

ZARA LAW OFFICES

Your Winery's Passport to the American Market



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Wines and Liquors from the Old World have developed into a success story in the US. Due to their quality and variety, they enjoy a prestigious reputation in a profitable but complex and competitive US market. The regulatory complexity in the US caused most European wineries in the past to feel they had no other choice but to delegate their business to US importers, thus ceding to them direct power over their brands in the US.

ZARA LAW OFFICES, with experience in the complexities of US Alcohol regulation, will help you directly establish your brand here in the US. Our goal is to help you become a direct importer, by assisting you in creating a wholly-owned importing entity in New York, obtaining the required federal and state licenses, or avoiding some of the common pitfalls when choosing a US importer or distributor.

To help you to become familiar with the American beverage alcohol market and the steps you must take to import into the United States, we offer you this information brochure.

European Wine in the United States: a Promising Market

For American consumers, European wines are strongly linked to European elegance and gastronomy. At first, European wines were placed on a pedestal, and Americans tended to admire them more than to drink them. But over time the wine market started to target a broader audience including young professionals who became wine aficionados. In the late 1990's in particular, wines from the newer wine-producing

regions of South America, South Africa, Australia and New Zealand seized a large share of the American wine market and began to seriously challenge Europeans' dominance, particularly at the low and increasingly at the middle ends of the market.

In order to avoid the high mark-ups through the US distribution channels, further increasing the already high retail price here, we believe now is the time for European wineries to broaden their foothold in the US by becoming direct US Importers and Distributors of their wine products. A currently very favorable Euro currency that as of September 2007, appreciated over fifteen percent (15%) against the Dollar facilitates the investment that a European winery would have to make to become a direct US Importer and Distributor.

The U.S. Market: A patchwork of federal and state regulation

The United States has two (2) different levels of governmental jurisdiction: A federal government with federal laws that apply to every state, and fifty (50) different state codes of laws. This somewhat resembles the European Union-Member State dichotomy. In addition to this complexity, which exists in numerous areas of American law, it must be remembered that the legislation that repealed Prohibition on the federal level was carefully drawn



to give states the maximum amount of power to regulate alcohol within their boundaries¹.

In other words, much like the domestic law of an EU Member state may not contravene a specific EU directive², US State Law cannot contradict US Federal Law, but state laws on wine imports and distribution can and do vary widely from state to state.

In the U.S., eighteen (18) states representing approximately 25% of the US population directly regulate alcohol sales by controlling its retail and/or wholesale distribution³. These states are called "*Monopoly States*." In these, the state has a monopoly over the wholesaling and/or retailing of some or all categories of alcoholic beverages, such as beer, wine, and distilled spirits. Please note however that the laws of monopoly states differ substantially as to whether liquor retail stores are actually state-run or state-contracted. Further, most of these states have different levels of regulation depending on the type of alcoholic beverage, with a number of them exempting wine and beer from the state monopoly altogether (i.e. in those states, wine and beer are sold in supermarkets, but liquor, distilled spirits etc. are sold in state-run or state-contracted liquor stores).

The other thirty-two (32) states which include New York, California, Texas, and Florida are called "*Licensure States*." These states issue licenses to private sellers. State agencies can place conditions on these licenses, which help the states more indirectly control the sale of alcohol.

¹ In 1933, the Twenty-First Amendment (21st) to the US Constitution in 1933 effectively repealed the Federal Prohibitionary laws encapsulated in the Eighteenth (18th) Amendment. However, as the 21st Amendment enabled states to continue the Prohibition at the local level, many did so, and it was not until 1966 that Mississippi, as the last hold-out state, effectively repealed all its Prohibition laws.

² *Flaminio Costa v. ENEL* Case 6/64 [1964] ECR 585, 593 is the seminal case where the European Court of Justice so established this fundamental precept of EU law.

³ The 18 "control states" are Alabama, Idaho, Michigan, Mississippi, Montana, New Hampshire, North Carolina, Ohio, Oregon, Pennsylvania, Utah, Vermont, Virginia, Washington, and West Virginia. In addition, in Montgomery County in Maryland, the county enjoys a monopoly over the sale and/or distribution of alcoholic beverages.

