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Winery Licensing Options for the Colorado Winegrape Growers

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The Rocky Mountain Association of Vintners and Viticulturalists and The Western Colorado Business Development Corporation requested that Compliance Service of America provide this report on the various options for winery licensing that would create greater opportunities for winegrape growers to turn their crop into wine.

Questions or comments about this report can be directed to Alex Heckathorn at 800-400-1353 or by e-mail at alex@csa-compliance.com. Additional materials and articles on these topics are available in CSA's article library at www.csa-compliance.com.

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Introduction

I attended a national alcoholic beverage industry conference in Colorado last June. Our host made sure that Colorado wines were served, and while the servers were tentative in offering those local wines, many of my colleagues from the major wine regions gladly tasted those wines. What was remarkable was that these professionals, who have served the wine industry for decades, were sincerely interested in the state of the art of Colorado's burgeoning wine industry. For them it was not whether the wine was great, they had seen many wine regions evolve and take years to achieve excellence. Better than anyone they understood that every region could develop its own unique contribution to the world of wine.

Colorado wine grape growers have a crucial role and opportunity to further the wine industry in your state. At present, Colorado ranks tenth in the nation for wineries, trailing the eighth and ninth states by a small margin. Growers are the natural sparkplug and boosters of the industry. In this report we make several recommendations that could transform the Colorado wine grape industry and those who follow will thank you for your vision and foresight.

Colorado's wine grape industry is being recognized and is beginning to flourish.[1] To continue to grow, more wine grapes will need to be grown in Colorado. Wine grapes, like any agricultural product, need to be processed in order to become a viable market commodity and to provide growers with the greatest return on their crop. The Western Slope wine grape growers see the need for additional options for the production of wine from their crops.

The production of wine is a highly regulated business. Permits and licenses from both the Federal government and the Liquor Enforcement Division of the Colorado Department of Revenue (LED) are required to engage in the production of wine in Colorado. Others businesses involved in the bottling or sales of bulk or bottled wine must also hold licenses. The privileges and restrictions of these various licenses have a dramatic effect on building a vibrant wine industry in a particular state. States like California, Oregon, Washington and New York have licenses and license privileges which have supported the growth of their wine grape industries. A recent report for the Oregon Wine Board found that the direct

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[1] Colorado's vineyards and wineries were featured in the September 2005 issue of *Wine Business Monthly* and the October 2005 issue of *Wines & Vines.* Both articles stated that improvements in quality were needed, but also noted that world class wines are being made in Colorado.

economic impact of the state's wine industry is $801 million on that state's economy.[2]

CSA has been asked to provide this report on the various licensing and compliance options which could be employed in Colorado to increase production and marketing channels for Colorado grown wine grapes. As a nationwide regulatory consulting firm to the wine industry, we have seen how various compliance models have helped the wine industry grow in other states.

Some of our recommendations do not require any changes in existing laws or regulations whereas other recommendations will require changes in laws, regulations or interpretation of the laws or regulations.

Executive Summary

This report examines the initial idea of using a cooperative winery to further your goals of having additional channels for the production and marketing of wine. The co-op model has a number of significant limitations, both practically and legally. Other types of co-ops for the sharing of equipment have no regulatory implications and are possible immediately.

Having seen the positive effects in other states of a grower's license and alternating proprietorship wineries, we analyze how those options could meet your objectives and make a recommendation that you propose legislation that would add those two privileges to Colorado's wine licensing system. With these additions, a cooperative winery, acting as host winery or as production facility for grower-licensees, becomes a viable option. However, we do not recommend these two options only to enable a cooperative winery.

The grower's license and the alternating proprietorship winery are two vehicles that have substantial independent merit and an established track record of developing the wine grape industry in other states and would give Colorado's wine grape industry the tools it needs to grow.

Licensing in the Wine Industry

Regulatory compliance and licensing is, by its nature, a technical subject, and to put our recommendations in context it is appropriate to provide some background on the basic licensing schemes used in the wine industry. This section will provide this overview.

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[2] Tims, Dana, More green in grapes, *The Oregonian*, Feb. 1, 2006

Traditional Winery Model

A winery is a production or manufacturing facility which converts juice from fruits into wine. To operate, a winery must obtain permits from the Alcohol and Tobacco Tax and Trade Bureau (TTB) of the Department of the Treasury and a license from the state licensing authority.

States often have a variety of winery licenses. For example, Colorado has a manufacturer's license for wines (winery license), a limited winery license and a vintner's restaurant license. The three have different privileges and restrictions. New York has a similar scheme, with a winery license, a farm winery license and a special farm winery license—each with different privileges and restrictions.

Wineries often have many privileges in addition to manufacturing wine. Those privileges include having a sales room where wine can be tasted and sold, and allowing wine to be sold directly to retailers or consumers. These privileges are extremely valuable, especially to small wineries.

Wineries may make wine under their own brand names and sell their wine for their own account. They may also make wine for other licensees such other wineries, distributors or wholesalers, retailers, or growers. These buyers of large quantities are commonly called custom crush clients or customers.

A winery may grow its own grapes or buy grapes from growers or both. Growers can enter into long term contracts with wineries or sell their grapes on the spot market. In an ideal world all the wine grapes that are grown get produced into wine. But, if there is a lack of production facilities, or the grape varietal is not popular or is unknown, the grower may not find a ready market for his crop, which ends up rotting in the vineyard before it even has a chance to become wine. If production facilities are scarce, growers do not have security and are not encouraged to the plant new vineyards. And without grapes, it's hard to create a wine industry.

But, if the grower can readily convert his grapes to wine—a far less perishable commodity—there are considerably more sales opportunities and less risk. It seems that the simple solution is for a grower to build his own winery, but building a winery requires a substantial investment.

The Alternating Winery

In answer to the high cost of building a stand-alone winery, alternating wineries were developed so several wineries could share the winery premises and equipment and share the costs of production. While the federal regulations had provided for alternation for many years, it was not until the early 1990's that the first alternating proprietorship winery was approved in California. The founder of that first alternating winery stated the reasons for doing so succinctly:

> When you look at the economics, there's no way for the little guys to compete against the big fellows unless you develop an innovative way for them to have production cost efficiency that wouldn't be available to them as a single producer in their own premise.

Since then numerous alternating wineries have been licensed in California, Oregon, Washington and New York. Breweries are also permitted to have alternating proprietorship breweries and they have been approved in several states.

The Business Practice Enforcement Book of the California ABC describes the alternating proprietorship winery as follows:

> An alternating proprietor (AP) arrangement is a small winery operation located within an existing winery facility (commonly referred to as the "host" winery.) The AP uses the facilities and equipment of the host winery to make its own wine. Typically, the host winery assists the AP in producing its wine and the AP usually stores his/her wine on the premises of the host winery, but it may be transferred to another bonded premises.

Both the host winery and the alternating proprietor are wineries and hold their own state winery licenses. They simply share the same facilities, equipment and staff. Normally each winery has its own dedicated licensed premises in the winery facility. By alternating the use of winery space and equipment with a host winery, a grape grower can become a winery with just a few tanks or barrels.

Generally host wineries have been larger producers willing to share with small wineries, but over the last few years we have seen a number of commonly owned host wineries established. Often several growers or winemakers come together and pool their resources to build a winery facility designed to be shared by all of them, as alternating proprietors.[3] These commonly owned host wineries have used traditional business structures, but there is no reason a host winery could not be established by a cooperative. We will discuss the cooperative approach in some detail later in this report.

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[3] The Carlton Winemakers Studio in Carlton, Oregon is the best known example of this new model. The Studio, which was built in 2002, is a multi-winery facility that allows up to ten different winemakers to create their own vintages all the way from grape crushing to the bottling. See: http://www.avalonwine.com/carlton-winemakers-studio-5.htm

Each winery, whether the host or an alternator, is a winery and has all of the privileges of a stand-alone winery; an important distinction to remember as we continue to look at other licenses used in the wine industry.

Brand Builders – Growers and Wholesalers

The other major players in the wine industry are the group we call "brand builders." They are the custom crush customers of wineries who have wines made for them. They are grape growers, bulk wine artisans commonly called negociants, brand builders and marketers who are often established wholesalers, and serious home wine makers with dreams of their own.

Although this brand-builder segment of the industry is small in number, modest in finances, and entirely without solidarity such as their own trade organization, their impact on the wine business is significant. The brand-builder style of operation provides a home for excess grapes and wine, a use for excess production or bottling capacity, and adds diversity and variety for consumers.

TTB treats all of these brand builders as Wholesale Liquor Dealers and requires them to hold a Basic Permit. The states have two basic licensing schemes for these brand builders: a grower's license or a wholesaler license.

Selling grapes requires no license, but since the sale of wine is regulated, a license is required to sell wine. Growers in California, Washington and Oregon can legally have their grapes custom crushed and sell the resulting wine to wineries, or even develop their own brand and sell to consumers. The grower's permit in California and Washington allows the grower to sell bulk wine to other wineries only, but the Oregon grower's license provides nearly all the privileges of a winery, except the right to produce wine. We will discuss this license in more detail later.

For those who do not grow grapes or need more grapes than they can grow, the major wine states allow brand builders to be licensed as wholesalers. These brand builders are important to wine grape growers because they buy excess bulk wines and often are some of the best marketers in the business. California brand builders hold a wholesale license ("Type 17") or an importers general license ("Type 10"). With these licenses a grower can buy other wine to blend with their own or bottle it separately if that seems advisable. The California wholesale and importer licenses do not allow sales wine to consumers, but California does permit wholesalers to obtain a restricted retail license for mail order sales. Oregon, Washington and New York also allow brand builders to be licensed as wholesalers, but none of them allow a wholesaler to hold any type of retail license which would allow sales to consumers.

Review of the Colorado Licensing Scheme for Wine

The Winery License

Colorado can license a wine producer under three separate statutes. First is the manufacturer's license for wines (winery license) provided for in §12-47-402. Subdivisions 1, 2 and 3 of this section establish the basic privileges of a winery, which include the following:

- To manufacture wine with fruit from any source and in any quantity,
- To sell wines to consumers with an added wholesaler's license,
- To sell wines to retailers without a wholesaler's license,
- To export wine to other states and foreign countries,
- To allow tasting and sales of wines of its own production and wines made by other Colorado wineries at the winery and one other off-site sales room, and
- To sell food and other products at the winery premises.

