

## Tied House: Pillar of Alcohol Regulation



Sara Schorske

TIED HOUSE restrictions are a fact of life in the alcoholic beverage business all over America. Many small winery owners may never confront tied house regulations, but as wine business competition escalates and entrepreneurs become increasingly creative, more and more industry members are finding they need a lesson in this area of law. In particular, the current interest on the part of wineries and retailers in reaching out-of-state consumers has both stimulated creative business plans and renewed interest in scrutinizing the benefits and problems of the three tier system.

"Tied house" refers to laws, adopted both on the federal level and by every state, that regulate how alcoholic beverages are marketed and how the various tiers of our industry interact. The name comes from a practice in England where a bar may be tied, by ownership links or contractual obligations, to a specific manufacturer. Prior to Prohibition, this practice was allowed in America, and it resulted in marketing practices that encouraged intemperance. (Tied houses in the U.S. would offer "free lunch" to promote business and heavily encouraged the consumption of their brand of

beer to defray the cost of the give-away meal.)

### The Purpose of Tied House

In an attempt to prevent the vertical integration of ownership which supported intemperate consumption, tied house legislation was enacted. The most fundamental purpose of tied house laws was the creation and preservation of the three tier system. This system, in case you aren't familiar with the term, is the marketing structure in which alcoholic beverages are sold by suppliers to wholesalers, and by wholesalers to retailers. Supplier, wholesaler, and retailer are the three tiers. Just like taxpaid and in-bond wine, they mustn't mingle! Although in California, wineries may directly sell to both wholesalers and retailers as well as to consumers, for most licenses in all states, the legal barriers between the tiers remains high and solid. The strong wholesale lobby, which funds election campaigns in every state, makes sure of that.

Tied house restrictions can be straightforward: In some states, a distributor (wholesaler tier) cannot have any interest in an importer (supplier tier) license. In most states, a distributor cannot have an interest in a retail establishment. Common sense, special interests, and lots of money sometimes combine to produce statutory exceptions to the hard and fast rules. In California we have many, and they can get pretty confusing. Here are a couple of examples.

- A winery (supplier tier) can own an off-sale beer and wine license (retail tier). So can a beer and wine wholesaler—but only if wine and no other alcoholic beverages (i.e., not beer) are sold in the retail store.

- In California, a winery can own up to two restaurants, if the winery supplies no more than 15% of the alcoholic beverages served there. And, unless the winery sells less than 125,000 gallons of its own brands annually in California, they must supply wine to their own restaurants through

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a licensed wholesaler. If a winery owns more than two restaurants, it must agree not to sell its own wine in the additional establishments.

### Legal Zigzag

A list of dozens of similar exceptions prompted the California State Senate to hold a hearing on tied house reform this year, in an effort to consider reforms. Following is an excerpt from testimony delivered to that hearing by John Pierce, Chief Counsel for the California ABC. This convoluted tale of legal zigging and zagging is a true story that underscores the complexity of tied house restrictions in this state.

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. The winery intends to be an investor and does not even produce sufficient amounts to supply the projected needs of the hotel. But they don't intend to sell their wines to the property. Nonetheless, 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 inviable.
- Drop the investor which might make the project economically inviable.

• 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.

### What Is Being Promoted?

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.

After the hearing, Assemblyman Dominic Cortese sponsored a bill that would give discretionary powers to our state ABC, so that situations like the one above could be administratively resolved when it was apparent that public 'welfare and morals' would not be harmed. The bill died before it even got out of committee, and no other legislation is pending.

Everyone in the industry benefits from better understanding our heavily regulated system. Sure, the world has many more pressing problems than tied house tangles. The industry has a few of its own. But that's no consolation when an unanticipated tied house restriction threatens to ruin more than your day by torpedoing your business plan. Hopefully, this column will promote good planning and healthy continued dialogue on the important subject of tied house law. 

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