The Corruption Chronicles, Part 1

BY JOHN HINMAN, ESQ.

The regulatory focus on alcoholic beverage industry corruption has its genesis in the pre-Prohibition American saloon. In the early part of the last century, brewers and distillers used many questionable — and some blatantly unlawful, even then — sales techniques, such as excessive credit, free goods, secretly paying employees, consignment sales and other inducements to persuade saloon owners to carry their beer and spirits over competing brands. Preventing the reemergence of those widely used and abusive business practices has been a core concern of alcohol regulators since the early 1930s when Prohibition was repealed. These are the "tied house" laws, and they exist today, in one form or another, both federally and in every state (and with exceptions that vary from state to state).

The perceived harm comes from increased consumer consumption of the specific alcohol brands to intemperate levels. This theory of intemperate consumption underlies almost all of the tied house laws as they were enacted in the original Federal Alcohol Administration Act.

There are currently significant disciplinary cases in process in California and Massachusetts that are worthy of attention.

California: In early January 2017, the California Department of Alcohol Beverage Control (ABC) filed 34 accusations (agency indictments seeking license suspension or revocation) for providing things of value (television sets, coolers and draft systems, reportedly) against Southern California beer distributors and the various on- and off-premises retail accounts that received the items. The ABC Trade Enforcement Unit is currently processing these accusations. Supplier and retail penalties may involve license suspensions or fines of $10,000 (the typical starting offer in compromise for tied house violations for the suppliers) or the value of the items provided.

The Lesson: Both suppliers and retailers must be very careful about which items other than alcohol are sold or provided to retail accounts, how they're accepted, how the transaction is recorded in a contract and whether they're covered by specific exceptions to the general prohibition against "things of value."

Massachusetts: In a case dating back to early 2016, the Craft Brewers Guild of Massachusetts (CBD; a beer wholesaler) was indicted by the Massachusetts Alcoholic Beverage Control Commission (MABCC) in a "pay-to-play" scheme alleging that CBD paid retailers monthly payments in exchange for their beer being on-tap at the retail accounts. Following a threatened 90-day license suspension, the MABCC fined CBD $2.6 million. The cases continue, however, against the retailers who received the payments. The retailers' defense is that this is normal activity and "everyone does it." If that defense prevails, I'll be astounded. As it stands, I'm watching this case carefully.

These aren't isolated examples of enforcement actions around the country. There are matters pending in Illinois involving alleged retailer smuggling of spirits purchased from lower tax jurisdictions such as Indiana and Iowa; TTB action in Ohio against major retailers and wholesalers over category management, leading Ohio to threaten license revocations; allegations of smuggling spirits from Maryland to New York that are the heart of a lawsuit by Empire Wine Merchants against Charmer in New York; and a dismissed indictment against a major wholesaler for (allegedly) illegally participating in a separate scheme to smuggle spirits from Maryland to New York.

Next issue, I'll discuss how cases like these are affecting the larger alcoholic beverage industry through practices such as "category management."

John Hinman is senior partner at Hinman & Carmichael LLP, a San Francisco-based law firm focusing on alcohol and cannabis regulation throughout the United States. He's been practicing in the industry for more than 40 years, and the lawyers and paralegals at Hinman & Carmichael LLP lead the nation in alcoholic beverage licensing, promotion, distribution and regulatory defense. More information can be found at www.beveragelaw.com.

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