The Limited Winery License

The second Colorado winery license is the limited winery license provided for in §12-47-403. The basic privileges granted by this section are:

- To manufacture up to 100,000 gallons of wine from fruit from any source,
- To sell wines of its own production at wholesale, retail or to consumers , including shipping by common carrier to customers who have visited the winery,
- To export wine to other states and foreign countries,
- To allow tasting and sales of wines of its own production and wines made by other Colorado wineries at the winery and up to five (5) other off-site sales rooms, and
- To sell food and other products at the winery premises.

The limited winery license is exemplary in the privileges it offers and forms the basis of many of the recommendations made in this report.

The Vintner's Restaurant License

The third statute created the vintner's restaurant license, which is very similar to Colorado's brewpub statute and is essentially a retail license for a restaurant with limited privileges to produce and sell wine. Given its specialized application, we have not considered it for this report.

The Wine Wholesaler License

As discussed above, growers in other states have used the wholesale license to market wines made from their grapes. Colorado's wholesaler's license is generous in its privileges, but it also has several important restrictions. The wholesaler's license allows the wholesaler to have wine custom crushed and bottled under a brand name owned by the wholesaler. It also permits the wholesaler to purchase and sell bulk wine. A wholesaler may purchase bulk wine from other states and have it imported by a licensed Colorado importer. When exercising these later privileges, the wholesaler normally uses a cooperating winery to handle, store and bottle the bulk wine.

Wholesalers can sell wine only to other wholesalers or retailers. But wine wholesalers in Colorado may *not* sell to consumers, nor may they hold any type of interest in a retail license. Wine wholesalers cannot operate tasting or sales rooms. The wholesaler law also prohibits wholesalers from holding any financial interest in a manufacturer or importer, which means a grower who was a member of a cooperative winery could not obtain a wholesaler's license.

Analysis and Recommendations

A Cooperative Winery

Agricultural cooperatives allow growers to combine their efforts to process and market their crops. However, under present Colorado law, the cooperative is a very limited vehicle for growth. First, we will explain why and then offer some recommendations that would make it viable possibility.

Cooperatives have been a traditional means of processing and marketing agricultural products and it would be tempting to think that a cooperative could build and operate as a single winery selling its members wines. Generally, agricultural cooperatives dictate to their members what will be grown, how it will be processed and how it will be marketed. The co-op receives all the proceeds from sales, which it divides with its members. Decisions are made collectively and there is a shared destiny.

But wine is a more unique product than oranges, almonds or cheese. To be competitive in the marketplace of wine, uniqueness and diversity are essential. At the same time the vision and level of skill of new vintners varies dramatically. One member of a co-op may make very marketable wines immediately, but another may make wines that will need years to become accepted in the marketplace. Small wine producers need all the privileges they can have to make and market their unique wines. For these reasons the traditional cooperative is rarely found in the wine industry.

Under present Colorado law, there is no reason a winery could not be cooperatively owned, but a co-op winery could not return the wine to each grower-member unless the member was licensed to engage in the alcoholic beverage business. Membership in the cooperative would not confer any privileges upon the grower-members to sell the wine made on their behalf.

To be able to acquire the wine from the winery and re-sell it, the member would be required to hold his or her own license. Under current Colorado law the only license a member could hold would be a winery or limited winery license, which would require the grower-member to have its own wine production facility—which is exactly opposite of the goal of having a single, shared winery facility for which the co-op was created.[4]

A grower-member could not hold a wholesale or retail license since the tied house laws prohibit someone with a financial interest in winery from holding either of those types of licenses. Even if a grower-member could hold a wine wholesaler's license, Colorado still does allow a wine wholesaler to have a sales room for consumers to taste and buy the wine. [5]

For these reasons, under present Colorado law, the co-op winery does not achieve the goal of having good options for the making and marketing of wine. We will discuss two recommendations for additions to Colorado's licensing scheme—the grower's license and the alternating proprietorship winery— which would make the cooperative winery a more viable option. However, our recommendations that Colorado provide for a grower's license and alternating proprietorship wineries are not exclusively to enable a cooperative winery. They have much broader privileges which would allow for a more robust wine grape industry regardless of whether a cooperative winery is ever established.

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[4] It is possible for each grower-member to have its own limited winery license located at his or her own separate facility and be a member of the co-op winery. As long as the grower-member actually produced at its own winery facility, the grower-member could have the co-op handle the bulk of the grower-member's production. Wine could be transferred between the facilities in a bond-to-bond transfer; however, such transfer may mean the loss of estate bottling labeling claims. To use "Estate Bottled" on a label requires that 100 percent of the wine came from grapes grown on land owned or controlled by the winery (including grapes grown by members of the co-op winery), which vineyards must be located in an approved viticultural area and the winery must crush and ferment the grapes, finish, age, process and bottle the wine **on their premises.** The better solution is an alternating winery as will be discussed below.

[5] A co-op winery could establish a remote sales room at several of its member's vineyards to sell wine made from the grower's grapes and other Colorado wines, but the structure of the business and division of revenues is still a complex consideration.

The Grower's License

We recommend that the Colorado wine grape growers propose legislation to adopt a grower's license similar to the grower's license existing in Oregon. The Oregon grower's license provides nearly all the privileges of a winery, except the right to produce wine. The Grower's Sales Privilege License permits wholesale sales of bulk or bottled wine to licensed wholesalers and retailers, retail sales of bottled wine and wine by the glass to consumers, tasting, and special events privileges.

The license can be issued to any location where the grower has a place of business and a licensed grower can add up to two additional licensed locations to their license where they can exercise all of the privileges, such as tasting and sales rooms. These privileges are similar to the Colorado Limited Winery license, without the privilege of production. A copy of the Oregon statute is attached as Attachment A.

The grower's license has the unique quality of encouraging the cultivation of Colorado fruit for wine. Since the privilege only extends to growers who have actually grown their fruit in Colorado, it promotes not only Colorado wines, but also Colorado agriculture. In light of the recent removal of the requirement to use Colorado raised fruit from the limited winery license, this license type is a means of supporting Colorado agriculture.

Currently, Oregon has 88 grower's sales privilege licensees[6] and has only 230 unique bonded wineries.[7] As noted by one of Oregon's pioneering vintners, Jim Bernau: "In less than 35 years, [the wine] industry has gone from being a dream and a hobby to one of Oregon's more significant agriculturally-based businesses."[8]

The grower's license would also help existing Colorado wineries by increasing the customers for their production services. If growers have the privilege of marketing wines made for them by a winery, the winery has built in customer—the grower.

According to some reports there are adequate wine production facilities in Colorado to process all of the wine grapes grown in Colorado. However, Colorado wineries may not have enough market share to sell all the wine that they could make from Colorado grown grapes. While existing wineries will buy grapes for their established products, the winery may not be willing to take the risk on a new grape variety or a new type of wine. To create a bigger market for Colorado wine

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[6] Source: Oregon Liquor Control Commission; 2/8/06.

[7] Source: *Wine Business Monthly*, Feb. 2006, p. 46.

[8] Tims, Dana, More green in grapes, *The Oregonian*, Feb. 1, 2006

grapes, there needs to be a greater diversity in both the wines made and the efforts to market those wines.

It is a classic "win-win." The winery can operate at fuller capacity while shifting the financial burden of growing the grapes and marketing the wine to the grower. In exchange, the growers have the opportunity to showcase their unique terrior and vision and use their passion and pride to market wines made with their grapes.

One of the primary ways small wineries garner market share is by having tasting or sales rooms to showcase their wines. History has also shown that the more tasting or salesrooms the more tourists will visit an emerging wine region. And not only tourists but also the wine elite and wine press will come if there are a sufficient number of destinations. And with each taste poured, the area establishes a reputation as a serious wine-growing region. The tasting and sales rooms play an important role in the development of that reputation.

Under current Colorado law, a grower who is an aspiring vintner must build a stand-alone winery to have a sales room, with the attendant costs. Under a grower's license, the grower can build his own sales room without incurring the cost of the winery equipment and facilities.

In addition, wineries often need access to a robust infrastructure such as municipal water and sewer systems, utilities, transportation and warehousing. These needs often push wineries into industrial parks. But, such locations do not conduce to the ideal agricultural tourist experience. A tourist may be willing to visit a brewery in a city, but tourists expect to find the wine tasting room in a viticultural setting. Indeed, the close correlation between where the fruit is grown and the nature and quality of the wine is indelibly established for wine. For these reasons, the grower's vineyards are an ideal location for a grower's sales rooms, while wineries could be located where services are available.

While the grower's license has its advantages, some restrictions do still apply. Under federal labeling regulations, the wine from the grower's grapes cannot be labeled as "*grown*, produced and bottled by [grower's brand or trade name]" because the bottling winery did not grow the grapes—the grower did. Any claims made on the label must be true for the *bottling winery.* For the same reason, the wines made for a grower cannot be labeled as "estate bottled." However, a grower may have his or her own brand and bottling trade names, and the winery can label the wine as “produced and bottled by [grower’s brand or trade name]” by adding the name to the winery’s permit.[9]

Under the Oregon model, ALL of the grapes or fruit used to make wine or cider must be grown in Oregon “under the control” of the licensee. Oregon’s definition of “under the control” is satisfied if the grower-licensee has the right to perform or does actually perform all the acts common to viticulture under a lease or agreement of at least three years duration.[10] But should a grower become an excellent vintner and wants to blend wine made from his own grapes with wine made from grapes grown by others, he cannot do so with a grower’s license. This limits the amount and types of wine the grower can offer to what he can grow.

Oregon also will not issue a grower’s license to someone who holds a winery license in another state. The grower’s license is classified as a manufacturer’s license, subject to the same tied house restrictions as other manufacturer’s licensees. These restrictions prohibit a licensed grower from holding an interest in wholesale and retail licenses. Vineyard owners who are connected with a wine or liquor store, restaurant, hotel, or other retail-licensed establishment may not be qualified to hold a grower’s license.

