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Brewery and Distillery Law in Ohio

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Submitted by Jeff C. O'Brien

Jeffrey C. O'Brien

ABOUT ME

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ATTORNEYS AT LAW

Brewery and Distillery Business Entity Selection, Formation, Finance, and Insurance

Topics To Be Covered:

- LLC vs. Partnership vs. Corporation
- Tax Considerations
- Operational Issues
- Documentation and State Filing Requirements
- Structuring, Management, and Governance
- Insurance Concerns
- Drafting and Negotiating Formation Agreements
- Crowdfunding and other Financing Challenges
- Language for Employee Handbooks and Policies

Entity Formation

- Partnership
  - Occurs when two or more people agree to conduct business together.
  - No specific documentation is required before a partnership is formed.

Entity Formation

- Limited Liability Partnership
  - Partners in an LLP have limited personal liability.
  - Governed by its own state law separate and distinct from the law of a general partnership.
  - General partners v. limited partners.

Entity Formation

- Subchapter S Corporation ("S Corp")
  - Must make an election with the IRS
  - Restrictions on who can own shares of an S Corp.
  - All shareholders have the same rights
  - Possible SE Tax Minimization
  - Preferable to C Corporation for small, closely held businesses (no double tax)

S Corp vs. LLC

- FICA Tax Minimization – S Corp
- Flexibility – LLC
- BUT: DON'T WORRY: Most state corporation and LLC statutes provide for a mechanism to convert an LLC to a corporation and a corporation to an LLC

Tax Considerations

Operational Issues

Documentation and State Filing Requirements

Standard Documents

S Corporation

- Articles of Incorporation
- Bylaws
- Initial Written Actions of Shareholders/Directors
- Shareholder Controls Agreement (w. Buy-Sell Provisions)
- Form SS-4
- Form 2553 (S Election)

LLC

- Articles of Organization
- Operating Agreement
- Initial Written Actions
- Form SS-4

Structuring, Management, and Governance

Insurance Concerns

Drafting and Negotiating Formation Agreements

Crowdfunding and Other Financing Challenges

Investment Capital

What is a Security?

Investment Capital – Private Offerings of Securities

- 1933 Act default requires registration of any securities offering
- Alternative: find an applicable exemption from registration
- Also need to find an exemption from registration under state Blue Sky Laws (each state where an investor resides)

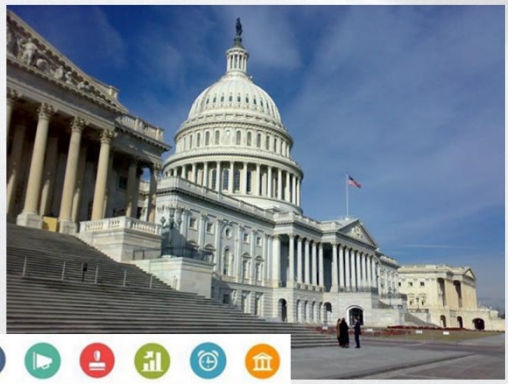
Key Concept: Accredited Investors

Investment Capital

- Section 4(2)
- Regulation D
  - Rule 504
  - Rule 505
  - Rule 506 (now 506(b))

JOBS Act: a Game Changer for Startups

- JOBS Act eases some of the most onerous restrictions on raising capital
  - General Solicitation (506(c))
  - Equity Crowdfunding
  - Regulation A+



JOBS ACT
JUMPSTART OUR BUSINESS STARTUPS

Structuring a Private Offering

- What percentage of ownership to sell?
- Difference between voting and financial rights
- Preferred distributions
- "Sunset" provisions – call rights, put rights, etc.

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Language for Employee Handbooks and Policies

Employee vs. Independent Contractor

- Why does it matter if a worker is deemed an employee – withholding taxes apply and worker may be eligible for benefits
- Misclassified worker = fines, penalties and taxes for employer
- There is no one factor; the IRS has twenty factors
- Look at the level of control that the business owner has over the worker
  - More control ➡ employee

Brewery and Distillery Business Entity Selection, Formation, Finance and Insurance

Submitted by Jeffrey C. O'Brien

A. LLC vs. Corporation

- A business organization is governed by both the laws of the jurisdiction in which it organizes and the laws of all jurisdictions in which it conducts business. This section is an introduction to the major concepts a brewery or distillery may face upon organization and should not be relied upon for any particular jurisdiction.
- An entrepreneur must first decide under which entity type it will operate. Most likely, the choice will come down to LLC, S-Corp, or C-Corp.
- There are many factors to consider when choosing an entity type, including liability, raising capital and control, and taxation.
-

1. **Limited Liability Company (LLC)**
    a. **Governing Law:** Governed by state statute. The affairs of an LLC are governed predominantly through its various governance documents. The most prevalent governance document is the operating agreement, which defines the rights and duties of the LLC's members.
    b. **Formation:** File articles of organization with the proper state office, typically the Secretary of State. The limited required articles include the name of the LLC, the LLC's in-state address, its organizer(s), the number of membership interests authorized, and the duration it is to exist.
    c. **Management:** Owners are called members. An LLC can have one or more members. The LLC can be member-managed, which means that its members perform the day-to-day management of the company, or it can be manager-managed, wherein managers control the management and governance of the company. In Minnesota, the LLC can also be board-managed, where there are one or more governors who designate officers and managers to act for the LLC who have limited authority granted by the board.
    d. **Capital Contributions:** An LLC can receive capital contributions by any and all of it members, in the form of any consideration, such as money, real property, personal property, or services for the company.
    e. **Pass Through Taxation Benefits:** Unless it chooses otherwise, an LLC is taxed as a pass-through entity, which means that the taxation passes through to the LLC

members based on the member's individual ownership interest. However, the members are taxed for their ownership interest regardless of whether or not they received any actual distributions in that tax year.

f. **Limited Personal Liability:** Members are not personally liability for the obligations and debts of the LLC beyond their initial capital contributions, provided that corporate formalities are observed by the members.
g. **Newer Form with Flexibility:** Not well-developed set of case law. LLC flexibility often results in a limitation of duties owed to minority owners. However, LLCs can be tailored to meet nearly any situation and are the most widely used business entities currently.

2. **Corporation: C-Corporation and S-Corporation**

a. **Governing Law:** State statutes govern. Most states have well-developed case law to interpret statutes governing corporations. Articles of incorporation, bylaws or shareholder control agreements create and enforce the rights and duties of a corporation's shareholders.
b. **Formation:** Both the S-Corp and C-Corp are separate legal entities formed by a state filing. These documents, typically called the Articles of Incorporation or Certificate of Incorporation, are the same for both S-Corps and C-Corps.
c. **Management Structure:** Both have shareholders, directors and officers. Shareholders are the owners of the company and elect the board of directors, who in turn oversee and direct corporation affairs and decision-making, but are not responsible for day-to-day operations. The directors elect the officers to manage daily business affairs.
d. **Liability Protection:** Shareholders are not personally liable for any debts or obligations beyond the amount of capital they have contributed to the corporation, unless the corporation fails to follow proper corporate formalities.
e. **Corporate Formalities:** Both are required to follow the same internal and external corporate formalities and obligations, such as adopting bylaws, issuing stock, holding shareholder and director meetings, filing annual reports, and paying annual fees.

f. Taxation: Taxation is often considered the most significant difference for small business owners when evaluating S-Corporations versus C-Corporations.

(1) C-Corporations: Separately taxable entities. They pay taxes at the corporate level. They also face the possibility of double taxation if corporate income is distributed to business owners as dividends, which are considered personal income. Tax on corporate income is paid first at the corporate level and again at the individual level on dividends.

(2) S-Corporations: Pass-through tax entities. They do not pay income, tax at the corporate level. The profits/losses of the business are instead "passed-through" the business and reported on the owners' personal tax returns. Any tax due is paid at the individual level by the owners.

g. Corporate ownership: C-Corporations have no restrictions on ownership, but S-Corporations do. The S-Corporation must meet certain characteristics such as:

(1) it cannot have more than 100 shareholders;

(2) its shareholders must be individuals;

(3) its shareholders must be citizens or residents of the United States;

(4) it must be organized in the United States; and

(5) it can only issue one class of stock.

C-Corporations therefore provide a little more flexibility when starting a business if you plan to grow, expand the ownership or sell your corporation.

B. Tax Considerations

1. **LLC:** May be taxed as:
   a. a disregarded entity if it has one member. The member experiences complete pass through taxation. The member gets taxed on all profits based on tax bracket, whether distributed or not; or
   b. a partnership if it has multiple members. The members experience complete pass through taxation. The members get taxed on all profits based on their tax bracket and ownership interest, whether distributed or not; or

c. it may elect to be taxed as a corporation. The members experience incomplete pass through taxation, which allows the company to retain earnings from year to year and avoid being taxed regardless of a distribution.

2. **Corporation**
    - **a.** C-Corporation; Double Taxation: Taxed at the entity level as well as shareholder level, who each get taxed individually for any distributions received from the corporation.
    - **b.** S-Corporation; Pass Through Taxation: Shareholders are only taxed individually.

C. Structuring, Management and Governance

1. **Management**
    - **a.** LLC/Corporation: States may require an LLC or corporation to have certain designated officers for assist in the company's day-to-day operations. These officer positions may be held by one or more of the company's owners, but can also be held by a non-owner. Officer positions will also often have statutorily-defined duties that can be general to each officer or specific to a particular position, but can be altered with approval of the members or shareholders through agreements. The officers must carry out their duties in the best interests of the company and its owners.
        - **i. LLC:** Can be managed by its members, designated managers, or board of governors. Managers and members of the board of governors can be, but are not required to be, members of the LLC. The individuals responsible for the management of the LLC may also delegate their authority to officers, such as the president, vice president, secretary, or treasurer.
        - **ii. Corporation:** Typically, management is vested in the board of directors. The board of directors serve the interests of the shareholders.
            - Closely Held Corporation: Generally, the shareholders will serve on the board.
2. **Fiduciary Duties**: Individuals responsible for management and operations of a company are generally required to adhere to the duty of care, duty of loyalty, and duty of good

faith in discharging their duties on behalf of the company. If such individuals fail to perform these duties, they may be liable to the company and its owners.

a. **Duty of Care:** A legal obligation which is imposed on an individual requiring adherence to a standard of reasonable care while performing any acts that could foreseeably harm others.
b. **Duty of Loyalty:** A legal obligation which requires fiduciaries to put the corporation's interests ahead of their own. Corporate fiduciaries breach their duty of loyalty when they divert corporate assets, opportunities, or information for personal gain.
c. **Duty of Good Faith:** A general presumption that the parties to a contract will deal with each other honestly, fairly, and in good faith, so as to not destroy the right of the other party or parties to receive the benefits of the contract. It is implied in every contract in order to reinforce the express covenants or promises of the contract.

3. **Corporate Formalities for LLC/Corporation:** Must observe certain formalities in order to maintain the limited liability shield extended to its members/shareholders .

- Piercing the Corporate Veil: The legal standard for extending personal liability varies by state, but the following suggestions help maintain the limited liability shield after forming a limited liability entity:

a. Ensure the entity is sufficiently capitalized;
b. Document any payments to the legal entity from the owners as either paid-in-capital or loans;
c. Do not commingle personal and business funds;
d. Do not pay owners in cash;
e. Owners should never use the business's cash or assets for personal use or pay personal bills with company funds;
f. All of the entity's taxable income should be reported on the entity's tax returns and tax returns should be filed promptly;
g. Shareholders who are actively involved in the business should receive a "reasonable" pre-determined wage or salary for their services;

h. All payments to shareholders should be clearly documented as being wages, expense reimbursements, or profit distributions;

i. All expenses paid to shareholders should be reflected in formal expense reimbursement reports, backed up by appropriate receipts and invoices;

j. Owners should not receive "profit distributions" if the entity is insolvent;

k. All creditors should be paid regularly before distributing any profits;

l. Any purchase of property, computers, equipment, etc. from shareholders should be at commercially reasonable prices and terms and documented in formal written agreement;

m. Obtain appropriate insurance for the type of business in question;

n. Prepare appropriate bylaws, operating agreements, etc.;

o. Hold annual meeting of directors, shareholder, or members and prepare the minutes in a corporate minute book, which should reflect major corporate transactions;

p. Hold elections and appoint officers and directors for the entity;

q. Obtain federal and state tax identification numbers;

r. Obtain sales tax exemption certificates;

s. Issue share certificates to owners (if corporation);

t. File annual registration statement with Secretary of State to remain in "good standing" if the state law requires it;

u. Sign all contracts, agreements, purchases, plans, loan, investments, and accounts in the name of and on behalf of the entity;

v. Train officers and directors how to sign contracts, purchase orders, and agreements on behalf of the entity;

w. Register all "assumed names" being used by the entity;

x. Use the official corporate name on all letterhead, business cards, marketing materials, coupons, websites, etc. to clearly notify third parties that the business has limited liability;

y. If possible, run the business profitably and pay dividends/profit distributions to the owners periodically; document the same;

z. Avoid entering into transactions or incurring debts when the company is insolvent;

aa. Avoid having the dominant owner siphon funds from the business;

bb. Ensure that all officers and directors have a meaningful voice in the business, participate in decision-making, and periodically meet and vote on major corporate decisions;

cc. Avoid using the corporation merely as a façade for individual dealings.

D. Drafting and Negotiating Formation Agreements

1. General Governance Documents

a. Drafting formation agreements is very important for memorializing the rights, responsibilities, and expectations of a business's owners, officers, managers, or board members.

b. 'Governance documents often expressly provide provisions regarding the decision-making process, profit and loss allocations and distributions, fiduciary duties, conduct and procedures for meetings, and delegation of officer positions and duties.

c. A few examples of agreements: operating, member control, partnership, shareholder control, buy-sell, bylaws.

2. Additional Brewery/Distillery Provisions

a. Include provisions that require all proposed members, shareholders, directors or officers to pass the appropriate TTB background check process.

b. Include provisions that require all proposed members, shareholders, directors or officers to pass any applicable local requirements to obtain and hold a liquor license or any other relevant local licensing requirements.

i. Include provisions that require the ownership in the business to be subject to maintaining or passing any required local licensing.

ii. If the owner does not meet these standards or fails to maintain these stands, the governance documents can establish procedures to terminate

the relationship with the individual, including a forced buy-out of the owner's interest in the company.

E. Capital Raising, Crowdfunding, and Other Financing Methods

1. Current Regulatory Landscape and Key Definitions
    a. **Generally:** Nearly every means by which a company raises capital involves securities laws. These laws regulate the manner in which securities are sold, the amount of money that may be raised, the persons to whom the securities may be offered, and the method by which investors may be solicited.
    b. **Federal Registrations and Exemptions:** As a general rule, in order to comply with Federal securities laws, a person selling a security must either:
        i. "register" such sale with the Securities Exchange Commission (SEC) or
        ii. identify a specific exemption that allows such sale to be conducted without registration.
            - SEC registration is time consuming and expensive.
            - For most small businesses, SEC registration is not a feasible option.
    c. **State Blue Sky Laws:** In addition, an issuer selling securities must adhere to blue sky laws in each state where the securities are being sold, all of which vary from each other.

2. **Private Placements**
    a. **Section 4(2):** The most common federal exemption entrepreneurs rely on is Section 4(2) of the Securities Act, which exempts "transactions...not involving any public offering" - i.e., a **private placement**. A company seeking to determine whether an offering will be exempt from registration under Section 4(2) will need to evaluate a number of factors which, although routinely addressed by courts, seldom lead to a definitive answer as to whether an offering is a "public offering" under Section 4(2). Different courts emphasize different factors critical to the Section 4(2) exemption, no single one of which necessarily controls. The factors are guidelines, and include:
        i. Offeree qualification (i.e., whether the investors are sophisticated);

ii. Manner of the offering (i.e., whether the company will engage in advertising or other promotional activities);

iii. Availability and accuracy of information given to offerees and purchasers (i.e., whether the people to whom the company proposes to sell securities have access to basic financial information about the company);

iv. The number of offerings and number of purchasers (i.e., whether the company solicited investment from a large group of people); and;

v. Absence of intent to redistribute (i.e., whether the people to whom the company proposes to sell securities have an intention to hold the securities for investment purposes - generally for a minimum holding period of 24 months).

b. **Regulation D:** The SEC provides a clear set of "safe harbor" rules that issuers can follow to ensure that they are conducting a valid private placement under Section 4(2). The most common safe harbors that small companies have customarily relied upon in conducting private placements are Rule 504 and Rule 506 (now called Rule 506(b) - see below).

i. **General Solicitation:** Rule 502(c) provides that "neither the issuer nor any person acting on its behalf shall offer or sell the securities by any form of general solicitation or general advertising, including, but not limited to, the following:

1. any advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio; and
2. any seminar or meeting whose attendees have been invited by any general solicitation or advertising." In general, this means that issuers will need to have a substantial pre-existing relationship with a potential investor before making an offer of securities under Rule 504 or Rule 506(b).

ii. **Accredited investor:** Under Rule 501(a), an accredited investor is a person who meets certain qualifications and, therefore, is deemed able to protect himself or herself in making investment decisions without

additional protections under the securities laws, such as those obtained through the SEC registration process and the public disclosure of information about the company that is made through the process of becoming an SEC reporting company. There are several ways to qualify as an accredited investor with the most common being:

1. an individual with at least $200,000 (or $300,000 jointly with a spouse) in annual income over the past 2 years or at least $1 million in net worth (excluding the value of a principal residence); or
2. an entity in which all of the equity owners are accredited investors or the entity has at least $5 million in net assets.

3. **The "Old Rules" For Raising Capital**
    a. **Rule 504:** Generally speaking, Rule 504 allows companies to raise up to $1 million from an unlimited number of accredited and non-accredited investors (subject to counterpart state Blue Sky registrations and exemptions). Companies are not permitted to engage is general solicitation except for in states where the securities have been registered or states that provide an exemption from registration that allows the company to generally solicit to accredited investors only.
        i. **State law counterpart:-** Limited Offering Exemption: Most states have a "limited offering" exemption that is often relied on by companies who are conducting Rule 504 offerings. Normally, sales by a company to no more than 35 non-accredited investors (and an unlimited number of accredited investors) during any 12 consecutive months are exempt from registration.
    b. **Rule 506:** Rule 506 is the most common "safe harbor" relied on by companies conducting private placements. Generally speaking, Rule 506 allows an issuer to raise an unlimited amount of capital from an unlimited number of accredited investors and up to 35 non-accredited investors. However, if even one non-accredited investor becomes a purchaser in the offering, then the company must provide all investors with a very detailed disclosure document that satisfies other

SEC requirements. For this reason, the practical reality is that Rule 506 offerings are usually restricted to accredited investors only.

i. **State law counterpart:** Securities issued in reliance on Rule 506 are considered Federal "covered securities" and the offer and sale of such securities are exempt from registration as long as the issuer makes a notice filing.

ii.

4. **The "New" Rules:** Jumpstart Our Business Startups (JOBS) Act: On April 5, 2012, Congress passed the JOBS Act in an effort to foster job growth by modernizing Federal securities laws. The JOBS Act consisted of three key parts that are relevant for securities crowdfunding:

Title II	Title III	Title IV
Advertising in Connection with Sales to Accredited Investors	**Crowdfunding for All**	**Reg A+/"Mini-IPOs"**
Also called Rule 506(c)	SEC released proposed rules in October 2013	SEC released final rules in March 2015
Became effective in October 2013	The proposed rules have been almost universally criticized	Became effective in June 2015
Growing in popularity	Revised rules went into effect in May 2016	Not very useful for small businesses

a. **Title II and Rule 506(c) - Advertising to Accredited Investors:** In late 2013, the SEC (pursuant to the authority granted to it under Title II of the JOBS Act), finalized new Rule 506(c) which allows companies to generally solicit (or advertise) their securities offerings so long as all of the investors who actually purchase securities in the offer are accredited. This means that companies may now talk about their offerings in public seminars, send out email blasts, push offering information out on social media sites, as well as run ads on TV, radio, and the Internet. Companies who comply with Rule 506(c) are now free to talk about their offering to whomever they want (including non-accredited investors).

Companies who generally solicit under Rule 506(c) may only sell the securities to accredited investors.

(1) Verification Steps: Using Rule 506(c), however, comes with certain additional compliance requirements. Companies must take additional steps to verify that all purchasers actually are accredited. In Rule 506(c), the SEC listed several non-exclusive methods that are deemed to satisfy the verification requirements (provided that the issuer does not have knowledge that the purchaser is non-accredited). The "safe harbors" include:

(i) Income verification by checking federal tax forms, including W-2's and tax returns, and a statement by the investor that he or she expects enough income in the current year to remain accredited;

(ii) Net worth verification by checking a recent credit report (with the past 3 months) and bank or investment account statements, together with a written representation from the purchaser that he or she has disclosed all liabilities necessary to make a determination of net worth; and

(iii) Certification of accredited investor status by a registered broker-dealer, SEC-registered investment advisor, licensed attorney, or CPA who has verified the purchaser's accredited investor status.

Comparison of Rules 504, 506(b) and 506(c)

	Rule 504	Rule 506(b)	Rule 506(c()
How much money can I raise?	Up to $1M	Unlimited	Unlimited
Can I advertise the sale of my securities?	No, unless coupled with a state exemption or registration that allows advertising.	No, unless coupled with a state exemption or registration that allows advertising.	Yes.
To whom can I sell securities?	Anyone. However, counterpart state exemptions or registrations may impose additional	Unlimited number of accredited investors. Up to 35 non-accredited investors if	Unlimited number of accredited investors

	restriction on number to non-accredited investors	you believe they are "sophisticated".	
Do I have to comply with SEC's formal information delivery requirements?	No, but counterpart state exemption or registration may impose additional requirements.	No, if only accredited investors are included. Yes, if any non-accredited investors are included.	No.
Do I have to verify that any accredited investors are truly accredited?	No, accredited investors can "self-certify".	No, accredited investors can "self-certify".	Yes, you must take "reasonable steps" to verify that the investors are, in fact, accredited.

b. Title III "retail" crowdfunding and Regulation CF: Title III of the JOBS Act was meant to democratize the business funding process by allowing non-accredited individuals the opportunity to participate online and invest into private companies. The SEC delayed releasing final rules for years, and the system finally went live in May 2016. Issuers must comply with multiple requirements and limitations, namely:

- Issuer may only raise up to $1M in any 12-month period.
- Individual investor limits:
    - If the investor's annual net income OR net worth is < $100k, then the investor may invest the greater of: (a) $2,000; or (b) 5% of the investor's annual income or net worth.
    - If the investor's annual net income AND net worth is > $100k, then the investor may invest 10% of the investor's annual income or net worth
- Investors are subject to a $100k max across all Reg CF offerings in any 12-month period.
- Issuer must provide financial statements based on offering size:
    - < $100k -› Internally prepared, certified statements

- $100k - $500k 4 CPA reviewed statements
- $500k - $1M -› CPA audited financials (or CPA reviewed statements if the issuer is a first time user of the system).

