

PROPOSED MODIFICATIONS TO ALCOHOL BEVERAGE REGULATION IN WISCONSIN

Wisconsin is among the majority of states that has adopted a three-tier system of alcohol beverage regulation. This “license” based system allows private enterprise to conduct production, wholesale distribution and retail sales of distilled spirits, wine, and beer – subject to industry oversight to promote health, welfare, safety and competition. The Wisconsin free-market model stands in stark contrast to the government monopoly system embraced in other states.

Under the state’s existing alcohol beverage regulatory structure, Wisconsin has developed one of the most robust alcohol beverage industries in the country, by any measure. Forbes magazine recently highlighted that 3 of the top 25 cities in the country to launch a successful craft brewery are located in Wisconsin (Madison (#2); La Crosse (#9); Milwaukee (#23)). Wisconsin craft beer production ranks 10th nationwide, producing over 333 million bottles of craft beer annually – roughly five gallons of beer per year for each adult over 21. The state is also home to dozens of wineries and a small winery cooperative with over 50 small winery members. And, more distilleries are opening each year, with over 30 established distilled spirit producers already in business.

Despite this success, Wisconsin can do better. The proposed legislation would make various changes to improve alcohol beverage regulation and further develop an already successful industry. These changes add consistency across regulations for brewers, brewpubs, wineries and distillers/rectifiers (“producers”)¹ and clarity to the existing three-tier system. The proposed changes also strengthen the overall alcohol beverage industry and regulatory framework by creating a new division dedicated to promoting and regulating the alcohol beverage industry.

The proposed legislation would (1) create a dedicated division at the Department of Agriculture, Trade & Consumer Protection (“DATCP”) for the promotion and regulation of the alcohol beverage industry; (2) clarify and expand permissible activities and abilities under production permits, including full-service retail sales at taprooms; (3) specify the types of passive or limited investments that are permitted across tiers while making clear that a specific statutory exception is necessary or cross-tier ownership would be prohibited regardless of subchapter and alcohol beverage product sold; (4) provide clarity on arrangements between producers for contract production of alcohol beverages; and, (5) make changes to taste samples and various other provisions of Chapter 125 providing clarity and consistency in retail license regulation. To combat illegal internet sales of alcohol, the legislation also would implement reporting requirements for common carriers shipping alcohol beverages.

¹ “Producers” is used as a term of convenience in this document to include breweries, brewpubs, wineries, manufacturers and rectifiers. The more precise terms and definitions will remain and continue to be used in Chapter 125 as will the three subchapters.

ALCOHOL BEVERAGE REGULATORY BODY

Most license states have administrative commissions or agencies dedicated to oversight of the alcohol beverage industry. These entities have staff familiar with trade practices and they play a more significant role in education – for industry participants, local governments, law enforcement and the general public. States without dedicated agencies typically have dedicated alcohol divisions or units structured within other, larger government departments. Wisconsin currently has neither.

Under the current structure, about a dozen employees within the Wisconsin Department of Revenue (“DOR”) handle alcohol beverage regulation in addition to their other subject matter responsibilities. As a result, there is no agency or employee dedicated solely to the education and enforcement of the state’s alcohol beverage laws and regulations.

This proposal would create a new Division of Alcohol Beverages attached to DATCP to serve this function for Wisconsin. The Division would be charged with administering regulatory programs, promoting business success and regulatory transparency, promoting statutory changes to create clarity, consistency and simplicity in alcohol beverage regulatory requirements and ensuring active, consistent enforcement of alcohol beverage laws.

- Create a Division of Alcohol Beverages dedicated exclusively to alcohol beverage promotion, education, regulation and enforcement. The Division and its staff would be located within DATCP and affiliated with DATCP for budgetary and administrative purposes.
- The Division would be headed by a Division Administrator who would be appointed by the governor, subject to senate confirmation, for a 6-year term. The Administrator’s 6-year term appointment would be fixed, but he or she may be re-appointed for subsequent terms, with each re-appointment subject to senate confirmation.
- The Administrator would be a full-time, salaried employee, appointed outside the classified service. The Administrator would have the authority to appoint and supervise staff necessary to carry out promotion, permitting, audit, education and enforcement duties. These staff would be appointed within the classified service.
- Staff reporting to the Administrator would include a director of business promotion, a director of enforcement, a director of legal education and community outreach and a director of legal services. All four positions would report directly to the Administrator.
- The Administrator and alcohol beverage promotional and regulatory staff would be subject to conflict of interest statutes and specifically prohibited from working or holding financial interests in the alcohol beverage industry.
- The Division would be independent from a regulatory and enforcement standpoint – neither the Administrator, directors nor office staff would report to, or be under the supervision of, the DATCP Secretary.