If Colorado was to adopt the grower’s license patterned on the Oregon law, the cooperative winery becomes more viable. The grower-member who holds a grower’s license can contract with the cooperative to make wine from the grower’s grapes and then re-acquire the bottled wine from the cooperative to market and sell it. The grower could have a tasting-sales room and sell directly to wholesalers, retailers and consumers. Since the grower’s license is in the same tier as a manufacturer’s license for tied house purposes, a grower licensee would be allowed to have a financial interest in the cooperative winery.

While the grower’s license is considered to be a manufacturer’s license for tied house considerations, a grower licensee obtains a TTB Basic Permit as a “wholesale liquor dealer” and *not* as a winery. This distinction becomes important because only *wineries* are entitled to obtain direct shipping permits allowing the direct shipment of wine to consumers. Most all of the states that issue such permits would not issue them to a grower licensee.

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[9] Growers cannot use a bottling trade name that contains the word “winery” but a grower can use the words, cellar and/or vineyards in the grower’s trade name. For more information on the rules for the use of trade and brand names in the wine industry, see: *The Rules of the Winery Name Game* and *The Marketing Power of Multiple Personalities* available in the article library at http://www.csa-compliance.com

[10] Even though this definition of viticultural control mirrors the federal estate bottling regulations, the wine still cannot be labeled as “estate bottled” for the reasons, explained above.

But still, as the wine industry grows in Colorado, the grower's license itself will become too limiting especially for grower-vintner who want to use the grapes grown by others, or make or blend wines made from grapes grown in other regions.[11] This leads to our second recommendation that a way should be found to permit alternating proprietorship wineries to exist in Colorado. An alternating proprietorship winery is also an ideal way to set up a cooperative winery arrangement.

The Alternating Proprietorship Winery

Alternating proprietorship wineries are now common in California, Oregon, Washington and New York. They are the perfect vehicle for small producers to come together to build and operate a wine production facility, while allowing each producer to have total control over their winemaking and the complete privileges of a winery to market and sell their wine.

The Alcohol and Tobacco Tax and Trade Bureau (TTB) described these facilities in its 2003 Industry Circular (I/C 2003-7) as follows:

> An "alternating proprietorship" is a term we use to describe an arrangement where two or more persons take turns using the physical premises of a winemaking facility. In most situations, the proprietor of an existing bonded wine premises (the "host" proprietor) agrees to rent space and equipment to a new ("tenant") proprietor. This allows existing wineries to use excess capacity and gives new entrants to the wine business an opportunity to begin on a small scale without investing in equipment.

The tenant winery, or alternating proprietor, is a separate winery in every sense of the word—it is *not* a virtual winery. The alternating proprietor must exercise control over its winemaking process and act in every way as an independent producer. Although alternators share space and equipment with the host winery, and almost always rely on the host's cellar workers to perform wine movements, each winery must ferment wine in their own premises each year, maintain separate records of all winery operations, and accept full responsibility for winemaking decisions, standards, and results. An alternating proprietorship

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[11] As noted in the *Wine Business Monthly* article, "One of the most important lessons for winemakers in the state to learn is that quality concerns may force them to move away from single-vineyard, single-varietals wines. 'It's just like French Bordeaux: We make very good single varietals, but sometimes you can improve on a single varietal by doing some blending. And it might not be blending different varietals—it could be blending the same varietals from Mesa County with some Delta County,' said Horst Caspari."

arrangement is a collaboration of independent wineries, each with separate records and responsibility for its own winemaking practices.

While accepted by TTB and other states, Colorado has not licensed an alternating proprietorship winery because the issues involving the "licensed premises" of each winery. In Colorado, there is strong interpretation of the statutory provisions relating to licensed premises which holds that any licensee must exercise complete and exclusive control over its licensed premises at all times and must have the right to occupy the premises for the duration of its license term. The two most relevant Colorado statutes relating to the licensed premises are as follows:

> **12-47-103. Definitions.** As used in this article and article 46 of this title, unless the context otherwise requires: …
> (14) "Licensed premises" means the premises specified in an application for a license under this article which are owned or in possession of the licensee within which such licensee is authorized to sell, dispense, or serve malt, vinous, or spirituous liquors in accordance with the provisions of this article.
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> **12-47-301. Licensing in general.**
> (3) (b) At all times a licensee shall possess and maintain possession of the premises or optional premises for which the license is issued by ownership, lease, rental, or other arrangement for possession of such premises.

In an alternating proprietorship winery, the winery licensees alternate the use of tanks and equipment in the production of their own wine and share the winery building. Federal regulations provide that either the host, or one of the alternators, may have exclusive control of a portion of the facility (such a the bottling line or a tank) for their winemaking activities for a flexible period of time, but not less than 24 hours. 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. When an alternator is finished using that portion of the premises, it reverts back to the host winery.

This alternation of the premises initially confounded regulators in California, but since the federal regulations allowed it, the California ABC found a way to interpret the "licensed premises" to accommodate this system. Initially, and still a common practice even today, the alternators have a permanent area—one that is continually 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). A suite or unit number at the winery's street address is used to designate these unique and discrete premises of the tenant wineries.

Both the host winery and the alternators must file detailed premise descriptions and alternation plans as part of their TTB application for a permit to establish a bonded wine premises. TTB has stated that "alternating proprietorships are conducted under an approved alternation plan that describes the area to be used by each proprietor when that proprietor is active. The host proprietor must not change the portion of the premises assigned to the tenant proprietor on an approved alternation plan without notice to the tenant proprietor and the Chief, NRC [National Revenue Center of TTB]."[12]

In California, both the host winery and the alternating proprietor provide a detailed diagram to the California ABC. We have enclosed a copy of the description attached to an approved TTB application and the California ABC diagram forms for an alternating winery in California as Attachments B and C. We have also reproduced the section on alternating proprietorship wineries from the Business Practice Enforcement Book of the California ABC in Attachment D.

The host and tenant winery also enter into formal written agreement(s) governing their relationship which are reviewed by the regulators. The agreement(s) provide for the lease or sublease of space by the tenant winery and shared use of equipment and services by each winery. To ensure access to both premises, both the host and all the alternating proprietors agree in writing that regulators can cross each other's premises at any time for inspections.

Since the statutory provisions defining the "licensed premises" are different in Colorado than the other states that have permitted alternating proprietor wineries, we recommend that the Colorado wine grape growers request the Colorado legislature to add a new subsection to §12-47-103 to define the licensed premises for manufacturers and limited wineries as follows:

> The licensed premises of a manufacturer and/or limited winery licensee may consist of a defined area within a building, which area is under the exclusive possession and control of the licensee by ownership, lease, rental, or other arrangement for possession of such premises and that such area may be expanded or curtailed in accordance with the Federal regulations for the alternation of proprietors and premises, notwithstanding that another manufacturer or limited winery licensee is also licensed at the premises.

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[12] TTB Industry Circular 2003-7, December 2003.

The federal regulations for the alternation of premises and proprietors of a winery are contained in section 27 CFR §§ 24.135 and 24.136, and are attached as Attachment E.

Once this issue involving the definition of the licensed premises is resolved satisfactorily, the Colorado existing winery licensing scheme works excellently. The host winery could either be a winery or limited winery licensee and the alternators or tenant wineries are likely to be licensed with the limited winery license. The host winery could be owned and operated by a cooperative and those growers who wished to have the full privileges of a Colorado winery or limited winery could become alternating proprietors at the host facility.

With the full compliment of winery privileges, the alternating proprietor winery can make wine from any source, sell the wine to the widest range of customers and open sales rooms offering both its own wines and wines of other Colorado wineries. The host facility could also have a tasting or sales room offering all of the wines made at the facility. The number of privileges and the flexibility granted by being a winery or limited winery licensee is essential for the growth of Colorado's wine grape industry.

TTB acknowledged the value of the state winery privileges as one the primary reasons for the alternating proprietorship wineries in its Industry Circular, where it said:

> TTB recognizes that alternating proprietor arrangements may be undertaken for many reasons. For instance, a tenant proprietor may qualify as a bonded wine premises proprietor to obtain privileges under State law that are not available to wholesalers. As a result, a qualified alternating proprietor may or may not be a producer eligible for the small domestic producers' wine tax credit. This credit was intended to encourage small new businesses to enter the wine industry.[13]

The small producer tax credit is also one of the driving forces for alternating proprietorship wineries. Each independent producer of wine is entitled to a reduced excise tax rate of $0.17 per gallon on the first 100,000 gallons of wine it produces. The full federal excise tax rate is $1.07 per gallon. As the host winery and each tenant winery is a separate winery, they are *each* entitled to produce 100,000 gallons at the lowest tax rate. In contrast, a large co-op winery (that did not have alternating proprietors) would be a larger producer and pay federal

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[13] TTB, Industry Circular 2003-7, December 2003.

excise taxes at a higher tax rate, which would affect the cost of wine produced for growers who held a grower's license. While this gallonage may seem large today, it will seem small in a few years.[14]

The value of shared winery facilities is tremendous to an emerging wine region. Sharing the cost of equipment such as presses, de-stemmers, tanks, refrigeration units, barrel racks, forklifts, bottling lines, pumps, and filters means that each winemaker has better equipment available to make better wine. Shared facilities can afford to maintain a staff that can assist winemakers with their cellar movements and operations. Shared office staff can help keep accurate records and develop compliance expertise. In general such facilities support professionalism and better winemaking practices by virtue of the support and collaboration which occurs naturally.

Another advantage of the alternating winery is that the right to use "estate bottled" on a label can be preserved by ensuring the wine always stays on the bonded premises of the alternating winery. Also a grower, who is also an alternating winery, can proudly claim on the label that the wine was "grown, produced and bottled" by the grower since he or she is the bottling winery.

A system as flexible as an alternating proprietorship winery raises a number of practical questions. Many of these questions have to be answered on a case-by-case basis, but we will attempt to provide some answers to the obvious questions.