- Issuer must file a robust disclosure document with the SEC.
- Issuer is subject to annual SEC reporting obligations.
- Offerings must be made through registered portals. The portals must be either (a) registered with the SEC as a broker-dealer; or (b) registered as a portal operator with the SEC and be a member of FINRA.

c. Title IV and Regulation A+: Reg A+, which went into effect in June 2015, has been described as a mini-IPO or "IPO-Lite," in that it allows nearly any company with principal offices in the U.S. or Canada to use internet crowdfunding to raise up to $50 million per year from any number of both accredited and non-accredited investors under a regulatory scheme that is far less burdensome than that of a traditional IPO. There is no prohibition on general solicitation, and offering companies are not required to independently verify the sophistication (income or net worth) of their investors. Corporations, limited liability companies, and limited partnerships can take advantage of Reg A+'s two-tiered offering scheme and can sell nearly all types of securities, including equity, debt, and debt securities convertible into equity securities. Furthermore, the securities issued in Reg A+ will be unrestricted and freely transferable. One of the most exciting changes for companies seeking to raise capital under Reg A+ is that Tier 2 offerings are not subject to state Blue Sky registration and merit review (further explained below).

a. Tier 1: Tier 1 offerings are largely similar to old Regulation A offerings, but the old limit of $5 million raised in a 12-month period per issuer has now been increased to $20 million. Unlike Tier 2, there is no limit on the amount a non-accredited investor may invest in any Tier 1 offering.

i. State Registration: Tier 1 still requires that offerors register under the Blue Sky laws of every state in which money is raised. However, the NASAA (North American Securities Administrators

Association) recently launched a multi-state coordinated review program for Regulation A offerings that, if successful, would allow an issuer to register with multiple states by filing just one package with a relatively quick turnaround time. This could make Tier 1 much more attractive for many issuers, given its lower cost.

ii. **Reporting:** Tier 1 is less burdensome than Tier 2 in terms of SEC requirements for initial filing and ongoing reporting. Tier 1 does not require audited financial statements nor ongoing reporting. The only requirement is that offering companies file a Form 1-Z to report the completion of their offering.

b. **Tier 2:** Under Tier 2, companies are allowed to raise up to $50 million in a 12-month period and, most importantly, there is no requirement that the offering company register under any state Blue Sky laws because the federal Reg A+ preempts state law. Tier 2 offerings must only be registered with and approved by the SEC. On the other hand, Tier 2 limits investment by non-accredited investors to the greater of 10% of their annual income or net worth, excluding their primary residence, per offering. Tier 2 also includes substantially more onerous reporting requirements than Tier 1.

   i. **Audited Financial Statements:** Tier 2 issuers must provide the SEC with two years of audited financial statements before approval, while Tier 1 issuers only need to provide "reviewed" statements.

   ii. **Ongoing Reporting:** After a successful Tier 2 raise, Tier 2 issuers who have 300 or more record holders of the security offered must also file the following ongoing reports:

      1. Detailed annual reports, using Form 1-K;
      2. Semiannual reports, using Form 1-SA, including unaudited interim financial statements and a management discussion; and

3. Current event reports, using Form 1-U, reporting all fundamental changes.

Comparison of Rule 506(c), Reg CR and Reg A+

	Title II Rule 506(c)	**Title III Reg CR**	**Regulation A+ Tier 1**	**Regulation A+ Tier 2**
Maximum Dollars Raised	No maximum	$1 million per 12 months, including affiliates	$20 million per 12months	$50 million per 12 months
Permitted Investors	Only Accredited	Anyone	Anyone	Anyone
Per-Investor Limits	None	Yes-depends on income and net worth of investor, and applies to all Reg CF deals per year.	None	For non-accredited investors, 10% of income or net worth whichever is more, per deal
General Solicitation (Advertising) Permitted?	Yes	Yes, but only through portal	Yes	Yes
Testing the Waters Permitted	Yes	Yes	Yes	Yes
Securities Sold Through Third Party Portal?	Yes (but not required)	Yes (required)	Yes (but not required)	Yes (but not required)
Can Issuer Run Its Own Portal?	Yes	No	Yes	Yes
Pre-Sale Information Required	Moderate	Substantial	Very substantial, akin to a registration statement for a public company.	Very substantial, akin to a registration statement for public company.
Audited/Reviewed Financial Statements Required?	No	Depends on size of offering; most first time users will have to provide reviewed statements.	No	Yes

	Title II **Rule 506(c)**	**Title III** **Reg CR**	**Regulation A+** **Tier 1**	**Regulation A+** **Tier 2**
Pre-Sale Approval Required	No	No	Yes-submission must be approved by SEC and the states where the securities will be sold (through a coordinated review).	Yes-Submission must be approved by SEC; state approval not required.
Investor Verification	Verification required	Self-certification	N/A	Self-certification
Ongoing Reporting	None	Moderate	None	Substantial ongoing reporting, akin to a min-public company, but waived depending on number of investors.
Length of Process	Fast	Moderate	Very Slow	Very Slow

5. Other Crowdfunding Methods

a. Rule 504 + State registration: Theoretically, a company may legally conduct a small (less than $1 million) crowdfunding campaign by combing a Federal Rule 504 exemption with state registered offering.

i. General Solicitation under Rule 504: Rule 504 allows an issuer to engage in general solicitation to accredited and non-accredited investors if the issuer either:

1. Registers the offering exclusively in one or more states that require a publicly filed registration statement and delivery of a substantive disclosure document to investors; or

2. Registers and sells the offering in a state that requires registration and disclosure delivery and also sells in a state without those requirements, so long as the company delivers the disclosure documents required by the state where the company registered the offering to all purchasers (including those in the state that has no such requirements).

ii. **SCOR Offering Option:** Some states provide a simplified process for "small corporate offering registrations" that otherwise are exempt from Federal registration under Rule 504.

b. Federal intrastate exemption + State crowdfunding exemption

i. **Section 3(a)(11) and Rule 147:** Another lesser known Federal securities exemption is the "intrastate" exemption embodied by Section 3(a)(11) of the Securities Act and Rule 147 promulgated by the SEC. Generally speaking, Section 3(a)(11) exempts from SEC registration any offering that is confined to the borders of a single state. To qualify for this exemption, the company must meet requirements of Rule 147, which include:

1. The company must be incorporated in the state in which it is offering the securities;

ii. The company must only sell the securities to individuals residing in that state;

iii. 80% of the company's consolidated gross revenues must be derived from the state in which the offering is conducted;

iv. 80% of the company's consolidated assets must be located within the state in which the offering is conducted; and

v. 80% of the offering's net proceeds must be intended to be used, and actually used, in connection with the operation of a business or real property, the purchase of real property located in, or the rendering of services, within the state in which the offering is conducted.

In addition to complying with the Federal "intrastate" exemption, the issuer must also satisfy the requirements of the state crowdfunding exemption. The requirements vary on a state-by-state basis, but they often impose:

i. Limits on the amount of money the issuer can raise;

ii. Limits on the amount of money that investors can invest (there are usually different limits for accredited investors vs. non-accredited investors);

iii. Disclosure requirements, including whether the issuer must provide purchasers with audited or reviewed financial statements;

iv. Escrow requirements;

v. Use of third party Internet portal; and

vi. Ongoing reporting requirements of the issuer.

c. General Solicitation in Intrastate Crowdfunding Offerings: There is no prohibition in Section 3(a)(11) or Rule 147 regarding general solicitation as long as such solicitation:

- complies with applicable state law; and
- does not result in an offer or sale to nonresidents of such state.

i. **SEC Guidance on Online Advertising:** In recent months, the SEC has provided guidance on how intrastate issuers can use the internet to publicize their offerings without having those online advertisements result in an offer or sale to nonresidents of that state.

a. Limiting Access to Out of State Residents: In April 2014, the SEC clarified in Questions 141.03-141.05 that issuers hoping to utilize the Rule 147 exemption could use the Internet for general advertising and solicitation if they implemented measures to limit the offers to people within the issuer's state. In the context of an offering conducted within state crowdfunding requirements, those measures have to include:

i. limiting access to information about a specific investment opportunity to persons who confirm they are residents of the relevant state "(for example, by providing a representation...such as a zip code or residence address)" and

ii. providing a disclaimer and restrictive legend clarifying "that the offer is limited to residents of the relevant state under applicable law." (Question 141.04).

b. IP Address Blocking: In recent years, the SEC suggested what might be a simpler method of limiting the offer to those within the relevant state. The issuer can "implement technological measures" that limit any offers to persons with an IP address originating within the issuer's state and prevent

offers to any individuals outside of the issuer's state (Question 141.05). However, the offer should still contain a disclaimer and restrictive legend. Presumably, this clarification allows issuers to skip the opt-in step where the viewer must verify they are residents of the relevant state before viewing the solicitation or advertisement. The simplification could greatly increase the number of views and potentially improve the effectiveness of the communication.

6. **Capital Raising Pitfalls**
    a. **Rights of Ownership:** When considering whether to engage in a private offering to raise investment capital, a company must consider that investors will be owners of the company following the offering (albeit likely constituting a minority stake in the entity) and as, such, those investors will have certain rights afforded to them by law.
    b. **Limited Liability Companies**
        i. **Governance Rights:** A member's governance rights (i.e., the right to vote and control) in a limited liability company (LLC) depends upon whether the LLC is member-managed, board-managed or manager-managed. If the LLC is member-managed, each member has equal rights in the management and conduct of the company's activities. Even if the LLC is manager-managed, certain proposed actions require consent of the members. In a board-managed LLC, while the board of governors manages the LLC's affairs, the board is selected by a majority vote of the members.
        ii. **Right to Profits:** Unless otherwise provided in the LLC operating agreement, each member is entitled to participate in any distribution(s) of the company's profits (although as noted herein, some additional incentives may be necessary).
        iii. **Right to Information:** Members have the right to access information from the LLC that is material to the member's interest as a member.
        iv. **Minority Rights Regarding Oppressive Conduct:** A member does not have the right to dissent from a proposed course of action and require the

LLC to purchase his/her membership interest. However, some states provide for certain rights and remedies upon a court finding of "oppressive conduct" towards a minority member or members. Note, however, that the LLC operating agreement can limit the remedies that a court may impose, including but not limited to a court-ordered buyout.

c. **Corporations**
    i. **Voting Rights:** Unless otherwise provided within the corporation's articles of incorporation, a shareholder in a corporation has one vote per share. In addition, even if the articles provide that the holders of a particular class of shares are not entitled to voting rights, in some instances, these shareholders are entitled to voting rights as a matter of law.
    ii. **Rights to Information:** Shareholders are entitled to inspect books and certain records of the corporation.
    iii. **Dissenters Rights:** Most significantly, a shareholder of a corporation may dissent from, and obtain payment for the fair value of the shareholder's shares in the event of certain actions.
d. **Maintaining Control:** Frequently in private offerings for startup ventures, the capital contributed by investors through the offering often exceeds the amount of capital contributed by the company's founders. This can prove problematic for the founders seeking to maintain control of the entity by offering a minority ownership stake in the company through the offering. However, various incentives can be employed to make ownership of a minority interest in the business more palatable for investors.
e. **Changes to Terms of Offering; Rescission Offers:** Frequently a prospective investor will propose a counteroffer which differs from the terms outlined in the offering document. If accepted, be aware that changed terms for even a single investor will trigger an obligation to make a rescission offer to prior investors.

7. **Other Sources of Funds**
    a. **Debt Financing:** Before embarking upon a private offering, it is best to consult with one or more lending institutions regarding a small business loan. Banks offer

several small business loan programs, ranging from their own private loan programs to those loan programs established by the U.S. Small Business Administration (SBA). These types of programs are particularly useful when seeking financing to acquire equipment and/or real estate, given the ability to pledge these assets as collateral. Personal guaranties of those owners holding 20% or more is also generally required.

b. "Gap" Financing: "Gap" financing refers to state and local financing incentives that can bridge the gap between a bank loan and an equity capital investment.

i. State Initiatives: Some states have financing programs available for small businesses. These initiatives provide financing to help add new workers and retain high-quality jobs on a statewide basis. The focus is usually on industrial, manufacturing, and technology-related industries to increase the local and state tax base and improve economic vitality statewide.

ii. Local Financing Incentives: Some cities have financing programs and incentives available for small businesses that locate within those cities. For example, some cities have a "Two-Percent Loan" program. Two-Percent Loans provide financing to small businesses (retail, service or light manufacturing) to purchase equipment and/or to make building improvements. A private lender provides half the loan at market rate and the City provides the rest, up to $50,000 at 2 percent interest (up to $75,000 in designated neighborhood commercial districts). The loan term is set by the private lender and can be for up to 10 years. Bank fees vary, but the City charges a 1 percent origination fee with a minimum of $150 due at closing.

iii. Tax Increment Financing: Tax increment financing, or TIF, is a public financing method that is used as a subsidy for redevelopment, infrastructure, and other community-improvement projects. Through the use of TIF, municipalities can dedicate future tax revenues of a "particular business or group of businesses toward an economic development project in the community.

c. **Kickstarter/Rewards Based Crowdfunding:** In recent years, websites such as Kickstarter.com have popularized "rewards-based" crowdfunding. Kickstarter.com is a web portal that allows individuals to make a contribution to a particular project in exchange for some reward, typically some type of tangible product. Other variations of rewards-based crowdfunding include "founders clubs" (often used by local breweries and distilleries) which offer a variety of member benefits (but not any voting rights or share of profits in the enterprise so as to steer clear of the definition of a "security") in exchange for payment of a one-time membership fee. These types of rewards-based incentives should be structured in a way that minimizes liability for the company; i.e., the terms and conditions of membership should be in writing and should specify what happens to the memberships if the company is sold or ceases to do business, that the memberships are non-transferrable and that the membership does not carry with it the rights of ownership.

8. Practical Considerations in Structuring a Private Offering

a. **Put Rights:** A put or put option is a device which gives the owner of the put the right, but not the obligation, to sell his/her shares, at a specified price (the put price), by a pre-determined date to a given party (typically the company).

b. **Call Rights:** In contrast to put rights, call rights or a call option refers to the right, but not the obligation, to buy an agreed number of shares within a certain time for a certain price (the "call price"). The seller is obligated to sell his/her shares to the buyer if the buyer so decides.

c. **Preferred Distributions:** In some instances, it may be necessary or advantageous to incentivize potential investors by including a preferred distribution for investors. Most closely held companies give their board the discretion to make (or not make) distributions of profits and the amount of such distributions. A preferred distribution constitutes the company's contractual obligation to pay a minimum amount to the holders of such preferred distribution rights ahead of making any discretionary distributions to all owners. Often times preferred distributions are "cumulative", meaning that a preferred distribution which is not

made in one year cumulates and is to be paid when the company has funds available to pay it.

d. Preferential/Accelerated Distributions: In regards to general distributions of profits, in order to maintain governing control of the company following a private offering, and in addition or alternative to preferred distributions it may be necessary to offer investors a distribution preference. For example, suppose the investors as a group own 40% of the company. A distribution preference would be to make 60% of the company's operating distributions to the investor class for a period of years until the investors recoup their initial investment. Upon doing so, distributions would then be made pro rata based upon ownership percentages.

e. Written Agreement. All of these mechanisms should be included in a written agreement between the owners (an operating agreement for an LLC or a shareholder agreement for a corporation), and new investors should be required to execute a joinder to the agreement in order to bind themselves to the agreement.

The Regulatory Framework at the Local, State and Federal Levels

A. Federal

i. Alcohol and Tobacco Tax and Trade Bureau (TTB)

a) The Alcohol and Tobacco Tax and Trade Bureau (TTB) regulates craft beer at the federal level. (Brew Law 101 at 59).

b) Anyone brewing beer for sale must obtain a Brewer's Notice from the TTB. You can find the form online at their website but be aware the process can take on average 129 days. *Id.*

c) The application requires a heavy amount of paperwork, including personal information for every officer, director, and shareholder who holds at least 10% interest in the company. *Id.*

ii. Food and Drug Administration (FDA)

a) Federally regulates any "facility that manufactures, processes, packs, or holds food or beverages – including alcoholic beverages – for consumption in the United States." *Id* at 60.

b) You must register with the FDA biannually, but there is no fee involved. *Id.*

B. State

1. Brewery License

a. Qualifications:

- An applicant must be 21 years of age, be of good moral character, be a legal resident of the United States and if applying as a Sole Proprietor, must be a legal resident of South Carolina for 30 days prior to submitting an application to this Department.
- The applicant must be the owner of the business seeking the permit and must not previously have had a permit revoked within the past two (2) years.
- All principals, officers, agents, and employees listed on the permit must be over the age of 21 and be of good moral character. A current criminal history of not more than 90 days old, on each principal, officer, and employee must accompany this application.
- Please check with the city and/or county authorities to ensure you are in compliance with zoning laws and local business license requirements.

b. Tax Liabilities:

- A permit cannot be issued is the applicant has any outstanding tax liabilities with the SCDOR.

c. Sign Posting:

- An agent of the SC Law Enforcement Division (SLED) must post and remove a sign at the proposed place of business.
- This sign must remain posted at the location for at least 15 days, and maybe removed only by the SLED agent.
- Permits will not be issued until the afternoon of the fourth day after the sign is taken down; unless your published ad provides for a later date.

d. Newspaper Advertisements:

- A notice of application must be placed at least once a week for three (3) consecutive weeks in a newspaper approved by the department for your area.
- This notice must:
    - Be in the legal notices section of the newspaper or an equivalent section if the newspaper has no legal notices section;
    - Be in large type, covering a space of one column wide and at least two inches deep; and
    - State the type of license applied for and the exact location of the proposed business.

- To complete your application you must submit your Affidavit of Publication and a copy of the ad furnished by the approved newspaper office.
- The ABL-32 lists all approved newspapers.

e. Requirements

- Completed application, signed, dated, and notarized.
- Submit nonrefundable filing fees: $300.00
- LICENSE FEES SHOULD NOT BE SUBMITTED UNTIL PERMIT IS APPROVED.
- Must complete ABL-946 (Consent and Waiver).
- Must attach copy of Articles of Incorporation, if applying as a corporation.
- Must attach a Certificate of Authority to do Business in South Carolina, obtained from the Secretary of State's office, if applying as a foreign corporation.
- Must attach a copy of Articles of Organization and Operating Agreement, if applying as a Limited Liability Corporation.
- Must attach copy of partnership agreement, if applying as a partnership or Limited Liability Partnership.
- All principals must attach a Criminal Records Check (CRC), not more than 90 days old.
- If the principal has lived in SC for more than two (2) years, obtain the CRC from SLED at www.sled.state.sc.us or from SLED Headquarters, Criminal Records Department, 4400 Broad River Rd., P.O. Box 21398, Columbia, SC 29221.
- If the principal has lived in SC less than two (2) years, obtain a CRC from previous state of residency AND a CRC from SLED.
- If principal is not a SC resident, obtain a CRC from current state of residency.
- If you own the property, you must submit a copy of the deed or tax bill; if not, submit a copy of your lease.
- Must attach completed residency status verification affidavit. Use Verification of Lawful Presence in the United States-Applicant and Principals (ABL-920) for each principal. Each principal, officer, owner, member, and/or partner MUST sign the form. If applicable include his/her non-citizen alien registration number and attach a copy of all appropriate immigration documents.

- General Location Requirements for Brewery to offer Samples:
- Sales to or samplings must be held in conjunction with a tour by the consumer of the licensed premise and the entire brewing process utilized at the licensed premise;

- Sales or samplings shall not be offered or made to, or allowed to be offered, made to, or consumed by an intoxicated person or a person who is under the age of 21;
- No more than a total of 48 ounces of beer brewed at the licensed premises, including amounts of samples offered and consumed with or without cost, shall be sold to a consumer for on-premises consumption within a 24 hour period.
- Of that 48 ounces of beer available to be sold to a consumer within a 24 hour period, no more than 16 ounces of beer with an alcoholic weight of above eight (8) percent, including any samples offered and consumed with or without cost, shall be sold to a consumer for on-premises consumption within a 24 hour period.
- General Location Requirements for Brewery to sell On-Premises Beer/Wine:
- A brewery licensed in this State is authorized to sell beer produced on its licensed premises to consumer for on-premises consumption within an area of its licensed premises approved by the rules and regulations DHEC governing each and drinking establishments and other food service establishments.
- Breweries approved through DHEC for eating and drinking establishments may also apply for a retail on-premises consumption permit for the sale of beer and wine of a producer that has been purchased from a wholesaler through the three-tier distribution chain set forth in Section 61-4-730 and Section 61-4-940.
- The brewery must comply with all state and local laws concerning house of operation.
- The brewery must remit taxes to the Department of Revenue for beer sales in an amount equal to and in a manner required for taxes assessed by Section 12-21-1020and Section 12-21-1030. The brewery also must remit appropriate sales and use taxes and local hospitability taxes.

2. Brewpub Beer/Wine License

a. 120 Day Temporary

- The existing business must have a biennial permit that has not expired, been suspended or revoked.
- This permit must be attached with the completed ABL-901 application. A $25.00 fee is required for each temporary permit requested.
- Attach a copy of the receipt from the approved newspaper indicating you have paid for the Notice of Application.
- Attach a copy of the bill of sale, lease, probate document, divorce decree, eviction order, or document showing how the business was acquired.
- Be sure to indicate the Retail Sales Tax Number on the ABL-901 application.

b. Qualifications

- Authorizes the sale of beer and wine, the manufacture of beer and the consumption of these products on the permitted premises.

- An applicant must be 21 years of age, be of good moral character, be a legal resident of the United States and if applying as a sole proprietor, must be a legal resident of South Carolina for 30 days prior to submitting an application to this department.
- The applicant must be the owner of the business seeking the license and must not previously have had a license revoked within the past five years.
- All principals, officers, agents, and employees listed on the license must be over the age of 21 and be of good moral character. A current criminal history background check of not more than 90 days old, on each principal, officer, and employee must accompany this application.
- Please check with the city and/or county authorities to insure you are in compliance with zoning laws and local business license requirements.

c. Tax Liabilities:

- A license or permit cannot be issued if the applicant or any principal has any outstanding tax liabilities with the SCDOR.

d. Sign Posting:

- An agent of the SC State Law Enforcement Division (SLED) must post and remove a sign at the proposed place of business.
- This sign must remain posted for at least 15 days, and may be removed only by the SLED agent. If the sign disappears before the SLED agent removes it, contact the SCDOR or SLED immediately.
- Permits/Licenses will not be issued until the afternoon of the fourth day after the sign is taken down by agent; unless your published ad provides for a later date.

e. Newspaper Advertisements:

- A notice of application must be placed at least once a week for three (3) consecutive weeks in a newspaper approved by the department for your area.
- This notice must:
    - Be in the legal notices section of the newspaper or an equivalent section if the newspaper has no legal notices section;
    - Be in large type, covering a space of one column wide and at least two inches deep; and
    - State the type of license applied for and the exact location of the proposed business.

- To complete your application, you must submit your Affidavit of Publication and a copy of the ad furnished by the approved newspaper office.
- Please refer to the ABL-32 for a complete list of approved newspapers.

f. Requirements

- Authorizes the sale of beer and wine, the manufacture of beer and the consumption of these products on the permitted premises.
- Completed application (ABL-901), signed, dated and notarized
- Submit nonrefundable filing fees - $300.00
- LICENSE FEES SHOULD NOT BE SUBMITTED UNTIL LICENSE IS APPROVED
- Submit an Affidavit of Publication from the newspaper running your ad. The affidavit must include a copy of your ad. If you just started your ad in the newspaper and have not received the ad and affidavit, you MUST include the receipt from the newspaper with your application. Forward the ad and affidavit as soon as the newspaper provides it to you. Your permit cannot be issued until this is received.
- Must complete the ABL-946 (Consent and Waiver)
- Must attach copy of Articles of Incorporation, if applying as a corporation.
- Must attach a Certificate of Authority to do Business in South Carolina, obtained from the Secretary of State's office, if applying as a foreign corporation.
- Must attach a copy of Articles of Organization and Operating Agreement, or LLC Supplemental Information Form (ABL-919), if applying as a Limited Liability Corporation.
- Must attach copy of partnership agreement, if applying as a partnership or Limited Liability Partnership.
- All principals must attach a criminal records check (CRC), not more than 90 days old.
- If the principal has lived in SC for more than 2 years, obtain the CRC from SLED at www.sled.state.sc.us or SLED Headquarters, Criminal Records Department 4400 Broad River Rd., P.O. Box 21398, Columbia, SC 29221.
- If the principal has lived in SC less than 2 years, obtain a statewide CRC from previous state of residency AND a CRC from SLED.
- If principal is not a SC resident, obtain a statewide CRC from current state of residency.
- Must attach a copy of your lease, deed or tax bill for the location for which you are seeking a license. The lease, deed, or tax bill must be in the applicant's name and list the physical address of the business location.
- Must attach completed residency status verification affidavit. Use Verification of Lawful Presence in the United States– Applicant and Principals (ABL-920) for each principal. Each principal, officer, owner, member, and/or partner MUST sign the

form. If applicable, include his/her non-citizen alien registration number and attach a copy of all appropriate immigration documents.

