

# HOW TO PLAN YOUR ENTRY INTO AND EXIT FROM THE WINE INDUSTRY

Cal Poly-Wine Law & Compliance

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# GUIDING PRINCIPLES

- Identify your wine business assets and how you intend to increase their value?
- What is your source of funds for acquisition and operation?
- What is your exit strategy?
- Do your legal structure and legal documents support your business plan?

# WINE BUSINESS MODELS

- Brick and mortar wineries
- Ownership or control of grape sources and production through AP or custom crush
- Third party marketer and brand owner

# HIGHLY REGULATED ACTIVITIES

- **Production and sale of alcohol beverages are regulated at the federal, state and local levels.**
- **Sale of securities are regulated at the federal and state levels.**

# BRICK AND MORTAR WINERY LICENSING

## I. FEDERAL REGULATION

- A. A producer, processor or warehouse of wine must obtain a Federal Basic Permit and wine bond before starting business.
- B. Investigation conducted by TTB investigator:
  - 1. Source of funds;
  - 2. Hidden ownership;
  - 3. Tied House;
  - 4. Protection of tax revenue.
- C. After qualification and approval:
  - 1. Reporting;
  - 2. COLA applications.
- D. The time needed to complete permitting must be considered in structuring a transaction.

# BRICK AND MORTAR WINERY LICENSING

## II. STATE OF CALIFORNIA REGULATION

- A. Administered by Department of Alcoholic Beverage Control (“ABC”) implementing and enforcing the California Alcoholic Beverage Control Act (“ABC Act”).
- B. Type 02 Winegrower License (Bus & Prof. Code §§23356, 23358) Privileges:
  - 1. Produce and sell wine;
  - 2. Conduct wine tastings on or off premises;
  - 3. Sell direct to consumers for off premises use;
  - 4. Sell alcohol beverages not produced by licensee for on premises consumption.
- C. Additional Steps:
  - 1. Post security deposit with State Board of Equalization;
  - 2. Establish permitting by local jurisdiction;
  - 3. Provide copy of TTB basic permit;
  - 4. Register as Processor with Department of Food and Agriculture.

# BRICK AND MORTAR WINERY LICENSING

## III. LOCAL REGULATION

- A. Varies County-to-County (e.g. Napa WDO).
- B. Buyer Due Diligence:
  1. General Plan and Zoning (permitted use, minimum parcel size);
  2. Property conditions (access, development potential);
  3. Production limitations (water, wastewater);
  4. Marketing restrictions (trips, turn lanes, events).

# CASE STUDIES

## Buying Winery and Vineyard Property

### I. DOUBLE TRACK VINEYARDS

- Double track due diligence:
  - (i) business assets (intellectual property, inventory, assumption of contracts); and
  - (ii) real property (vineyards, winery, warehouses, water, wastewater).
- Seller operated business to flip it.
- Grape supply critical to business plan- GPAs all uniform.



# Double Track Property



# CASE STUDIES

## Buying Winery and Vineyard Property

### II. DM FAMILY WINERY AND VINEYARDS

- Purchase of real property with winery, vineyard, residence and shared water diversion and storage system.
- Seller was not prepared to sell the property.
- Deferred maintenance.
- Hobby winery/ second home sellers.
- Increase in cost of transaction.
- Renegotiation of purchase price.

# CASE STUDIES

## Selling Winery and Vineyard Property

### I. MOONSHADOW CELLARS

#### RED BALLOON VINEYARD



Moonshadow Cellars

# LEGAL ISSUES PRESENTED

## I. Moonshadow Cellars Builds RED BALLON VINEYARD Brand

### A. Vineyard Designation (27 C.F.R. § 4.39(m))

At least 95% of the wine must be produced from grapes grown on the named vineyard.

- Who owns the vineyard name?
- Is the name a registered trademark?
- Have the parties negotiated a license agreement?
- Who capitalizes on development of goodwill in vineyard name?
- What are the post-termination name rights?

### B. Grape Supply Secured Through “evergreen” GPA

“The initial term of this Agreement shall commence January 1, 1990 and continue until December 31, 2000. If this Agreement is terminated by either party during the initial term of January 1, 1990 through December 31, 2000, the term will end on December 31, 2005. This Agreement shall continue in full force and effect for each additional harvest thereafter, on a rolling five year basis, unless terminated on or before December 1 of the year prior to each successive five year period.”