Who is the host winery? The host winery is often an established producer who is willing to share their facility with others. If necessary, the facility could be enlarged to handle the alternators. In the case of a newly built facility, an existing winery that wishes to move to a new, better equipped facility could serve as the host. A cooperative can be formed to fill the role of the host winery or a group of growers and/or wineries could decide among themselves who would act as the host based on experience, willingness and energy. The host can be compensated for the extra work needed to act as the host. The host could also provide custom crush services to growers and/or wholesalers as an additional revenue stream. One of the basic decisions a group or co-op would need to decide whether they will provide custom crush services to others or simply operate for the benefit of the host and alternators. The following diagrams show these two options graphically:

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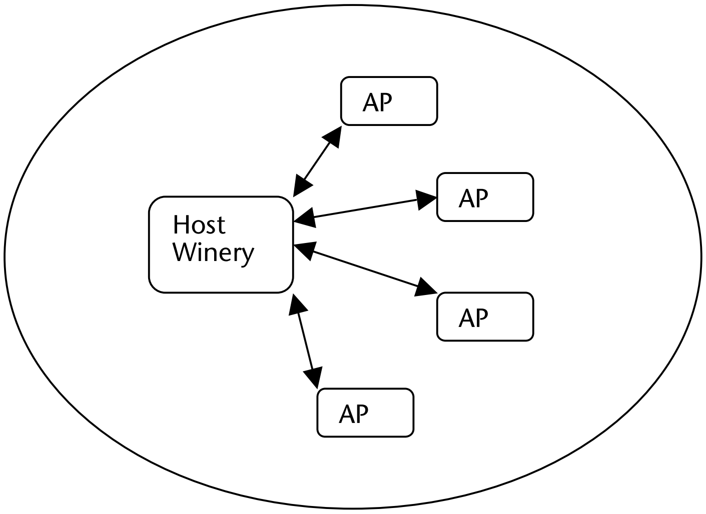
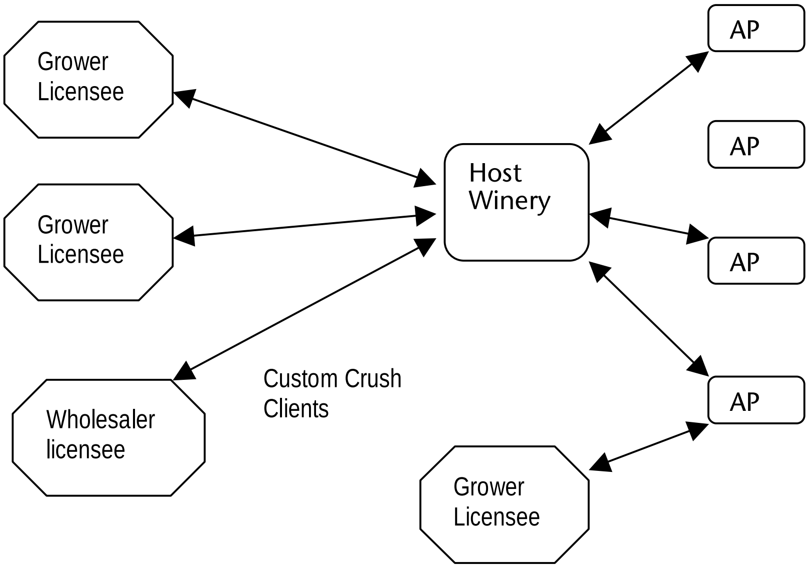
[14] Considerations about how the small producer credit interacts with winery ownership structures and operations are complex and are specific to each situation. For more information on the basic rules, see: *Refesher Course on Wine Taxes* available in the article library at http://www.csa-compliance.com These considerations become relevant if the initial threshold of 100,000 gallons would be reached in the foreseeable future.





How is the host winery licensed? It can be licensed either as a manufacturer-winery or as a limited winery. We recommend the limited winery license if the host's production is less than 100,000 gallons annually since a limited winery has more privileges.

How are the alternating proprietors or tenant wineries licensed? Again, they may be licensed as a manufacturer-winery or as a limited winery. We recommend the limited winery license if the alternator's production is less than 100,000 gallons annually since a limited winery has more privileges.

How do the alternating proprietors or tenant wineries compensate the host? The best practice is for the tenant wineries to pay the host rent for the space they occupy and pay for services as used according to a standard rate sheet. This is specified in the "alternating proprietorship agreement" entered into by the host and the tenant winery. Compensation of the host using a fee or charge for each case should be avoided since TTB has stated such arrangements indicate a custom crush arrangement, not a true alternating proprietor arrangement.[15]

How do custom crush clients compensate the host or an alternating winery? Generally the wineries have a standard contract with a rate sheet for custom crush clients. There are a variety of ways to set the compensation, but a common method is to establish a charge based on the number of cases delivered to the custom crush clients. This charge would vary based on whether the custom crush client provided the grapes (as in the case of a grower licensee) or provided the bulk wine or had the winery source the grapes and make the wine.

Who gets the federal label approval for wine made at an alternating proprietorship winery? It depends on which winery has the bottling line under their control when the wine is bottled. Since control of the bottling line can rotate and be under the bond of either the host or one of the alternators, it would depend on the method use to schedule of the bottling line. Since the bottling line can only rotate every 24 hours, it would depend on whether the volume of wine to be bottled will take an entire day or whether efficiencies dictate multiple wineries should bottle on the same day. In the later situation, the host would control the bottling line and the wine would be transferred to the host (in a bond-to-bond transfer) for bottling. If the host is bottling, it obtains the label approval. The only time this should not be done is when the wine is to be labeled as "estate bottled" or the production statement states the wine was "grown, produced and bottled by (the name of the winery that grew the grapes)." In these cases, the bottling line must be under the control of the winery which grew the grapes and fermented the wine and the label approval is obtained by that winery.[16]

While the alternating proprietorship winery seems complex and there is a learning curve, the benefits are tremendous. The flexibility, the economies of scale, the shared overhead and the enhancement of quality of the wines have proven to be more valuable than the effort it takes to establish and operate an alternating proprietorship winery. The number of alternating proprietorship wineries in other states is increasing dramatically, proving that the benefits are worth the effort.

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[15] See TTB Industry Circular, 2003-7, December 2003, available on TTB's website.

[16] For more information on labeling, there are several articles on labeling available on CSA's article library at http://www.csa-compliance.com

While it may appear that the burgeoning Western Slope wine grape industry does not need it this minute, in reality it would be a wise choice to pursue now. It would have a synergistic and positive effect on the growth of wine production in your area and pave the way for expansion.

Amending the Wine Wholesaler Law

As noted early in this report, California permits its growers to become wholesalers with a limited retail license to make sales to consumers by mail, phone and internet orders. Many aspiring vintners have started out this way in California and have moved on to be an alternating winery or even a stand-alone winery. Consequently, the idea of giving wine wholesalers in Colorado additional privileges is not a replacement for the alternating proprietorship winery or even the grower's license discussed above.

At present, Colorado wine wholesalers have no privilege to have a sales room where they can sell wine directly to consumers or offer tastes or wine by the glass. Nor can a wholesaler have an interest in a retail or manufacturer's license. These restrictions do not support using this license for wine brand builders.

Colorado does permit its *malt beverage* wholesalers to have a sales room where they can sell malt beverages directly to the public. However, very few do so and it is not a popular feature of the Colorado law even among the beer wholesalers.

While an attempt could be made to add a retail privilege to the wine wholesaler license provision, it would open the proverbial Pandora's box and would probably be opposed by the retail package stores and the wholesalers in the state. The other recommendations in this report are likely to have the support of (or at least the acquiescence of) the other tiers of the industry, but attempting to change the wholesaler license law would trigger great concern among the other tiers of the industry. For these reasons, we do not recommend this course of action.

Other Ideas for Helping Grow Your Industry

The Incubator Building or Winery Nursery

One option to promote the growth of wineries that would not need any changes in Colorado law is to construct a facility or group of buildings designed to house several small wineries. These buildings include sloped floors with drains, high ceilings and roll up doors to facilitate tank movements, and other features to facilitate winemaking. This facility would likely be built where there was adequate infrastructure for such operations.

The Port of Walla Walla Washington used a state grant to build several buildings designed to hold several small winery operations. The facility was built specifically for wine production and offered low cost leases for a term of 6 years, at which point the winery would have to move to make room for the next incubator winery. We have attached an article on this program as Attachment F.

This "incubator" building or buildings can provide space for small wineries to get started. Each winery would occupy its own premises and would be a separately licensed winery or limited winery. Each occupant of this facility would have to invest in their own equipment for their winery. Because all the premises are in adjoining spaces close to each other, there is the possibility of sharing equipment. It would be possible to have a commonly used crush pad and presses to be shared by all, so long as no fermentation step was involved and the juice or must had not yet started to ferment. Both TTB and the DOR may require that such a crush pad be part of one bonded and licensed premises and in that case, there could be a lose of the estate bottling claim. Then there are the inevitable scheduling issues during busy times.

The other practical differences of such an incubator facility from an alternating proprietorship winery is that there is less overarching management of the facility or equipment and the lending or borrowing of equipment is on an *ad hoc* basis. Also it is unlikely that shared and experienced staff would be available to the tenants of the facility. It also provides significantly less flexibility for growth. Each winery is limited by the physical space it occupies and even if it were to take another nearby bay or premises, it may not be contiguous or it may be more space than is needed. In an alternating proprietorship winery there is greater flexibility to provide exactly the amount of space and services a growing winery needs without having to re-invest in the facilities and equipment repeatedly.

The Equipment Cooperative

As a way of reducing the start up costs for equipment, it has been suggested that a cooperative be formed to purchase equipment that could be shared by the members of the cooperative. Each member would have its own winery facility, but certain pieces of equipment would rotate between the members for use. A mobile bottling line would be an ideal piece of equipment for this type of cooperative venture. Smaller and portable equipment such pumps and filters could also be easily shared.

However, when it comes to larger pieces of equipment such as de-stemmers and presses the idea is less practical. On top of the difficulty of moving large pieces of equipment, there are scheduling difficulties which are compounded by the time needed to transport, set up and break down the piece of equipment at each location. While this could be a stopgap measure to assist small wineries in the immediate future, the practical difficulties would eventually militate to a shared facility where the equipment was permanently installed and could be used most efficiently.

Conclusion

As a result of the recent Supreme Court decision on the direct shipment of wine and the efforts by the states to harmonize their laws with the Court's mandate of non-discrimination, several wine bills have been introduced in the Colorado legislature this session. This may be the best time to push for new legislation to broaden the privileges of Colorado wineries and growers.