3. In State Liquor Manufacturer

a. Qualifications

- An entity operating a plant or place of business in this State for distilling, rectifying, brewing, fermenting, blending, or bottling alcoholic liquors.
- An applicant must be 21 years of age, be of good moral character, be a legal resident of the United States and if applying as a sole proprietor, must be a legal resident of South Carolina for 30 days prior to submitting an application to this department.
- The applicant must be the owner of the business seeking the license and must not previously have had a license revoked within the past five years.
- All principals, officers, agents, and employees listed on the license must be over the age of 21 and be of good moral character. A current criminal history background check of not more than 90 days old, on each principal, officer, and employee must accompany this application.
- Please check with the city and/or county authorities to ensure you are in compliance with zoning laws and local business license requirements.

b. Tax Liabilities:

- A license cannot be issued if the applicant or any principal has any outstanding tax liabilities with the SCDOR.

c. Sign Posting:

- An agent of the SC State Law Enforcement Division (SLED) must post and remove a sign at the proposed place of business.
- This sign must remain posted for at least 15 days, and may be removed only by the SLED agent. If the sign disappears before the SLED agent removes it, contact the SCDOR or SLED immediately.
- Licenses will not be issued until the afternoon of the fourth day after the sign is taken down by the agent; unless your published ad provides for a later date.

d. Newspaper Advertisements:

- A notice of application must be placed at least once a week for three (3) consecutive weeks in a newspaper approved by the department for your area.
- This notice must:

- Be in the legal notices section of the newspaper or an equivalent section if the newspaper has no legal notices section;
- Be in large type, covering a space of one column wide and at least two inches deep; and
- State the type of license applied for and the exact location of the proposed business.
- To complete your application, you must submit your Affidavit of Publication and a copy of the ad furnished by the approved newspaper office.

e. Requirements

- An entity operating a plant or place of business in this State for distilling, rectifying, brewing, fermenting, blending, or bottling alcoholic liquors.
- Completed application (ABL-902), signed, dated and notarized
- Submit nonrefundable filing fees: $200.00
- Submit an Affidavit of Publication from the newspaper running your ad. The affidavit must include a copy of your ad. If you just started the ad in the newspaper and have not received the ad and affidavit, you MUST include the receipt from the newspaper with your application. Forward the ad and affidavit as soon as the newspaper provides it to you. Your license cannot be issued until this is received.
- Must complete the ABL-946 (Consent and Waiver)
- Must attach copy of Articles of Incorporation, if applying as a corporation
- Must attach a Certificate of Authority to do Business in South Carolina, obtained from the Secretary of State's office, if applying as a foreign corporation
- Must attach a copy of Articles of Organization and Operating Agreement, if applying as a Limited Liability Corporation, LLC
- Must attach copy of partnership agreement, if applying as a partnership or Limited Liability Partnership.
- All principals must attach a criminal records check (CRC), not more than 90 days old.
- If the principal has lived in SC for more than 2 years, obtain the CRC from SLED at www.sled.state.sc.us or SLED Headquarters, Criminal Records Department, 4400 Broad River Rd., P.O. Box 21398, Columbia, SC 29221.
- If the principal has lived in SC less than 2 years, obtain a statewide CRC from previous state of residency AND a CRC from SLED.
- If principal is not a SC resident, obtain a statewide CRC from current state of residency.

- If you own the property, you must submit a copy of the deed or tax bill; if not, submit a copy of your lease
- Must attach completed residency status verification affidavit. Use Verification of Lawful Presence in the United States– Applicant and Principals (ABL-920) for each principal. Each principal, officer, owner, member, and/or partner MUST sign the form. If applicable, include his/her non-citizen alien registration number and attach a copy of all appropriate immigration documents

C. <u>Local</u>

a) Growlers

b) Tap Rooms/ Cocktail Rooms

c) Zoning/Land Use

Top Permitting/Licensing Issues

a) First and foremost, it is imperative to understand what permits and licenses must be obtained at each level of government before operations can legally begin.

b) At the Federal level, when you are seeking a brewer's notice or distilled spirits plant license, be sure that your application is complete and accurate, as incomplete applications will not be reviewed and will ultimately be dismissed.

c) At the state level, be aware of which agency or agencies are responsible for reviewing your application and provide such agency/agencies with all required and requested documentation in order to ensure expeditious review and approval.

d) It is also imperative to understand what local requirements exist as to the brewery or distillery, be they taproom/cocktail room licenses or other issues (such as growler sales restrictions and/or garden variety land use/zoning requirements).

D. <u>Navigating TTB Labeling Regulations – and Landmines to Avoid!</u>

i. **TTB:** At the federal level, breweries and distilleries are regulated via the Alcohol Tobacco Tax and Trade Bureau, an agency falling under the U.S. Department of Treasury. Commonly referred to as the "TTB", this agency grew out of the Bureau of Alcohol, Tobacco, Firearms and Explosives

("ATF") in 2003. The TTB handles all federal liquor law issues including tax revenues, permits, licenses, tax audits, trade investigation and labels.

ii. **Navigating Local, State and Federal Rules, Regulations and Requirements:** While the TTB's licensing requirements and regulations apply for breweries and distilleries in any state within the U.S., state and local laws vary by jurisdiction.

iii. **State and Federal, TTB Registration Requirements**

a. **<u>Federal</u>**

1. The TTB requires anyone brewing beer for sale to acquire a Brewer's Notice. Historically, the process for obtaining a Brewer's Notice through the TTB was time consuming, but with the recent craft brewing and distilling boom, the TTB has streamlined the process through its Permits Online site, https://www.ttbonline.gov/permitsonline.
2. Information and documents to be submitted to the TTB in connection with the Brewer's Notice application include the following:
    - Articles of Organization (LLC) / Articles of Incorporation Corp.)
    - Operating Agreement (LLC) / By Laws (Corp.)
    - Federal EIN (from IRS)
    - Owner Officer Questionnaires (for each owner of 10%+ and each officer)
    - List of all owners and officers identifying percentage of voting ownership, amount of funds invested, etc. (if owner is an entity, EIN)
    - Source of Funds Documents (bank statements, loan documents, etc.)
    - Diagram of Premises
    - Description of Property (usually metes & bounds is best)
    - Description of Equipment (more reviewers are requiring this, at least provide size of tanks)
    - Description of the Building (walkthrough of the brewery premises)
    - Environmental Questionnaire (number of employees, amount of waste, disposal of liquid and solid waste, electric/gas provider name, etc.)
    - Supplemental (disposal of waste into navigable waterways, etc.)
    - Brewer's Bond

- Consent of Surety (if using a non-contiguous warehouse, alternating premises between a brewery and a distillery, running an alternating proprietorship, etc.)
- Lease agreement or mortgage (with permission to use premises as a brewery/distillery)
- Assumed name registration (if applicable)
- Security statement
- Designation of a main contact person
- Copy of ID for main contact person
- Signing authority resolution for application contact
- TTB's Signing Authority Form
- Power of attorney (if being filed by an attorney)
- Other (historic buildings, variance request, etc.

3. Similarly, anyone seeking to produce distilled spirits must obtain a distilled spirits plant license through the TTB with similar requirements as for the Brewer's Notice.

b. <u>State Licensing Issues</u>

i. While the TTB's licensing requirements and regulations apply for breweries and distilleries in any state within the U.S., state and local laws vary by jurisdiction.

c. Formula Approvals

i. <u>Beer Formulas</u>

1. Beers do not typically require a formula approval, unless they contain a non-traditional beer ingredient or are made using a non-traditional brewing method.

2. In 2015, TTB issued a ruling broadly expanding the definition of "traditional." Under the new rule, traditional ingredients and processes have been expanded, and are listed in the attachment on the next page.

3. If the beer includes a "non-traditional" fruit, spice (e.g., elderberry), or "sweetener" (e.g., aspartame), or contains a coloring (e.g., Blue No. 1), flavoring (e.g., an extract), or TTB limited ingredient (e.g., calcium chloride), or is made by a "non-traditional" process (e.g., "ice distilling"), the beer requires a TTB formula approval before TTB will issue a COLA approval. For more information on ingredient issues, see Appendix 1.

ii. <u>Spirits formulas</u>

1. Most traditional spirits do not require a formula approval, unless they contain a restricted product (e.g., thujone), or are infused with flavors or colored. Occasionally, a product must also be sent in to TTB's lab for analysis. Lab analysis is more typically required for imported products to make sure certain requirements are met. TTB's chart is attached hereto as Appendix 2, which shows if/when formula and/or laboratory approval is required for a distilled spirits product prior to label submission.

iii. <u>Labeling</u>

1. Another integral responsibility of the TTB is to regulate and approve labels for packaging beer and spirits. Section 105(e) of the Federal Alcohol Administration Act (27 USC 205(e)) authorizes the Secretary of the Treasury to issue regulations regarding product labeling that:

   - (1) ensure that consumers are provided with adequate information as to the identity and quality of alcohol beverages, and

   - (2) prevent consumer deception. The Secretary has delegated to the Alcohol and Tobacco Tax and Trade Bureau (TTB) authority to administer the regulations promulgated under section 105(e). Section 105(e) and the TTB regulations require a Certificate of Label Approval ("COLA") for each alcohol beverage product regulated by the agency. TTB issues COLAs on TTB Form 5100.31.

2. First, you must register for the COLA's. Appendix 3 contains instructions on how to successfully register using the online system. If you choose not to file electronically, you must TTB Form 5100.3, in duplicate form, to the following address:

   Advertising, Labeling and Formulation Division
   Alcohol and Tobacco Tax and Trade Bureau
   1310 G Street, NW, Box 12
   Washington, DC 20005

3. A copy of Form 5100.3 is included at Appendix 4.
4. NOTE: You must obtain label approval prior to bottling if you are shipping out of state.
5. For many alcohol beverage products, TTB requires a product evaluation to determine whether a proposed label identifies the product in an adequate and non-misleading way. Pre-COLA product evaluation entails a review of a product's ingredients and

formulation and also may include a laboratory analysis of the product. Laboratory analysis involves a chemical analysis of a product.

6. Such pre-COLA product evaluations ensure that:

- No alcohol beverage contains a prohibited ingredient.
- Limited ingredients are used within prescribed limitations or restrictions.
- Appropriate tax and product classifications are made.
- Alcohol beverages labeled without a sulfite declaration contain less than 10 parts per million (ppm) of sulfur dioxide.

7. The type of pre-COLA product evaluation required for a particular product depends on that product's formulation and origin. TTB regulations require formulas most commonly when flavoring or coloring materials are added. Field investigations can be used to verify the accuracy of these documents. Since TTB does not have access to foreign plants, some imported products are subject to laboratory analysis or pre-import letter approval.

8. The relevant Federal regulations for labeling and advertising of malt beverages can be found Part 7 of Title 27 of the Code of Federal Regulations. Processing times for COLA's can be found : https://www.ttb.gov/labeling/processing-times.shtml.

§7.11 Use of ingredients containing alcohol in malt beverages; processing of malt beverages

(a) *Use of flavors and other nonbeverage ingredients containing alcohol—*

i. (1) *General.* Flavors and other nonbeverage ingredients containing alcohol may be used in producing a malt beverage. Except as provided in paragraph (a)(2) of this section, no more than 49% of the overall alcohol content of the finished product may be derived from the addition of flavors and other nonbeverage ingredients containing alcohol. For example, a finished malt beverage that contains 5.0% alcohol by volume must derive a minimum of 2.55% alcohol by volume from the fermentation of barley malt and other materials and may derive not more than 2.45% alcohol by volume from the addition of flavors and other nonbeverage ingredients containing alcohol.

ii. (2) In the case of malt beverages with an alcohol content of more than 6% by volume, no more than 1.5% of the volume of the malt beverage may consist of

alcohol derived from added flavors and other nonbeverage ingredients containing alcohol.

(b) *Processing.* Malt beverages may be filtered or otherwise processed in order to remove color, taste, aroma, bitterness, or other characteristics derived from fermentation.

iv. Labeling Requirements

Permission to Re-label: Application for permission to re-label shall be accompanied by two complete sets of the old labels and two complete sets of any proposed labels, together with a statement of the reasons for relabeling, the quantity and the location of the malt beverages, and the name and address of the person by whom they will be relabeled.

Land Use, Zoning and Environmental Issues

A. Industrial Waste & Water

a. Breweries use a substantial amount of water and create a large amount of byproduct waste through their operations. (Brewlaw p. 47). The spent grain is considered "industrial waste and must be handled accordingly". *Id.*

b. Be aware that some cities and locations are not friendly to breweries because they use a substantial amount of water. *Id.* Additionally, at drought-stricken areas, your brewery will need to expend more on water as it may be more expensive. *Id.*

B. Pollutants

a. Brewing creates pollutants that must be handled appropriately. These pollutants are governed by different agencies. *Id.*

b. "The wastewater created by boilers, referred to as effluent, is regulated by the Environmental Protection Agency (EPA) for nitrogen oxide level." *Id.*

c. Plan to have a silo? You need to obtain a permit from the Air Pollution Control District (APCD). *Id* at 48.

C. Zoning & Licenses

Considerations for Clients Doing Business in Multiple States

A. Onus is on the brewery to ensure they are compliant with each state and federal law.

B. Non-extensive checklist for laws:

a. Environmental laws in different states;

b. Zoning;

c. Licensing;

d. Labeling;

Negotiating/Drafting Brewery and Distillery Contracts

Submitted by Jeff C. O'Brien

Negotiating/Drafting Brewery and Distillery Contracts

Jeffrey C. O'Brien

chestnut cambronne
ATTORNEYS AT LAW

Topics To Be Covered:

- Distribution Agreements
- Contract Production Agreements
- Agreements With Suppliers
- Licensing Agreements
- Alternating Proprietorships
- Equipment, Retail, Production, and Distribution Space Leases
- Sample Agreements

Distribution Agreements

Distribution Agreements

- Laws vary from state to state
- Creation
- Termination
- Scope of Agreement
- Small Brewer Exemptions

Contract Brewing/Licensing

- Definition: a brewery that hires another brewery to produce its beer. The licensor generally handles marketing and brand development of the beer, while leaving the brewing and packaging to the licensee brewery.
- Pros of Contract Brewing:
  - Can help alleviate producer brewery supply issues to meet demands.
  - Producer breweries avoid costs since they do not need to own a brewing facility

Alternating Proprietorship

- Definition: An arrangement in which two or more people take turns using the physical premises of a brewery. Generally, the proprietor of an existing brewery, the "host brewery", agrees to rent space and equipment to a new "tenant brewer."
- Pros of an Alternating Proprietorship:
  - Tenant brewers can develop a brand before they are ready to invest in their own premises and equipment.
  - Tenant brewer may be eligible for a lower tax rate on beer.
  - Host breweries can offset their investment by renting out their excess capacity.

Alt Prop vs. Contract Brewing

	ALT PROP	CONTRACT BREWING
Title Ownership	Tenant brewer holds title to its beer, including the ingredients and raw materials it uses to produce its beer, during all stages of production.	Contract brewer holds title to the beer, including the ingredients and raw materials used to brew the beer, during all stages of production.
Record Keeping	Tenant brewer and host brewer each retain their own records for production and removal of beer and each provides reports to the TTB.	Contract brewer retains all records of production and removal of beer and provides reports to the TTB.
Taxes	Tenant brewer and host brewer are individually responsible for paying their own taxes on their own beer removed from the brewery.	Contract brewer is solely responsible for paying taxes on beer removed from the brewery.
Brewer Licensure	Tenant brewer and host brewer must each qualify as a brewer and have separate licenses.	Only the contract brewer must qualify as a brewer, so the producer brewer does not need a license.
Ease of Paperwork	Requires significant paperwork for both parties.	Simple agreement; Brand is added to the contract brewer's Notice.

Negotiating Brewery and Distillery Contracts

Submitted by Jeffrey C. O'Brien

I. Brewing Models

A. Production Brewery

1. **Definition:** A brewery that brews its own beer onsite and packages its beer for sale largely off-premise. May have a tasting room.
2. **Examples of Large Production Breweries:** Lagunitas, Bell's, Stone.

B. Brewpub

1. **Definition:** A brewery whose beer is brewed primarily on the same site from which it is sold to the public, such as a pub or restaurant. If the amount of beer that a brewpub distributes off-site exceeds 75%, it may also be described as a craft or microbrewery. Most brewpubs must adhere to laws which limit the total ratio of beer sales to food sales. A brewpub cannot be considered a bar or beer garden which offers a limited amount of food or limits the restaurant's hours of operation. It must operate as a public restaurant which happens to offer a wide selection of micro-brewed beers.
2. **Pros of a Brewpub**
   - **a.** Brewpubs create marketing to new customers who may not be willing to go to a brewery just to taste beer, but who may be willing to try a new restaurant closer to home.
   - **b.** Brewpubs may be located in a more accessible location to attract more people because the brewery is not actually manufacturing beer onsite.
   - **c.** Brewpubs can easily develop their own identity by designing the brewpub to reflect their branding and style.
3. **Examples of National/Regional Brewpubs:** Rock Bottom Brewery, Gordon Biersch, etc.

C. Alternating Proprietorship (AP)

1. **Definition:** An arrangement in which two or more people take turns using the physical premises of a brewery. Generally, the proprietor of an existing brewery, the "host brewery," agrees to rent space and equipment to a new "tenant brewer." Under this arrangement, tenant brewers are solely responsible for brewing their beer, maintaining all

of the brewing records, labeling the beer using their own name and address, and paying tax on the beer upon their removal of the beer from the brewery.

2. Pros of an Alternating Proprietorship

a. Tenant brewers can develop a brand before they are ready to invest in their own premises and equipment.

b. Tenant brewers can begin placing their product in the stream of commerce to better preserve intellectual property rights.

c. Host breweries can offset their investment by renting out their excess capacity.

d. Host breweries often serve as a buffer to allow for easy transition into a highly-regulated industry.

e. Host breweries take on much of the physical pressure, burden and liability of the brewing operation.

f. Tenant brewer may be eligible for a lower tax rate on beer. Where a brewer produces less than 2,000,000 barrels of beer during a calendar year, there is a reduced tax rate of $7 per barrel on the first 60,000 barrels on beer produced that is also consumed or sold in that same year.

3. Examples of Alternating Proprietorships: 21st Amendment Brewery in CA (Tenant Brewer) within Cold Spring Brewery in MN (Host Brewer), Avery Brewing in CO (Tenant Brewer) within New Belgium Brewing in CO (Host Brewer).

D. Contract Brewing

1. Definition: A business that hires another brewery to produce its beer. It can also be a brewery that hires another brewery to produce additional beer. The contract brewing company handles marketing, sales and distribution of its beer, while generally leaving the brewing and packaging to its producer brewery. The producer brewery provides the recipes for the beer to the contract brewer.

2. Pros of Contract Brewing

a. Producer breweries that cannot supply enough beer to meet demands can contract with a larger brewery to help alleviate their supply issues.

b. Producer breweries do not need to own a brewing facility, so they can avoid the costs associated with a physical brewery.

c. Producer breweries do not need a separate license.

3. Example of Contract Brewing: Gluek Brewing Company in MN (Producer Brewery) within Hard Energy Company in CA (Contract Brewery)

Comparison of Alternating Proprietorship and Contract Brewing Models

Differences	Alternating Proprietorship	Contract Brewing
Title Ownership	Tenant brewer holds title to its beer, including the ingredients and raw materials it uses to produce its beer, during all stages of production.	Contract brewer holds title to the beer, including the ingredients and raw materials used to brew the beer, during all stages of production.
Record Keeping	Tenant brewer and host brewer each retain their own records for production and removal of beer and each provides reports to the Alcohol and Tobacco Tax and Trade Bureau (TTB).	Contract brewer retains all records of production and removal of beer and provides reports to the TTB.
Taxes	Tenant brewer and host brewer are individually responsible for paying their own taxes on their own beer removed from the brewery.	Contract brewer is solely responsible for paying taxes on beer removed from the brewery.
Brewer Licensure	Tenant brewer and host brewer must each qualify as a brewer and have separate licenses.	Only the contract brewer must qualify as a brewer, so the producer brewer does not need a license.
Ease of Paperwork	Requires significant paperwork for both parties.	Simple agreement; Brand is added to the contract brewer's Notice.

II. Negotiating Brewery and Distillery Contracts

A. Distribution Agreements

State Distribution Laws

i. Distribution laws vary between states. See Appendix 1 for a summary of each state's law.

Franchise Laws

A majority of the states have enacted full-fledged beer franchise laws. Although it is not hard to detect a whiff of protectionism in these enactments, their stated purpose is to correct the perceived imbalance in bargaining power between brewers (who are presumed to be big and rich) and wholesalers (who are presumed to be small and local). Temperance concerns are also cited. A full-fledged beer franchise law will usually:

- Define franchise agreements to include informal, oral arrangements, making any shipment to a wholesaler the start of a franchise relationship.
- Prohibit coercive brewer practices, most often including actions in which a brewer (a) requires the wholesaler to engage in illegal acts, (b) forces acceptance of unordered beer, or (c) withholds shipments in order to impose terms on the wholesaler.
- Require "good cause" or "just cause" before a brewer can terminate a wholesaler.
    - The burden is generally on the brewer to demonstrate cause for termination.
    - "Good cause" is usually defined to include a significant breach of a "reasonable" and "material" term in the parties' agreement.

- Dictate that a brewer give prior written notice (60 or 90 days is common) to a wholesaler before termination is effective, with the notice detailing the alleged deficiencies that justify termination.
- Grant wholesalers an opportunity to cure the deficiencies alleged in a termination notice, with termination ineffective if a wholesaler cures the defect(s) or presents a plan to cure the defect(s).
    - "Notice-and-cure" requirements usually are waived under certain circumstances. These most often include a wholesaler's (a) insolvency, (b) conviction or guilty plea to a serious crime, or (c) loss of a license to do business. Many franchise laws also permit expedited termination where a wholesaler (d) has acted fraudulently or (e) has defaulted on a payment under the agreement despite a written demand for payment.
- Require wholesalers to provide brewers with notice of any proposed change in ownership of the wholesaler, giving the brewer an opportunity to object. The brewer's approval of an ownership change cannot be "unreasonably" withheld.
    - Brewers usually have little or no right to block a transfer to a previously designated family successor.
- Create remedies for unfair termination, generally granting wholesalers the right to receive "reasonable compensation" following termination.
    - Most beer franchise laws grant wholesalers the right to seek an injunction that, if granted, would quickly halt termination proceedings pending the resolution of wrongful termination claims. The forum for such relief can be either a state court or the state's alcohol control authorities.

    - Although arbitration of the entire dispute is not required, and sometimes prohibited, disputes over what constitutes "reasonable compensation" often must be arbitrated at the request of a party.
    - Even if the franchise law prohibits arbitration, an arbitration clause in the parties' written agreement is likely enforceable under the Federal Arbitration Act if the parties reside in different jurisdictions.
- Declare any waiver of franchise law protections void and unenforceable.
- Set a date that the law becomes effective. Some franchise agreements may predate franchise acts' effective dates, likely making the franchise law inapplicable to that agreement.

In addition to the extremely common provisions described above, other terms may:

- Require beer franchise agreements to be in writing.
- Mandate that sales territories be exclusive.
    - Wholesalers may face substantial penalties for making deliveries outside their designated territory, and such conduct may permit expedited termination by the brewer.
    - Territorial designations may need to be filed with state liquor control authorities.
- Restrict a brewer's ability to dictate prices, with restrictions that often go beyond the strictures of antitrust law. Common provisions prohibit brewer price fixing, require brewers to file and adhere to periodic price schedules, and ban price discrimination between wholesalers within the state.

- Provide that the prevailing party in a termination dispute will be compensated for its attorneys fees.
- Bind succeeding brand owners to existing franchise agreements, although some permit not-for-cause termination after a change in brand ownership, as long as compensation is paid.
- Impose a good faith obligation on both parties. Under modern contract law, this good faith obligation is already implied in all contractual relations.
- Impose specific obligations on wholesalers, occasionally specified to include a duty to properly rotate stock, maintain tap lines, and comply with other reasonable quality control instructions.

Most states have enacted at least a few laws that regulate brewer-wholesaler relations. In some, beer wholesalers are covered by a franchise law protecting all alcohol beverage wholesalers. In a few states, beer wholesalers are protected by franchise laws that apply to a variety of franchise relationships, from beer to burgers. Still others partially regulate beer franchise relationships through their alcohol control laws by, for example, requiring exclusive territories as a condition for licensing. Finally, a few states and the District of Columbia have, to date, left brewer-wholesaler relations essentially unregulated, thereby allowing the franchise relationship to be governed exclusively by the terms of the parties' agreement, to be enforced under general contract law principles.

Appendix 1 sets forth a state-by-state summary of beer distribution laws.

Self-Distribution

Many states permit breweries below a certain production threshold to distribute their product directly to retailers without the use of a distributor. While self-distribution can be a viable means around the complex and onerous franchise laws, the time and capital required to operate an effective distribution system is significant and tends to detract from other operations. Further, breweries that grow beyond the production thresholds are forced into the franchise system as they lose their rights of self-distribution.

Appendix 2 sets forth a state-by-state summary of these self-distribution laws.