For example New York State through its Alcoholic Beverage Control Law Section 101-b -a price-posting statute- regulates prices. The New York Law⁴ requires a wholesaler to register with the New York State Liquor Authority, on a monthly basis, a list of the prices the wholesaler has decided to charge other wholesalers or retailers for its products during the specified period, with provision for a downward reduction to meet a competitor's prices⁵. The statute does not, however, authorize anyone to determine retail prices for wine, nor does it bind wholesalers as to the prices they may charge their own dealers.

The Three-Tier Distribution System

Under the so-called three-tier distribution system widely in effect throughout the US including in New York, the individual states through their Alcoholic Beverage Control Agencies, license and regulate three (3) groups of alcoholic beverage players: Tier-one manufacturers or importers, sell their products only to tier-two licensed beverage distributors or wholesalers, who in turn sell only to tier-three properly licensed retailers (including bars and restaurants). The latter have the right to sell alcoholic beverages to customers over the age of 21 in areas where alcohol sales are allowed and only after the proper collection of taxes.

⁴ *Alcoholic Beverage Law § 101-b(3)*

⁵ Price posting schedules apply to wholesalers selling to other wholesalers, as well as to wholesalers selling to retailers. For wholesalers selling to other wholesalers, the price postings are due on the 25th day of each month, and the prices and discounts set forth therein are effective on the first day of the second calendar month, and shall be in effect for such second succeeding calendar month. In other words for example the wholesale price schedules for December 2007, are due to be filed with the New York State Liquor Authority by the 25th day of October 2007.

For wholesalers selling to retailers, the price postings are due on the 5th day of each month, and the prices and discounts set forth therein are effective on the first day of the first calendar month, and shall be in effect for such first succeeding calendar month. In other words for example, the retail price schedules for December 2007, are due to be filed by the 5th day of November 2007.

Finally please note that only wholesalers selling to retailers may amend their price schedules once filed, and may do so only to meet a competitor's prices. Such amendments are due on the 20th day before the calendar month for which they are effective. In other words, retail price schedules for December 2007 may be amended up to November 20th, 2007, but as stated before, only to meet a competitor's price.

Please understand however that in some States including for example in the State of New York, it is not sufficient to merely have a Basic Importer's Permit (importing License) issued by the Alcohol and Tobacco Tax and Trade Bureau (TTB) to import



wine: The New York State Liquor Control Authority also requires that each such importer also hold a Wholesaler's Wine License.

The aim of the three-tier system is first to clearly delineate the exclusive authorized channels through which alcohol enters each state; and second to establish regulatory guidelines that state regulators and law enforcement can monitor. The combination of these safeguards aims at ensuring the safe distribution of alcoholic beverage products to consumers throughout the United States.

However a 2005 Supreme Court opinion struck a blow to this three-tier system, and held that one of the provisions of the US Constitution (the so-called Commerce Clause) prevents states from discriminating between in-state and out of state wineries, with respect to direct sales to consumers. The New York laws -and those of Michigan- at issue in the Supreme Court case were held to be discriminatory because they allowed in-state wineries to ship directly to consumers, while out-of-state wineries had to go through a wholesaler and a retailer⁶. In other words the New York laws required a foreign (non-NY) winery to establish a physical presence in New York as a condition of having the privilege of shipping wine directly to consumers, and this stated the US Supreme Court, was unconstitutional.

Moreover, within each state, there are distinct regulatory regimes for beer, wines, and spirits.

⁶ Granholm, Governor of Michigan, et. al. v. Heald et. al., 554 US 460 (2005).

The legal and regulatory complexities of the US market have deterred European wineries from entering the American market as a whole. Instead such wineries have traditionally chosen to market their wines through National Importers that distribute their wines state by state through the National Importers' own distribution channels.

The various actors in the U.S. Market

Importers, distributors and retailers are the principal actors of the wine market. Each of them must have a specific license. The importation license is issued by the federal government and is thus valid for the whole United States, while the distribution and retail licenses are issued by each state and are valid only within the state of issuance. Therefore an imported item must have at least one importer at the national level and can be distributed by several distributors located in the different states where the product is going to be marketed.

Can European Companies directly import their wine and liquor into the United States?

YES!