At this moment you have the most allies ever aligned together—the public, the media, the agriculture department, local economic development boards, and the national and state wine trade organizations. The wholesale and retail tiers of the industry are open to compromises.

Your agenda of adding winery and grower privileges is not likely to be controversial, especially since Colorado is poised to play a bigger role in the wine business. As noted by one of Oregon's pioneering vintners, Jim Bernau: "In less than 35 years, [the wine] industry has gone from being a dream and a hobby to one of Oregon's more significant agriculturally-based businesses."[17] Given the efforts already undertaken in Colorado and the rapid growth in the last five it is likely to take less than 35 years for wine grapes to become a significant agricultural product in Colorado.

The growth of the Colorado wine grape industry can be benefited immediately and for the foreseeable future by implementing the two recommendations to add a grower's licenses and the provisions necessary to permit alternating proprietorship wineries. Since our recommendation to amend the licensed premises provisions for manufacturers and limited wineries would apply to breweries as well, such legislation would also benefit the craft brewing industry in Colorado, and you could find support for that legislation from that segment of the industry.[18] Given the combination of all these factors, we believe you would be successful in advancing these recommendations at this time and that these regulatory enhancements would secure the future of your wine grape industry.

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[17] Tims, Dana, More green in grapes, *The Oregonian*, Feb. 1, 2006

[18] Alternating proprietorship breweries are also allowed under federal regulations for breweries. Since the small brewer's tax rate is lost entirely when production exceeds 60,000 barrels, and the economies of scale are even more essential in the brewing industry, brewers have even greater reasons to embrace and support alternating proprietorships.

Attachment A

Oregon Grower’s Sales Privilege License

Oregon's Grower Sales Privilege License

471.227 Grower sales privilege license. (1) A grower sales privilege license shall allow the licensee to perform the following activities only for fruit or grape wine or cider where all of the fruit or grapes used to make the wine or cider are grown in Oregon under the control of the licensee:

(a) To import, store, transport or export such wines or cider.

(b) To sell such wines or cider at wholesale to the Oregon Liquor Control Commission or licensees of the commission.

(c) To sell such wines or cider at retail directly to the consumer for consumption on or off the licensed premises.

(d) To conduct the activities allowed under paragraph (a), (b) or (c), or all, of this subsection at a second or third premises as may be designated by the commission.

(e) To obtain a special events grower sales privilege license which shall entitle the holder to conduct the activities allowed under paragraph (c) of this subsection at a designated location other than the one set forth in the grower sales privilege license for a period not to exceed five days.

(2) For purposes of ORS 471.392 to 471.400, a grower sales privilege licensee shall be considered a manufacturer.

(3) A person holding a winery license in another state is not eligible for a license under this section.

(4) A person licensed under this section is not eligible for a limited on-premises sales license or an off-premises sales license.

(5) As used in this section, "control" means the grower either owns the land upon which the fruit or grapes are grown or has a legal right to perform or does perform all of the acts common to fruit farming or viticulture under terms of a lease or similar agreement of at least three years' duration.

(6) For the purposes of tax reporting, payment and record keeping, the provisions of law that shall apply to a manufacturer under ORS chapter 473 shall apply to a grower sales privilege licensee, but such a licensee is not a manufacturer for purposes of ORS 473.050 (5). [1989 c.740 §2; 1995 c.58 §2; 1995 c.301 §82; 1999 c.351 §23a]

Attachment B

Description of Alternating Winery From TTB Application to Establish a Bonded Wine Premises

4. Winery Premise:

a. Description of bonded premises:
The applicant’s bonded wine premise is located on a 13.5 acre parcel at 7850 Silverado Trail, Oakville, California. The premise consists of indoor and outdoor areas. The Point of Commencement shall be the north side of the driveway entrance at 7850 Silverado Trail. From the Point of Commencement, proceed 136′ east, then 132′ northeast to the southwest corner of the winery building at the tank pad/crush area, this is the Point of Beginning.

From the Point of Beginning proceed around the bonded premise as follows:

148′ east,
108′ north,
153′ east, heading away from the winery building,
270′ north,
153′ west,
142′ south, to the corner of the dock area
148′ west, and
228′ south, along the front of the winery building back to the Point of Beginning.

b. Description of security:
All exterior doors are secured by commercial locks or steel bolts that can only be accessed from inside the buildings. All windows in the winery are fixed and unopenable.

c. Description of tax paid areas:
Indoor areas of the bonded premises will alternate between bonded wine premises and taxpaid wine premises. Case goods will be stored in stacks either designated as taxpaid or will be in bond (in bond case goods are not to be mixed with taxpaid cased goods in the same stack). Each taxpaid stack will be labeled with a 4″ x 9″ inventory control label, which clearly identifies each pallet as taxpaid. All case goods will be in bond unless labeled taxpaid.

The second and third floors of the winery building are off bond. These floors house the offices, the tasting room and a banquet room.

d. Description of alternating areas:
   Only one alternating proprietor will operate each alternating area or tank at a time. When any of the approved alternating proprietors are not using these areas or tanks, they will be under the control of the host winery. Each alternating proprietor will keep the records required by §24.136, including the gallons of wine received or removed while operating the alternating areas or tanks, and the effective date and hour when it takes over and when it surrenders operation of the alternating areas or tanks.

   Alternating areas are described as follows:
   Crush Pad
   From the Point of Beginning for the bonded winery premises, proceed 35′ east to the southwest corner of the crush pad. This is the Point of Beginning for the crush pad. From the Point of Beginning, proceed 61′ north, 55′ east, 61′ south, and 55′ west, back to the Point of Beginning for the crush pad.

   Bottling Room
   From the Point of Beginning for the bonded winery premises, proceed approximately 120′ north to the southwest corner of the bottling room. This is the Point of Beginning for the bottling room. From this Point of Beginning, proceed 80′ north,
   27′ 6″ east, 80′ south, and 27′ 6″ west, back to the Point of Beginning for the bottling room.

   Outdoor Tank Area
   The Point of Beginning for the bonded winery premises shall be the Point of Beginning for the outdoor tank area. From the Point of Beginning proceed 35′ east, 61′ north, 35′ west, and 61′ south back to the Point of Beginning for the outdoor tank area. This area contains stainless steel tanks, which will each alternate separately.

   Indoor Tank Room
   From the Point of Beginning for the bonded winery premises proceed 61′ north to the southwest corner of the indoor tank room. This is the Point of Beginning for the indoor tank room. From the Point of Beginning for the indoor tank room, proceed 90′ east, 60′ north, 90′ west, and 60′ south back to the Point of Beginning. This area contains stainless steel tanks, which will each alternate separately.

Alternating wineries:
The following wineries will alternate the use of the designated alternating areas, and will occupy permanent dedicated bonded areas as listed below. The following areas are to be curtailed from the bonded premises of the host winery, Miner Family Winery, LLC:

Clark-Claudon Vineyards, LLC Suite A:
From the Point of Beginning for the host winery, proceed 228′ north and 90 east to the enrtrance to the cave, then continue 127′ east and 53′ north. This will be the Point of Beginning for Suite A, the bonded winery premise of Clark-Claudon Vineyards, LLC.

From the point of beginning proceed around the bonded winery premise as follows:
67′ 6″ west,
13′ north,
67′ 6″ east, and
13′ south, back to the Point of Beginning for Suite A.

Cafaro Cellars Inc. Suite B:
From the Point of Beginning for the host winery, proceed 228′ north and 90 east to the entrance to the cave, then continue 127′ east and 86′ north. This will be the Point of Beginning for Suite B, the bonded winery premise of Cafaro Cellars Inc.

From the point of beginning proceed around the bonded winery premise as follows:
67′ 6″ west,
13′ north,
67′ 6″ east, and
13′ south, back to the Point of Beginning for Suite B.

e. Description of winery buildings

The winery building measures 140′ X 90′ and is of conventional wood frame construction with a stucco exterior and tile roof. There is an attached outdoor covered crush area and outdoor tank area. The winery building has three floors, described as follows:

Ground Floor
The ground floor production area inside the building measures 90′ x 140′, and contains the fermentation room, barrel room, bottling room, warehouse, lab, employee locker room, and winemaker office.

Second Floor (off-bond)
The second floor is accessible via elevator, exterior stairway and interior stairway, and contains the retail tasting room, deck, gallery, and public rest rooms. Additional winery production offices are located to the rear of the second floor and are accessible from the north side of the building at ground level (the rear of the winery is recessed for grape delivery at the second level). A break room is located next to the production office, also on level 2.

Third Floor (off-bond)
The third floor of the winery contains a reception area near the back of the building (north end) accessible via stairway and a technical training area. The kitchen is adjacent to these rooms. The balance of the third floor consists of administrative, sales and marketing offices and a deck next to the open office area.

Cave
The cave is irregularly shaped, and measures approximately 266′ X 150′. The walls, floor, and ceiling are cement. The cave is used for wine storage.