Small Brewer Exemptions

In response to the continued consolidation of beer wholesalers in the U.S. and the imbalance in negotiations between larger wholesalers and small craft brewers, several states have created exemptions within their distribution laws for "small brewers" relative to the onerous termination provisions:

- Arkansas: Small brewers within the state are fully exempt from any remedies under the state's franchise act. Ark. Code Ann. §§ 3-5-1102(12)(B); 3-5-1403(13). An Arkansas statute defines a small brewery as a "licensed facility that manufactures fewer than thirty thousand (30,000) barrels of beer and malt beverages per year for sale or consumption." Ark. Code Ann. § 3-5-1403(13).
- Colorado: None of the state's franchise protections are enforceable against small manufacturers. Colo. Rev. Stat. § 12-47-406.3(8). Specifically, the applicable statute exempts manufacturers that produce "less than three hundred thousand [300,000] gallons of malt beverages per calendar year." *Id.*

- Illinois: The state's franchise provisions allow small brewers whose annual volume of beer products supplied represents 10 percent or less of the wholesaler's entire business to terminate upon payment of reasonable compensation to the wholesaler. 815 Ill. Comp. Stat. 720/7.
- Nevada: The state's good cause franchise protection against terminations is not enforceable against small suppliers in-state and out-of-state. Nev. Rev. Stat. § 597.160(2). Specifically, the statute exempts suppliers that sell "less than 2,000 barrels of malt beverages . . . in this state in any calendar year." *Id.*
- New Jersey: A brewer from within or without the state who succeeds another brewer is exempt from a rebuttable presumption that favors an injunction preventing termination of the preexisting wholesaler when the affected brands represent a small portion (*i.e.*, less than 20 percent) of the terminated wholesaler's gross sales, the terminated wholesaler receives compensation, and the brewer assigns the brands to a wholesaler that already distributes its other brands. N.J. Rev. Stat. § 33:1-93.15(4)(d)(1).
- New York: A small brewer whose annual volume is less than 300,000 barrels produced in the state or outside of the state and who represents only a small amount (*i.e.*, no more than three percent) of a wholesaler's total annual sales volume, measured in case equivalent sales of twenty-four-twelve ounce units, may terminate a wholesaler upon payment of compensation for only the distribution rights lost or diminished by the termination. N.Y. Alco. Bev. Cont. Law § 55-c(4)(c)(i). The statute defines "annual volume" as "the aggregate number of barrels of beer" brewed by or on behalf of the brewer under trademarks owned by the brewery, or the aggregate number of barrels of beer brewed by or on behalf of any person controlled by or under common control with

the brewer, "during the measuring period, on a worldwide basis." N.Y. Alco. Bev. Cont. Law § 55-c(4)(c)(iv).

- North Carolina: A small brewer may terminate a wholesaler upon payment of compensation for the distribution rights with five days' written notice without establishing good cause. N.C. Gen. Stat. § 18B-1305(a1). North Carolina's alcohol beverage statutes define a small brewer as "a brewery that sells, to consumers at the brewery, to wholesalers, to retailers, and to exporters, fewer than 25,000 barrels . . . of malt beverages produced by it per year." N.C. Gen. Stat. § 18B-1104(8).
- Pennsylvania: Although not a small brewer carve-out, the state's franchise provisions exempt in-state manufacturers whose principal place of business is in the state, "unless they name or constitute [or have named or constituted] a distributor or importing distributor as a primary or original supplier of their products." 47 Pa. Cons. Stat. § 431(d)(5). **Warning**: this provision likely violates the Commerce Clause of the U.S. Constitution.
- Rhode Island: Although not a small brewer carve-out, the state's franchise laws exempt Rhode Island-licensed manufacturers. R.I. Gen. Laws § 3-13-1(5). **Warning**: this provision likely violates the Commerce Clause of the U.S. Constitution.
- Washington: Small brewers holding certificates of approval are excluded from the state's franchise protections. Wash. Rev. Code § 19.126.020(10). Specifically Washington's franchise law excludes from the definition of "supplier" "any brewer or manufacturer of malt liquor producing less than two hundred thousand [200,000] barrels of malt liquor annually." *Id.*

Distillery Distribution Issues

ii. Regarding distilleries, most states do not have statutory distribution provisions similar to breweries. In Minnesota, for example, a distillery can have a distribution agreement for a term certain and is not subject to the franchise-type termination provisions described hereinabove. However, distilleries typically have little to no rights of self-distribution

B. Contract Production Agreements

- Definition: a brewery that hires another brewery to produce its beer. The licensor generally handles marketing and brand development of the beer, while leaving the brewing and packaging to the licensee brewery.

- Pros of Contract Brewing:
  - Can help alleviate producer brewery supply issues to meet demands.
  - Producer breweries avoid costs since they do not need to own a brewing facility

Most states provide that employees are "at will" employees; that is, they can leave their employment whenever they wish, for any reason or no reason. If a business owner has a key employee that is integral to its success, that employee should have a written employment agreement that provides for a fixed term of employment. A covenant not to compete can be included to deter a key employee from leaving to work for a competitor. Absent this type of agreement, the key employee can leave at any time.

A written employment agreement is imperative for your head brewer who knows a brewery's formulas could do the most damage to the business working for the competition. Hence, a master brewer employment agreement should include a covenant not to compete and provisions that clearly state that the beer formulas are "trade secrets" and thus the property of the brewery.

Covenants not to compete must be narrowly tailored to balance the interests of employer and employee. The employer must show (i) the covenant not to compete was supported by consideration when it was signed (if the consideration for the covenant is the continued

employment of the employee, then the covenant must be signed prior to the start of employment to be valid); (ii) the covenant protects a legitimate business interest of the employer; and (iii) the covenant is reasonable in duration and geographic scope to protect the employer without being unduly burdensome on the former employee's right to earn a living.

Use of "Volunteers"

Many breweries take advantage of the abundance of people interested in helping their business grow by allowing them to volunteer at the brewery. Depending upon the nature of the duties they are performing, classifying an individual who ought to be treated – and compensated – as an employee as a "volunteer" can lead to significant penalties under Minnesota and federal law. In the past few years as both state and federal government have tried to get more revenue, they have focused on going after employers for misclassification of workers, whether they be independent contractors, interns or the use of volunteers.

Minnesota Law:

There is a presumption anyone performing work for a "for-profit" enterprise is an employee. In Minnesota, the nature of the employment relationship is determined by using worker classification tests, similar to the manner in which employee status is determined under both workers' compensation and unemployment insurance laws. Compensation of Minnesota employees is determined under Minn. Stat. § 181.722, Subd. 3, and the federal Fair Labor Standard Act. Correctly assessing a worker as an employee, student/intern, independent contractor, or volunteer is critical.

Minnesota Statute Section 177.23 governs the use of volunteers. Minn. Stat. §177.23, Subd. 5 states that "Employ" means “to permit to work”, and Subd. 6 states that an “Employee” means any individual employed by an employer, subject to certain enumerated exceptions. There is an exception for “any individual who renders service gratuitously for a nonprofit organization”, but there is no exception for an individual who renders service gratuitously for a for-profit organization.

Federal Law:

The Fair Labor Standards Act (FLSA) defines employment very broadly, i.e., "to suffer or permit to work." However, the Supreme Court has made it clear that the FLSA was not intended "to stamp all persons as employees who without any express or implied compensation agreement might work for their own advantage on the premises of another." In administering the FLSA, the Department of Labor follows this judicial guidance in the case of individuals serving as unpaid volunteers in various community services. Individuals who volunteer or donate their services, usually on a part-time basis, for public service, religious or humanitarian objectives, not as employees and without contemplation of pay, are not considered employees of the religious, charitable or similar non-profit organizations that receive their service. Members of civic organizations may help out in a sheltered workshop; men's or women's organizations may send members or students into hospitals or nursing homes to provide certain personal services for the sick or elderly; parents may assist in a school library or cafeteria as a public duty to maintain effective services for their children or they may volunteer to drive a school bus to carry a football team or school band on a trip. Similarly, an individual may volunteer to perform such tasks as driving vehicles or folding bandages for the Red Cross, working with disabled children or disadvantaged youth, helping in youth programs as camp counselors, scoutmasters, den mothers,

providing child care assistance for needy working mothers, soliciting contributions or participating in benefit programs for such organizations and volunteering other services needed to carry out their charitable, educational, or religious programs.

Under the FLSA, employees may not volunteer services to for-profit private sector employers. On the other hand, in the vast majority of circumstances, individuals can volunteer services to public sector employers. When Congress amended the FLSA in 1985, it made clear that people are allowed to volunteer their services to public agencies and their community with but one exception - public sector employers may not allow their employees to volunteer, without compensation, additional time to do the same work for which they are employed. There is no prohibition on anyone employed in the private sector from volunteering in any capacity or line of work in the public sector.

Student/Interns:

Until recently, student/interns have not received the same close scrutiny as other groups of workers. Student/interns are <u>not</u> considered employees under both state and federal law, if their use in the workplace generally passes six tests offered by the Department of Labor. The tests are:

1. The training experience is similar to what is provided at school;
2. The training experience is for the benefit of the student/interns;
3. The student/interns do not displace regular employees;
4. The employer providing the training receives no immediate advantage from the activities of the trainees;
5. Student/interns are not necessarily entitled to a job at the conclusion of the training; and

6. The employer and the student/interns understand the work is unpaid training.

Whether an employment relationship exists is not always clear. Instead, whether an intern or trainee is entitled to such things minimum wage and overtime compensation will often depend upon whether the individual is receiving training without displacing other employees or providing any real benefit to the employer. (Note: a reasonable stipend may be permitted)

Independent Contractor:

Independent contractors are hired to perform special services of a limited scope and duration, and they typically perform the same services for a variety of businesses. The standards in Minnesota to be considered in determining whether or not an individual is an employee or an independent contractor depend upon the purpose for which such classification is to be considered but typically include factors such as:

1. The right to control the means and the manner of performance;
2. The mode of payment;
3. The furnishing of materials or tools;
4. The control of the premises where the work is done; and
5. The right of the employer to discharge the individual.

Generally, the more control, or right of control, an employer has over the individual performing the work, the work site, and the nature, quality, and manner in which work is performed, the more likely the relationship is an employer-employee relationship vs. an independent contractor arrangement.

B. Agreements with Suppliers

C. Licensing Agreements

D. Alternating Proprietorships

Definition: An arrangement in which two or more people take turns using the physical premises of a brewery. Generally, the proprietor of an existing brewery, the "host brewery", agrees to rent space and equipment to a new "tenant brewer."

Pros of an Alternating Proprietorship:

i. Tenant brewers can develop a brand before they are ready to invest in their own premises and equipment.

ii. Tenant brewer may be eligible for a lower tax rate on beer.

iii. Host breweries can offset their investment by renting out their excess capacity.

	Alt Prop	Contract Brewing
Title Ownership	Tenant brewer holds title to its beer, including the ingredients and raw materials it uses to produce its beer, during all stages of production.	Contract brewer holds title to the beer, including the ingredients and raw materials used to brew the beer, during all stages of production.
Record Keeping	Tenant brewer and host brewer each retain their own records for production and removal of beer and each provides reports to the TTB.	Contract brewer retains all records of production and removal of beer and provides reports to the TTB.
Taxes	Tenant brewer and host brewer are individually responsible for paying their own taxes on their own beer removed from the brewery.	Contract brewer is solely responsible for paying taxes on beer removed from the brewery.
Brewer Licensure	Tenant brewer and host brewer must each qualify as a brewer and have separate licenses.	Only the contract brewer must qualify as a brewer, so the producer brewer does not need a license.
Ease of Paperwork	Requires significant paperwork for both parties.	Simple agreement; Brand is added to the contract brewer's Notice.

E. Equipment, Retail, Production and Distribution Space Leases

i. Distribution Space Leases

i. As the old cliché goes, in real estate it's all about "location, location, location", and this is especially true for a brewery or distillery business. If you're looking to be the neighborhood hangout complete with a taproom (for breweries) or cocktail room (for distilleries), you'll need to find a suitable space close to

home. Should you have larger ambitions, you may seek a more strategic location amenable to later expansion. Whatever the case may be, you'll need to have a space secured in order to complete the licensing process.

ii. A new brewery or distillery owner will most likely lease a building at the start, and negotiating a suitable lease is a crucial step in the process.

iii. Commercial lease agreements typically come in one of two varieties: "triple net" and "gross."

iv. In a triple net, the tenant pays rent to the landlord, as well as a pro rated share of taxes, insurance and maintenance expenses. In the typical triple net lease, the tenant pays a fixed amount of base rent each month as well as an "additional rent" payment which constitutes 1/12 of an estimated amount for taxes, insurance and maintenance expenses (also called CAM or common area maintenance expenses). At the end of the lease year, the estimated amounts are compared to actual expenses incurred and adjusted depending upon whether the tenant paid too much or too little through its monthly payments.

v. In a "gross" lease, the landlord agrees to pay all expenses which are normally associated with ownership. The tenant pays a fixed amount each month, and nothing more.

F. Additional Contracts and Agreements

Breweries and distilleries, like most businesses, face a myriad of insurance requirements. In addition to the surety bond required to obtain their license, breweries and distillers will need several types of coverages including:

- General liability insurance;

- Workers compensation; and
- Dram shop (if the business is serving alcohol for on-premise consumption).

With respect to general liability coverage, given the growth in breweries and distilleries and the increase in trademark and other intellectual property related disputes, it is imperative to carry coverage for these issues.

Many insurance companies now have special “craft brewery programs” which provide breweries with a package tailored to the needs of the industry.

Appendix 1

Summary of State Beer Franchise/Distribution Laws

State	Summary of Law	Statutory Citation
Alabama	• Written agreement required. • Exclusive territories. • State approval required before a brand is transferred. • Termination upon 60 days' notice, with wholesaler allowed to submit a plan for cure within 30 days and to cure defects within 120 days. • Immediate termination where wholesaler becomes insolvent, loses license for more than 61 days, or is convicted of a felony. • Termination on 15 days' notice for fraudulent conduct, sales outside territory, failure to pay after a written demand for payment, or a transfer of the business without brewer's permission. • Termination must be made in good faith and for good cause. • Good cause includes failure to comply with agreement provision that are reasonable and of material significance.	Ala. Code §§ 28-8-1 to 28-9-11
Alaska	• No beer franchise law	n/a
Arizona	• Exclusive territories are permitted, but not required. • Termination must be made in good faith and for good cause. • Good cause includes a failure to comply with a term in the franchise agreement, unless that term is unconscionable or requires an illegal act.	Ariz. Rev. Stat. §§ 44-1565 to 44-1567
Arkansas	• Exclusive territories, filed with the State. • Termination requires 30 days' notice with opportunity to cure. • No termination without good cause and good faith. • Good cause includes a wholesaler's insolvency, repeated violations of law, or failure to maintain a reasonable sales volume. • Immediate termination permitted for a number of reasons, including insolvency, license loss for more than 31 days, and sales outside of the wholesaler's territory. • Small brewery (less than 30,000 barrels a year) is not a supplier and exempted from the above provisions.	Ark. Code Ann. §§ 3-5-1101 to 3-5-1111 and § 3-5-1416.

California	• Territorial appointments must be in a written agreement, filed with the State. • Regardless of the parties' agreement, supplier may not terminate a wholesaler solely for wholesaler's "failure to meet a sales goal or quota that is not commercially reasonable under prevailing market conditions." • Some brewer-wholesaler relationships, particularly those involving large brewers, might be covered under California's general Franchise Relations Act. • A manufacturer that unreasonably withholds consent to transfer can be liable for damages. • Recent unpublished Attorney General letter suggested that manufacturer approval rights over wholesaler personnel decisions and business plans, impositions of changes to wholesaler standards or agreements, control over other manufacturers' brands, and control of wholesaler ownership changes are unlawful under the California Alcoholic Beverage Control Act. • In Crown Imp., LLC v. Classic Distrib. & Beverage Grp., Inc., to be published Cal. App. 3d (2014), the court found that even if you interpret the letter to disallow for a manufacture to unreasonably withhold consent to a sale of the distributorship, the law specifically allows for this and a specific statue controls.	Cal. Bus. & Prof. Code §§ 25000.2 to 25000.9
Colorado	• Exclusive territories in a written contract, filed with the State. • Franchise protections applicable to manufacturers producing at least 300,000 gallons of malt beverages annually. • Termination upon 60 days' notice, with wholesaler opportunity to cure during that period. • Grounds for immediate termination include failure to pay after written demand, insolvency, license loss for more than 14 days, fraud, and sales outside of the wholesaler's territory. • Not-for-cause termination permitted upon 90 days' written notice, with copies to all other wholesalers in all other states with the same agreement.	Colo. Rev. Stat. §§ 12-47-405 to 12-47-406.3
Connecticut	• Franchise protections apply following product distribution for more than six months. • Termination in writing, setting forth reasons and giving the wholesaler an opportunity to challenge. • Prior to termination, a brewer may appoint a replacement wholesaler, provided that the appointment is not effective until six months after the wholesaler receives notice of termination.	Conn. Gen. Stat. § 30-17

	• Termination for "just and sufficient cause," to be determined in a hearing before the Liquor Control Commission.	
Delaware	• Territorial arrangements filed with the State. • Where parties have an exclusive arrangement, brewer must obtain ABCC consent before appointing a second distributor. • Termination upon 60 days' notice, with wholesaler opportunity to cure during the notice period. • Good cause is required to terminate a wholesaler without paying "reasonable compensation," which includes the laid-in cost of inventory and goodwill. • Good cause includes, among others, a wholesaler's refusal to comply with a material provision of the franchise that is essential, fair, and reasonable; failure to meet reasonable and fair performance standards; insolvency; and license loss for more than 30 consecutive business days. • Not-for-cause termination is allowed, provided the brewer receives the permission of the Commission to pay "reasonable compensation" and the termination does not violate the terms of the franchise agreement.	Del. Code Ann. tit. 6, §§ 2551 to 2556; 4 Del. Code Regs. § 46
District of Columbia	• No beer franchise law	n/a
Florida	• Exclusive sales territories, in writing, and filed with the State. • Termination upon 90 days' notice, with wholesaler permitted to cure defects within the notice period. • Termination without good cause is forbidden. • Good cause includes a violation of a reasonable and material contract term. • Termination upon 15 days' notice is allowed in certain instances such as insolvency, license loss for more than 60 days, fraud, and sales outside of the wholesaler's territory.	Fla. Stat. §§ 563.021 to 563.022
Georgia	• Exclusive sales territories, filed with the State. • Termination notice containing specific reasons for	Ga. Code Ann. §§ 3-5-29 to 3-5-34; Ga. Comp. R. & Regs. 560-2-5.10

	termination must be filed with the State, giving the State and wholesaler 30 days to object and request a hearing. Georgia Department of Revenue decides whether to allow a termination. • Justifications for termination include a wholesaler's financial instability, repeated violations of law, or failure to maintain sales volume that is reasonably consistent with other wholesalers of the brand.	
Hawaii	• No beer franchise law	n/a
Idaho	• Territorial agreements must be filed with the State. • Termination upon 90 days' notice, with 30 days to submit a plan of corrective action and an additional 90 days to cure defects. • Termination without notice-and-cure permitted upon the wholesaler's bankruptcy, conviction of a felony, loss of license for more than 30 days, sales outside of the wholesaler's territory, transfer without consent, failure to pay within five business days of written demand for payment, or fraud.	Idaho Code Ann. §§ 23-1003; 23-1101 to 23-1113
Illinois	• Written contract required. • Exclusive territories permitted. • Termination upon 90 days' notice, with opportunity for the wholesaler to cure within notice period. • Immediate termination permitted for wholesaler's insolvency, default on payments, conviction of a serious crime; attempt to transfer business without approval, permit revocation or suspension, or fraud in dealing with the brewer. • Termination must be for good cause, following good faith efforts to resolve disagreements. • Good cause includes failure to comply with essential and reasonable requirements of the franchise agreement that are consistent with the law. • A brewer may not discriminate among wholesalers when enforcing agreements with wholesalers. • Small suppliers whose annual volume of beer products supplied represents 10% or less of wholesaler's entire business have a mechanism to terminate upon payment of reasonable compensation to the wholesaler. • Compensation, if not agreed upon, subject to a potentially lengthy arbitration or litigation process. Pending bill (as of April 2014) seeks to amend to permit termination in 6 months while process proceeds.	815 Ill. Comp. Stat. 720/1 to 720/10
Indiana	• Exclusive territories permitted, not required. • Prohibits unfair terminations by suppliers or wholesalers, described as those without due regard for "the equities of the other party."	Ind. Code §§ 7.1-5-5-9

	• Currently pending legislation (as of April 2014) would allow a "small brewer" of less than 30,000 barrels to terminate the agreement without cause with notice and payment of a multiple of gross profit. Number is based on the timing of the termination.	
Iowa	• Written agreement with exclusive territories required. • Termination upon 90 days' notice, with the wholesaler given 30 days to submit a plan to correct deficiencies within 90 days. • Immediate termination permitted upon a wholesaler's failure to pay when due after written demand, insolvency, dissolution, conviction of a crime that would adversely affect its ability to sell beer, an attempted transfer without approval, fraudulent conduct in dealing with the brewer, license loss for more than 31 days, or sales outside the territory. • Termination must be in good faith and supported by good cause. • Good cause exists if the wholesaler failed to comply with reasonable and materially significant requirements of the agreement that are legal and do not discriminate as compared with the requirements imposed on or enforced against similarly-situated wholesalers. • Good faith means honesty in fact and the observance of reasonable standards of fair dealing in the trade, as interpreted under Iowa's Uniform Commercial Code.	Iowa Code §§ 123A.1 to 123A.12
Kansas	• Agreements must be in writing. • Exclusive territories, filed with the State. • Termination must be for reasonable cause. • Must file written termination notice with the agency at least 30 days before the effective termination date.	Kan. Stat. Ann. § 41-410
Kentucky	• Written contract, designating exclusive territories, filed with the State. • Good cause and good faith required for termination • Termination upon written notice and reasonable opportunity (60 to 120 days) to cure. • Grounds for termination include insolvency, felony conviction, fraud, license loss for more than 31 days, sales outside of the wholesaler's territory, and ownership change without consent.	Ky. Rev. Stat. Ann. §§ 244.585; 244.602 to 244.606
Louisiana	• Written agreement required. • Exclusive territories.	La. Rev. Stat. Ann. §§ 26:801 to 812

	• Termination upon 30 days' notice, with termination ineffective if the wholesaler produces a plan for corrective action within the notice period that will cure the defect within 90 days. • Immediate termination permitted for numerous contingencies, including a wholesaler's insolvency, loss of license, conviction of a serious crime, or fraudulent conduct towards the brewer. • Termination for good cause only. • Good cause includes wholesaler's failure to comply with a reasonable and material term of the agreement.	
Maine	• Exclusive territories, filed with the State. • Termination requires at least 90 days' notice, plus a reasonable time to cure. • Immediate termination permitted upon wholesaler's bankruptcy, loss of license, or conviction of a serious crime. • Termination must be for good cause. • Good cause does not include a change in wholesaler ownership, but includes a wholesaler's loss of license, insolvency, or failure to substantially comply with reasonable and material terms of the agreement.	Me. Rev. Stat. Ann. tit. 28-A, §§ 1451 to 1465
Maryland	• Exclusive territories. • Termination upon 180 days' notice, with 180 days for the wholesaler to cure any deficiency. • No notice required to terminate for a wholesaler's insolvency. • Termination must be for good cause. • Good cause always includes a wholesaler's loss of license.	Md. Code Ann., art. 2B, §§ 17-101 to 17-107
Massachusetts	• No refusals to sell after six months of regular sales. • Termination upon 120 days' notice to wholesaler and the State. • Termination may be suspended upon wholesaler's request, pending a hearing before the Alcoholic Beverage Control Commission. • Pending bill (as of April 2014) would allow for a quicker hearing by the Commission. • Termination only for good cause. • Good cause limited to wholesaler's disparagement of the brewer's product, unfair preference of a competing brand, failure to exercise best efforts, encouragement of improper practices, or failure to comply with contract terms.	Mass. Gen. Laws. ch. 138, § 25E

