

## Custom Crush or Shared Premise?



By Sara Schorske

CRUSH WILL be upon us by the time this article appears and it will probably be over before many *V&WM* subscribers take the time to read this column. For the custom crush customers among you, the end of harvest is not too soon to start considering your alternatives for next year. If your business goals are principally conceived in terms of market share or profit margin, you may be well advised to continue contracting out your production.

But perhaps you aspire towards greater security, a guaranteed home for your grapes, more stability in winemaking style and quality from year to year, or more control over costs and pricing. If so, establishing a winery may be an important step toward that goal. And of course, many industry members who don't yet have their own winery dream of someday seeing their family name on a cellar door.

It is no longer a million-dollar prospect to start a winery. The shared premise approach has now been with us for nearly a decade since the first shared premise or "alternating proprietor" winery was approved by ATF, and these arrangements are now common and well-accepted in the industry. By alternating the use of winery space and equipment with an established producer, a grape grower or brand builder can become a vintner with just a few tanks or barrels to his name.

### Pros and Cons of Shared Premise Arrangements

There are many advantages to operating as a winery. Here are the principal ones:

1. *Small wineries including "alternators" without their own bricks and mortar qualify for a tax break of \$0.90/gallon on the first 100,000 gallons of wine removed from bond each year.* Wineries that provide services to custom crush customers may pass along some of their tax savings, if they qualify for this tax credit. However, because of the 100,000 gallon limit, a medium size custom crushing winery or one with many custom crush customers may not have enough tax breaks to

go around each year. Establishing your own winery gives you access to the full amount of the credit each year.

2. *Almost all states have statutory exceptions that allow winery principals to hold interests in retail establishments that are prohibited for wholesalers under the tied house laws.* Since brand builders and grape growers must be licensed as wholesalers to sell their wine, those with previous retail investments, such as in a restaurant or hotel, will not qualify for the license they need. In some cases, becoming an alternating proprietor holding a winery rather than wholesale license solves the problem.

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3. *In many states wineries have more marketing and promotional privileges than wholesalers* such as making retail sales and offering tastings that make the winery form of operation more successful, more profitable and more fun.

4. *Holding your own winery permit gives you an extra measure of control over winemaking technique and consistency.* These are especially important for premium brands, and for brands aiming for fast growth.

### Is an Alternating Proprietor Just a Glorified Custom Crush Customer?

Oftentimes, shared premise arrangements look so much like custom crush deals that the two seem indistinguishable. Although many alternators have their own winemaker, very few employ their own "cellar rats" or record keeping staff, so these essential functions are fulfilled by "host" winery personnel just as they would be if the host winery was providing custom crush services. Even the fee structure for the host winery's winemaking services is frequently identical in most regards to the fees charged custom crush customers. Don't be fooled! The similarity is only skin deep. Under the hood, what you have in a shared premise situation is two independent wineries, each with separate records and sovereign responsibility for its own winemaking practices no matter who's dragging the hoses.

### How to Set Up an Alternating Arrangement

Establishing an alternating proprietor winery requires the same paperwork as starting a stand-alone winery, and then some. The alternator needs to add to its winery application a request to be allowed to alternate the use of winery areas and equipment with the host winery. In addition to describing the permanent spot allocated to the alternator's winery, specific descriptions of the areas to be alternated with the host including a list of shared tanks and the methods to be used for alternate operations and record keeping should be included. The host winery must likewise apply to ATF for permission to alternate, and must amend its winery description to curtail the alternator's permanent premise from the host's bonded area.

In addition, the host's application must also describe the areas and methods of alternation. Each alternator must have a permanent area; one that is con-

tinually controlled by the alternator and not shared with the host. This can be a separate room, a fenced area, or even a tank (which is considered a closed space and therefore can be designated as a separate premise).

In addition to using its permanent premises, the alternator will temporarily "take over" control of other areas it uses occasionally, such as a bottling room or outdoor area where a mobile bottling line parks, any tanks in which its wine is placed, and barrel work areas when barrels are moved there for racking, cleaning, re-stacking, etc. All alternating tanks and any other alternating areas must be readily identified by use of placards showing its bonded winery registry number (BW#) when controlled by the alternator. Only one proprietor will control each alternating area at a time. When an alternating proprietor is not controlling an area approved for alternating, the host winery will control it.

### General Record Keeping

One of the most challenging aspects of creating and maintaining an alternating arrangement is the need to think differently about wine movements. Cellar workers must always be mindful of which winery is controlling an alternating area. Also, there are sometimes situations when an alternator must transfer its wine to the host winery for processing in an area that does not alternate. In this case, as strange as it sounds, transfers from tank to tank within the same building can be bond-to-bond transfers!

Special care must be taken to track the changes in control of each alternating area. Each proprietor must keep records of gallons of wine received or removed while operating any alternating area, as well as the effective date and hour when it takes over and when it surrenders operation of the premise. A physical log can be used. At wineries where cellar work orders are used to initiate and document wine movements, cellar workers should date and time stamp the cellar work order manually or using an ordinary time clock; then the time information can be entered into a log or a computer from the work orders.

There is no set format for a log. The regulations require wineries to simply record the time and date each area switches from the control of one proprietor to the control of another. Wineries that use computerized tracking utilize the "remarks" field in the tank

input screen to record the time when inputting information on a wine transfer into an alternating tank or other area. (In a computerized system, separate "premises" are set up for each bonded winery, and the wine tracker makes sure the tank record correctly indicates which winery controls it at the time.)

Wineries that use manual systems can keep a simple chronological log in a binder or composition book. The log shows the date and time, which tank or other area is changing control, and the BW number of the newly controlling winery. Alternately, they can note the time and date a tank or other area changes control on the tank cards or lot cards of their manual system.

### The Agreement between Host and Alternator

Many wineries have standard custom crush or custom bottling agreements and tend to want to use these for their alternating proprietor arrangements as well. This is not appropriate, since the standard agreements generally specify that the host winery does all the processing.

When wineries alternate, they are independently existing entities, each of which has full responsibility and control over its own operations, even when they borrow each other's spaces and even each other's personnel. Therefore, I always caution clients to take care in converting any existing agreements or copies of agreements they have seen in use by other wineries.

If you are customizing an existing agreement, you should review the standard provisions and change terminology that is appropriate for custom crushing but inappropriate for alternating. Examples of such provisions would be references to production by the host winery on behalf of the customer, etc. In addition, I recommend adding extra provisions that:

- Clarify the relationship between the two wineries as independent producers (as opposed to the relationship of joint venturers or the relationship between custom crusher and custom crush customer);
- Confirm each party's control of its own premises, records, and winemaking activities;
- Ensure ATF access to the alternator's permanent premises (especially if ATF inspectors must cross property not leased to the alternator in order to get to the alternating winery);
- Require of both parties compli-

ance with the specific regulations governing alternation of proprietors.

In terms of compensation of host wineries, normally there is a rental fee for the permanent premises in addition to other fees which are proportionate to the use of personnel and alternating areas. These fees are most frequently assessed very much like fees for custom work, with different rates for different types of services performed. Sometimes, fees are simply assessed on a straight per case basis.

### Is Alternating in Your Future?

Although a shared premise operation is more complicated to set up and maintain, it is currently working well in dozens of cases, and the regulators are no longer skeptical about the concept. If establishing an alternating proprietor winery or hosting one sounds like a possibility for your business, I encourage you to explore the possibility with local regulators or your compliance advisor. The issues to be resolved in each situation are case-specific, and contain many complexities beyond the scope of this article. But the rewards can make the effort well worthwhile. #

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