There are three (3) different options to import wine and liquor into the United States. (1) The first option is to import directly, by setting up a separate corporation or a corporate subsidiary in the United States, or having the foreign winery itself become authorized to do business in the United States. (2) The second option is to sell the wine to a classic importer that will resell the wine through its own network of distributors. (3) The third option is to export through an alternative importer that focuses on logistics, administration, and compliance. That importer will import, warehouse, and distribute the wine, using a brand-manager chosen and employed by the winery to sell the wine.

1. Becoming your own importer

This solution has the advantage of permitting the wine producer to be the actual manager of the entire operation in the American market, because there is no intermediary. The foreign producer is its own importer and its own distributor.

There are two (2) possibilities. First, you can register the winery itself as a foreign corporation authorized to do business in each of the states in which you wish to market your wines. Secondly, you can create a new and separate entity⁷ that may or may not be a subsidiary of your winery. The creation of a new entity is valuable: On one hand the parent winery will generally not be liable for its debts; and secondly a new entity eliminates the risk that the US Tax Authorities will deem certain income from your foreign entity -now registered in the US- as income that *is effectively connected with a US Trade or business*⁸.

The corporation, once established in the United States, can then apply for a Basic Importer's Permit from the TTB, as well as for any State Wholesalers' Wine Licenses.

In both cases, it is mandatory to have a permanent office in the State where the corporation is going to be domiciled. This office must have at least one (1) employee and be open from 9am to 5pm every business day. A mere mailbox address is thus insufficient. While the TTB will allow operation through a home-office as long as access thereto is available 24/7, some states including New York State do not allow a home office and will require an office address prior to the issuance of a Wholesaler's Wine License.

The process to obtain a federal license includes an interview with the TTB. During that interview, the corporation must provide all documents and information requested by the TTB. The TTB will check the basic corporate documents (the certificate

⁷ Limited Liability Companies (LLCs) are generally the entity of Choice, *see our Guide to Create a Business Entity under the Practical Guides tab of this website*

⁸ See <http://www.irs.gov/businesses/small/international/article/0,,id=96409,00.html>

of incorporation and the bylaws for corporations, and the articles of organization and operating agreements for limited liability companies) and will trace the source of funds of the corporation. The law requires payment of a \$500 Special Occupational Tax payable to the US Treasury, collected by the National Revenue Center (even though the current administration has waived these fees) and the process of registration usually takes thirty (30) to sixty (60) days unless the application is singled-out for further inspection.

Why become a direct importer?

Despite the initial investment, for European wine producers, there are clearly advantages to establish their own businesses in America as direct importers. Among these advantages are:

- Vertical integration of the market, permitting control of the product from production to retailer
- Elimination of intermediaries in the chain of distribution, and concomitant reduction in costs
- A deeper knowledge of the market and the local actors, allowing you to target the offer at the distributor's level and at the consumer's level
- The possibility of using this knowledge in strategic marketing to the local market
- The possibility of enlarging the customer base through proprietary market research

While the quantity of wine that pours into the US has soared, the number of wholesalers -the second tier- available to distribute it has significantly declined over the past decade. The result is that it has become more and more competitive for foreign wineries to succeed at the "beauty contest" that has developed to attract the attention of a top US Distributor.

Your rights:

The US Corporation or the foreign corporation registered in the United States, as an importer, has the right to:

1. Apply to the TTB to approve and register its products
2. Register a trademark and ask the TTB to accept it. The application must conform to the requirements on packing and labeling. The wine will not be allowed to be marketed in the US if it does not comply with these requirements
3. Before the wine is shipped out, register -as well as your foreign winery- with the Food and Drug Administration
4. Work with a customs agent specializing in wines that will handle the relations with the Customs Service, arrange payment of duties and taxes and communicate relevant information to the importer.
5. Establish its own distribution network
6. Obtain the TTB's approval to its wine labels, what is known as Certificates of Label Approval or by its acronym COLA⁹
7. Import your wine or liquors into the US
8. Obtain the required state Wholesaler's Wine Licenses and introduce the wines or liquors into the U.S. market through your own network of distributors, or search for, contact, and sell to wholesalers that have their own distribution network or directly to retailers
9. Promote and sell its wines or liquors

We can:

- Accomplish all the steps required to register your entity in the United States, or alternatively create a new entity here in the US
- Make application on your behalf for a Federal Import License from the TTB
- Assist you in obtaining the TTB's Certificates of Label Approval

⁹ COLA is the acronym for the TTB's Certificate of Label Approval;

http://www.ttb.gov/industry_circulars/archives/2007/2007_04.html provides the different types of evaluations that some alcohol products must undergo before TTB will issue its COLA. The TTB will accept electronically the information it requires to issue its COLAs. The TTB's processing time for COLAs is generally nine (9) days.