Michigan	• Written agreement with exclusive territories. • Termination upon written notice, with the wholesaler having 30 days in which to submit a plan to cure deficiencies within 90 days. • Termination upon 15 days' notice is permitted upon a wholesaler's fraud in dealing with the brewer, sales outside its territory, or sales of goods known to be ineligible for sale. • Immediate termination is permitted upon a wholesaler's insolvency, loss of license for more than 60 days, or conviction of a felony. • Termination by the brewer must be in good faith and for good cause. • Good cause is established by a wholesaler's failure to comply with reasonable and material contract terms.	Mich. Comp. Laws §§ 436.1401; 436.1403
Minnesota	• Exclusive territories. • Termination requires 90 days' notice, during which time the wholesaler may cure deficiencies. • Termination upon 15 days' notice permitted upon the wholesaler's insolvency, loss of license, or violation of a significant law. • Termination must be for good cause. • Good cause does not include a change in brewery ownership, but includes a wholesaler's loss of license, bankruptcy, or failure to substantially comply with reasonable and material terms of the franchise agreement.	Minn. Stat. §§ 325B.01 to 325B.17
Mississippi	• Written contract and exclusive territories required. • Termination upon 30 days' notice, with the wholesaler given 30 days to submit a plan to cure deficiencies within 90 days. • Immediate termination is permitted for a variety of contingencies, including a wholesaler's fraudulent conduct towards the brewer, insolvency, loss of license, or failure to make payments according to established credit terms. • Termination must be in good faith, for good cause. • Good cause exists when the wholesaler fails to comply with reasonable and material provisions of the agreement, the deficiency arose within the past two years, and the wholesaler failed to cure.	Miss. Code Ann. §§ 67-7-1 to 67-7-23
Missouri	• Written agreement required. • Exclusive territories presumed unless otherwise provided for by written agreement. • Community of Interest must exist for there to be a franchisor-franchisee relationship per Missouri	Mo. Rev. Stat. §§ 311.181 to 311.182; 407.400 to 407.420

	Beverage co., Inc. v. Shelton Bros., Inc. 669 F3d 873 (2012). The court found no relationship because wholesaler's sales of importer's products never exceed 1.16% of wholesaler's annual sales, its name was not used in marketing, and it made no sizable investments particular to the importer. • Termination upon 90 days' notice. • Immediate termination upon criminal misconduct, fraud, abandonment, insolvency, or issuing an NSF check. • Termination requires good cause. • Good cause includes failure to comply substantially with essential and reasonable terms of the parties' contract, bad faith, or wholesaler's loss of license for more than 31 days.	
Montana	• Written contract, filed with the State. • Agreement must include a list of mandatory terms, and designate exclusive territories. • Termination upon 60 days' notice, with the wholesaler given a reasonable time to cure deficiencies. • Mandatory term in every contract includes a procedure for the regular review and correction of wholesaler deficiencies. • Termination must be for just cause or in accordance with brewer's contract terms, as applied equally to all wholesalers within the State.	Mont. Code Ann. §§ 16-3-217 to 16-3-226
Nebraska	• Written agreement required. • Exclusive territories, filed with the State. • Termination upon 30 days' notice, with the wholesaler given a reasonable opportunity to cure deficiencies within 90 days. • Termination upon 15 days' notice permitted in certain circumstances, including a wholesaler's fraudulent conduct towards the brewer, sales outside its territory, failure to pay according to the agreement's terms and after written demand, and intentional cessation of brand business for more than 31 days. • Immediate termination permitted upon the wholesaler's insolvency, loss of license, conviction of a felony, or an agreement to terminate. • Termination must be in good faith and for good cause. • Good cause includes a wholesaler's failure to comply with reasonable and material provisions of the contract. • Good faith means factual honesty and the "observance of reasonable commercial standards of fair dealing in the trade," as interpreted by the Uniform Commercial Code. • Wholesaler is obligated to maintain clean taps, adhere to the brewer's freshness program, and comply with other reasonable written quality control standards.	Neb. Rev. Stat. §§ 53-201 to 53-223

Nevada	• Exclusive territories presumed, but non-exclusive franchise permitted if specified in writing. • Termination upon 90 days' notice, with 60 days to cure deficiencies. • Termination upon written notice after wholesaler's loss of license for more than 31 days, insolvency, conviction of a felony, fraud toward the brewer, sale of beer to an unlicensed retailer, failure to pay according to agreement and seven days after demand for payment, attempt to transfer without notifying the brewer, or discontinuance of the brewer's brand. • Termination must be for good cause. • Good cause means either the wholesaler's failure to substantially comply with essential and reasonable requirements of the agreement or the wholesaler's bad faith acts in carrying out the agreement. • Brewers selling less than 2,500 bbls. within the State in a calendar year are exempt from the good cause termination requirement.	Nev. Rev. Stat. §§ 597.120 to 597.180
New Hampshire	• Written agreement. • Exclusive territories. • Termination upon 90 days' notice, with wholesaler given a reasonable time to cure deficiencies. • Immediate termination permitted upon the wholesaler's insolvency, loss of license, conviction of a serious crime, willful breach of a material provision of the franchise agreement; attempt to transfer business without notice to the brewer, fraud, or failure to pay account upon demand. • Termination only for good cause. • Good cause generally includes a wholesaler's loss of license, insolvency, or failure to substantially comply with the brewer's reasonable and material requirements.	N.H. Rev. Stat. Ann. §§ 180:1 to 180:12
New Jersey	• Exclusive territories required unless dualing prior to March 1, 2006. • Written agreements required. • Termination upon written notice and 120 days to cure • Immediate termination upon insolvency, felony conviction, fraud, license loss for more than 31 days, intentional sales outside of the wholesaler's territory, or transfer of business without consent. • Good cause required for termination. • Good cause means a wholesaler's failure to substantially comply with a reasonable term of the non-discriminatory franchise agreement.	N.J. Rev. Stat. §§ 33:1-93.12 to 33:1-93.20
New Mexico	• Exclusive territories permitted, and must be filed with	N.M. Stat. §§ 60-8A-1;

	the State. • Termination must be in good faith, for good cause. • Good faith means factual honesty and observance of reasonable commercial standards under the circumstances. • Good cause includes a wholesaler's failure to substantially comply with essential and reasonable contract provisions, or bad faith actions. • Good cause does not include wholesaler consolidation.	60-8A-2; 60-8A-7 to 60-8A-11
New York	• Written agreements required. • Termination for cause upon written notice, with wholesaler given 15 days (or more by court order) to submit a plan to cure deficiencies within 75 days. • Time for corrective action may be limited by a wholesaler's prior failure to satisfactorily cure deficiencies, or if the brewer's product makes up less than either 1,000 cases or 1/2 of 1% of wholesaler's total purchases. • Wholesaler can demand that brewer supply it with a written plan for curing deficiencies. • Immediate termination permitted upon a wholesaler's insolvency, conviction of a felony, loss of license for more than 31 days, fraudulent conduct towards the brewer, failure to pay monies due under the agreement, acts constituting grounds for termination under the agreement, or under a written agreement to terminate. • Upon 15 days' notice, a brewer may terminate a multiple brand wholesaler within 120 days of a competing brewer's loan to or acquisition of an interest in that wholesaler. • Termination only for good cause. • Good cause includes the brewer's implementation of a national or regional consolidation policy (upon 90 days' notice) that is reasonable, nondiscriminatory, essential, and disclosed in writing, or the wholesaler's failure to comply with a material term of the franchise agreement. • Termination based upon consolidation requires payment of to wholesaler of "fair market value" of wholesaler's lost business. • Small brewers (annual volume less than 300,000 barrels and sales to wholesaler 3% or less of wholesaler's annual business) may terminate an agreement without good cause upon payment of fair compensation to the wholesaler.	N.Y. Alco. Bev. Cont. Law § 55-c
North Carolina	• Exclusive territories, filed with the State. • Termination upon 90 days' notice, with wholesaler given 45 days to cure. • Immediate termination permitted upon the wholesaler's insolvency, loss of license for more than 30 days, conviction of a serious felony, fraudulent conduct in dealing with the brewer, failure to pay for delivered	N.C. Gen. Stat. §§ 18B-1300 to 18B-1308

	beer, or transfer of the business without notice to the brewer. • Termination requires good cause. • Good cause means a wholesaler's failure to comply with contract terms that are reasonable, material, and not unconscionable or discriminatory. • Good cause does not include a change in either brewery ownership or the right to distribute the brand, sale or transfer of brand rights to a successor supplier, a wholesaler's failure to meet performance standards if imposed unilaterally by the supplier, a wholesaler's establishment of a franchise agreement with another supplier, or a supplier's desire to consolidate franchises. • Small brewery (fewer than 25,000 barrels) exception allows for termination absent good cause following the fifth business day after confirmed receipt of written notice and payment of fair market value.	
North Dakota	• Written contract with exclusive territories required. • Termination upon 90 days' notice, with the wholesaler having 90 days to rectify deficiencies. • Immediate termination permitted upon the wholesaler's insolvency, loss of license, or significant violation of the law. • Termination must be for good cause. • Good cause does not include a change in brand ownership, but does include the wholesaler's loss of license, insolvency, or failure to comply with reasonable and material obligations of the agreement.	N.D. Cent. Code §§ 5-04-1 to 5-04-18
Ohio	• Agreement must be in writing. • Exclusive territories. • Termination upon 60 days' notice. • Termination without notice permitted upon wholesaler's insolvency or loss of license for more than 30 days. • Termination must be in good faith and for just cause. • Good faith requires fair and equitable business dealings. • Just cause cannot include the failure to perform an illegal act, the restructuring of a brewer's business, or the transfer of a brand. • A wholesaler must act in good faith, properly represent the brewer, adequately serve the public, and protect the brewer's reputation and trade name.	Ohio Rev. Code Ann. §§ 1333.82 to 1333.87
Oklahoma	• Franchise law applies to "low point beer" (not more than 3.2% ABW).	Okla. Stat. tit. 37, §§ 163.2; 163.18A to

	• Franchise protections do not apply to suppliers producing fewer than 300,000 gallons of low point beer per calendar year. • Written agreement, designating exclusive territories. • Good cause required for termination. • Must provide written notice of termination and 60 days to cure defects. • Immediate termination upon written notice permitted if wholesaler engages in unapproved sales outside its designated territory, fails to pay upon written demand, insolvency, loss of license for more than 14 days, felony conviction, violation of a serious law, business transfer without approval, fraud, or ceases to do business for five business days.	163.18H (for "low point beer")
Oregon	• Agreement must be in writing and filed with the State. • Exclusive territories required. • Termination upon 90 days' notice, with the wholesaler given 30 days to submit a plan that will correct any deficiency within 60 days. • Immediate termination upon written notice permitted upon the wholesaler's insolvency, loss of license for more than 31 days, conviction of a felony, fraudulent conduct towards the brewer, substantial misrepresentations to the brewer, or for certain unapproved assignments of rights under the agreement. • Termination requires good cause, with the brewer acting in good faith. • Good cause exists where the wholesaler fails to comply with a reasonable and material term of the agreement.	Or. Rev. Stat. §§ 474.005 to 474.115
Pennsylvania	• Pennsylvania brewers are exempt from the franchise law's provisions if they do not designate a distributor as a primary or original supplier and had not done so before 1980. • Written agreement, filed with the State. • Exclusive territories. • Termination upon 90 days' notice, with 90 days to cure any deficiencies. If a deficiency relates to inadequate equipment or warehousing, a wholesaler's positive action to comply with the required change satisfies the cure provision. • Immediate termination permitted upon a wholesaler's insolvency, fraudulent conduct towards the brewer, or loss of license for more than 30 days. • Termination must be for good cause.	47 Pa. Cons. Stat. §§ 4-431; 4-492; 40 Pa. Code § 9.96
Rhode Island	• Licensed Rhode Island brewers are not considered suppliers within the meaning of the franchise law, and are exempt from its requirements. • Written contract required. • Exclusive territories.	R.I. Gen. Laws §§ 3-13-1 to 3-13-12

	• Termination upon 90 days' notice, with opportunity to cure within the time frame of the notice. • Immediate termination permitted in case of a wholesaler's insolvency, loss of license, or violation of a law significant to the business. • Termination must be for good cause. • Good cause means the failure to substantially comply with a reasonable requirement of the agreement.	
South Carolina	• Exclusive territories, in writing, filed with the State. • Termination upon 60 days' notice. • Termination by either party must be fair, and for just cause or provocation.	S.C. Code Ann. §§ 61-4-1100 to 61-4-1320
South Dakota	• Exclusive territories, in writing. • Termination upon written notice that gives wholesaler at least 30 days in which to submit a plan to correct deficiencies within 90 days. • Termination by written notice is permitted upon numerous contingencies, including a wholesaler's loss of license for more than 31 days, insolvency, conviction of a felony, or fraudulent conduct towards the brewer. • Termination must be for good cause, and in good faith. • Good faith imposes a duty on each party to act in a fair and equitable manner. • Good cause means a failure to substantially comply with terms that are reasonable, material, and are not unconscionable or discriminatory.	S.D. Codified Laws §§ 35-8A-1 to 35-8A-20
Tennessee	• Exclusive territories for each brand. • Termination upon 90 days' notice, with the wholesaler having 30 days to submit a plan to correct deficiencies within 90 days. • Termination upon 30 days' notice permitted upon a brewer's discontinuance of the brand in the State (which cannot be reintroduced for one year) or wholesaler's conviction for a significant felony. • Termination upon written notice is permitted upon a wholesaler's loss of license for more than 60 days, insolvency, fraud in dealing with the brewer, sales outside its designated territory, or failure to pay monies due under the agreement within five days of demand. • Termination must be in good faith, for good cause. • Good cause exists where the wholesaler failed to substantially comply with essential and reasonable requirements of the agreement, so long as those terms	Tenn. Code Ann. §§ 57-5-501 to 57-5-512; 57-6-104

	are not discriminatory.	
Texas	• Written contract required. • Exclusive territories, filed with the State. • Termination upon 90 days' notice, with the wholesaler having 90 days to cure any deficiencies. • Immediate termination permitted upon a wholesaler's insolvency, conviction of a serious crime, loss of a license for 30 days or more, or failure to pay money when due, after demand. • Termination only for good cause. • Good cause means a failure to substantially comply with an essential, reasonable, and commercially acceptable term of the agreement.	Tex. Alco. Bev. Code Ann. §§ 102.51; 102.71 to 102.82
Utah	• Small brewers (manufacturers producing less than 6,000 barrels per year) exempted from franchise law. • Exclusive territories, filed with the State. • Written agreement required. • Termination upon 90 days' notice, with wholesaler given the opportunity to cure within 90-day period. • Immediate termination permitted for wholesaler's insolvency, conviction or a felony, loss of license for more than 30 days, or fraudulent conduct. • Good cause required for either brewer or wholesaler to terminate contract. • Good cause means the material failure to comply with terms that are essential, reasonable and lawful.	Utah Code Ann. §§ 32B-1-102; 32B-11-201; 32B-11-503; 32B-14-101 through 32B-14-402
Vermont	• Exclusive territories. • Termination upon 120 days' notice, with the wholesaler given 120 days to rectify any deficiency. • Immediate termination permitted upon a wholesaler's insolvency, or when the brewer shows that providing 120 days' notice would cause irreparable harm to the marketing of the brand. • Termination must be for good cause.	Vt. Stat. Ann. tit. 7, §§ 701 to 710
Virginia	• Exclusive territories (except where overlaps are caused by changes in brewer ownership), in writing and filed with the State. • Termination upon 90 days' notice and notice to the State, with a wholesaler given 60 days to provide the brewer with a plan for corrective action. • Immediate termination permitted in the case of a wholesaler's insolvency or loss of license. • Termination requires good cause. • Good cause is determined by the Virginia Department of Alcohol Beverage Control.	Va. Code Ann. §§ 4.1-500 to 4.1-517

	• Good cause includes a wholesaler's loss of license, insolvency, or failure to substantially comply with reasonable and material requirements. Presumptively legitimate requirements include maintaining a brand's sales volume, providing services at a level comparable to that provided by other Virginia wholesalers, and requiring a brewer's reasonable consent to a transfer of the wholesaler's business. • Obligation of good faith is implied in every contract.	
Washington	• Franchise laws do not cover certain domestic suppliers producing fewer than 200,000 barrels of beer annually. • Written contract required. • Termination upon 60 days' notice, giving the wholesaler 60 days to cure any deficiency. • Immediate termination upon a wholesaler's insolvency, loss of license for more than 14 days, or fraud. • Wholesaler required to give a brewery 90 days' notice before termination.	Wash. Rev. Code §§ 19.126.010 to 19.126.901
West Virginia	• Written agreement, filed with the State. • Exclusive territories. • West Virginia must approve all new territorial appointments. • Distributor must be allowed to distribute new brands. • Termination upon 90 days' notice. • Termination must be for just cause.	W. Va. Code § 11-16-21
Wisconsin	• Parties must share a "community of interest" before "dealership" law applies. • Although the "dealership" provisions may not apply, Wisconsin law specifies the compensation due upon certain wholesaler terminations. • Written agreement required. • Exclusive territories required. • Termination upon 90 days' notice, with wholesaler given 60 days to rectify any deficiencies. • Termination upon 10 days' notice permitted where wholesaler is in default on payments under the agreement. • Immediate termination is permitted upon the wholesaler's insolvency. • Termination requires good cause. • Good cause includes the wholesaler's failure to substantially comply with essential and reasonable requirements of the agreement which are not discriminatory, or the wholesaler's bad faith acts.	Wis. Stat. §§ 125.33 to 125.34; 135.01 to 135.07
Wyoming	• Exclusive territorial agreements, filed with the State. • Termination upon 30 days' notice, during which time	Wyo. Stat. Ann. §§ 12-9-101 to 12-9-119

	the wholesaler can cure with a plan to remedy deficiencies within 90 days. • Immediate termination permitted upon a wholesaler's insolvency, loss of license for 60 days or more, conviction of a felony, intentional sales outside the territory, or fraud. • Termination must be in good faith, and for good cause. • Good cause means wholesaler's insolvency, loss of license for more than 60 days, conviction of a felony, intentional sales outside its territory, or failure to comply with a reasonable and material provision of the franchise agreement. • Good faith requires honesty in fact and observance of reasonable commercial standards in the trade.	

Appendix 2

Summary of State Beer Self-Distribution Laws

State	License to Self Distribute	Statutory Citation
Alabama	No	Code of Ala. § 28-3A-6
Alaska	Yes	Alaska Stat. § 04.11.010
Arizona	Yes	A.R.S. § 4-205.08
Arkansas	Yes	A.C.A. § 3-5-1405
California	Yes	Cal Bus & Prof Code § 23357
Colorado	Yes	C.R.S. 12-47-402; C.R.S. 12-47-415
Connecticut	Yes	Conn. Gen. Stat. § 30-16
Delaware	No	4 Del. C. § 512C; Brewpubs at § 512B
District of Columbia	Yes	D.C. Code § 25-110
Florida	No	Fla. Stat. § 563.022
Georgia	No	O.C.G.A. § 3-5-32
Hawaii	Yes	HRS § 281-31
Idaho	Yes	Idaho Code § 23-1003
Illinois	Yes	235 ILCS 5/5-1; 235 ILCS 5/3-12
Indiana	Yes	Burns Ind. Code Ann. § 7.1-3-2-7
Iowa	Yes	Iowa Code § 123.124

Kansas	No	K.S.A. § 41-308b
Kentucky	No	KRS § 243.157
Louisiana	No	La. R.S. 26:273
Maine	Yes	28-A M.R.S. § 1355-A
Maryland	Yes	Md. Ann. Code art. 2B, § 2-208
Massachusetts	Yes	ALM GL ch. 138, § 19
Michigan	Yes	MCLS § 436.1401
Minnesota	Yes	Minn. Stat. § 340A.301
Mississippi	No	Miss. Code Ann. § 67-3-46
Missouri	No	§ 311.195 R.S.Mo.
Montana	Yes	Mont. Code Anno., § 16-3-214
Nebraska	No	R.R.S. Neb. § 53-169
Nevada	No	Nev. Rev. Stat. Ann. § 369.382
New Hampshire	Yes	RSA 178:12; RSA 178:12-a; RSA 178:13
New Jersey	Yes	N.J. Stat. § 33:1-10
New Mexico	Yes	N.M. Stat. Ann. § 60-6A-26.1
New York	Yes	NY CLS Al Bev § 51; NY CLS Al Bev § 52; NY CLS Al Bev § 64-c
North Carolina	Yes	N.C. Gen. Stat. § 18B-1104

North Dakota	Yes	N.D. Cent. Code, § 5-01-11; N.D. Cent. Code, § 5-01-14
Ohio	Yes	ORC Ann. 4303.02; ORC Ann. 4303.022; ORC Ann. 4301.24
Oklahoma	Yes	37 Okl. St. § 521
Oregon	Yes	ORS § 471.220; ORS § 471.200
Pennsylvania	Yes	47 P.S. § 4-431
Rhode Island	Yes	R.I. Gen. Laws § 3-6-1
South Carolina	No	S.C. Code Ann. § 61-4-940
South Dakota	No	S.D. Codified Laws § 35-8A-8
Tennessee	Yes	Tenn. Code Ann. § 57-5-101; Tenn. Code Ann. § 57-2-104
Texas	Yes	Tex. Alco. Bev. Code § 62.01; Tex. Alco. Bev. Code § 74.01 and 74.08
Utah	Yes	Utah Code Ann. § 32B-11-503
Vermont	Yes	7 V.S.A. § 230
Virginia	Yes	Va. Code Ann. § 4.1-208
Washington	Yes	Rev. Code Wash. (ARCW) § 66.24.244
West Virginia	Yes	W. Va. Code § 11-16-6; W. Va. Code § 60-4-3
Wisconsin	Yes	Wis. Stat. § 125.29; Wis. Stat. § 125.295
Wyoming	Yes	Wyo. Stat. § 12-2-201; Wyo. Stat. § 12-4-412; Wyo. Stat. § 12-5-401

Intellectual Property and Advertising

Submitted by Emeric J. Dwyer

Intellectual Property and Advertising

Emeric J. Dwyer

Emeric J. Dwyer

ABOUT ME

Topics To Be Covered:

- Critical Considerations When Choosing Names
- Trademark Clearance, Filing , and Protection – Top Mistakes Made by Attorneys
- Trade Dress and Design Patent
- Alcoholic Beverage Copyright Filing, Registration, and Protection
- Trade Secrets in Brewery and Distillery Law – How, Why, and What to Protect
- Brewery and Distillery Confidentiality/Non-Disclosure Agreements
- Review Tips: Non-Compete Agreements
- Top Brewery and Distillery Advertising Mistakes – Social Media and More

Intellectual Property and Advertising Issues

Submitted by Emeric J. Dwyer

A. Disputes Regarding Beer Names and Trademarks

1. Purposes of trademarks

    a. Indicate product source

    b. Distinguish products from each other and competitors

    c. Protect company's investment in its business and brand

    d. Protect consumer expectations of quality

2. U.S. Breweries continue to increase with a 16 percent growth from 2016 to 2017

    a. Saturation in the market leads to increased trademark infringement litigation and inter partes proceedings before the Trademark Trial and Appeal Board.

B. Issues with Protecting Trademarks and Characteristic Beer Bottle Trade Dress

1. Nearly any matter that distinguishes the source of one product from another can qualify as a trademark, including, words, designs, color, product configurations, packaging and containers, sales environments, scents, sounds and touch.

2. Trade dress generally refers to the overall appearance or image of a product, including features such as size, shape, color, texture, or graphics. *John H. Harland Co. v. Clarke Checks, Inc.*, 711 F.2d 966, 980 (11th Cir. 1983). When considered in the context of breweries, trade dress generally applies to beer bottles, tap handles or a taproom's layout or design.

3. Issues in obtaining trade dress protection include issues with functionality and distinctiveness.

    a. Functionality: A product or its attribute may not be protected as trade dress if it serves a functional purpose. The purpose underlying the non-functionality rule is to prevent producers from acquiring monopolies so as to ensure that functional characteristics are available to all competitors in the marketplace.

        i. Functional means any attribute that makes the product more useful, or more easily used, or that contributes to the ease or economy of manufacture or distribution.

        ii. Courts apply two tests in determining functionality: utilitarian functionality and aesthetic functionality. Under the traditional utilitarian functionality test, a product feature will be considered

functional if it is essential to the use or purpose of the article or if it affects the cost or quality of the article. *Inwood Labs., Inc. v. Ives Labs., Inc.*, 456 U.S. 844, 850 n.10 (1982). Under the aesthetic functionality test, a product feature will be considered functional if it is one, the exclusive use of which, would put competitors at a non-reputation related disadvantage. *Qualitex Co. v. Jacobson Products Co., Inc.*, 514 U.S. 159, 165 (1995).

b. Distinctiveness: A product or its attribute's ability to identify a single source of goods or services, even if the source is unknown. Distinctiveness may be either inherent or acquired (known as secondary meaning).

i. Inherently distinctive trade dress is immediately capable of identifying a source of origin for a good or service. *Two Pesos, Inc. v. Taco Cabana, Inc.*, 505 U.S. 763, 768 (1992). Courts vary in the test applied in determining whether trade dress is inherently distinctive with some applying the same spectrum used for assessing traditional word marks (generic, descriptive, suggestive, arbitrary, fanciful), *Abercrombie & Fitch Co. v. Hunting World, Inc.*, 537 F.2d 4, 9 (2d Cir. 1976), and others applying a four-factor test of whether the trade dress is common or basic, unique or unusual in a particular field, a mere refinement of a commonly adopted and well-known form of ornamentation for a particular class of goods or services viewed by the public as dress or ornamentation, and capable of creating a commercial impression distinct from any accompanying words, *Seabrook Foods, Inc. v. Bar-well Foods Ltd.*, 568 F.2d 1342 (C.C.P.A. 1977).

ii. Acquired distinctiveness is trade dress that has obtained distinctiveness through use or promotion over time. In determining whether dress has acquired distinctiveness, courts consider a variety of evidence, including, consumer testimony, surveys, exclusivity, manner and length of use, amount and manner of advertising, amount of sales, number of customers, establishment in the marketplace, and proof of intentional copying by an infringer.

