they constitute a law firm.

15. However, as a compromise with the Bar, the Respondent has agreed for purposes of this matter that he will alter his agreements with his attorneys so that they are employees of the firm and is now taking steps to do so as of May 22, 2012.

16. The Bar contends that in his website, srislawyer.com, Respondent represents that each of the attorneys of the SRIS Law Group primarily practices in only one are of the law:

    i. "Each attorney in our law firm primarily focuses his or her practice in only one area of law. Our Virginia, Maryland & Massachusetts lawyers who primarily handle criminal, traffic or reckless driving cases don't attempt to dabble in unrelated areas of law." 2/22/10 website.

    ii. "The SRIS, P.C. **Massachusetts, Maryland & Virginia** attorneys provide legal services to clients in a broad range of practice areas. However, each of our attorneys focuses primarily in one area of the law." 11/7/11 website.

    iii. "Our Virginia, Maryland & Massachusetts lawyers who primarily handle criminal, traffic or reckless driving cases don't attempt to dabble in unrelated areas of law." 11/7/11 website.

    iv. "Our firm has case specific attorneys . . ."

17. The Bar claims that notwithstanding Respondent's website, each of the SRIS Law Group attorneys handle several areas of practice – both according to the firm's websites and by their own admission. Examples to which the Bar points include but are not limited to:

    i. A website page in which the respondent states that he handles 18 practice areas on the firm website. These could be considered three major areas of criminal defense, immigration, and civil litigation:

        - Criminal Law
        - DUI/DWI
        - Immigration & Naturalization
        - Litigation & Appeals
        - Traffic Violations

- White Collar Crimes
- Criminal Fraud
- Drug Violations
- Federal
- Felonies
- Juvenile Crimes
- Misdemeanor
- Sex Offenses
- Immigration & Naturalization Law
- Deportation
- Immigration
- Naturalization & Citizenship
- Visas

2/22/10 website, 12/7/11 website.

ii. The firm's website listing for attorney Shannon Hadeed listed the following practice areas:

- 30% criminal
- 30% Traffic Matter
- 20% Family Matters
- 20% Immigration

2/22/10 website.

iii. The firm's website listing for attorney Christine Hissong listed 7 practice areas, being essentially family law, general civil litigation, and mediation:

- Family Law
- Divorce
- Child Custody [sic]
- Support
- Adoption
- Civil Litigation [sic]
- Mediation

2/22/10 website.

iv. The firm's website listing for attorney Garrett Green stated on one page, "handles criminal and traffic matters exclusively." 2/22/10 website. Thereafter, the website listed five practice areas:

- Business & Commercial law
- Contracts
- Criminal Law
- Litigation & Appeals

GHP

- "Real Estate Law
- Litigation Percentage
- 75% of Practice Devoted to Litigation

2/22/10 website.

18. The Respondent replies that his attorneys in fact handle primarily one area of law and that the separate listings reflect the same general area of law. He claims, therefore, that he has not misled the public. However, the Respondent has agreed and has taken steps as of May 22, 2012, to amend his attorney profiles on his firm website to reflect that the attorneys handle more than one area of law.

19. In various public communications, including the srislawyer.com website, letterhead, and business cards, Respondent makes the representation of a law firm that has at least six law offices in the Commonwealth of Virginia. These representations include:

    i. "Since our founding in 1997, SRIS, P.C. has grown to include six offices in seven cities spanning three states . . . Click on the office you are trying to locate and view the directions to that office." Thereafter, the firm website lists 13 locations: Fairfax, Fredericksburg, Lynchburg, Manassas, Richmond, Virginia Beach, Annapolis, Md, Rockville, Md, Baltimore, Md, Boston, Mass, Cambridge, Mass, New York, NY, and Orange, Cal. 2/22/10 website

    ii. "In Virginia, we have offices in Northern Virginia, Central Virginia, Western Virginia & the Hampton Roads/Tidewater Area. In Virginia, we're located in Fairfax County, Fredericksburg, Lynchburg County, Manassas (Prince William County), Richmond & Virginia Beach."

    iii. SRIS Law Group, P.C. business card: "New York, NY, Orange, CA, Richmond, VA, Boston, MA, Manassas, VA, Charlotte, N.C., Lynchburg, VA, Rockville, MD, Virginia Beach, VA, Baltimore, MD, Fredericksburg, VA, Cambridge, MA, Chennai, India."

20. The Bar claims that in fact, the firm has a single office in Virginia, the Fairfax, Virginia office and that along with an off–shore office in Chenai, India, the Fairfax office handles prospective client calls via a toll-free, 1-888 telephone number. The remaining Virginia locations are 5 virtual and unstaffed office locations consisting of various arrangements to use the location for client meetings. The Bar contends that some of the locations (i.e., executive office suites) do not provide space exclusive to Respondent's firm but rather, the same space is offered to multiple other entities on an as-needed reservation basis. None of the non-Fairfax locations houses firm office staff or contains firm office equipment, firm office furniture, or firm files.

21. The Respondent has countered that there is no requirement under the Rules that his law firm's offices be permanent, fully staffed offices that are open for a set period of time each day. He asserts that there are no client files maintained at these offices but

HJR

rather the client files are secured electronically and hence, client confidentiality is not jeopardized.

22. The Respondent has agreed however, and has taken steps as of May 22, 2012, to amend his firm website to reflect that any location that is not a permanent, fully staffed location with set working hours is identified as a "client meeting location."

23. Finally, the Bar and the Respondent agree that should the Bar have any further concerns about the Respondent's website in the future the Respondent shall respond to such concerns as stated in writing within 30 days and the parties shall be permitted an additional 60 days in which to reach agreement on those concerns prior to any complaint being instituted.

II. NATURE OF VIOLATION

Such conduct by Atchuthan Sriskandarajah constitutes a violation of the following provision of the Rules of Professional Conduct:

RULE 7.4 COMMUNICATION OF FIELDS OF PRACTICE AND CERTIFICATION

Lawyers may state, announce or hold themselves out as limiting their practice in a particular area or field of law so long as the communication of such limitation of practice is in accordance with the standards of this Rule, Rule 7.1, Rule 7.2, and Rule 7.3, as appropriate.

The Court hereby ORDERS that Respondent be and is hereby issued this PUBLIC REPRIMAND WITHOUT TERMS for such violation.

The Clerk of the Disciplinary System shall comply with all requirements of Part 6, §IV, ¶13 of the Rules of Court, as amended (the "Rules"), including but not limited to assessing costs pursuant to ¶13-9E.1 of the Rules and complying with the public notice requirements of ¶13-9G of the Rules.

The Court Reporter who transcribed these proceedings is Angela N. Sidener, Chandler & Halasz Court Reporters, P.O. Box 9349, Richmond, VA 23227.

Let the Clerk of the Court send a copy *teste* to all counsel of record and to Barbara S. Lanier, Clerk of the Virginia State Bar Disciplinary Board, Virginia State Bar, 707 E. Main Street, Suite 1500, Richmond, VA 23219.

Entered 6 / 18 /2012

H. Thomas Padrick, Jr.
Chief Judge Designate

A COPY TESTE:
JOHN T. FREY, CLERK
BY: _____
Deputy Clerk
Date: 6/21/2012
Original retained in the office of the Clerk of the Circuit Court of Fairfax County, Virginia
CL-2012-4137

THANK YOU

for choosing NBI for your
continuing education needs.

Please visit our website at
www.nbi-sems.com
for a complete list of
upcoming learning opportunities.

NBI | NATIONAL BUSINESS INSTITUTE ™