⁹ <http://www.ttb.gov/importers/index.shtml> provides United States importers with an updated listing of country of origin certification requirements for wines and spirits

- Register your US company, as well as your foreign winery with the FDA
- Represent you, if requested, at the interview with the TTB, for the purpose of obtaining the Federal Import License
- Hire a Customs Agent specializing in wines
- Prepare a report concerning the requirements of each state in which you want to market your wines and for which it will be necessary to obtain a State Distribution License
- Make application on your behalf to the State Liquor Authorities to obtain the State Wholesaler's Wine Licenses you will need to distribute your wine in the states you have chosen to distribute it
- Refer you to immigration lawyers to obtain visa and work permits for your employees
- Draft and negotiate contracts with distributors, agents or retailers

2. Working with a classic importer

In our experience, most wineries exporting to the United States employ a classic importer. This is the most expensive way to import, but it is often the only way known to many wineries.

It is also the fastest way to get your wine into distribution in the United States, since the importer is in charge not only of importing but also of selling via distributors which the importer locates itself. This technique also does not require the winery to obtain any licenses, since the importer is already licensed. The producer has only to provide the necessary Letters of Authority as may be required by the national importer or importer in each state.

Even though this method is an easy way to export wine to the United States with only a few administrative requirements, it has significant weaknesses. Firstly, the importer is an additional intermediary in the distribution chain between the wine producer, the distributor, the retailer and the consumer. The presence of such an

additional intermediary will increase the expenses linked to the importation and the importer will only buy the wine if the price of the wine at the producer level is sufficiently low.

Secondly, the producer contracts only with the importer and the importer will find his own distributors which will redistribute the product to the retailers. Thus, the producer has absolutely no control over the sale of the wine to the distributor, retailer or consumer. He often does not even know who the distributors are.

If a distributor decides not to sell the wine anymore, the producer -your winery- must rely on importer's efforts to find a new distributor. If the importer considers that the sale of this wine is not profitable enough for him, the importer's response may be to stop buying the wine from the producer, instead of looking for other distributors who may want to handle your wine. In this manner of selling, your winery -the producer- loses control over how its wine is marketed, and finds itself entirely dependent on the importer.

If you are already considering a specific importer, we can:

- Check the importer's credit history
- Check the size of the importer's distribution network
- Check the importer's litigation history
- Negotiate and draft a contract of sale with the importer
- Follow up on collecting your unpaid invoices including through litigation if needed

3. Working with an alternative importer

Unlike the classic importer, an alternative importer will only offer you its infrastructure through which you will export your wines into the United States market. You will invoice the alternative importer at an agreed-upon price. You will eventually receive payment as the sales agents you employ sell the wines and distributors' payments are remitted to the alternative importer. The alternative importer has a licensed wine

warehouse where the wine is stored until it is sold. We can recommend an alternative importer with whom we have worked in the past. It is licensed to distribute wines nationally and to sell directly to retail restaurants in New York State. Sister companies do similar direct distribution in Connecticut, Florida, and California. In other states, your National Sales Manager¹⁰ would have to find distributors to sell the wine to restaurants and/or retail. The key difference with the classic importer is that with the alternative importer, it is the winery that must find its own sales representatives.

The advantage of this method of importation is that the winery has a direct link with its sales force, because the importer allows the winery to relate directly to its distributors.

On the other hand, it is necessary to remember that this method requires the winery to locate and employ its own sales force to take charge of finding buyers in the different states. Payment to the winery's sales force may be made through the alternative importer if the winery so desires.