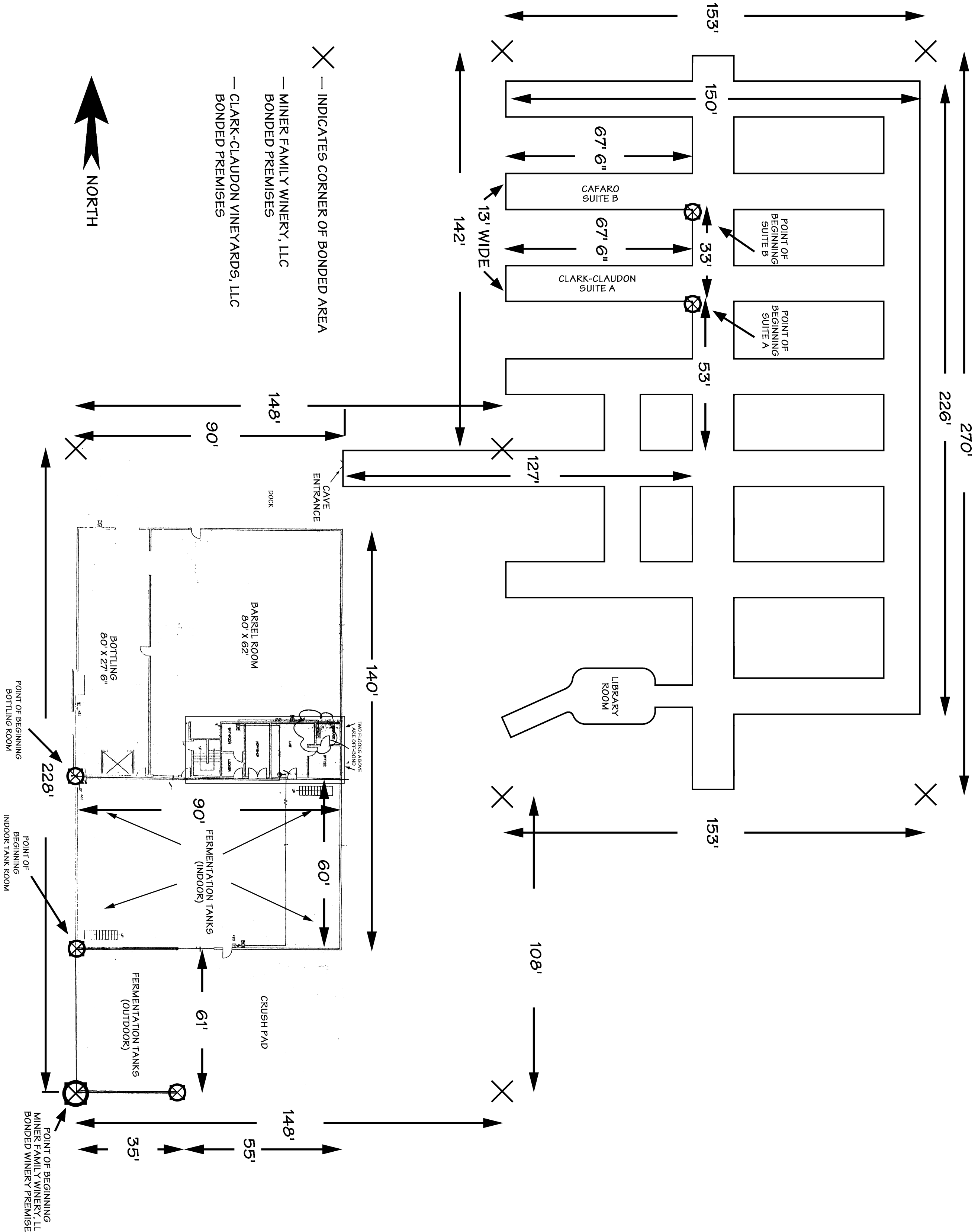
f. Means of ingress/egress

Winery building
The winery building has a total of 11 doors, varying in size from 3′ to 12′ wide. Doors are hinged, on sliders, or roll up.

Cave
The cave has 3 heavy, wooden hinged double doors, measuring 8′ wide.

Attachment to TTB 5120.25, Application to Operate Wine Premise, Serial number 3
Miner Family Winery, LLC
March 3, 2005
Page 8

Diagram - Bonded Winery Premises



Attachment C

California ABC Form 257
Premises Diagram
for Alternating Winery
Host & Tenant Wineries

Department of Alcoholic Beverage Con

LICENSED PREMISES D GRAM (NON-RETAIL)

State of California
GRAY DAVIS, Governor
Business, Transportation & Housing Agency
MARIA CONTRERAS-SWEET, Secretary

1. APPLICANT NAME (Last, first, middle)
Miner Family Winery, LLC

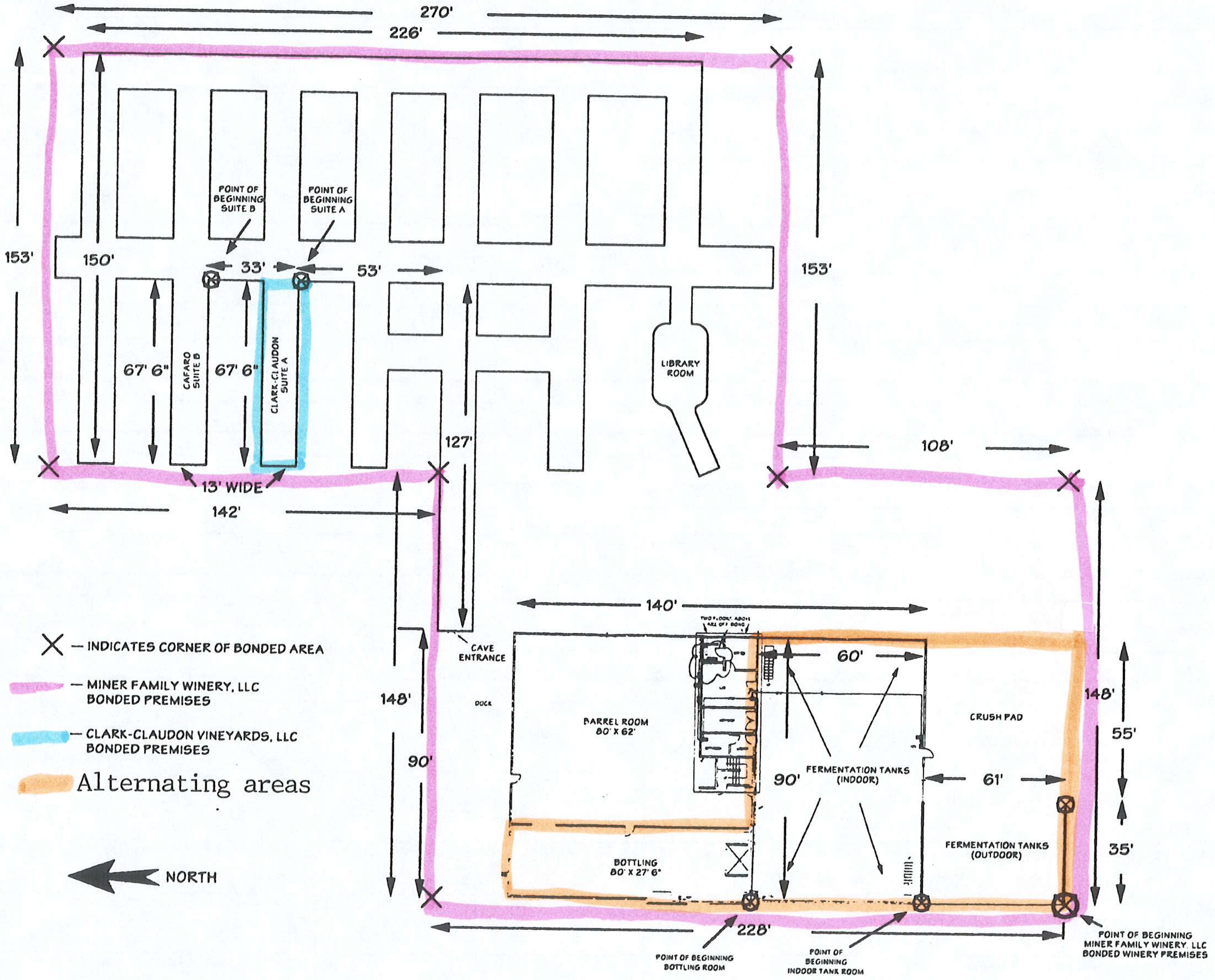
2. LICENSE TYPE
02

3. PREMISES ADDRESS (Street number and name, city, zip code)
7850 Silverado Trail, Napa, CA 94558

4. NEAREST CROSS STREET
Oakville Cross Rd.

The diagram below is a true and correct description of the entrances, exits, interior walls and exterior boundaries of the premises to be licensed, *including dimensions*.

DIAGRAM



It is hereby declared that the above-described boundaries, entrances and planned operation as indicated on the reverse side, will not be changed without first notifying and securing prior written approval of the Department of Alcoholic Beverage Control. I declare under penalty of perjury that the foregoing is true and correct.

APPLICANT SIGNATURE (Only one signature required)
X David W. Miner, Managing Member

DATE SIGNED
6-27-05

FOR ABC USE ONLY

CERTIFIED CORRECT (Signature)

PRINTED NAME

INSPECTION DATE

ABC-257-NR (9/01)

Department of Alcoholic Beverage Contr

LICENSED PREMISES DI RAM (NON-RETAIL)

State of California
GRAY DAVIS, Governor
Business, Transportation & Housing Agency
MARIA CONTRERAS-SWEET, Secretary