# CUSTOM CRUSH MODEL

## I. CUSTOM CRUSH

- Brand owner (Client) is a wholesaler, not a bonded winery.
- Host Winery conducts all winemaking operations.
- Client relies on production permit and bond of the Host Winery.
- Client holds Federal Wholesaler's Basic Permit and California 17, 09, 20.

## II. OBLIGATIONS OF HOST WINERY

- Make wine.
- Obtain COLAs.
- Pay the wine tax.

## III. OBLIGATIONS OF CUSTOM CRUSH CLIENT

- Provide winemaking specifications.
- Sell wine wholesale.

# CUSTOM CRUSH MODEL

## I. ADVANTAGES

- Low cost of entry.
- No reporting responsibilities to TTB and no direct payment of taxes.
- Business resources available for marketing focus.
- Portability of business.

## II. DISADVANTAGES

- No control over winemaking process, no right to produce wine.
- Restricted rights to sell direct to consumer in other states compared to holder of 02 Winegrower License.
- No winetastings; no tasting rooms.
- No ability to apply for label approval and labels cannot use the word “winery”.

# ALTERNATING PROPRIETOR MODEL

## I. ALTERNATING PROPRIETOR

- AP is a bonded winery operating within a “host winery” facility.
- AP must maintain control over all licensed activities.
- AP maintains title to grapes and wine throughout processing.

## II. ADVANTAGES

- Total control over winemaking process.
- Type 02 Winegrower License privileges.
- Small Domestic Producer’s Wine Tax Credit.

## III. DISADVANTAGES

- TTB Scrutiny of AP Arrangements (see TTB Industry Circular No. 2008-4).
- Possible tax avoidance if AP misused.
- Does the AP have the required control over licensed activities.
- Suitability of the premises for alternation.

# CASE STUDIES

## Custom Crush to Alternating Proprietor

### I. GRANT FAMILY WINES



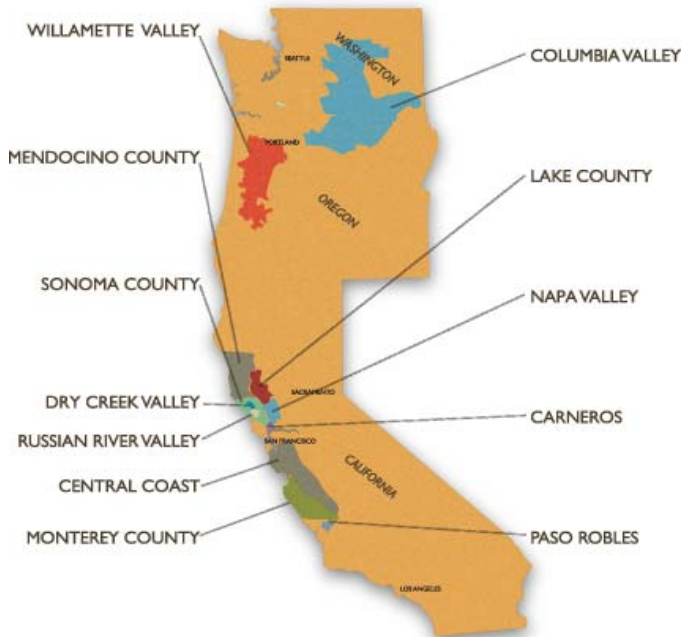
- Winemaker cuts his teeth at Turley, PlumpJack, Corizon and Mondavi.
- Works on his own wine project at employer's winery as custom crush.
- Low cost, easy integration to AP model and direct to consumer push at Tiburon tasting room.





# CASE STUDIES

## Custom Crush



- No. 27 of Top 30 Producers of 2013.
- No ownership of real property.
- Brand built on bulk market wine, now grape supply largely secured through GPAs.

# THIRD PARTY MARKETERS

- Requires production agreement often in the form of License Agreement.
- Control of winemaking through TM.
- No ownership of wine.
- No licenses or permits.
- Profits through TM royalty/marketing fees.