C. Trademark Difficulties With PTO Considering Beer in Same Class as Wine and Spirits

1. In order to establish a likelihood of confusion, the goods or services at issue do not need to be identical or directly competitive, but instead merely "related in some manner and/or if the circumstances surrounding their marketing [be] such that they could give rise to the mistaken belief that [the goods or services] emanate from the same source." *Coach Servs., Inc. v. Triumph Learning LLC*, 101 U.S.P.Q.2d 1713, 1722 (Fed. Cr. 2012).

a. The nature and scope of a party's goods or services is determined based on the goods or services recited in the application or registration. The International Class identification "is wholly irrelevant" to a likelihood of confusion claim. *Jean Patou, Inc. v. Theon, Inc.*, 29 U.S.P.Q.2d 1771, 1774 (Fed. Cir. 1993).

2. The Trademark Trial and Appeal Board and courts have recognized that beer and wine and other alcoholic beverages are related. The Trademark Trial and Appeal Board and the courts' finding of relatedness is often supported by evidence demonstrating that the same entity offers both products at issue thereby establishing that consumers are accustomed to seeing the goods emanating from the same source.

3. Clearance searches need to be conducted in order to determine whether a trademark is available. There are generally two types of clearance searches that can be performed: (1) a preliminary search and (2) a comprehensive search. Because the Trademark Trial and Appeal Board and the courts are finding that beer is related to other alcoholic beverages, including wine, a proper trademark clearance search for a mark that is going to be used in connection with beer needs to include a search of marks used in connection with other alcoholic beverages, including wine.

   a. A preliminary search is a quick knock out search of the USPTO's database to identify clear problems.

   b. A comprehensive search looks at not only the USPTO's database, but also common law uses, such as websites and state databases.

4. Adopt strong marks at the outset. Stronger marks provide a wider range of exclusivity and are immediately protectable.

D. Intellectual Property Infringement: Difficulties in Protecting Breweries and Distilleries in a Competitive Market.

1. To maintain trademark rights, trademark owners need to be diligent in protecting their marks against infringement and misuse by third parties as failure to do so may diminish the value of the marks.

   a. Proper protection of a trademark owner's rights includes monitoring the marketplace for infringement or misuse of the mark and monitoring third-party applications. Trademark owners should develop, and follow, a trademark enforcement strategy prior to any potential infringement or misuse.

2. Formal action to enforce trademark rights include actions before the Trademark Trial and Appeal Board to oppose third party registrations and to cancel existing

registrations. The Trademark Trial and Appeal Board can only address registration of the trademark; it cannot issue injunctions or monetary awards.

3. Formal action to enforce trademark rights also includes commencing litigation before the court. Claims may include trademark infringement and unfair competition. The court may award injunctive relief and monetary damages.

4. Before pursing formal action, the trademark owner may consider whether the infringement or misuse may be resolved informally. This could include contact between the business owners or a cease and desist letter issued by an attorney.

E. Challenges in Protecting and Copyrighting Brewing Recipes and Processes

1. Copyright protects original works of authorship. The works of authorship include literary works, musical works, dramatic works, pantomimes and choreographic works, pictorial, graphic and sculptural works, motion pictures and other audiovisual works, sound records and architectural works. 17 U.S.C. § 102(a).

    a. Copyright does not protect ideas, procedures, methods, systems, processes, concepts, principles or discoveries.

2. A recipe is a statement of the ingredients and procedure required for making a dish of food or beverage. Copyright does not protect recipes that are mere listings of ingredients. However, a recipe that creatively explains or depicts how or why to perform a particular activity may be copyrightable. If registration is afforded in this instance, the registration will not extend to the list of ingredients that appear in the recipe or the underlying process for making the recipe.

F. Brewery and Distillery Confidentiality/Non-Disclosure Agreements: Hidden Dangers that Make Them Unenforceable.

1. Breweries and distilleries that share, receive and exchange confidential information with and from customers, suppliers and other parties would benefit from and should implement the use of confidentiality and nondisclosure agreements to protect their confidential information and data. Effective protection of confidential information and data, however, includes not only having confidentiality and nondisclosure agreements in place, but also having comprehensive policies and procedures regarding confidential information and data.

2. Confidentiality/Non-Disclosure agreements generally include the following provisions:

    a. The parties to the agreement (business entities or individuals).

i. If a Confidentiality/Non-Disclosure agreement is signed by someone who does not have the power to execute a binding agreement, it could potentially invalidate the agreement.

ii. If the Confidentiality/Non-Disclosure agreement is entered into by a business entity, it is important to ensure that the correct legal name of the business entity is used in order to bind the correct party.

b. The business purpose of the agreement.

i. Identifying a business purpose limits the disclosure or exchange of confidential information to the specified business purpose.

c. The definition of confidential information.

i. Confidential information should be defined broadly enough to cover all of the confidential information that may be disclosed and to identify the type of information that is confidential. However, confidential information should not be so broadly defined that it is unenforceable.

d. Identification of what is excluded from the definition of confidential information.

i. Generally information that is or becomes public other than through breach of the agreement, was already in the recipient's possession or was available to the recipient on a non-confidential basis prior to disclosure, is received from a third party not bound by the confidentiality agreement, or is independently developed by the recipient without use of the confidential information is excluded from the definition of confidential information.

e. Use and access restrictions.

i. Access to the confidential information may be restricted even within a business entity, such as, to those employees who have a "need to know."

f. Safekeeping and security requirements.

i. The Confidentiality/Non-Disclosure agreement may identify the manner in which the confidential information is stored, including, network security protections.

g. The term of the agreement and any survival provisions.

i. A Confidentiality/Non-Disclosure agreement may be perpetual or terminate on a specified date or event. If the agreement terminates on specified date or event, a set period can be defined during which the nondisclosure obligations remain in effect after expiration of the agreement.

h. Provisions relating to return or destruction of confidential information.

i. Intellectual property rights.

i. Confidentiality/Non-Disclosure agreements generally provide that the disclosing party retains the intellectual property rights in the confidential information being disclosed and disclaims any license to the recipient.

G. Advertising Breweries and Distilleries: Mandatory Statement Challenges.

1. The Alcohol and Tobacco Tax and Trade Bureau ("TTB") defines "advertisement" as any written or verbal statement, illustration, or depiction, which is in, or calculated to induce sales in, interstate or foreign commerce, or is disseminated by mail. 27 C.F.R. § 7.51.

a. The definition includes any written, printed, graphic, or other matter accompanying the container; markings on cases, billboards signs, or other outdoor display; and broadcasts made via radio, television, or in any other media. *Id.* Examples include ads in newspapers or magazines, trade booklets, menus, wine cards, leaflets, circulars, mailers, book inserts, catalogs, promotional materials, or sales pamphlets. *Id.*

2. Advertisements for malt beverages need to include the following information:

a. Name and address (city and State) of the permittee responsible for the advertisement; and

b. Class to which the product belongs, corresponding with the information shown on the approved label, *e.g.*, lager, ale, stout. 27 C.F.R. § 7.52.

3. The TTB also identifies what may not be included in advertisements for malt beverages. See 27 C.F.R. § 7.54 for a complete list of prohibited statements. From a trademark perspective, the most applicable prohibitions are:

a. No names that are misleading with respect to the characteristics of the product;

b. No statements that are disparaging of a competitor's product; and

c. No statements, designs, devices or representations that are obscene or indecent.

4. The TTB monitors the advertising of malt beverages through pre-clearance of advertising materials, referrals and/or complaints and internal selections for review.

   a. The TTB offers business owners a voluntary, free of charge advertising pre-clearance service in which the TTB reviews an advertisement for compliance with applicable advertising regulations.

Licensing, Labeling, and Regulatory Compliance

Submitted by James G. Niekamp

Licensing, Labeling, and Regulatory Compliance

James G. Niekamp – Niekamp Law Ltd

The Federal Permit Process

Historically, one had to decide when beginning the federal permit process whether to submit the application as a hard copy application (using the pre-existing forms), or to use the new Permits Online system. The Alcohol & Tobacco Tax & Trade Bureau (or "TTB" for short), has been pushing industry members to use Permits Online since it was created several years ago.

TTB now requires that all new permit applications be submitted via Permits Online, however they do still accept amendments via paper for applications originally submitted on paper. Perhaps the greatest incentive to use the Permits Online application is that the program will provide you with the name of the TTB specialist who is currently reviewing your application. This can be helpful for follow up and accountability purposes.

An additional issue is that TTB historically required amendments to be submitted in the same format as the original; i.e., if your original application was submitted as a hard copy, then any amendments must be submitted as hard copy as well. This can make for a tedious process, especially when considering the ease of copying and pasting information in the Permits Online system.

As of July 2018, TTB has been transitioning all paper files into Permits Online internally, meaning that anyone who previously had a paper permit file will eventually be able to make amendments to the permit electronically via Permits Online.

As a practical matter, I generally advise all of my clients to submit their paperwork via Permits Online if possible. Although it is far from perfect, there are simply many benefits associated with it that are not available for those who continue to utilize the hard copy application forms.

The TTB Permit Application Process – What is Needed

I. Owner-Officer Information/Personnel Questionnaires

Historically, when beginning a permit application, the first administrative action was to complete the "Owner/Officer Information" (or "OOI") portion after setting up initial registration. The OOI is a fairly extensive questionnaire into the history and personal information of an applicant. An OOI is required for every 10%+ stockholder of a corporation and technically every member of an LLC (however, TTB generally applies the 10% rule to LLC members). Until recently, the OOI required information on one's employment history, residence history, criminal background, and personal and professional references. Now TTB generally requires enough information to run an FBI background check on these individuals.

After the changes to TTB's Permits Online system in July 2018, this process is still required but has been rolled into a new requirement, whereby every new permit application must also designate an entity that it falls under. The purpose of this development was to reduce redundancy for larger industry members which were required to submit the same OOI's and corporate documents (outlined below in more detail) for each new location under the same entity.

II. Corporate/Organizational Documents

In addition to OOI's for all necessary parties, the applicant must also submit corporate organizational documents, including articles of incorporation or LLC operating agreement, and a certificate of filing. The applicant may, but is not required to, submit any tradename registrations.

III. Lease or Proof of Ownership of the Premises

The applicant must also submit documentation showing evidence of a right to occupy the space where the permitted activity will occur. Practically speaking, this means that the applicant

must either submit a deed (if owned) or a lease (if rented). It should also be noted that TTB will often request an addendum to the commercial lease if they have any concern that the current lease does not make it explicitly clear that the activity to be conducted is within the purview of TTB (e.g., TTB will often require a lease addendum which states that the landlord authorizes the tenant to manufacture or store alcohol).

IV. Source of Funding Documentation

The applicant must also submit documentation demonstrating the source of funding for the operations. This can be satisfied by submitting a certified financial statement from the applicant's accountant. In lieu of a certified financial statement, TTB will require a loan letter (if applicable – as well as evidence that the money was actually deposited into the business account), or TTB may also require bank statements from members making significant financial contributions to the applicant entity. In recent years, TTB has become less strict on the bank statement requirements and appears to be requesting these less frequently, but focusing more on bank names and addresses.

V. Bond

A bond covering the excise tax liability of the premises has long been a contentious and tedious step. A TTB bond is essentially an insurance policy covering the applicant's tax liability (i.e., it ensures that the government will still collect the revenue if there is any doubt as to collectability, such as bankruptcy or unqualified losses). There are multiple types of bond coverage, however, it is recommended to most craft brewers and craft distillers to obtain a "Unit Bond", which provides for both "Withdrawal" and "Operations" coverage. "Withdrawal" coverage applies to the excise tax that attaches to product when it is removed from the "Bonded Premises" and "Operations" coverage applies the product that is contained within the Bonded Premises.

Up until January 2017, all permit applicants were required to obtain a TTB bond, however, this was recently changed due to the passage of the PATH Act. Essentially, the PATH

Act eliminates bond requirements for DSP's and Breweries that had an annual excise tax liability under $50,000 for the prior year, and who reasonably expect to have an annual excise tax liability under $50,000 for the current/upcoming year. In light of the passage of the PATH Act, many question whether they need to have a bond, assuming they are under the purview of the new law.

VI. Bonded Premises and the Diagram

The applicant must also submit a diagram of the premises and clearly define the bonded premises. The bonded premises is the area that is covered by the bond, and more specifically, is space dedicated solely to the purpose of the approved activity (i.e., any space where spirits are distilled, stored, and bottled must be bonded). Conversely, one cannot have on the bonded area an activity that runs counter to the approved activity, such as a bathroom or an office. Note that, of course, a bathroom and office can be included on the DSP or brewery premises, however, it must be designated as "General Premises" and not "Bonded Premises". The diagram submitted to TTB must be surprisingly detailed. Among other things, it typically, must include a compass rose, the physical address, and the physical dimensions of the building and the rooms within. Additionally, TTB will often require a layout of the equipment and clear descriptions of the areas (i.e., "bottling area", "storage area", "main distilling area", etc.). TTB generally also requires that each piece of equipment is clearly notated with a unique serial number. Note that the serial number need not be the manufacturer's serial number, but could also be a random identifier created by the applicant, such as "Still-1" or "S1". The name of the equipment on the diagram does not matter so long as it matches the equipment list, which will be described in greater detail below.

Lastly, the diagram should clearly note every point of ingress/egress to the bonded premises. One of TTB's largest concerns is protection of the revenue, and it is very important to the agency that the applicant takes the proper measures to adequately secure the bonded premises from the public. TTB has strict regulations on the type of locks permissible, which is provided in detail in the Code of Federal Regulations.

VII. Process Description (DSP's Only)

As distilled spirits are a more potent product and are taxed at a higher rate, there are certain requirements in the permit application process that only apply to DSP's. One example of this is the Process Description portion of the permit application. Although rarely scrutinized, TTB requires that DSP applicants submit a detailed description of each product to be made at the premises. An appropriate description is generally a paragraph in length and details each step of the process, from boiling and fermenting the grain, to distilling, aging, and bottling.

VIII. Equipment List (DSP's Only)

List of all major equipment used in any part of the process applied for. Must have unique serial numbers. You can make up the serial numbers, so long as you clearly mark them and are consistent on them for reporting purposes. Among other things, the equipment listed must specify the function and capacity (e.g., 200-gallon fermentation tank).

IX. Types of DSP Permits – Producer, Warehouseman, Processer

When filing in the initial application for a DSP, one must designate which activities will be covered by the permit. There are three main categories; 1) Production, 2) Warehousing, & 3) Processing. These categories may be a bit perplexing to one unfamiliar to the industry but they seek to capture fairly simple activities. First, "production" encompasses the general process of manufacturing distilled spirits, and basically covers everything from boiling the grain, fermenting, and the distillation process. The concept of "warehousing" is fairly straight-forward and includes the process of barrel-aging product for long durations. Lastly, "processing" is perhaps the more confusing label of the categories, as it generally applies to simply bottling spirits.

State of Ohio Permit Process

I. The A1 Permit

In Ohio, breweries which produce over 31 million gallons per calendar year operate under the A1 permit. The A1 permit allows breweries to sell beer to consumers for home use and for sale to wholesale distributors. The A1 permit has an annual fee of $3,906 per year.

II. The A1C Permit

The A1C permit is issued to breweries which produce less than 31 million gallons per year. Similar to the A1, the A1C allows for the sale of beer to personal consumers for home use and for sale to wholesale distributors. However, unlike the A1, the A1C allows for sale to consumers for on premise consumption. The A1C is not subject to local option, meaning it may be issued in a dry precinct. The class fee for the A1C is $1,000 per year.

III. The A3 Permit

The A3 permit allows for the production of alcohol and distilled spirits, and the ability to sell the products to the Ohio Division of Liquor Control, or to other A3 or A4 permit holders. The class fee for the A3 is $3,906 per year. If the distillery's annual production capacity is less than 25,000 gallons, then the fee is $2 per fifty gallons produced.

IV. The A3a Permit

Commonly referred to as the "micro-distillery" permit, the A3a permit is available to distilleries which produce less than 100,000 gallons per year. A unique aspect of the A3a, is that it allows for the sale to personal consumers for off-premises consumption. This process can be somewhat cumbersome as Ohio is a "control" state, and therefore the A3a permit holder must technically act as a contract liquor agency on behalf of the state, and must process an "on-paper" transfer of the product to Ohio before it is sold to the consumer. The class fee for the A3a permit is $2 per fifty gallons per year.

V. The A1A Permit

Many breweries and distilleries wish to also have a restaurant at which they can sell not only their beer or spirits, but also alcoholic beverages produced by other manufacturers, including beer, wine, and spirits. The A1A permit allows for such operations and is available to A1C and A3a permit holders. The annual fee for the A1A permit is $3,906.00, with renewal applications being due every year on October 1.

In order to qualify for an A1A permit, the applicant must have separate men's and women's restrooms and hold a retail food establishment license ("F.E.") or a food service operation license ("F.S.0.") issued by the local health department. In addition, an A1A permit cannot be issued in a precinct that is dry for the sale of beer or wine, or spirituous liquor. The precinct must be wet for the permit issuance.

VI. The State of Ohio Permit Application Process

During the application process, the applicant must complete and submit the following:

(1) *DLC Form 4030 or 4032*: Corporation or LLC disclosure form. This form is required to indicate to the Division of Liquor Control all officers of the company, as well as any individual with 5% or more ownership.

(2) *DLC Form 4085*: Summary of Tenancy Rights (in lieu of lease agreement). This must be provided to prove to the Division of Liquor Control that the applicant has the actual legal right to occupy the premises.

(3) *DLC Form 4121*: Personal History Background Form for each officer or individual disclosed on the Form 4030 or 4032. The information contained on this form is used by the Division of Liquor Control to conduct the background checks outlined below.

(4) *DLC Form 4096*: The applicant must also provide an estimate of the total cost to set up the business and provide the source of those funds. This is accomplished by completing a Financial Verification Worksheet along with supporting documentation (most commonly a letter from a bank confirming the existence of an account with the purported funds).

(5) *Fingerprints/Background Checks*: All officers and/or owners of 5% or more of the brewery or distillery are subject to a criminal background check through the Ohio Bureau of Criminal Identification and Investigation ("BCI"), of the Ohio Attorney General's Office. The background check must be accomplished by submitting fingerprints in accordance with The Ohio Division of Liquor Control's requirements. Typically, this is most easily and efficiently accomplished by completing a "WebCheck" fingerprint card, whereby the applicant can visit a number of pre-approved businesses to have their fingerprints electronically scanned and automatically forwarded to the Ohio Division of Liquor Control.

For out of state residents, the process can be a bit more arduous. Out of state residents must request an exemption from the electronic requirement due to out of state residency, and then must request hard copy fingerprint cards to be mailed to them to take to a local law enforcement office. The Division of Liquor Control has a strong preference that the fingerprints be taken on a BCI fingerprint card, however, they will accept an FBI fingerprint card if the fingerprinted applicant submits a signed BCI card authorizing BCI to conduct a record check.

Before granting approval, the premises must be inspected by an Ohio Division of Liquor Control Compliance Officer. The final inspection consists of ensuring that the premises is "builtout" and ready to begin operations and meets all other requirements. The facility must also contain at least one toilet facility (i.e., one unisex restroom is acceptable for an A1C permit, provided that meets all local health department requirements).

The permit will not be issued by the Division of Liquor Control until all of the above requirements are satisfied and until the applicant provides a copy of the issued TTB Brewer's

Notice or Basic Permit. However, it is advisable to begin the State application process before the TTB permit is issued rather than waiting until after the TTB permit is issued. The Ohio Division of Liquor Control will process all documents before the TTB Basic Permit is issued, so often times the permit is ready to issue pending TTB permit approval.

Alcohol Beverage Labeling

I. Certificate of Label Approval ("COLA")

An approved TTB label is called a Certificate of Label Approval (or "COLA"). A COLA is required for the product to be sold in interstate commerce. If the product is a malt beverage and only being sold within one state, it may qualify for an exemption. An applicant cannot apply for a COLA until after receiving a Brewer's Notice or TTB Basic Permit.

A. What is Required?

There are two main regulatory frameworks which govern alcohol beverage labels: 1) TTB laws and regulations for products that require a COLA; and 2) all federal laws which broadly apply to alcoholic beverages sold in commerce, regardless of whether a COLA is required. In general, the requirements are outlined below:

- Brand Name: A brand name is required to identify the malt beverage. A brand name may not mislead the consumer about the age (more of an issue for wine and distilled spirits), identity, origin, or other characteristics of the malt beverage.

- Name & Address of Bottler or Importer: The name and address of the bottler or importer must appear on the brand label. However, the address of the bottler's principal place of business may be used instead of the actual location where the bottling took place. It is also permissible for a bottler/importer to use an authorized trade name in place of its usual operating name, so long as the trade name is on file with TTB.

- Class Designation: The brand label of a malt beverage or spirits must contain the class designation of the product. Examples of class designations are "beer", "ale", and "lager".
    - "Ale", "stout", and "porter" are classes that must be fermented at a comparatively high temperature.

- Net Contents: The net contents of a malt beverage container must be stated in English units of measure (e.g., pints, fluid ounces).

- Government Warning: By federal law, this statement is required on all alcohol beverages containing 0.5% or more alcohol by volume:

    - **GOVERNMENT WARNING**: (1) ACCORDING TO THE SURGEON GENERAL, WOMEN SHOULD NOT DRINK ALCOHOLIC BEVERAGES DURING PREGNANCY BECAUSE OF THE RISK OF BIRTH DEFECTS. (2) CONSUMPTION OF ALCOHOLIC BEVERAGES IMPAIRS YOUR ABILITY TO DRIVE A CAR OR OPERATE MACHINERY, AND MAY CAUSE HEALTH PROBLEMS.

- Alcohol Content: An optional statement of alcohol content expressed in percent by volume may appear on the label for beer (it is mandatory for spirits). Federal regulations require the alcohol content to appear on the labels of flavored malt beverages that derive alcohol from added flavors. However, some State laws have their own requirements with regard to alcohol content statements. You may see "ABV" listed on a beer can from time to time – this is technically an improper designation, which TTB sometimes approves incorrectly. In general, the alcohol content can only be stated in one of the following ways:

    - "ALCOHOL (ALC) % BY VOLUME (VOL)"
    - "ALCOHOL (ALC) BY VOLUME (VOL) %"
    - "% ALCOHOL (ALC) BY VOLUME (VOL)"
    - "% ALCOHOL (ALC)/VOLUME (VOL)"

- "Lite" Beer Designation:
    - A malt beverage may be labeled with a caloric representation (such as "Light" or "Lite") as long as a statement of average analysis appears on the label. This statement must include the amount per serving of calories, carbohydrates, protein, and fat. In addition, a malt beverage may be labeled as "Low-Carbohydrate" if the label includes a statement of average analysis, and the product contains no more than 7 grams of carbohydrates per 12-ounce serving.

- Formula Approval:
    - What is a formula?
        - A formula is a recipe:
            - It must include a quantitative list of ingredients
            - It must include a description of how the product is produced

- It must indicate a total yield or batch size

- When is a formula required?
  - Flavors with alcohol are added
  - Compounded flavors are added
  - Colors are added
  - Artificial sweeteners are added
  - Agricultural ingredients not listed in TTB Ruling
  - For unique, non-traditional processes.