Authority

The new Division's statutory authority will derive from existing provisions in Chapter 125. Proposed legislation would not expand the Division's substantive regulatory jurisdiction beyond DOR's existing jurisdiction under Chapter 125. The legislation would not interfere with a municipality's or district attorney's existing jurisdiction under Chapter 125.

Budget

Total staff would be approximately 20 full-time equivalent positions; and the initial office budget would be approximately \$2.5 million annually. (For comparison, DOA's Division of Gaming has a current annual budget of ~\$2.6 million and 22 full-time staff.)

According to the Legislative Fiscal Bureau, alcohol-related permit and administrative fees totaled approximately \$2.4 million for fiscal year 2016; and Wisconsin state liquor, wine, and beer taxes generated \$58.97 million in 2016 fiscal year revenue.

ALCOHOL BEVERAGE PRODUCTION PERMIT ACTIVITIES

Expansion of Small Winery Cooperative Wholesaler Permit to Include All Intoxicating Liquor

Under current law, small winery cooperative wholesalers may receive wholesale permits to distribute on behalf of their members. The law allowed permits to be issued to six small winery cooperative wholesalers before December 31, 2008. Membership in the cooperative is limited to small wineries that produce and bottle less than 25,000 gallons of wine in a calendar year, and the winery must hold a direct shipper's permit and be certified by the department for eligibility in the cooperative. Membership is available to both Wisconsin and out-of-state wineries. Members of the cooperative must distribute exclusively through the wholesaler cooperative and may not sell directly to any other wholesaler or retailer.

The proposal would expand the activities and membership of small cooperative wineries to operate as "small cooperative wholesalers" that include all small producers of intoxicating liquor – distilled spirits and wine. The proposal would increase the "small" producer volume size from 25,000 to 50,000 gallons per year. Otherwise, it would include the same requirements as current law, but for the direct shipper's permit requirement that is unavailable for distilled spirits. The proposal would also allow for the creation of new, additional small cooperative wholesalers provided that the cooperative must be issued a permit prior to January 1, 2020. The proposal would also clarify that cooperative wholesalers do not purchase alcohol beverages on consignment as such arrangements are prohibited under federal law.

Alcohol Beverage Production Permits and Retail Sales

Under current law, breweries, wineries and manufacturers/rectifiers have various ability to provide taprooms or retail sales.

- Brewers are able to conduct retail sales of beer for on-site and off-site consumption at the brewery premises or an off-site retail outlet established by the brewer. Brewers may also

offer taste samples at the brewery premises, off-site retail location or Class "A" retail locations.

- A winery may have either one "Class A" license or one "Class B" license, but not both; the license may be issued for the winery premises or for real estate owned or leased by the winery. The winery may provide wine manufactured, mixed, or blended on the winery premises directly to the "Class A" or "Class B" premises, and may provide taste samples on the premises. Under current law, the "Class A" or "Class B" license only allows for the retail sale of wine, not distilled spirits.
- A manufacturer or rectifier permit authorizes the retail sale of intoxicating liquor manufactured or rectified on premises for consumption on or off the premises and authorizes the provision of taste samples subject to limitation.