If you prefer to work with an alternative importer, we can:

- Check that the alternative importer is legally present in the targeted states
- Negotiate and draft a contract with the alternative importer
- Negotiate and write contracts with the sales agents
- Follow up on payment of your invoices to the ultimate buyers through litigation if needed

¹⁰ Or whomever your winery employs to help it sell the wine in the US

A recent Change in US Law: The Bioterrorism Act

The Public Health Security and Bioterrorism Preparedness and Response Act of 2002 (the Bioterrorism Act) requires that the *Food and Drug Administration* (FDA) receive prior notice of food imported into the United States. Alcoholic beverages are classified as food and therefore are subject to the requirement of prior notice. Importers as well as Wine Producers must register with the FDA and notify the FDA every time a shipment is to come to the United States. It is possible to register on the Internet, and the registration must include the following information in English:

- Name and address of the entity that is registering
- Name and address of the person to contact in case of emergency
- Trademarks and trade names
- Name and address of the U.S. representative of the registrant in the United States
- A detailed list of the producer's products

Registration with the FDA is free. Nevertheless, you must have an agent who will act as your company's representative with respect to FDA matters. That agent must be available at all times, day and night.

Setting up a wine corporation in the United States: Step by Step

1. Define a commercial strategy including short and long term objectives. Select which of the states you wish to market your product in; generally, we recommend starting out with a maximum of three (3) states
2. Obtain necessary funds for setting-up an office in the US, employment expenses, etc...
3. Register your foreign entity with the Department of State as a foreign corporation, or alternatively -and preferably- create a new Limited Liability Company in the US and obtain its Employer Identification Number (EIN)
4. Open a bank account and have some funds deposited for start-up expenses
5. Apply for a visa and work permit for every foreign member of the staff
6. Locate and rent an office
7. Apply for a Federal Import License
8. Register your trademark
9. Before you start shipping into the US:
 - Hire a customs agent and establish a customs bond
 - Register your foreign entity (or US Company) with the FDA
 - Comply with the TTB's labeling requirements (Obtain COLA Certificates), as the TTB must approve every wine label imported into the US.
 - Comply with the Country of Origin Certification requirements for Imported Wines¹¹
 - Obtain a wholesaler's distribution license in every state targetedLocate sales agents who will promote your products
 - Negotiate contracts with your sales agents, setting forth the rights and obligations of each party
10. After you have started to ship, evaluate your initial sales to determine whether to expand to additional states

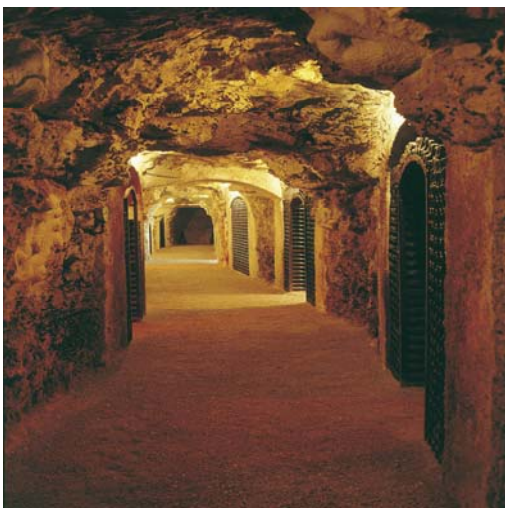
¹¹ <http://www.ttb.gov/importers/index.shtml> provides United States importers with an updated listing of country of origin certification requirements for wines and spirits

“I would rather work with a classic importer”

How can I choose one?

If you decide to work with an importer already established in the United States, different features are relevant. Among them are:

- The nature of the importer’s distribution network. Local agents established at a regional level have usually close relationships with wholesalers and can dedicate more time to a new product
- The importer’s type of license is of great importance, as well as the state or states in which the importer is licensed
- The importer’s portfolio with the kind of beverages the importer deals in and the place the producer’s wines will have within that portfolio
- How much time, money and effort will the importer devote to your wines?
- How much feedback will the importer give you? How accessible is the importer to your needs?
- The reliability of the importer: Has it been the subject of legal complaints? Has it been sued for nonpayment or for breach of contract?



Because we have been working with European winemakers for a number of years, we are aware of the regulatory hurdles that foreign wineries face when importing their wines in the United States. We will help you locate an importer that suits your needs, negotiate a contract that protects your interests, and follow up on collecting your unpaid invoices including through litigation if needed.

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