The New Regulator

By Sara Schorske

CHANGE IS coming; is that good or bad? What should we do about it? There's no guarantee that any change will be an improvement, but it's also true that we're guaranteed no improvement without change. In other words, if ever we want anything to get better, change is a risk we have to take. And hopefully, the odds of a positive outcome are at least partly under our influence.

Wait a minute, is this "Compliance Watch," or Philosophy 101? Yes, you're still reading *Vineyard & Winery Management,* and this is a column about compliance. We are philosophizing about change today, because things are really changing in the halls of government, and we'd like to help our industry relate constructively, and even creatively, to those changes.

Nowadays we're seeing a "new breed" of regulator, and some pretty unexpected governmental responses and proposals. We are also seeing some disturbingly reactionary responses to these changes from members of the alcoholic beverage industry. Surprisingly, it seems that the regulators may have to fight the industry to make the regulatory world a simpler and better place.

Changes in the Making

Recently, we have attended several conferences where regulators and commissioners have spoken frankly, and sometimes passionately, about a modern and more enlightened approach to regulating the alcoholic beverage industry. More striking than any of their specific ideas for modernization is the novel and refreshing fact that so many regulators are thinking and talking about changing the regulatory climate. Notably, many of their ideas are aimed at reducing the compliance burdens for both the industry and the regulator alike. And the proposals are not merely symptomatic treatments; many are deeply thoughtful attempts to simplify regulation by returning it to its philosophic roots.

Where is this coming from? In many cases, the force behind the government-sponsored initiatives is an influx of younger regulators and new-to-the-industry commissioners who bring modern management skills and fresh ideas to their agencies. In the old days, we saw far less business savvy and almost no independent imagination exercised in regulatory offices. Certainly, creative thinking didn't used to be encouraged there. Now, government is wrestling with new imperatives: the budgetary need to be cost conscious, the executive mandate to become more efficient, and the politically inspired agenda to actually be more "business-friendly." These new goals require nontraditional solutions.

The modern regulator also recognizes that times have changed, and that the issues that were important immediately following Prohibition may be irrelevant now. After seventy years of regulation, a stable and responsible industry has evolved. Many of the agencies have lost their institutional memory of the old abuses, and thus, their enthusiasm for enforcing the outworn rules.

Crushed to Death by an Unwieldy ABC Code

You'd think our industry would welcome any simplification. Industry members perennially complain about the complex web of rules and procedures that seem to slow or even obstruct progress and creativity in our businesses. Now, the regulators are also complaining about the myriad regulations, but for different reasons. Government's beef is, the rules lack a clear and rational connection to the core principles of alcoholic beverage regulation, which have to do with prevention of social ills.

A growing number of regulators feel that the social goals of alcoholic beverage regulation have been lost in the complex web of rules and laws. Regulators understand that the lack of a clear and rational connection between the regulations and shared societal goals makes the rules harder to enforce, weakens the industry's willingness to comply, and of course makes compliance dauntingly difficult.

Compliance Watch is written by Sara Schorske, founding member of CSA—Compliance Service of America, LLC (www.csa-compliance.com) and Alex Heckathorn. CSA specializes in licensing and compliance for the wine and beer industries. To reach the authors—E-mail: csa@csa-compliance.com; Tel.: (800) 400-1353.

Although they are the brunt of many of industry's complaints, the regulators cannot be held responsible for the baroque intricacy of the rules they must enforce. Much of the complexity is actually due to suppliers' and retailers' self-interested demands, and to some lesser extent, requests from the public and other parts of government. The tied house chapter of California's alcoholic beverage code, which contains literally dozens of miscellaneous exceptions, is a classic case in point. The following excerpt from a previous Compliance Watch column on tied house issues reveals the extent of the regulators' headaches. It is a direct quote from an ABC attorney addressing a legislative committee considering tied house reform several years ago.

"A major development is being planned in a foothills county that calls for a golf course and clubhouse, residential properties and a licensed resort hotel. One of the investors in the project is a small California winegrower. . . . Business and Professions Code §25500 prohibits a winery from holding any interest, direct or indirect, in California on-sale license. The project is dead.

