



PARTNERING FOR RETAIL ADVOCACY



The Country Vintner

A member of The Winebow Group



February 28, 2018

The Honorable Ralph Northam
Governor of Virginia
State Capitol Third Floor
Richmond, VA 23219

RE: Amendments to SB 174/HB 1005 and SB 382/HB 820

Dear Governor Northam:

Two pair of bills that significantly change how wineries and wholesalers do business, and how alcohol is delivered in Virginia passed the General Assembly this year. While all four passed unanimously, there was significant opposition from all three industry tiers: wineries, wholesalers and retailers. The Virginia Wine Wholesalers Association requested these bills, which were strongly opposed by Total Wine & More with 17 Virginia locations; the California winery members of Wine Institute responsible for 80% of domestic wine production; Virginia-based wine wholesaler Country Vintner; and members of the Virginia Retail Federation. The Virginia Wineries Association had concerns that were addressed with amendments. This memo explains industry concerns with this legislation and proposes additional amendments to mitigate the potential impacts.

CHANGES TO WINE FRANCHISE LAW in HB 1005 (Gilbert) & SB 174 (Stanley)

These bills set back wine distribution in Virginia decades by eliminating what little flexibility wineries currently have in establishing wholesaler sales territories. They reinforce an unfair government-run system of assigned sales territories that props up incumbent wholesalers by allowing them to assert exclusive rights to brands in unassigned sales territories at the expense of wholesalers newer to the marketplace.

Specifically, language deleted in these bills narrows the current "primary area of responsibility" or "PAR" to an exclusive sales territory. Years ago, it was the wholesalers themselves that created the existing law to allow them to "bleed" into unassigned territories and "poach" into territory assigned to other wholesalers. Wholesalers now want to delete the term and firm up their expanded territory boundaries to settle ongoing intra-industry disputes over rights to distribute wine brands. Wineries lose in this turf battle, being hamstrung into choosing which wholesalers have superior rights to sell their brands. The resulting shift of territory

boundaries after this law changes will require wineries to face competing claims before the ABC Board from multiple wholesalers claiming exclusive rights to each of their brands.

A strong argument against this legislation is that Va. Code §4.1-404 is currently the subject of five lawsuits at ABC against five wineries by a Virginia wholesaler challenging what constitutes a “new brand” for purposes of deciding whether a wholesaler has rights to it. (See *Blue Ridge Beverage v. Constellation Brands, et al*, December 11, 2017.) ABC Hearing examiners made an initial recommendation against the complainant wholesaler, who has indicated his intent to appeal the decision to the ABC Board. Amending this statute now would violate a long standing policy against legislating change while a statute is currently in litigation.

VIRGINIA WINE FRANCHISE ACT PRIMER

Beyond the policy concern is the practical impact this new law will have on claims against wineries under the Wine Franchise Act at Va. Code §4.1-400, et seq., which governs the complex commercial relationship between a winery and its Virginia wine wholesaler. In places, the Act already supersedes common law contracting. For example, the statute – not a written contract negotiated by the parties - outlines the only conditions under which a wholesaler may be terminated. Further, a winery may not unilaterally amend an agreement with a wholesaler, or unilaterally terminate an agreement with a wholesaler unless certain conditions in the Act are met. Nor may a winery discriminate in its commercial dealings with different wholesalers. Remedies for breach of the Act and a formula for valuing brands are also outlined.

Importantly, under the Act an “agreement” between the parties may be created by a written document, an unwritten “course of conduct” between the parties, or a combination thereof. A course of conduct agreement is created by fulfillment of a single order between a winery and wholesaler, or by one delivery from a wholesaler to a retailer. These course of conduct agreements are typically evidenced only by correspondence or other communications between the parties, not by a written contract. Further, the winery has no idea to which retailers its brands have been sold by a wholesaler, and is prohibited under the Act from directing wholesaler activity. Therefore ABC franchise designation filings and the understanding of “agreement” terms by the winery likely do not reflect the actual boundaries of sales territories.

Under §4.1-218, before a wine can be sold in Virginia, the importer (winery brand owner or wholesaler) must designate a sales territory for each wholesaler with which it has an agreement by filing a Franchise Designation Form with Va. ABC. The designated territory can be the entire state or various regions identified along city or county lines; not all counties/cities must be assigned to any wholesaler. The designated territory may also be a portion of a locality. As a practical result, wineries often designate one or two counties for a wholesaler on the Franchise Designation Form, leaving it to the wholesalers to “bleed” into unassigned and “poach” into others’ assigned territories to create a larger sales territory or PAR for themselves. Today, wholesalers commonly sell via course of conduct into PARs not assigned to them by a winery on an ABC Franchise Designation Form. In some cases, multiple wholesalers are selling the same brand into the same unassigned territory created by their course of conduct, resulting in robust competition and increased wine sales.

THE PROBLEM WITH THIS LEGISLATION

Despite representations by the wholesalers that this amendment of Va. Code §4.1-404 prompts no immediate change to the winery/wholesaler relationship, the long term effect on wineries is significant and specific. For example, a winery currently has two wholesalers selling its brands in Virginia. Wholesalers A and B have been assigned a sales territory on the ABC Franchise Designation Form, but a large and economically important part of the state is

unassigned. Both wholesalers are selling the same brand to multiple retailers in that unassigned territory via “course of conduct” agreements with the winery not evidenced in writing or at ABC in a territory designation. Wholesaler A believes the course of conduct between it and the winery creates an exclusive agreement as allowed by the new law. After July 1, 2018 wholesaler A asserts an exclusive agreement covering the unassigned territory and asks the winery to refile a Franchise Designation Form assigning this territory to it exclusively.