TTB formula approval is rarely required of malt beverages unless there are non-exempted additives (most commonly compound/artificial flavors) or the product was made in a non-traditional method (such as "ice-beer"). If TTB formula approval is required, TTB will not approve a COLA until the formula application has been submitted and approved. The formula process requires a method of manufacturing description, where the permit holder details the entire production process from beginning to end of a batch, and provides a list of all ingredients that are used in the production. If the product contains compounded flavors, a Formula Information Data Sheet (or "FID" sheet) must be completed by the flavor producer. The FID sheet is a detailed document which provides a parts per million breakdown of every additive in the flavor.

B. Miscellaneous Labeling Requirements

The label must be readily legible under ordinary conditions and must appear on a contrasting background (especially so for the government warning). Other than the brand name, labeling language must be in English, with exceptions for malt beverages bottled for consumption in Puerto Rico.

C. State of Ohio Requirements

In general, the labeling process in Ohio is pretty straightforward. A brewery needs to complete and submit a Product Registration form (DLC form 1151), affixing a copy of the label along with a payment of $50. If the product is exempt from COLA approval, Ohio Division of Liquor Control allows the brewery to write this information on the form. The Division of Liquor

Control will send the brewery or distillery a certificate once the form is approved, at which point you the permit holder can finally start using the label. Historically, the Ohio Division of Liquor Control takes approximately 30-90 days to approve new product registration applications.

The process for a distillery is a bit more complicated – the distillery must submit a product registration application with OHLQ (Ohio's state-run wholesale liquor agency), so that the state of Ohio can buy the product and sell it to retailers and the public.

Federal and State Tax Reporting Requirements

Submitted by James G. Niekamp

Federal and State Tax Reporting Requirements for Breweries and Distilleries

James G. Niekamp – Niekamp Law Ltd

The alcohol industry is unique in many ways, as the product is both heavily regulated for consumption purposes, and heavily taxed by both the state and federal government. Accordingly, the state and federal tax reporting requirements are far more complicated than many would initially think, and all industry members are required to keep detailed records of production operations in order to substantiate the taxes which are reported to the government.

On a fundamental level, the taxation and recordkeeping requirements can be broken down into three different components:

1. State and Federal Excise Taxes;
2. Reports of Operations (submitted to TTB throughout the year); these numbers should substantiate the Excise Taxes owed; and
3. Daily Operations Logs, or "batch" records (again, these should substantiate the data reported in Operations Reports submitted to TTB).

At the Federal level, the Alcohol and Tobacco Tax and Trade Bureau ("TTB") regulates federal excise taxes and the Brewer's Report of Operations ("BROP") or DSP Monthly Reports. The BROP must be filed monthly or quarterly, depending on the taxpayer's tax bracket, and federal excise taxes are filed annually, semi-monthly, or quarterly, again depending on the taxpayer's tax bracket. DSP Operations Reports are filed monthly regardless of tax bracket.

A) Brewer's Report of Operations

As stated above, the industry member is required to maintain daily records of operations. The entries in the daily records must show dates of events and clearly reflect details of the transaction.

In some ways, the BROP is an accumulation of data for the reporting period. Unfortunately, the federal compliance requirements in this regard are geared more towards larger industrial breweries rather than smaller, independent brew pubs, and thus these requirements are frequently headaches for smaller breweries that cannot afford a compliance manager, or the reports are simply ignored. It is not uncommon for smaller breweries to have never submitted reports, and in recent years TTB has been unable to police the industry to the extent it normally could, as the total number of breweries has exploded over the past decade, and is still growing.

Title 27 CFR 25.292 provides the daily record keeping requirements that breweries must maintain:

1. Each material received and used in the production of beer and cereal beverage;
2. The amount of beer and cereal beverage produced;
3. Beer and cereal beverage transferred for, and returned from, bottling and racking, or bottled, racked, or removed from the brewery
    a. Beer removed for consumption or sale -- the record must show the removal date, the person to whom the brewer shipped or delivered the beer, and the quantities of beer removed calculated in kegs and in bottles;
    b. Beer removed without payment of tax -- the record must show the removal date, the person to whom the brewer shipped or delivered the

beer, and the quantities of beer removed in kegs, bottles, tanks, tank cars, tank trucks, tank ships, barges, or deep tanks of vessels;

4. Packaged beer used for laboratory samples at the brewery;
5. Beer consumed at the brewery;
6. Beer returned to the brewery from which it was originally removed or from another brewery that the brewer owns;
7. Beer reconditioned, used as material, or destroyed;
8. Packaged beer used for laboratory samples at the brewery;
9. Beer received from other breweries or received from pilot brewing plants;
10. Beer and cereal beverage lost due to breakage, theft, or other unusual cause;
11. Brewing materials sold or transferred to pilot brewing plants (including the name and address of the person to whom it was shipped or delivered), and brewing materials used in the manufacture of wort, wort concentrate, malt syrup, and malt extract for sale or removal;
12. Record of tests of measuring devices; and
13. Beer purchased from other brewers in the purchasing brewer's barrels and kegs and such beer sold to other brewers.

Physical Inventories

On occasion, the brewery must also perform a physical inventory. A common issue is that breweries can sometimes rely too much on their book inventory figures while completing Reports for TTB, and failing to conduct physical inventories. Unfortunately, this practice can lead to discrepancies between the inventory listed on the report versus the actual physical inventory, as typically physical inventories reveal incidental small losses over time, such as breakage or spoilage.

The problem is that small discrepancies can "snowball" over a period of years, which can culminate in TTB conducting an audit, and asking why the Report indicates there are 8,000 bbls in inventory, but the physical inventory only found 6,000 bbls. If the industry member cannot explain the difference, TTB will likely consider the "missing" 2,000 bbls as removed without payment of tax, and then assess taxes on it right then and there. At $3.50/bbl, this would amount to $7,000 in taxes owed, plus penalties and interest.

Losses and Shortages

As stated above, one of the most common recordkeeping mistakes is the failure to maintain supporting documents concerning losses and shortages.

- A loss is defined as beer, wine or spirits lost due to breakage, casualty or other unusual cause.
- A shortage is "an unaccounted for discrepancy (missing quantity) of beer disclosed by physical inventory"
- See 27 CFR 25.11.

Generally speaking, there is no tax liability for explainable losses, but TTB may assess taxes for shortages. In the event of shortages disclosed by a physical inventory, brewers must explain the reason for the shortage on the report.

B) DSP Monthly Reports

Similar to a brewery, a DSP must file reports with TTB on a scheduled basis. However, unlike the BROP, which in some instances may be filed quarterly, DSP's must file TTB reports on a monthly basis.

These reports tend to be more involved than a BROP, and can include more activities, such as production, warehousing, and processing, depending on the nature of the DSP. Many DSP's are required to file all three reports on a monthly basis, which means over the course of the year, they file 36 reports to TTB, whereas their brewery counterpart files 4 in that same year.

A common issue is that one employee at the DSP becomes trained and knowledgeable on the TTB reporting requirements, and then leaves the DSP for a new job opportunity. In such cases, a new employee is required to immediately take over this responsibility and start completing and filing reports for the first time. This can lead to compliance issues, because errors in an initial report can cause all future reports to be incorrect as well.

Therefore, a good practice is to develop standard operating procedures ("SOP's") so that a new employee can take over compliance obligations in the event of employee turnover, as well as routinely conducting physical inventories in accordance with TTB laws and regulations, and conducting internal audits from time to time, to ensure that record-keeping practices are adequate and compliant with TTB laws and regulations.

DSPs are required to keep daily activity records in accordance with 27 CFR 19.581, 19.582, 19.584. However, these records do not require filing with TTB. With the requirement that the records are updated daily and are available upon request in either electronic or paper copy format by TTB. TTB does not require a particular format for these records. So, the records may be kept as part of the ordinary business transaction provided they include all information listed in the relevant statute. Please bear in mind that TTB

expects the daily recorded updated by the close of business each day with the relevant information.

C) Excise Tax Reporting

Federal law requires every brewer and DSP file a Federal Excise Tax Return (TTB Form 5000.24, attached herein) with the TTB for each applicable return period, including when no product was removed for consumption or sale, or even if no product was produced.

Each return must include full payment of the tax for all product removed for consumption or sale during the reporting period.

Returns may be filed via paper submission, by mail, or online through the website Pay.gov. Online submission through Pay.gov requires an account by an account holder with appropriate authority on file with TTB Permits Online. An individual signing a paper copy of a Federal Excise Tax return must having TTB Signing Authority for Corporate Officials in order to sign the form, otherwise TTB will not accept the return.

There are three reporting periods a brewery or distillery may fall under: 1) Semi-monthly, 2), Quarterly, or 3) Annually. These periods are outlined in more detail below.

(1) Semi-monthly Reporting Period Returns

Semi-monthly reporting is the default return reporting period unless an industry member qualifies for the annual or quarterly reporting period. Semi-monthly begins on

the first day of the month and goes through the 15th day with the next reporting period covering the 16th day through the last day of the month.

Below are the due dates for semi-monthly Tax Returns for Calendar Year 2022

Return Period	Due Date
January 1-15, 2022	January 28, 2022
January 16-31	February 14
February 1-15	March 1
February 16-28	March 14
March 1-15	March 29
March 16-31	April 14
April 1-15	April 28
April 16-31	May 12
May 1-15	May 26
May 16-31	June 14
June 1-15	June 29
June 16-30	July 14
July 1-15	July 28
July 16-31	August 14
August 1-15	August 29
August 16-31	September 14
September 1-15	September 29
September 16-25	September 28 Non-EFT
September 16-26	September 29 EFT
September 26-30	October 14 Non-EFT
September 27-30	October 14 EFT
October 1-15	October 28
October 16-31	November 14
November 1-15	November 29
November 16-30	December 14
December 1-15	December 29

December 16-31	January 31, 2023

(2) Quarterly Reporting Period

Pursuant to the PATH ACT, a taxpayer may file quarterly if it did not owe over $50,000 in tax liability in the prior year, and it does not reasonably expect to exceed $50,000 of FET in the current year.

The period and due dates of Quarterly Excise Tax Returns for 2022 are:

Return Date	Due Date
January1- March 31, 2022	April 14, 2022
April 1-June 30	July 14
July 1-September 30	October 14
October 1- December 31	January 13, 2021

(3) Annual Reporting Period

A brewery or DSP that reasonably expects to have $1,000 or less in tax liability for the year and did not owe $1,000 or more in taxes the prior year, may file an annual return with TTB. If the brewery or distillery exceeds the $1,000 threshold during the year, any tax that is owed will be due on the due date for a quarterly or semi-monthly filer – whichever return is applicable.

Common Tax Reporting Issues:

- Failing to keep an actual physical inventory of the product.
- Failing to keep daily batch records.

- Removing product from bonded premises for storage purposes without paying appropriate tax at the time of removal.
- Failing to make increasing or decreasing tax adjustments on excise tax returns or reports, for product shortages and overages (TTB generally expects this, and sees it as a red flag when it does not happen).

D) <u>State Tax Reporting – Excise Tax Issues</u>

(1) Beer & Malt Beverage

All Ohio A1C permit holders who produce less than 9.3 million gallons of beer per year, are exempted from paying the Ohio Beer & Malt Beverage excise tax. That being the case, the brewery is still required to make the filing on an annual basis on an ALC-83 tax return form.

Even if no taxes due, failure to make this filing can lead to compliance issues, including a "tax hold" on permit renewals with the state of Ohio Division of Liquor Control, or permit transfers. Therefore, it is critical that Ohio breweries stay on top of these tax reporting requirements, even if nothing is owed.

In addition to the Ohio Beer & Malt Beverage excise tax, Ohio breweries are required to pay Sales taxes on products sold at retail. Retail sales taxes must be filed and paid on a monthly basis. Similar to state excise taxes, the failure to make this filing can lead to compliance issues, even when no taxes are due, including a "tax hold" on the permit.

(2) Distilled Spirits Taxes

Excise taxes for high proof spirits in Ohio are treated differently from other beverages due to the fact that Ohio is a control state. This means that all high proof spirits are sold to the state of Ohio at the wholesale level.

When the state of Ohio purchases the alcohol from a distillery, the excise taxes (and wholesale mark-up) is factored into the purchase price. The process for calculating the taxes owed can be surprisingly complicated and nuanced, and there is no simple rate like other products have. If the Ohio distillery is selling products other than spirits made on site, it must also obtain a vendor's license to report taxes on eligible products.

OMB No. 1513-0083

DEPARTMENT OF THE TREASURY
ALCOHOL AND TOBACCO TAX AND TRADE BUREAU (TTB)

EXCISE TAX RETURN
(Prepare in duplicate – See instructions below)

1. SERIAL NUMBER

3. AMOUNT OF PAYMENT
$

2. FORM OF PAYMENT
☐ CHECK ☐ MONEY ORDER ☐ EFT ☐ OTHER *(Specify)*_____

NOTE: PLEASE MAKE CHECKS OR MONEY ORDERS PAYABLE TO THE ALCOHOL AND TOBACCO TAX AND TRADE BUREAU *(SHOW EMPLOYER IDENTIFICATION NUMBER ON ALL CHECKS OR MONEY ORDERS).* IF YOU SEND A CHECK, SEE PAPER CHECK CONVERSION NOTICE BELOW.

4. RETURN COVERS *(Check one)*
☐ PREPAYMENT ☐ PERIOD
BEGINNING _____
ENDING _____

5. DATE PRODUCTS TO BE REMOVED *(For Prepayment Returns Only)*

FOR TTB USE ONLY

TAX	$
PENALTY	
INTEREST	
TOTAL	$
EXAMINED BY:	
DATE EXAMINED:	

6. EMPLOYER IDENTIFICATION NUMBER

7. PLANT, REGISTRY, OR PERMIT NUMBER

8. NAME AND ADDRESS OF TAXPAYER *(Include ZIP Code)*

CALCULATION OF TAX DUE *(Before making entries on lines 18 – 21, complete Schedules A and B)*

PRODUCT *(a)*	AMOUNT OF TAX *(b)*
9. DISTILLED SPIRITS	$
10. WINE	
11. BEER	
12. CIGARS	
13. CIGARETTES	
14. CIGARETTE PAPERS AND/OR CIGARETTE TUBES	
15. CHEWING TOBACCO AND/OR SNUFF	
16. PIPE TOBACCO AND/OR ROLL-YOUR-OWN TOBACCO	
17. TOTAL TAX LIABILITY *(Total of lines 9-16)*	$ 0.00
18. ADJUSTMENTS INCREASING AMOUNT DUE *(From line 29)*	0.00
19. GROSS AMOUNT DUE *(Line 17 plus line 18)*	$ 0.00
20. ADJUSTMENTS DECREASING AMOUNT DUE *(From line 34)*	0.00
21. AMOUNT TO BE PAID WITH THIS RETURN *(Line 19 minus line 20)*	$ 0.00

Under penalties of perjury, I declare that I have examined this return *(including any accompanying explanations, statements, schedules, and forms)* and to the best of my knowledge and belief it is true, correct, and includes all transactions and tax liabilities required by law or regulations to be reported.

22. DATE | 23. SIGNATURE | 24. TITLE

SCHEDULE A – ADJUSTMENTS INCREASING AMOUNT DUE

EXPLANATION OF INDIVIDUAL ERRORS OR TRANSACTIONS *(a)*	AMOUNT OF ADJUSTMENTS *(b)* TAX	*(c)* INTEREST	*(d)* PENALTY
25.	$		$
26.			
27.			
28. SUBTOTALS OF COLUMNS (b), (c), and (d)	$ 0.00	$ 0.00	$ 0.00
29. TOTAL ADJUSTMENTS INCREASING AMOUNT DUE *(Line 28, Col (b) + (c) + (d))* Enter here and on line 18.			$ 0.00

SCHEDULE B – ADJUSTMENTS DECREASING AMOUNT DUE

EXPLANATION OF INDIVIDUAL ERRORS OR TRANSACTIONS *(a)*	AMOUNT OF ADJUSTMENTS *(b)* TAX	*(c)* INTEREST
30.	$	$
31.		
32.		
33. SUBTOTALS OF COLUMNS (b) and (c)	$ 0.00	$ 0.00
34. TOTAL ADJUSTMENTS DECREASING AMOUNT DUE *(Line 33, Col (b) + (c))* Enter here and on line 20.		$ 0.00

Notice to Customers Making Payment by Check

If you send us a check, it will be converted into an electronic funds transfer (EFT). This means we will copy your check and use the account information on it to electronically debit your account for the amount of the check. The debit from your account will usually occur within 24 hours, and will be shown on your regular account statement.

You will not receive your original check back. We will destroy your original check, but we will keep the copy of it. If the EFT cannot be processed for technical reasons, you authorize us to process the copy in place of your original check. If the EFT cannot be completed because of insufficient funds, we may try to make the transfer up to 2 times.

TTB F 5000.24sm (11/2016)

OMB No. 1513–0007

DEPARTMENT OF THE TREASURY
ALCOHOL AND TOBACCO TAX AND TRADE BUREAU (TTB)

QUARTERLY BREWER'S REPORT OF OPERATIONS

Our brewery's EIN is:
Our TTB brewery number is: **BR-**
TTB can reach the brewery by calling:

What is the name of your brewery?

What is the location of your brewery?

(Number and Street) *(City)* *(County)* *(State)* *(Zip Code)*

Reporting Period (enter year) _____

This quarterly report is for: ☐ **January–March** ☐ **April–June** ☐ **July–September** ☐ **October–December**

Part 1 – Beer Summary

Additions to Beer Inventory	**Number of Barrels** (round to the nearest second decimal)		**Removals from Beer Inventory**	**Number of Barrels** (round to the nearest second decimal)	
1. **Total amount of beer on hand at beginning of quarter** *(see #17 from last quarterly report or #33 from TTB F 5130.9. If this is the first report for this brewery, enter "0".)*			10. Beer removed for consumption or sale including beer removed tax determined for consumption or sale in a tavern on brewery premises		
2. Total amount of beer produced by fermentation, plus total amount of water or other liquids added			11. Beer removed without payment of tax as outlined under Subpart L of 27 CFR part 25 *(see Instruction #12)*		
3. Beer received in bond *(see Instruction #10)*			12. Beer consumed on premises *(see Instruction #13)*		
4. Beer returned to the brewery after removal from the brewery *(see Instruction #11)*			13. Beer destroyed on premises *(see Instruction #14)*		
5. Physical inventory disclosed an overage			14. Losses, including theft *(see Instruction #15)*		
6.			15. Physical inventory disclosed a shortage *(see Instruction #15)*		
7.			16.		
8. **Total additions to inventory, plus beer on hand** *(add lines 1 through 7)*	0.00		17. **Total amount of beer on hand at end of quarter** *(see Instruction #16)*		
9. *Adjustments to additions from a prior reporting period (see Instruction #17)*	(+)	(-)	18. *Adjustments to removals from a prior reporting period (see Instruction #17)*	(+)	(-)
			19. Total beer *(see Instruction #18)*	0.00	

Part 2 - Cereal Beverage Summary (products that are less than 0.5% alcohol by volume)

1. Produced	Bbls.	4. Received	Bbls.
2. Removed	Bbls.	5.	Bbls.
3. Loss and wastage	Bbls.	6. Total on hand at end of quarter	0.00 Bbls.

Part 3 – Remarks

(Add remarks below or on a separate piece of paper attached to this form)

Under penalties of perjury, I declare that this report is supported by true, complete, and correct records that are available for inspection at my brewery. I have examined this report and to the best of my knowledge and belief it is true, complete, and correct.

Signature	Title	Date

See Instructions and Paperwork Reduction Act Notice on TTB F 5130.26i.

OMB No. 1513-0007

DEPARTMENT OF THE TREASURY
ALCOHOL AND TOBACCO TAX AND TRADE BUREAU (TTB)

BREWER'S REPORT OF OPERATIONS

Our Brewery EIN is:

Our TTB Brewery Number is:
BR-

TTB can reach the brewery by calling:
( )

What is the name of your brewery?

What is the location of your brewery?

(Number & Street) (City) (County) (State) (ZIP Code)

Reporting Period (enter year) _____

Monthly Report for (enter month) _____ **OR** Quarterly Report for: ☐ January - March ☐ April - June ☐ July - September ☐ October - December

Part 1 - Beer Summary

Operations	Cellar	Racking		Bottling		Totals
		Bulk	Keg	Bulk	Case	
(a)	(b)	(c)	(d)	(e)	(f)	(g)
Additions to Beer Inventory (*round your entries to the nearest second decimal*)						
1. On hand beginning of this report period *(see line 33 totals from last monthly report or line 17 from last quarterly report)*						
2. Beer produced by fermentation						
3. Addition of water and other liquids						
4. Beer received from racking and bottling						
5. Beer received in bond *(see Instruction #10)*						
6. Beer received from cellars						
7. Beer returned to this brewery after removal from this brewery *(see Instruction #11)*						
8. Beer returned to the brewery after removal from another brewery of same ownership *(see Instruction #11)*						
9. Racked						
10. Bottled						
11. Physical inventory disclosed an overage						
12.						
13. Total additions to inventory, plus beer on hand *(add all columns in lines 1 through 12)*						
Removals from Beer Inventory (*round your entries to the nearest second decimal*)						
14. Removed for consumption or sale *(see Instruction #7)*						
15. Removed tax-determined for consumption or sale to tavern on brewery premises *(see Instruction #12)*						
16. Removed without payment of tax for export						
17. Removed without payment of tax for use as supplies (vessels/aircraft)						
18. Removed without payment of tax for use in research and development						
19. Removed without payment of tax to other breweries and pilot brewing plants of same ownership						
20. Removed without payment of tax as beer unfit for sale removed for use in manufacturing						
21. Beer consumed on premises *(see Instruction #12)*						
22. Beer transferred for racking						
23. Beer transferred for bottling						
24. Beer returned to cellars						
25. Beer racked						
26. Beer bottled						
27. Laboratory samples						
28. Beer destroyed at brewery *(see Instruction #13)*						
29. Beer transferred to a distilled spirits plant						
30. Losses, including theft *(see Instruction #14)*						
31. Physical inventory disclosed a shortage *(see Instruction #14)*						
32.						
33. Total amount of beer on hand at the end of this period *(see Instruction #15)*						
34. Total beer *(see Instruction #16)*						

TTB F 5130.9 (04/2015) Page 1 of 2
See instructions and Paperwork Reduction Act Notice on TTB F 5130.9i.

Prior Period Adjustments *(see instruction #16)*					
35. Additions to beer inventory	(+)	(-)	36. Removals from beer inventory	(+)	(-)

Under penalties of perjury I declare that this report is supported by true, complete, and correct records that are available for inspection at my brewery. I have examined this report and to the best of my knowledge and belief it is true, complete, and correct.

Signature | Title | Date

Part 2 - Cereal Beverage Summary
(products that are less than 0.5% alcohol by volume)

1. Produced	Bbls.	4. Loss and wastage	Bbls.
2. Removed	Bbls.	5.	Bbls.
3. Received	Bbls.	6. Total on hand end of period	Bbls.

Part 3 – Remarks
(Add remarks below or on a separate piece of paper attached to this form)

Ohio | Department of Taxation
P.O. Box 530
Columbus, OH 43216-0530

ALC 83
Rev. 9/21

Ohio Beer and Malt Beverage Tax Return

Reporting period _____ 20____

Return is due on or before the 10th day of the month following the reporting period.

Account number _____ FEIN _____

Name _____

Address _____

City _____ State _____ ZIP _____

For Department of Taxation Use Only

1. Total beer and malt beverage production everywhere in gallons				
2. Schedule A line 3	$			
3. Schedules B and B1 line 4	$			
4. Total beer and malt beverage tax liability (total of lines 2 and 3)			$	
5. Monthly advance tax payment received by the Ohio Department of Taxation on or before 18th day of report period			$	
6. If line 4 exceeds line 5, enter difference here			$	
7. If line 4 exceeds line 5, enter line 5 multiplied by 10%	$			
8. Discount (enter the lesser of line 6 or 7 multiplied by 3%)	$			
9. If line 5 exceeds line 4, enter difference here	$			
10. Monthly advance tax payment received by the Ohio Department of Taxation between the 19th and the last day of the report period	$			
11. Credit balance, if any, from previous return	$			
12. Additional credit (line 5 multiplied by 3%)	$			
13. Total of lines 8, 9, 10, 11 and 12			$	
14. Tax due, if any (if line 6 exceeds line 13, enter difference here or line 4 if no advance payment was made)			$	
15. Credit balance, if any (if line 13 exceeds line 6 enter difference here and carry forward to line 11 of next return)	$			

Complete lines 5 through 13 **only** if you made an advance payment.