"But wait! Business and Professions Code §25503.16 allows a supplier to own an interest in any retail license operated in conjunction with a hotel or motel of 100 guest rooms or more. The project lives.

"But wait! The resort hotel is projected to be 75 rooms. The project is dead.

"But wait! Business and Professions code §25503.15 allows a winery to own an on-sale license if they file an undertaking with the Department not to sell their wine at the on-sale licensed premises. The project lives.

"But wait! The winery, as do many California wineries, holds a beer and wine importers license and Business and Professions Code §25503.15 does not create an exception for importers. The project is dead.

"But wait! Beer and wine importer licenses are not separate licenses; they can only be issued to winegrowers and cannot stand on their own. The Department is prepared to rule that therefore the undertaking can cover the beer and wine importers license. The project lives.

"But wait! The winegrower has made friends with an Australian winemaker and primarily as a favor is importing the Australian's wine for distribution to wholesalers throughout the county. It is not a beer and wine importers license that he holds but a beer and wine importers general license. Business and Professions Code §23375.6 provides that 'no retail license shall be issued to any beer and wine importer's general licensee.' There is no exception. The project, for the present is again dead. The developers are left with the following choices:

- Increase the number of guest rooms to at least 100, which might make the entire project economically unviable.
- Drop the investor, which might make the project economically unviable.
- Have the winery investor cancel his beer and wine importer's general license leaving his Australian friend high and dry.
- Seek legislative relief with a new exception.

"One might well be tempted to ask how any of this promotes the economic well-being of the state or the state's policy interests in promoting temperance, providing an orderly market, preventing vertical integration of the market and the abuses of tied houses.

"I can only hope that the Legislature will find the magic sword to cut this Gordian knot."

California's extremely convoluted ABC Act has been twisted out of shape by the forces of strict legal interpretations, alleviated in isolated instances by special interest legislation. The system "works"—at least for those who can afford to pay the attorneys and lobbyists it takes to create a new loophole. But it is creating a code of law so top-heavy and hard to understand that it threatens to collapse under its own weight. And the regulators feel the unwieldiness of the system more than anyone.

And Now, for Something Completely Different!

Many of the state ABC's have undertaken a process of re-inventing themselves. The Washington State Liquor Control Board is a good example of this process. Over the last few years, on its own initiative, the Board reviewed its procedures and processes and made numerous streamlining changes.

Even more impressive is the accessibility and commitment to finding solutions shown by the WA LCB staff.

COMPLIANCE SERVICE *of* AMERICA, LLC

CSA

Alcoholic Beverage
Licensing and Compliance
Nationwide

Federal, State and Local agencies
Wineries, Wholesalers, Importers
On-Sale and Off-Sale Retailers

800-400-1353
www.csa-compliance.com

When we recently called to discuss an alternating proprietorship at a Washington winery, three senior members of the staff joined the conversation on the speaker phone to give the most complete answers possible. When it was discovered that a chain grocery store company had been inconsistently licensed at its various Washington State locations over the years, the Board staff blamed no one and devised a simple, direct way to change the licenses on seven stores so they would be consistent with the others.

Katherine Kreiter, a new member of the Washington State Board, recounts that she was so unknowledgeable and inexperienced when first appointed that she thought "tide house" had something to do with floating smuggled alcoholic beverages past "revenuers" on boats carried by the incoming tide! However, Ms. Kreiter has proven to be an avid learner and quick study. When confronted with the issue of winery web sites listing retailers, Ms. Kreiter got an earful about the real "tied house" rules from the LCB staff. But she still asked the logical questions: Can a consumer call the winery and ask for the information? How is it different to get the information from a live person versus a computer at the other end of the phone line? Hasn't our Governor told all state agencies to use the phone less and the web more to provide information? Doesn't the Board use its web site to provide the locations of its package stores? As a result of her common sense questions, the Board decided to allow retailer locator listings on winery web sites. The same result that took legislation in California was accomplished administratively in Washington by the Board and its staff.

Over the last decade, ATF has attempted in various ways to re-invent the way it delivers its services, and according to most accounts, it has largely succeeded. The consolidation of the licensing and administrative functions at the National Revenue Center was feared by many, but the actual results have lived up to ATF's promises. The consolidation has resulted in consistent and uniform interpretations of regulations and procedures. And, although many older employees were lost when district offices closed, ATF has developed a capable roster of supervisors who take service and management seriously and are available to address problems. The agency has also assembled its most experienced employees into customer service teams to provide expert guidance in such technical areas as labeling and product formulation.