1. APPLICANT NAME (Last, first, middle)
Clark-Claudon Vineyards, LLC

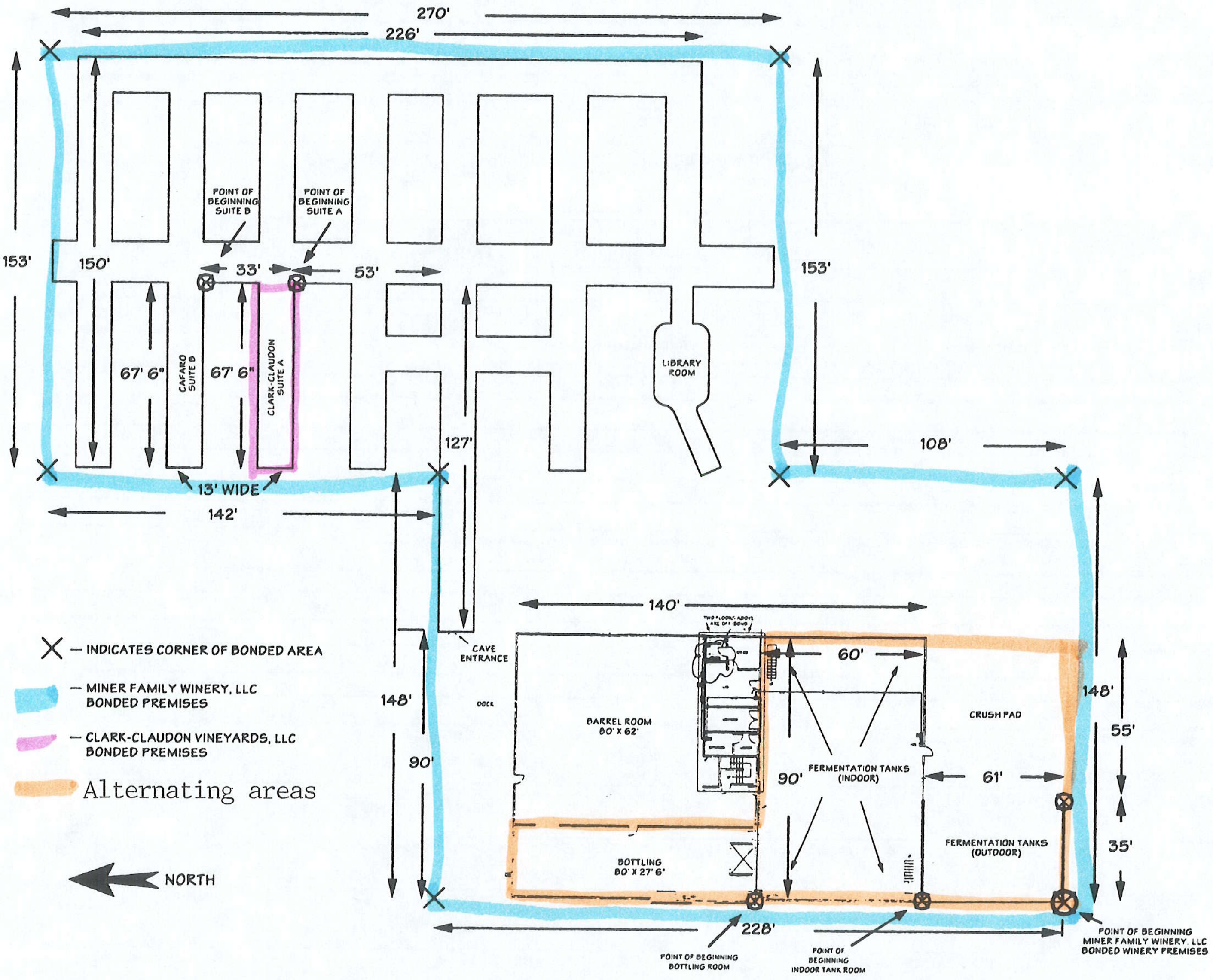
2. LICENSE TYPE
02

3. PREMISES ADDRESS (Street number and name, city, zip code)
7850 Silverado Trail, Suite A, Napa, CA 94558

4. NEAREST CROSS STREET
Oakville Cross Rd.

The diagram below is a true and correct description of the entrances, exits, interior walls and exterior boundaries of the premises to be licensed, *including dimensions*.

DIAGRAM



✕ — INDICATES CORNER OF BONDED AREA
🟦 — MINER FAMILY WINERY, LLC BONDED PREMISES
🟪 — CLARK-CLAUDON VINEYARDS, LLC BONDED PREMISES
🟧 Alternating areas

It is hereby declared that the above-described boundaries, entrances and planned operation as indicated on the reverse side, will not be changed without first notifying and securing prior written approval of the Department of Alcoholic Beverage Control. I declare under penalty of perjury that the foregoing is true and correct.

APPLICANT SIGNATURE (Only one signature required)
Laurie A. Claudon-Clark

DATE SIGNED
2-14-05

FOR ABC USE ONLY

CERTIFIED CORRECT (Signature)

PRINTED NAME

INSPECTION DATE

ABC-257-NR (9/01)

Attachment D

California ABC
Business Practice Enforcement Book
Section on Alternating Proprietorship Wineries

From CA ABC Business Practices Enforcement Book, page 4

ALTERNATING PROPRIETORSHIPS AND PREMISES DESIGNATIONS
An alternating proprietor (AP) arrangement is a small winery operation located within an existing winery facility (commonly referred to as the “host” winery.) The AP uses the facilities and equipment of the host winery to make its own wine. Typically, the host winery assists the AP in producing its wine and the AP usually stores his/her wine on the premises of the host winery, but it may be transferred to another bonded premises. The AP must apply for its own Type 02 license from us and a bonded winery permit from the Alcohol and Tobacco Tax and Trade Bureau (TTB). The privileges of a Type 02 license are the same when operating as an alternating proprietor except that AP’s rarely conduct winetastings on the host winery’s premises.

Recently, the TTB determined that establishing a physical separation and dedicated premises for each alternating proprietor is not required for all AP applications. Where no separation/dedication is required, then there is no need for the host to reduce its existing premises and the AP is no longer required to define a dedicated premises on the Form 257-NR. Form 257-NR should show the whole facility of the host winery when diagramming an AP. It is not unusual to have multiple alternating proprietors at one host premises.

In those cases where TTB deems that such separation/dedication is required, or where the host winery wishes to physically establish a separate premises for each alternating proprietor, then each AP applicant must complete the diagram portion of Form 257-NR. Likewise, the host winery should complete a new diagram reducing its existing licensed premises. If there is a dedicated premises for the AP, then the dedicated area and alternating areas should be clearly defined. This is usually done by color coding the alternating areas differently from the dedicated premises of the AP. The areas where the wine is produced become the “alternating” areas shared by each proprietor. These “shared” areas may consist of a crush pad, wine processing tanks, barrel areas, bottling lines, etc. If there is a dedicated premises, it usually has barrels containing wine that is in the fermentation or aging process or it may have cases of finished wine. In either situation, neither federal nor state excise taxes have been paid on this wine. This is also known as wine “in-bond”. Wine that is moved in and out of these areas must be documented by the wineries and reported to the TTB. In this manner, the TTB is able to identify whose wine is located in a specific area for a specific period of time.

While Rule 64.2(c), CA Code of Regulations, exempts winegrowers and brandy manufacturers from the diagram requirement unless they conduct either (1) winetastings; or (2) retail sales of wine/brandy, it is preferable to ask all applicants to complete both sides of the 257-NR. In any event, the reverse side of Form 257-NR describing the proposed premises operation must be completed.

The alternating proprietor arrangement has been approved by TTB. Information on this arrangement is contained in the Federal Register Volume 55, No. 118 dated 6/19/90 listed under Rules and Regulations #24.136. Alternating proprietorship is also acceptable for beer and distilled spirits manufacturers.

Available at http://www.abc.ca.gov/BP/BP_Enforcement_Book.pdf

Attachment E

TTB Regulations on
Alternation of Premises and Proprietors

27 CFR §§ 24.135 & 24.136

is more than one surviving partner. (Sec. 201, Pub. L. 85–859, 72 Stat. 1379, as amended (26 U.S.C. 5356))

(Approved by the Office of Management and Budget under control number 1512–0058)

§ 24.129 Change in location.

Where there is a change in the location of wine premises, the proprietor shall file an amended application and an application for amendment of the basic permit, if any, and if a bond has been filed, either a new bond or a consent of surety. Operation of wine premises may not be commenced at the new location prior to approval of the amended application and issuance of any amended permit. (Sec. 201, Pub. L. 85–859, 72 Stat. 1379, as amended (26 U.S.C. 5356))

(Approved by the Office of Management and Budget under control number 1512–0058)

§ 24.130 Change in volatile fruit-flavor concentrate operations.

If the proprietor desires to make any change in the process employed to produce volatile fruit-flavor concentrate and the change affects the accuracy of the description of process included in the application, the proprietor shall file an amended application to include the amended or new process. The new or changed process may not be used prior to approval of the amended application. (Sec. 201, Pub. L. 85–859, 72 Stat. 1379, as amended, 1392, as amended (26 U.S.C. 5356, 5511))

(Approved by the Office of Management and Budget under control number 1512–0058)

§ 24.131 Change in building construction and use of premises.

Where a change is to be made to buildings located on wine premises, or in the use of any portion of the wine premises, which affects the accuracy of the application, the proprietor shall, before making such change in construction or use, submit a notice to the appropriate ATF officer. The notice will describe the proposed change in detail. The proprietor shall include the change covered by the notice in the next amended ATF F 5120.25 required to be filed, unless the appropriate ATF officer requires immediate amendment. (Sec. 201, Pub. L. 85–859, 72 Stat. 1379, as amended (26 U.S.C. 5356))

(Approved by the Office of Management and Budget under control number 1512–0058)

[T.D. ATF–299, 55 FR 24989, June 19, 1990, as amended by T.D. ATF–312, 56 FR 31077, July 9, 1991; T.D. ATF–409, 64 FR 13685, Mar. 22, 1999]

ALTERNATION

§ 24.135 Wine premises alternation.

(a) *General.* The proprietor of a bonded winery or bonded wine cellar may alternate all or a portion of wine premises for use as a taxpaid wine bottling house or use as taxpaid wine premises. The proprietor may also alternate the use of adjacent or contiguous premises qualified under 26 U.S.C. chapter 51 (distilled spirits plant, brewery, etc.) for use as wine premises or *vice versa.* If a proprietor of a bonded wine cellar or winery wishes to use all or a portion of such premises alternately as a volatile fruit-flavor concentrate plant or vice-a-versa, the proprietor must comply with the requirements of §§ 18.40 through 18.43 of this title.

(b) *Qualifying documents.* Where the proprietor desires to alternate bonded wine premises as taxpaid wine bottling house premises or taxpaid wine premises, or other premises qualified under 26 U.S.C. chapter 51, the following qualifying documents will be filed:

(1) A statement on the application ATF F 5120.25 that an alternation of wine premises will occur;

(2) Evidence of existing bond, consent of surety, or a new bond covering the alternation;

(3) A description of how taxpaid wine or spirits, or untaxpaid wine or spirits will be identified and segregated; and

(4) Any other document or additional information the appropriate ATF officer may require.

(c) *Alternation.* After the necessary qualifying documents have been approved by the appropriate ATF officer, the proprietor may alternate wine premises as described in the application. Any portion of wine premises on which taxpaid wine is located will be considered taxpaid wine premises or taxpaid wine bottling house premises and any portion of the premises on which wine not identified as taxpaid is located will be considered bonded wine premises. The proprietor shall, prior to the initial alternation of the premises, identify by portable signs or tags, or by any other method or manner satisfactory to the appropriate ATF officer, either all taxpaid wine on taxpaid wine premises or taxpaid wine bottling house premises or all untaxpaid wine on bonded wine premises.