I declare under penalties of perjury that this return, including any accompanying schedules and statements, has been examined by me and to the best of my knowledge and belief is a true, correct and complete return and report.

Authorized signature _____ Date _____

Telephone _____

Make check or money order payable to the Ohio Treasurer of State and mail to Ohio Department of Taxation, P.O. Box 530, Columbus, OH 43216-0530. This tax return and payment must be **postmarked** on or before the 10th day of the month following this reporting period.

Schedule A
Beer and Malt Beverages in Barrels

Schedule A – Barrel Beer and Malt Beverages	Number of Barrels and Sizes					
	1/4	1/2	1	13.2 Gal. Keg	4-5L Case	
1. Sold in Ohio and/or consumed on premises in Ohio						
Tax rate	$ 1.395	$ 2.79	$ 5.58	$ 2.376	$ .951	
2. Multiply totals on line 1 by tax rate	$	$	$	$	$	$
3. Tax liability (total of amounts on line 2) – insert here and on line 2 of page 1						$

Schedules B and B1
Beer and Malt Beverages in Containers Other Than Barrels

Schedule B – Case Beer and Malt Beverages	Number of Cases and Sizes					
	24/12	12/32	12/40	24/7	12/12	
1. Sold in Ohio and/or consumed on premises in Ohio						
Tax rate	$ .403	$ .605	$ .706	$ .235	$ .202	
2. Multiply totals on line 1 by tax rate	$	$	$	$	$	$
3. Tax liability (total of amounts on line 2)						$

Schedule B1 – Case Beer and Malt Beverages	Number of Cases and Sizes					
	24/12	12/32	12/40	24/7	12/12	
1. Sold in Ohio and/or shipped to a personal consumer in Ohio						
Tax rate	$ .403	$ .605	$ .706	$ .235	$ .202	
2. Multiply totals on line 1 by tax rate	$	$	$	$	$	$
3. Tax liability (total of amounts on line 2)						$
4. Total tax liability (add Schedule B line 3 and Schedule B1 line 3) - insert here and on line 3 of page 1						$

Walking the Ethical Line

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WALKING THE ETHICAL LINE

A. ETHICAL STANDARDS AND CIVIL LIABILITY

1. The Ohio Supreme Court publishes the Ohio Rules of Professional Conduct, the latest version being adopted February 1, 2007. The Rules cover the active and broader requirements for lawyer's ethical standards in this state. Every lawyer should have a copy of the Rules handy and be aware of the Rules directives. The enforcement of the Rules is governed either by a local Bar Association and/or the Ohio Disciplinary Counsel. The start of a grievance can be by a referral from another lawyer, Judge, Magistrate, etc. and/or by an aggrieved client. The process starts off with an investigation leading to a report that is either accepted and acted upon or dismissed. This is a disciplinary process that can lead to the lawyer being placed on suspension or disbarment from the practice of law. This process does not create any civil liability nor can be the basis of a negligence claim.
2. Legal negligence: The elements of breach of fiduciary duty are: 1) existence of a duty arising from a fiduciary relationship [attorney-client]; 2) failure to observe the duty [omission or commission] and 3) an injury resulting proximately there from. *Strock v. Presell* (1988) 38 Ohio St.3d 207, 216. A fiduciary is a person having a duty, created by an understanding, and acts primarily for the benefit of another in matters connected with his undertaking. A fiduciary relationship has been defined as one in which "special confidence and trust is posed in the integrity and fidelity of another and there is a resulting position of superiority or influence, acquired by virtue of this special trust." *Federated Mgt. Co. v. Coopers & Lybrand,* (2000) 137 Ohio St.3d 366,384 citing *Ed Schory and Sons, Inc. v Soc. National Bank,* (1996) 75 Ohio St.3d 433, 442.

The statute of limitations on a cause of action for legal malpractice is one (1) year. Ohio Revised Code §2305.11(A). However, the cause of action accrues and the one (1) year statute of limitations begins to run when there is a cognizable event such that the client discovers or should have discovered that the injury complained of was related to an attorney's act or non-act and the client is put on notice of a need to pursue his possible remedies against the attorney, or when the attorney-client relationship for that particular transaction or undertaking terminates, whichever occurs later. *Zimmie v. Calfee, Halter and Griswold* (1989), 43 Ohio St. 3d 54, at syllabus; *see also*, *Daniel v. McKinney*, 181 Ohio App3d 1 (2d Dist. Montgomery County 2009). Generally, the determination of whether an attorney-client relationship has ended is necessarily one of fact, to be decided by the trier of fact. *Mobberly v. Hendricks* (1994), 98 Ohio App. 3d 839, 843. "However, if affirmative actions that are patently inconsistent with a continued attorney-client relationship are undertaken by with the attorney or the client, the question of when the attorney-client relationship has ended may be taken away from the trier of fact and decided as a matter of law." *Downey v. Corrigan*, Case No. 21785 unreported (9th Dist. CA, Summit, May 19, 2004).

The Ohio Supreme Court in *Vahilla v. Hall*, (1997), 77 Ohio St. 3d 421, set the legal elements of a legal malpractice case. The Court of Appeals have upheld this rationale. *Lewis v. Michael*, 1997 Ohio App Lexis 1136; *Robinson v. Handleman*, 1997 Ohio App Lexis 1543. Accordingly, the Supreme Court in *Vahilla* declared that the damages standard to be applied in a legal malpractice claim is not what could have been won but what has been lost.

B. THE ROLE OF THE ATTORNEY AS ADVISOR IN ENTITY FORMATION

1. Identify the parties
    a) Each will have separate goals, objectives, and interests
    b) Buyers v. Sellers
    c) Sellers v. Buyers
    d) Passive versus active participants in the day to day operations

e) Nondisclosed third parties

2. Due diligence: Perform due diligence if required separate from that of the client.
3. Reasonable communication between clients and their attorneys is required on a regular basis regarding the status of matters for which the lawyer has been retained. Rule 1.4. While the Court prefers it to be in writing, the rules do not require that the essential elements of representation, including the nature and scope of representation or any limits on the scope, need to be reasonable and discussed with clients so as to allow the client an informed consent. Create an engagement letter and tie in an office policies and procedures letter about office staff and billing procedures.
4. An individual cannot represent the interests of a corporation in the State of Ohio: Supreme Court has ruled this as practicing law. At a minimum, get the Board of Directors and/or the CFO/outside CPAs involved hands on.

C. AVOIDING CONFLICTS OF INTEREST; WHO IS THE CLIENT?

1. Rule 1.9 governs conflicts and duties to former clients which comports in substance with the decision in *Kala v. Aluminum Smelting: and Refining Co., Inc.* (1998) 81 Ohio St. 3d 1. A conflict waiver must be confirmed in writing.
2. Identify the parties: each will have different and separate goals, objectives, and interests – for example in a divorce case custody, visitation, support, asset & debt allocation needs to be discussed immediately so as to get direction on where to place your work load and not have the client unaware of the intended goals as instructed and/or as you advised.
3. Perform due diligence if required separate from that of the client. Given mandatory disclosure rules in our local Courts, obtaining that needed information at the start of the representation only enables you to better advise the client and better your ability to advocate for your client.
4. Rule 1.8 (e) expressly permits a lawyer to pay Court costs and expenses on behalf of an indigent client.

5. Rule 1.8 (j) prohibits a sexual relationship with a client (other than one pre-existing the representation) and is consistent with the ruling in the *Cleveland Bar Association v. Feneli* (1999), 86 Ohio St. 3d 102 and *Disciplinary Counsel v. Moore*, (2004) 101 Ohio St.3d.261. This includes "sexting". *Disciplinary Counsel v. Detweile,* 135 Ohio St,3d 447 (May 2. 2013) – one-year suspension. The Supreme Court permanently disbarred a lawyer whom among a throng of other things engaged in a sexual relationship with his client and settled a case without consent. *Cleveland Metropolitan Bar Assn. v Frenden*, 149 Ohio st.3d 548 (2016).
6. Detailed record keeping: Rule 1.15 requires that now record keeping must be maintained on behalf of a lawyer for seven (7) years, including the retention of files, fee agreements, monthly reconciliation of the lawyer's records and IOLTA bank account records. This can be shortened if agreed upon by the client to four (4) years. Point this out in your policy and procedures letter as well as your closure letter to the client.
7. You cannot charge for consultation to a prospective client unless there is formed an attorney-client privilege, as well as use of the legal advice. *John v. Heutiche Co., L.A.A.*, 151 Ohio Misc. 2d 23 (2008). I believe this would apply to your experts when you are at the beginning of a search for one's opinions.
8. Rules for joint representation: don't do it. If mandated by the circumstances, get written waivers in line with Rule 1.9. A lawyer cannot represent multiple parties in a contract or a court case unless the lawyer reasonably believes that the representation of one party will not adversely affect the representation of the other. Lot of risks; lot of potential conflicts.
9. CAVEAT EMPTOR!! Any time you try to negotiate with an unrepresented party, <u>put in writing a warning</u> to that pro se party that they need to seek counsel given the statutory and common law nuisances that could affect the currently involved transaction. Also point out to your client that the case will be more difficult to bring to trial and in all likelihood be more expensive.
10. Rule 4.3 sets forth the requirement that we as lawyers must take reasonable efforts to correct a misunderstanding by an unrepresented party.

11. Rule 4.3 clearly requires a lawyer to state his interest is on behalf of his client and not that of the unrepresented party.
12. Rule 4.4 requires also request for third persons' rights which you are not duty bound unless you elect to be involved.
13. Referral fees are allowed as long as there is a disclosure of the referral fee to the client, and the referring counsel is a signatory on any contingency fee contract. See Rule 1.4(c)(2) and Rule 1.5(e). The Rules require joint responsibility for the representation or in proportion to the work performed by each, written consent from the client, written closing statements for contingency fee contracts, and that the fee is reasonable.

D. CONFIDENTIALITY – INFORMATION DERIVED FROM AN EARLIER REPRESENTATION

1. Client Confidentiality: Rule 1.6 extends the obligation to maintain the confidentiality of all information related to the representation of a client, including that which is in confidence and secret. There are exceptions. The lawyer further must take reasonable steps to preserve client on former clients' confidences and secrets. Note: what is of public record?
2. Rule 1.6 covers the confidentiality of information by a lawyer. It is tantamount to a directive that a lawyer shall not reveal any information about the representation of a client unless he/she has informed consent from the client.
3. The lawyer may reveal information concerning the representation of a client if the lawyer reasonably believes it is necessary for the following purposes:
   a) To prevent reasonably certain death or substantial bodily harm;
   b) To prevent the commission of a crime;
   c) To mitigate substantial injury or significant financial damage of an interest in property of another by the client's illegal or fraudulent act;
   d) To secure legal advice that the lawyer is in compliance with these rules;

e) To establish a claim or defense on behalf of the lawyer if a controversy arises;

f) To comply with the law or Court Order.

5. A lawyer may also divulge information in order to be in compliance with Rule 3.3 (to a tribunal) or Rule 4.1 (truthfulness in statements to others). However recently a lawyer received a public reprimand for signing his client's name to an affidavit without disclosing he signed it, and then notarized that signature; this violated the rule prohibiting a lawyer from knowingly making a false statement of fact or law to a tribunal. *Disciplinary Counsel v Moore*, 149 Ohio St.3d 509 (2017).

6. See Rule 1.18 for the lawyer's duties with the respect to information provided to the lawyer by a perspective client.

7. See Rule 1.9(c) (2) for the lawyer's duty not to reveal information relating to the lawyer's prior representation of a former client.
8. See Rules 1.8(b) and 1.9(c)(1) for the lawyer's duties with respect to the use of information to the disadvantage of clients and former clients.
9. Rule 1.0(f) has a definition of "informed consent": "denotes that the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks and reasonably available alternatives to the proposed course of conduct." This includes legally damaging or embarrassing subject matter and advice to the client to refrain from wrongful conduct.
10. A lawyer must act competently to safeguard information relating the representation of the client by the inadvertent or unauthorized disclosure by the lawyer and/or the persons who are participating in the representation of the client or who are subject to the lawyer's supervisions. See Rule 1.1, 5.1 and 5.3. When transmitting a communication, lawyers must take reasonable precautions to prevent the information coming into hands of unintended recipients.
11. A party waives its attorney-client privilege when it names an attorney as an expert witness. *Masters v. Kraft Foods*, 2012-Ohio-5325, 6th Dist.

(2012). That includes all documents that fall within the express scope of Rule 26(B)5b in that they pertain to facts known or opinions held by the expert which are relevant to the stated subject matter. The Court in *Nunley*, supra at ¶12, noted: "The issue of confidentiality of non-testifying expert opinions in Civ. Rule 26(B)5(a) is more appropriately termed work product, rather than privileged materials. As noted above, it should not be held to be a waiver of the work product protection.

12. Recently the Supreme Court indefinitely suspended a lawyer for making a bribe during his representation of a client in a criminal proceeding; the lawyer offered substantial payments to the victims as a civil settlement and show that restitution had been made. *Disciplinary Counsel v. Doumbas*, 149 Ohio St.3d 628 (2017).
13. A lawyer can delegate responsibilities to others in his office such as paralegals, secretaries, law clerks, etc. but cannot delegate the establishment of the attorney client relationship, set fees to be charged, or render legal opinions. *In Re Van Dyke*, 296 B.R. 591, 595 (Bankr. D. Mass. 2003) concerning use of paralegals; *In Re Bass*, 227 B.R. 103, 108 (Bankr. E.D. Mich. 1998) concerning engagement. The U.S. Supreme Court has acknowledged that paralegals are capable of carrying out many tasks, under the supervision of an attorney, that might otherwise be performed by a lawyer and billed at a higher rate. *Missouri v. Jenkins*, 491 U.S. 274 (1989).
14. A lawyer who must testify in a client's case is in a conflict of interest. Rule 3.7 and 1.7. See also, *Brown v. Spectrum Networks, Inc.*, 180 Ohio App 3d 99, (2008), wherein corporate counsel disqualification requires an evidentiary hearing.
15. When dealing with business transactions with a client, Rule 1.8 (a) corresponds with the ruling in *Cincinnati Bar Association v. Hartke* (1993), 67 Ohio State 3d 65, but adds the requirement that the client must consent in writing to a conflict. Must also give an opportunity to seek the advice of independent counsel. See also, *Disciplinary Counsel v.*

McNamee, 119 Ohio St. 3d 269, (2008 – Ohio – 3883) and *Stark Cty. Bar Assn. v. Marosan*, 119 Ohio St. 3d 113, for a frank discussion on representing clients with competing interests without full disclosure and without client's waiver of consent.

16. Rule 1.7 states the general requirements for identifying and evaluating all potential conflicts of interest recognizes that a conflict can arise from (1) the fact that two clients are directly adverse in the matter or (2) a circumstance with the lawyer or expert's ability to serve one client loyally and effectively may be limited by the lawyer or expert's personal interest. The representation in the same litigated case with two (2) clients or as to expert opinions (past or present) as adverse parties is absolutely now prohibited by Rule 1.7 (c) (2). Other conflicts can be waived if the lawyer or expert determines that he/she can competently, diligently, and loyally represent each affected client and the conflict is not otherwise prohibited by law. Rule 1.7(c) (2). This is a prohibition even if each client gives an informed consent (confirmed in writing). It is permissible for the lawyer confirming this type of disclosure if he/she promptly records it and transmits it to the client following oral consent. This applies to experts used by the lawyer as well.
17. Rule 1.9 governs conflicts and duties to former clients. Rule 1.9 comports in substance with the decision in *Kala v. Aluminum Smelting: and Refining Co., Inc.* (1998) 81 Ohio St. 3d 1.
18. The imputation of a lawyer or an expert's conflict to others in a firm or office is governed by four (4) rules: Rule 1.10, Rule 1.8(k), Rule 1.8(11) (b), and Rule 1.12(c). The Rule states that a lawyer's personal interest as well as a duty to former clients or other persons. Rule 1.10(c) imputes the disqualification of an individual lawyer to the firm when the lawyer has switched sides in the same matter. Rule 1.10(d) permits screening to prevent disqualification of a firm representing a client in a substantially related matter to the one on which its new lawyer was adverse. This

should be the rule as well for experts, but it may just be an issue of weight versus conflict for the Court or jury.

E. ADEQUACY OF FEES AND CHARGES

Rule 1.5 sets forth Fees and Expenses. The Supreme Court used the directive words "shall not" when a lawyer is making an agreement for, charge, or collects an illegal or clearly excessive fee. The Rule has provisions for what a reasonable fee is, although they are not exclusive, nor will each factor be relevant in each circumstance. Those factors are:

a) The time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;

b) The likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;

c) The fees customarily charged in the locality for similar legal services

d) The amount involved, and the results obtained;

e) The time limitations imposed by the client or by the circumstances;

f) The nature and length of the professional relationship with the client;

g) The experience, reputation, and ability of the lawyer or lawyers performing the services.

h) Whether the fee is fixed or contingent.

Hold true to these principles with respect to any expert that you hire. You need to discuss up front with the expert his/her fees and anticipated time involved so as to make sure it is reasonable in comparison to other experts in his/her field. Be careful and look back into other cases if you have used this expert previously to determine what was charged there. Request the expert to keep an accurate and detailing billing statement so as to show the Court and/or jury that the expert's work was done in a businesslike manner, and independent.

1. The Supreme Court does not mandate that the scope of a lawyer's representation be in writing although they did suggest that "preferably" it be so, and within a reasonable time after commencing representation. I would agree this would apply to experts as well but having an engagement

letter from your expert clearly adds to the professional businesslike manner in which he/she was hired. There must be an understanding as to the fees and expenses to be charged by the expert. As long as the client agrees in advance, a lawyer may seek reimbursement for the reasonable cost of expenses, such as an expert's fees.

2. Contingency fees charged by a lawyer must be in writing. Rule 1.5 (c). The Rule is for discipline against the lawyer. Contingency fee contracts are still statutorily driven as well. O.R.C. §4705.15 is still in place. The Rules of Professional Conduct mirror the statutory requirements for the lawyer to prepare a closing statement if funds are to be distributed. Although I have seen it done, rarely does an expert charge a contingency fee; if so, carefully scrutinize the scope of the engagement to make sure the expert's opinions are indeed independent and have factual or scientific basis; presumably the contingency fee was entered into given the insolvency of the client which should be reflected in the fee agreement.
3. All of the costs and expenses deducted by the lawyer and any expert shall be set forth, and signed by the client, expert and the lawyer. Rule 1.5(c) (2) and under O.R.C. §4705.15(c). The Supreme Court disciplined an attorney for a six (6) month suspension for not properly accounting to a client for litigation settlement expenses under the previous DR 9-102(A) and (B) **even though the attorney overpaid the client**. The rationale was he could not locate his signed written contingency fee contract as required. *Cincinnati Bas v. Trainor*, (2003) Ohio LEXUS 1971 (July 23, 2003).
4. Rule 1.8(e) (1) allows for the advancement of Court costs and expenses of litigation, the repayment of which may be contingent upon the outcome of the matter.
5. Rule 1.5(d) specifically prohibits any contingency fee in a Domestic Relations matter which is contingent upon the securing of a divorce, or the amount of spousal support or child support, or for any property settlement in lieu thereof. This applies to experts as well. These types of provisions

do not preclude a contract for a contingency fee for legal representation in connection with the recovery on judgment balances due under support or other financial Orders because such contracts do not implicate the same policy concern. This restraint was illuminated because of the human relationships involved in unique character proceedings whereby a contingency on the arrangement in Domestic Relations cases is not justified.

6. A lawyer may require advanced payment of an expert's fee but is obligated to return any unearned portions. See Rule 1.15(d) 3. A retainer is in fact an advance payment to ensure that fees are paid when they are subsequently earned, whether on a flat fee or hourly fee basis. The fee is not earned until the work is performed. The client may be entitled to refund of a retainer, even though it has been denominated as non-refundable or earned upon receipt. Rule 1.5(d) (3) requires a disclosure to the client of the advisement that he/she may possibly have a refund based upon the application of the facts or set forth in division (a) of this Rule for any retainer. See also, *Cleveland Bar Assn. v. Davis*, 121 Ohio St 3d 337, (2009), wherein failure to refund retainers resulted in indefinite suspension for lawyer. See also, *Lake Cty Bar Assn. v. Kabyn*, 121 Ohio St. 321(2009): public reprimand for failure to return retainer.
7. Non-refundable fees Rule 1.5(d) (3) are permissible but only if client is advised in writing and the lawyer or expert completes representation.
8. Rate charges during the course of representation must be communicated to the client in writing. Rule 1.5.

F. WHAT WOULDYOU DO? DIFFERENT ETHICAL SCENARIOS

1. Enhanced communication with clients by attorneys requires regular communication with their clients regarding the status of matters for which they have been retained Rule 1.4. While the Court prefers it to be writing, the rule does require that: the essential elements of the representation, including the nature and scope of representation or any limits on the scope, need to be reasonable and discussed with

their clients. If the lawyer is engaged as a scrivener, that should be clearly denoted with a disclaimer that the parties did all of their own due diligence and the terms solely negotiated by them. Further disclaim any advice beyond that of legal advice. KNOW YOUR LIMITS. Downloading from the Internet a form without appreciating the extent of the documents' terms and conditions, as well as other options that could be available to your client, is dangerous.

- follow-up by staff with clients to obtain necessary information to help representation: tax returns; income verification, assets and need for valuation; real estate deeds, notes & mortgages; vehicle information; retirement accounts information; children's needs.
    - business leases, deeds, corporate resolutions, recorded docs (like POAs, Trusts)
- probate court forms
- litigation: discovery responses
- promote use of email/facsimile for document exchanges – quicker and can be done 24/7
- software needs: ADOBE/EXCEL (PRO)
- hardware needs:scanner/fax/printer: $300 - $500/per
- regular billing procedures – mail/email
- effective use of retainers / refresher needs
- detail time pro formas
- detail rates/expenses
- follow-up biweekly – email effective/phone
- use of credit cards to collect fees/costs
- regular appointments with attorney
- status for client
- exchanges of information
- compare old/new versions of documents plus need for special language

COMMON SENSE:

i. fire your worst client

ii. make sure you are paid up front

iii. staff issues = attorney issues: beware: Failing to supervise a secretary or paralegal can result in suspension. *Disciplinary Counsel v. Maley*, 119 Ohio St. 3d 217 (August 13, 2008). Improper notarization violates DR 1-102(A). *Akron Bar Association v. Finan*, 118 Ohio St. 3d 106 (April 23, 2008); *Cincinnati Bar Association v. Gottesmann*, 115 Ohio St. 3d 222 (September 20, 2007).

iii. awareness of past counsel used: get files of

OUTSIDE CONSULTANTS TO COMPLIMENT

i. tax ramifications or business evaluations → C.P.A.

ii. estate planning for cessations issues or disability/death issues → attorney/financial planner

iii. appraisers – valuation issues

iv. realtors – value of residential or commercial property

MULTIPLE FORMS / CROSSCHECK EACH TIME

1. go over all forms to integrate for clients' case

DO NOT SIMPLY USE FORM WITHOUT LISTENING TO YOUR CLIENT'S NEEDS, WANTS AND MEANS – PROPERLY TAILOR IT TO THE NEEDS OF THE PARTICULAR TRANSACTION

Sorry to say but communicate in writing and request the same from the adversarial party/lawyer. I once heard that you should prepare the letter/email and then not send it until the next day after you review it again to be sure that you do not overstep your own professional boundaries.

1. Often times a face to face meting softens the adversarial party/lawyer since he/she cannot hide behind the wickedness of the pen.
2. Define the parameters of what you really need from the adversarial party/lawyer; clearly you have the Rules of Civil Procedure to back you up when you eventually go to the Judge to get what has been

requested – familiarize yourself with those rules and the enforcement of them for discovery purposes.

3. While it can be more troublesome, can you &/or your client obtain the information and/or documentation? Thus, avoiding the difficulty involved with the adversarial party/lawyer.
4. I have found that more can be obtained from the adversarial party/lawyer if you listen more than what you say. Often having your secretary/paralegal with you to be sure there are no misunderstandings can be helpful.
5. Understand particularly for the opposing party that litigation in and amongst itself is adversarial; those who have not traveled the road in court can be frustrated as well as difficult. Being patient helps.
6. Last warning: do not engage in disrespectful conduct that puts you and fellow lawyers in a bad light. Once said that if you fight with the pig you will get dirty – better not to do so and have the honor of being more professional.

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