The proposed legislation would modify the law surrounding retail sales by a producer and create more consistent treatment for brewers, wineries and manufactures/rectifiers. As a part of the producer's permit, the proposal would allow for full-service retail sales at the producer's premises or at an off-site location. The proposal would state:

- A production permit allows full-service retail sales at a single location. The retail sales could occur at the production premises or another location. The producer will indicate on its permit the location where retail sales will occur and it be considered as part of the "premise" under that permit.
- "Full-service retail sales" means the sale for on and off-premise consumption of fermented malt beverages and intoxicating liquor as well as the taste sampling of those alcohol beverages.
- The producer's retail sales location would be allowed to sell alcohol beverages manufactured by the producer, without purchasing the product through a wholesaler (or small brewery permitted to engage in direct-to-retail sales under current law).
- Provided that the alcohol beverages are purchased through a wholesaler, the retail sales location may sell alcohol beverages from other producers for on-premise and off-premise consumption.
- The producer may operate a restaurant at the retail sales location but is not required to do so.
- Although the retail sales location would not be subject to a locally issued retail license, approval for full-service retail sales by the producer would be required by the local municipality in a manner similar to how retail licenses are issued. Similar to a retail license, a municipality could limit the scope of products offered for sale by the producer. For example, a brewery could be limited by the municipality to only selling beer and wine. However, a producer's state-issued permit would still allow for the retail sale of alcohol beverages manufactured under that permit and a municipality could not limit a

producer's retail sales of those products. Only a producer's ability to engage in full-service retail sales could be limited by the municipality.

As part of its permit, a brewery would be allowed to engage in retail sales at one additional location as indicated on that brewers permit. This one additional location could change during the year provided that timely notice of any change in location is provided to the Division. To qualify, the brewery's additional retail sales location would be limited to on-premise consumption and taste sampling. Moreover, the brewery would limit its sales of alcohol beverages at this retail sales location to fermented malt beverages produced by the permittee or purchased through a wholesaler (or small brewery permitted to engage in direct-to-retail sales under current law). Subject to these restrictions, this one additional location could operate as a restaurant.

Remove Cap on Number of Production Permits and Create Bona Fide Production Facilities

Current law restricts the number of production permits and production locations that a person may hold for the production of a particular alcohol beverage product. Any one person may not hold more than two manufacturers' or two rectifiers' permits. No similar limitation exists for breweries.

The proposal would remove the cap on permits for intoxicating liquor producers and allow multiple permits to be issued for manufacturing the same product or brand. However, a producer would only gain approval for an additional retail sales location at bona fide production facilities, and a producer would have to maintain its status as a bona fide production facility over the life of the permit.

A bona fide production facility would be a facility that is capable of producing the alcohol beverage from raw materials to a completed form that is ready for distribution. It would hold the necessary federal basic permit required for production at that location. Additionally, a bona fide production facility must have a capacity to produce a certain amount of product annually at that specific premises and contract production at other locations would not qualify.

- A winery would be required to produce 5,000 gallons of wine annually.
- A manufacturer or rectifier would be required to produce 20,000 liters annually.
- A brewery would be required to produce 5,000 barrels annually.

While permits would still be issued to producers who do not exceed these minimum production levels, they would not qualify as a bona fide production facility and, as a result, would not qualify as an additional retail sales location for a producer.

Match Permit Retail Outlet Closing Hours with Retail License Closing Hours

Under current law, Class "B" licensed premises must close between 2:00 a.m. and 6:00 a.m. during the week, and 2:30 a.m. and 6:00 a.m. on Saturdays and Sundays. Various other exceptions apply. Sales at class "A" premises and off-site consumption sales at Class "B" premises must cease sales between 12:00 midnight and 6:00 a.m., however a municipality may

impose a narrower window for sales. Similar requirements apply for intoxicating liquor retailers.

Wineries operating under a "Class B" license must remain closed between 9:00 p.m. and 8:00 a.m. No explicit closing hours exist for retail sales at breweries or distilleries.

The proposed legislation would state that the same closing hours that apply to retail licensees in a municipality would apply to all producers in that municipality selling alcohol beverages pursuant to their alcohol beverage production permit at a retail sales location.

Hours of Operation for Nonretail Activity

Additionally, the proposal would clarify that only the sale and consumption of alcohol must cease during closing hours for a permittee. The production, shipment, transportation or delivery of beer, wine or distilled spirits may continue during the closing hours applicable to retail sales and consumption.

Double the Brewpub Production and Self-Distribution Caps

The proposal would increase the annual production cap for brewpub permits from 10,000 to 20,000 barrels. The proposal would also increase the brewpub self-delivery cap from 1,000 to 2,000 barrels.

Allow Brewpubs to Satisfy Permit Requirement through Sale of Beer from another Brewpub

Under current law, to maintain a brewpub permit, a brewpub must sell beer from another brewer other than the brewpub permittee. The proposal would clarify that a brewpub could satisfy this requirement by selling beer from another brewpub instead of a brewer.