(d) *Segregation.* The proprietor shall keep untaxpaid wine or spirits physically separated from taxpaid wine or spirits and on the designated premises. This separation will be by use of tanks, rooms, buildings, partitions, pallet stacks, or complete physical separation, or by any other method or manner which will clearly and readily distinguish untaxpaid wine or spirits from taxpaid wine or spirits and is satisfactory to the appropriate ATF officer. Where necessary for the protection of the revenue or enforcement of 26 U.S.C. chapter 51, the appropriate ATF officer may require that the portions of wine premises alternated under this section be separated by partitions or otherwise.

(e) *Conditions.* Authority for the alternation of bonded wine premises, taxpaid wine bottling house premises, taxpaid wine premises, or other premises qualified under 26 U.S.C chapter 51 is conditioned on compliance by the proprietor with the provisions of this section. Authority for the alternation of bonded wine premises, taxpaid wine bottling house premises, taxpaid wine premises, or other premises qualified under 26 U.S.C. chapter 51 may be withdrawn whenever in the judgment of the appropriate ATF officer the revenue is jeopardized or the effective administration of this part is hindered by the continuation of the authorization.

(Sec. 201, Pub. L. 85–859, 72 Stat. 1379, as amended, 1380, as amended, 1381, as amended (26 U.S.C. 5356, 5357, 5361, 5363, 5365, 5367))

(Approved by the Office of Management and Budget under control number 1512–0058)

[T.D. ATF–299, 55 FR 24989, June 19, 1990, as amended by T.D. ATF–409, 64 FR 13683, 13685, Mar. 22, 1999; T.D. ATF–455, 66 FR 29483, May 31, 2001]

§ 24.136 Procedure for alternating proprietors.

(a) *General.* Wine premises, or parts thereof, may be operated alternately by proprietors who have each filed and received approval of the necessary applications and bonds and have qualified under the provisions of this part. Where operations by alternating proprietors are limited to parts of the wine premises, the application will describe areas, buildings, floors, or rooms which will be alternated and will be accompanied by a diagram delineating the parts of the wine premises to be alternated. A separate diagram will be submitted to depict each arrangement under which the wine premises will be operated. Once the qualifying documents have been approved, and operations initiated, the wine premises, or parts thereof, may be alternated. Any transfer of wine, spirits, or other accountable materials from one proprietor to the other proprietor will be indicated in the records and reports of each proprietor. Operation of a bonded winery engaged in the production of wine by an alternate proprietor will be at least one calendar day in length.

(b) *Alternation.* All operations in any area, building, floor, or room to be alternated will be completely finished and all wine, spirits, and other accountable materials will be removed from the alternated wine premises or transferred to the incoming proprietor. However, wine, spirits, and other accountable materials may be retained in locked tanks at wine premises to be alternated and remain in the custody of the outgoing proprietor.

(c) *Bonds.* The outgoing proprietor who has filed bond and intends to resume operation of the alternated areas, buildings, floors, or rooms following suspension of operations by an alternating proprietor shall execute a consent of surety to continue in effect all bonds. Where wine, spirits, or other accountable materials subject to tax under 26 U.S.C. chapter 51 are to be retained in tanks on the wine premises to be alternated, the outgoing proprietor shall also execute a consent of surety to continue the liability of all bonds for the tax on the materials, notwithstanding the change in proprietorship.

(d) *Records.* Each proprietor shall maintain separate records and submit a separate ATF F 5120.17, Report of Bonded Wine Premises Operations. All transfers of wine, spirits, and other accountable materials will be reflected in the records of each proprietor. Each proprietor shall maintain a record showing the name and registry number of the incoming or outgoing proprietor, the effective date and hour of alternation, and the quantity in gallons and the percent alcohol by volume or proof of any wine, spirits, or other accountable materials transferred or received. (Sec. 201, Pub. L. 85–859, 72 Stat. 1378, as amended, 1379, as amended, 1380, as amended, 1381, as amended, 1382, as amended (26 U.S.C. 5351, 5352, 5354, 5356, 5361, 5362, 5363, 5367, 5373))

(Approved by the Office of Management and Budget under control numbers 1512–0058, 1512–0216 and 1512–0298)

[T.D. ATF–299, 55 FR 24989, June 19, 1990, as amended by T.D. ATF–338, 58 FR 19064, Apr. 12, 1993]

§ 24.137 Alternate use of the wine premises for customs purposes.

(a) *General.* The wine premises may be alternated as a Customs Bonded Warehouse under applicable customs laws and regulations, for the purpose of measuring, gauging, and bottling or packing wine. The use of the portion of the wine premises alternated as a Customs Bonded Warehouse is subject to the approval of the district director of customs and the appropriate ATF officer. When it is necessary to convey wine in customs custody across bonded wine premises, the proprietor shall comply with the provisions of § 24.92.

(b) *Qualifying documents.* Where the proprietor desires to alternate a portion of wine premises for customs use, the following qualifying documents will be filed:

(1) ATF F 5120.25 to cover the alternation;

(2) A diagram clearly depicting any area, building, floor, room or major equipment in use during the alternation; and

(3) Any other documents or additional information the appropriate ATF officer may require.

(c) *Alternation.* After approval of the qualifying documents by the appropriate ATF officer, the proprietor may alternate the wine premises. Portions of the wine premises to be excluded by curtailment or included by extension may not be used for purposes other than those authorized. Prior to the effective date and hour of the alternation, the proprietor shall remove all wine and spirits from the portion of the wine premises to be alternated for customs purposes. (Sec. 201, Pub. L. 85–859, 72 Stat. 1379, as amended, 1380, as amended, 1381, as amended (26 U.S.C. 5356, 5357, 5361, 5365, 5367))

(Approved by the Office of Management and Budget under control number 1512–0058)

[T.D. ATF–299, 55 FR 24989, June 19, 1990, as amended by T.D. ATF–344, 58 FR 40354, July 28, 1993; T.D. ATF–409, 64 FR 13683, 13685, Mar. 22, 1999]

PERMANENT DISCONTINUANCE OF OPERATIONS

§ 24.140 Notice.

(a) *General.* Where all or part of the operations at a wine premises are to be permanently discontinued, the proprietor shall file with the appropriate ATF officer a notice in letter form to cover the discontinuance. The proprietor shall state in the notice the date on which operations will be discontinued and, if the wine premises are to be transferred to a successor proprietor, the name of the successor proprietor. Any basic permit issued to the proprietor under the Federal Alcohol Administration Act (49 Stat. 978; 27 U.S.C. 203) for the operation discontinued will be submitted to the appropriate ATF officer with a written request for cancellation.

(b) *Bonded wine premises.* The proprietor shall certify in the notice, as applicable, that:

(1) All wine, spirits, or volatile fruit-flavor concentrate have been lawfully removed from bonded wine premises, destroyed, or transferred to a successor as of the effective date of discontinuance,

(2) No wine, spirits, or volatile fruit-flavor concentrate are in transit to bonded wine premises, and

(3) All approved applications covering the transfer of spirits to bonded wine premises have been returned to the appropriate ATF officer.

Attachment F

Winery Incubator Building Article
Walla Walla Union-Bulletin
August 25, 2005

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WALLA WALLA
UNION-BULLETIN

Bringing the valley home to you since 1869

Thursday, August 25, 2005

Port hatches plan for winery incubator

A state grant will be used to build a home for several startup operations at a time.

By Vicki Hillhouse of the Union-Bulletin

Thursday, August 25, 2005

Never mind elegance or decorative frills associated with many boutique wineries in the Valley.

When Matt Huse first stepped into the building that was to become home to his Five Star Cellars about three years ago, he would have been happy just to have insulation.

``It was just pretty much studs and a wall,' he said.

Located at the Port of Walla Walla's industrial park at the airport, the building at 840 C St. came with little more than plywood floors and a ceiling half-framed with rafters.

But it had at least two qualities that were increasingly difficult to find in other buildings Huse had looked at: It was the right size and the right price.

Signed to a five-year lease, he got help and went to work, converting the relatively hollow space into a winery and tasting room with tile floors, wood cabinetry and warm colors.

With the number of local wineries expected to hit the mid-70s by the end of harvest this year, finding a place to put them is becoming increasingly difficult.

But with a $1 million state grant, the Port of Walla Walla plans to build a cluster of small buildings at its airport property to help new wineries get up and running.

Depending on the bid climate, either four or five 2,000-square-foot buildings will be built, said Port Executive Director Jim Kuntz.

The buildings, slated for the former U.S. Army Corps of Engineers site at the airport, will be designed for bonded wineries that produce about 1,000 cases annually as part of their business models.

Port officials are referring to the proposed village of wineries as an ``incubator' because tenants will be on a six-year plan. After that period they must find new homes to make way for other startup wineries, though those that have the means could leave sooner.

While not limited to, the proposal could be a next step for graduates of Walla Walla Community College's Institute for Enology & Viticulture.

Myles Anderson, director of the program and co-owner of Walla Walla Vintners, said finding the right facility gets more challenging as the number of wineries rises here.

In a 2002 story in the Union-Bulletin, Washington State University agriculture economist Ray Folwell estimated that starting a 2,000-case winery would take a little less than $500,000.

One of the tricks is finding a facility or property to build one in an area that will allow for a conditional-use permit - a necessity for most wineries with ancillary uses.

``It's going to provide an opportunity for some folks that want to start a small premium winery and make it a bit easier for them,' Anderson said. ``It will be built specifically for wine production so they will not have to buy a facility and then reconstruct or redesign it to fit their particular needs.'

Krista McCorkle, director of the Walla Walla Valley Wine Alliance, said the project fits in with the climate of the wine industry. The majority of the Valley's 67 wineries operate as ``boutique' wineries - small, single-family owned businesses that produce 5,000 or less cases of wine per year. As a result, room for growth exists, she said, even if the space for it is harder to come by.

Port officials have already hired a firm to develop design concepts. Construction is expected to take place throughout winter, with the first tenants in place by June.

And though the project comes too late for some relatively newer wineries - such as Five Star Cellars operated by Huse and his father, David - the help it could give to startups is invaluable.

``With the price of land right now, it's just ridiculous,' Huse said. ``Building a building with a boutique winery - there's no way we could have made any profit.'

FOR MORE INFORMATION

For more information on the wine incubator project, call the Port of Walla Walla at 525-3100.

Related Links