A Case Study of a Proposed Regulatory Change

One of ATF's bolder initiatives was the proposed revisions to its Certificate of Label Approval (COLA) form unveiled early last year. The proposal expanded the kinds of changes that could be made on a label without needing a new approval. (This proposal was discussed in detail in a previous column, "ATF's Proposed COLA Form Heralds Greater Changes to Come," *V&WM* May/June 2001).

This initiative had the potential to significantly reduce the paperwork burden for producers (and ATF) and virtually eliminate ATF's role as the "big brother" of labeling. Many astutely saw that it would require the industry to be more responsible, to comply voluntarily, and to be self-policing.

Given the potential for relief from a

large and long-standing regulatory burden, it was surprising that many of the initial responses circulated among industry trade organizations were opposed to the proposal. The industry position statements exaggerated possible problems: for example, that products would be recalled from the marketplace to be relabeled if found objectionable; that unscrupulous industry members would use the new system to misrepresent their products; and that ATF would downsize its staff, thus reducing labeling assistance and levels of service.

Susan Stewart, the Acting Chief of the Labeling and Formulation Division, spoke to several industry groups on the initiative. At a presentation we attended, industry members were skeptical and asked questions that focused on rare or hypothetical problems. The concerns that were raised prevented a fair consideration of the value of the proposal. The benefits which could have accrued to the overwhelming majority of responsible producers ended up being shot down by exaggerated fears supported by a few egregious examples of mislabeled products.

Rather than welcome the benefits of self-responsibility offered in the proposal, the industry seemed to be saying that they wanted ATF to continue its traditionally strict regulation of labeling.

Do We Have to Fear Change?

Any regulated industry may be justified in reacting with distrust to regulatory change, for many reasons. First and foremost, the traditional, punitive method of securing compliance in the past inevitably colors the industry's response when regulators ask for a new collaborative relationship with industry. Moreover, we've been burned by change before. We've all suffered the results of new, poorly written laws, courtesy of inexperienced legislators and political jockeying. We've all done our best to find ways to cope with existing rules and interpretations, and now, our adaptation to current systems is a vested interest we don't want disturbed. New policies may mean a violation will be deemed to exist where one did not exist before, or permissions will be withheld that would have been forthcoming before.

Industry's desire for the safe haven of specific rules naturally increases as the lower ranks of the agencies are filled by employees who do not have the skills or training to exercise discretion in a complex field. As a Chief Counsel of an ABC said: "For industry members, the prospect of unfettered discretion in the hands of a changing cadre of public servants may simply be too great a risk to bear." Therefore, it is not surprising that when regulators speak of reducing regulation and relying more on regulator discretion, the regulated industry usually will push back and demand constraints on the agency's discretion, normally in the form of minutely detailed and specific regulations.

So, fearing the worst in the agency, industry often derails many initiatives that have the potential for a better regulatory system. In addition to fear, competitive interests drive industry to preserve the status quo. The larger, more powerful players, in particular, believe they can use the present, known system to their competitive advantage, and don't want to lose that edge.

Change Is Inevitable

Fear of change is certainly natural. Even so, change is inevitable. Given that both these statements are true, the question is whether we can overcome our fears of change enough to build a more efficient and ethical regulatory model together.

Industry could wait for the agencies to show that they can act in a more rational and just manner, to prove that the industry's fears are groundless. But a "wait and see" attitude doesn't make the other person's part any easier, and could completely sabotage it. Even more to the point, wouldn't it be better to participate in the design of the changes in our regulatory climate, than to stand on the sidelines and watch?

Industry stands to greatly benefit if it were willing to meet the new regulator half way to create a new regulatory model. A cooperative scheme of regulation cannot be achieved without broad based support from the industry. To reap the maximum benefits of a more flexible and cooperative system, the alcoholic beverage industry must transcend its fears, however well "justified" they seem, and help craft a shared vision of the true purposes of alcoholic beverage regulation.