INTEREST RESTRICTION MODIFICATIONS

Under current law and guidance from Department of Revenue, individuals who are owners and employees of licensees and permittees are greatly restricted in any investment of an entity that is licensed or permitted in a different, restricted tier. The proposal would make several changes to the interest restrictions in state law by allowing incidental, passive investments, while ensuring independence among regulated entities across tiers. Unless there is a specific statutory exception, however, cross-tier ownership would be prohibited and the prohibition on cross-tier ownership would apply to all producers, wholesalers and retailers of alcohol beverages regardless of subchapter and type of alcohol beverage product sold.

Specify Permissible Passive Investment Arrangements

Under the proposal, state law would be modified to make clear that minority, passive investments do not violate the cross-tier restrictions. The specify that:

- Individuals and entities subject to Chapter 125 on a license or permit (that is, individuals identified on a manager's or operator's license and individuals identified as an officer,

director, member, manager or agent of a corporation or limited liability company holding a license or permit) would be considered "restricted investors".

- "Restricted investors" would also include any individual or entity holding more than a 10% ownership interest.
- The aggregate amount of ownership held by restricted investors could not at any time exceed 49% of the ownership of the entity in the other tier.
- No single restricted investor could hold more than a 10% ownership interest, including any passive or disregarded entities connected to the restricted investor.
- A restricted investor would be strictly limited to a passive investment and could not be involved in the day-to-day operations of the permittee/licensee or exert any control over such operations beyond their ability to vote as an investor.
- A restricted investor could not serve as an officer, director, manager, operator or agent of the licensee/permittee in the other tier.

To be able to monitor such investments, licensees and permittees would be required to disclose the ownership interest of any restricted investor to the department.

Nothing would limit or modify the ability under current law to have ownership or investments within a tier. For example, a person could hold an unlimited ownership in multiple breweries, distilleries or wineries at the same time. Similarly, a person could have ownership interest in multiple wholesalers, including both fermented malt beverage and intoxicating liquor wholesalers. And, a person could have an ownership interest in multiple retail licensees. The restrictions ownership and exception passive investments only applies to cross-tier ownership.

Exclude Real Estate Investments from Cross-Tier Ownership Restrictions

The proposed legislation would specify that the mere act of owning real estate is a permissible passive investment, even if that real estate is leased to a licensee or permittee. For example, if a brewery or restricted investor owns a building that also contains retail space, that space could be leased to a restaurant provided that the brewery does not have any day-to-day involvement in the restaurant or control over its operation. Similarly, a tenant could not be party to a licensing or exclusivity agreement or other arrangement with the landlord that would limit the tenant from operating in an arm's-length and independent manner. And, such restriction on day-to-day involvement, control or exclusivity would need to be included as a term in the lease using standard language contained in state law.

Allow Marital Property Agreements to Avoid Cross-Tier Ownership Restrictions.

Presently, the Department of Revenue does not recognize pre-marital agreements or other marital property planning documents as a mechanism to avoid cross-tier ownership restrictions. For example, a husband cannot own a brewery if his wife owns a bar even when there is marital property agreement in place.

The proposal would amend state law to recognize the use of such agreements to allow spouses to avoid triggering cross-tier ownership restrictions. The existence of such an agreement would need to be disclosed on any license/permit application and a copy provided to the clerk or department issuing the licenses or permit. The department also develop an affidavit to be signed

by each individual swearing to a complete lack of involvement in the day-to-day operations of each respective business as well as a lack of control. Violation of this affidavit would be subject to penalty and license revocation.

CONTRACT PRODUCTION AGREEMENTS

Under current law, contract production agreements exist whereby one producer permittee contracts with another for the production of alcohol beverages. These contractual agreements occur entirely within the production tier of the three-tier system and between producers. Wisconsin administrative code provisions define the terms “production brewer” and “recipe-brewer” and include certain requirements for each. However, no similar provisions exist for intoxicating liquor production, despite the prevalence of such contract production agreements between producers in this state.