The winery asks both wholesalers for their interpretation of their course of conduct agreements regarding that brand in that territory. Wholesaler A and B disagree on who has superior rights to sell the brand, so the winery asks ABC for advice on how to refile. Only facts gathered from correspondence between the parties can show the course of conduct to date, so ABC cannot offer advice. And since the only avenue to settle disputes over brand rights is for a wholesaler to challenge a winery, both wholesalers file complaints against the winery with ABC under the Wine Franchise Act alleging unilateral amendment, unilateral termination and/or discrimination between wholesalers. The winery and competing Virginia wholesaler is forced into expensive and time-consuming litigation before the ABC Board. These disputes may include every brand the winery owns currently being sold by more than one wholesaler in each unassigned territory.

Therefore, the following amendment is proposed to address the very specific circumstance of multiple wholesalers operating under a course of conduct agreement asserting a claim for exclusive rights to a wine brand in an unassigned territory as evidence by the ABC form for franchise designation:

PROPOSED AMENDMENT to SB 174/HB 1005:

§ 4.1-404. Sales territory. Each winery which enters into an agreement with a wine wholesaler shall designate a sales territory as the primary area of responsibility of that wholesaler which is applicable to the agreement. ~~The term "primary area of responsibility" shall not be construed as restricting sales or sales efforts by a wine wholesaler exclusively to retailers located within the designated sales territory, and any agreement to the contrary shall be void.~~ Assertion by a wine wholesaler of the exclusive right to sell brands within a sales territory shall be void unless such sales territory has been assigned to that wine wholesaler on a franchise territory designation form as prescribed by the Board. No winery shall enter into any agreement with more than one wholesaler for the purpose of establishing more than one agreement for its brands of wine in any territory. However, the existence of more than one such agreement as a result of a sale of a winery as contemplated by § 4.1-405 shall not be prohibited. Notwithstanding any other provision in this chapter, a winery may enter into agreements with more than one wholesaler in a sales territory for new brands which are not clearly extensions of existing brands. Territories served by a wine wholesaler on February 18, 1989, shall be deemed designated sales territories within the meaning of this section. Each winery shall notify the Board in writing of all designations of sales territories, the identity of the wholesaler appointed to serve such territory and a statement of any variations which exist in the designated territory in regard to a particular brand. Redesignations shall be reported to the Board within ~~thirty~~ 30 days.

4-HOUR COME TO REST PROVISION: HB 820 (Knight) & SB 382 (Chafin)

Va. Code §4.1-223 currently states that a wine wholesaler cannot obtain a Virginia license “unless such person has established or will establish a place or places of business within the Commonwealth at which will be received and from which will be distributed all alcoholic beverages sold by such person in the Commonwealth.” Further, Va. Code §4.1-310 governing importation and shipment of all alcohol notes that except for direct wine shipments, “no wine shall be imported, shipped, transported or brought into the Commonwealth unless it is consigned to a wholesale wine licensee.” Violators of these statutes are subject to Class 1 misdemeanor charges. Virginia ABC currently interprets these statutes as requiring wine and

beer on trucks coming into Virginia, at a minimum, to be unloaded and touch the floor at a wholesaler's warehouse.

This legislation would significantly expand the current interpretation of law to require that wine and beer be unloaded at and remain in a wholesaler's possession for at least four (4) hours before being reloaded for delivery to shops and restaurants. While the speed of American commerce is increasing, these bills slow down the pace of alcohol deliveries in Virginia. Unloading and remaining in a wholesalers' possession for four hours means more time and delivery costs. Higher delivery costs mean higher alcohol prices for Virginia consumers.

The role a wholesaler plays in transporting wine and beer, and collecting excise taxes is invaluable, but the problem these bills seek to fix has not been outlined. ABC presented no evidence that collection of excise taxes by wholesalers under the current law is lacking. If wholesaler bad actors are prompting this change, then consider other ways to give ABC the enforcement tools it needs. These bills merely create a new, inefficient requirement that alcohol sit in a wholesaler's warehouse for four hours before it can be delivered to retailers. If enacted, this legislation will certainly result in higher alcohol costs for consumers and supply chain disruptions in Virginia.

PROPOSED AMENDMENTS to SB 382/HB 820:

1. Remove the four-hour requirement.

Virginia's statute does not explicitly require wholesalers to unload their trucks before making deliveries to retailers. However, ABC's practice is to require wholesalers to unload products in their warehouses before making deliveries. The bills should be amended to bring the statute into alignment with ABC's practice by striking the words: "for not less than four hours." Striking these words would strengthen the wholesalers' legal obligation by elevating the requirement from an ABC interpretation to a statute. Further, it will ensure that wholesalers are fully aware of their legal requirements, without adding a new, costly and inefficient obligation that is no less difficult to enforce than current law.

2. Delay the effective date until January 1, 2019.

Currently, the bills' new requirements would take effect on July 1, 2018. This effective date does not provide wholesalers with enough time to alter their business practices. Nor does it allow retailers time to prepare for supply chain disruptions resulting from the additional time for wine and beer to rest in warehouses. A January 1, 2019 effective date is more appropriate.

Representatives of the above-mentioned organizations would be pleased to discuss this matter in person as requested. Please contact Terri Cofer Beirne with Wine Institute at (804) 301-5505 or tbeirne@wineinstitute.org to arrange such a meeting. Thank you for your consideration.

Cc: The Honorable Brian Moran, Secretary of Public Safety
Jeffrey Painter, Chairman, Va. ABC
Travis Hill, Va. ABC
Edward Cooper, Total Wine & More
David Townsend, Country Vintner
Robert Koch, Wine Institute
President, Va. Retail Federation