The proposal would provide clarity and certainty in state law regarding these contract production arrangements. The proposal would specify:

- Contract production is allowed for all producer types.
- All contract production must occur pursuant to a written agreement between the purchasing producer and manufacturing producer.
- Contract production includes the production, bottling or labeling of alcohol beverages – all reported and occurring under the purchasing producer’s federal basic permit.
- Contract production volume is considered to be production of the requesting producer for various thresholds under chapter 125 (self-distribution, brewpub permit requirements, advertising purchases, cooperative wholesale arrangements) tied to the permit but not status as a bona fide production facility.
- Transportation of a product between the premises of the producers who are parties to the production contract is allowed.
- Contract production arrangements between producers do not create an impermissible direct or indirect interest of one party with respect to the other or an impermissible agency relationship.

RETAIL LICENSE ISSUES

Allow Producers to Bring Alcohol Beverages to Licensed Retailers to Provide Free Samples

Under current law, a brewer may provide taste samples free of charge on Class “A” licensed premises, subject to certain requirements regarding the size of the sample, the number of samples per person per day, and the hours during which samples may be made available. When providing samples on a Class “A” premises, the brewer is required to purchase the sample products from the Class “A” licensee on whose premises the taste samples are provided.

Wineries are able to provide samples on "Class A" licensed premises under similar circumstances, but may only provide samples of wine purchased directly from a wholesaler.

Similarly, distillers and rectifiers are able to assist a "Class A" licensee in dispensing or serving taste samples of intoxicating liquor that is purchased from a wholesaler.

The proposal would remove the requirements in these various sections that samples of alcohol beverages be purchased from a wholesaler or retailer. Instead, producers would be allowed to bring and serve taste samples of their products to any retail location, including Class "B"/"Class B" and temporary retail licensees. However, the proposal would prohibit the producer from leaving at the retail location any unused product brought by the producer.

Expand Temporary "Class B" Licenses to All Intoxicating Liquor

Under current law, a temporary "Class B" license only allows the sale of wine. The proposal would allow temporary "Class B" licenses to be issued for the sale of all intoxicating liquor, subject to the existing requirements for temporary "Class B" licenses.

Create Wine-Only Bars/Remove Certain "Class C" Wine License Restrictions

"Class C" licenses authorize the retail sale of wine by the glass or in an unopened original container for consumption on premises. Under current law, "Class C" licenses may only be issued for restaurants in which the sale of alcohol beverages accounts for less than 50 percent of the gross receipts and (i) which does not have a barroom ("a room primarily used for the sale and consumption of alcohol beverages"), or (ii) has a barroom in which wine is the only intoxicating liquor sold. Additionally, "Class C" licenses may not be issued to foreign corporations or LLCs, or a person acting as an agent for or in the employ of another.

The proposal would remove these restrictions from "Class C" license eligibility, and instead include similar restrictions as those for "Class B" licensees.

Recapping Bottles of Wine

Under current law, sales of the wine by the bottle in restaurants under "Class B" or "Class C" retail licenses may be "recorked" and removed from the premises. The proposal would clarify that wine bottles could also be "recapped".

COMMON CARRIER REGULATION

The proposal would include the provisions on common carrier regulation advanced by the Joint Legislative Council's Study Committee on Alcohol Beverages Enforcement. Under that proposal, any common carrier that transports into or delivers within the state any alcohol beverages must submit monthly reports to the DOR. This proposal would require reporting to the Division instead of DOR but maintain all of the other requirements and provisions in the Study Committee bill draft.

This proposal would also require that any common carrier shipping alcohol into Wisconsin register with the Division and obtain a new common carrier shipping permit subject to annual fee

based on the amount of alcohol shipped into the state each year. Under current law, only wine may be shipped to individual consumers in Wisconsin. Any common carrier that ships alcohol beverages other than wine would be subject to a monetary penalty and permit subject to revocation with repeat violations.

This proposal would also include the Study Committee's proposed legislation requiring out-of-state permittees to consent to jurisdiction in Wisconsin for any proceeding to enforce the state's alcohol beverage laws.

INTOXICATING LIQUOR WHOLESALER – LIMITATION ON MULTIPLE PERMITS

Under current law, no person shall be issued more than two intoxicating liquor wholesaler permits. The proposal would eliminate this limitation as intoxicating liquor wholesalers are already subject to bona fide wholesaler requirements.