

INTERNET RULES OF THE ROAD OF ADVERTISING, MARKETING AND TRANSMITTING ORDERS ONLINE FOR LICENSED BEVERAGE PRODUCTS

By

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I. ONLINE ADVERTISING

A. Federal and State advertising standards.

For a winery, distiller, brewer or wholesaler, online advertising is no different than conventional media advertising. The federal advertising standards (which apply to advertising content in “any media,” presumptively including on the Internet) are set forth in 27 CFR §§4.60 to 4.65 for wine, 27 CFR §§5.61 to 5.66 for distilled spirits and 27 CFR §§7.50 to 7.55 for malt beverage products. These standards generally require identification of the advertiser and legible mandatory information (i.e., class and type of product). They further prohibit untrue, misleading, obscene, indecent, curative or therapeutic statements or disparaging statements (including “deceptive” comparative tests) about a competitor’s products. The requirements are quite specific and should be well understood by the persons responsible for website design related to product presentation.

It should be kept in mind that the federal advertising content standards apply only to “industry members” (i.e., licensed members of the production and wholesale tier). Retailers are not generally subject to regulation under the Federal Alcohol Administration Act (or to these federal advertising regulations, which were promulgated in accordance with the FAA Act) and therefore have more leeway than industry members when designing advertising layouts and presenting products and product information in either conventional or Internet based advertising mediums.

State law content restrictions on retail advertising of alcoholic beverage products based on the transmission of information are generally unenforceable (in the few places that such restrictions exist) as a result of the Supreme Court decision in 44 Liquormart, Inc. v Rhode Island [517 U.S. 484 (1996)] interpreting the First Amendment as “trumping” the 21st Amendment in the context of beverage alcohol advertising. The constraints that any state may legitimately

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place upon retail advertising content primarily relate to truthfulness and accuracy. The First Amendment, however, does not shield either retailers or industry members from unfair business practices charges predicated upon deceptive or misleading statements, or (probably – we know of no cases testing this proposition) from providing tangible intellectual property (such as free downloads) that go beyond clearly First Amendment protected transmission of information.

Unfair business practices based upon Internet advertising are typically subject to state regulation in the state of residence (or licensing) of the advertiser, subject to normal jurisdictional principles applicable to torts of this nature.

We also typically advise our clients that content of alcoholic beverage advertising apparently aimed at ineligible purchasers (i.e., minors), or that includes free offers of tangible intellectual property with an ascertainable value (such as downloads) may well be the subject of legislative and regulatory action based upon the rationale of protecting minors and encouraging temperance. Thus far, the major website advertisers (including the spirits companies and the specialty products producers) appear to be cautious in this area and are using disclaimers and age-enforcement barriers preventing access to their sites as self-enforcement mechanisms.

Content, we suspect, will always be an issue depending upon what the content is and how it is offered. For example, sites that glorify alcohol consumption or encourage drinking games or contests will certainly invite negative regulatory attention. The regulators will assuredly attempt to assert jurisdiction over sites of these sorts operated by (or on behalf of) industry members or retail licensees. Similarly, the offering of free downloads (common on many Internet sites currently aimed at young net users), including screensavers, free software, videos, MP-3 songs and the like, raises troubling questions about when the line between “advertising content” and “premiums, gifts and free goods” may be crossed. For example, if a hypothetical beer company produced a download that includes a skateboard video game (with beer company logos and advertising) attractive to teenage boys, and that item was offered as a free download on an unlicensed marketing site aimed at teenage boys and was accessible in California, we suspect that the “free goods” statute would be invoked by the California regulators as a matter of administrative discipline against the beer company if the beer company was licensed to do business in any fashion in California. That case, which is sure to come as the frontiers of Internet marketing expand, will provide the next test of the limits of administrative jurisdiction.

B. Advertising versus order taking.

The distinction between “advertising” and “order taking” is critical to website operations. We define “advertising” to be any depiction or statement about a brand of alcoholic beverage product that is disseminated in any “media,” including on the Internet. An industry member (winery, brewery, distiller, wholesaler – subject to federal advertising standards) and a retailer may freely advertise their alcoholic beverage products on the Internet. However, only a licensee may accept an order for a specific product to be delivered to a consumer (or, if the order taking is between tiers, from one tier to the next lower tier).

The licensee taking the order must be operating within the jurisdiction of its license with respect to the fulfillment of the order. For example, while a licensee in California may not accept an order for wine from a Florida customer for direct fulfillment in Florida (indirect shipments through the three-tier system would, of course, be permitted), that same Florida customer may order alcoholic beverages from a California licensee for fulfillment in California or in any other jurisdiction in which the California licensee may legitimately fulfill.

It is our position, based upon 44 Liquormart, that any website may advertise on the Internet (including those run by unlicensed marketing services that hyperlink or connect by contract to licensees) but that only licensees may accept and fulfill orders for products, and then, only in those jurisdictions where their licenses permit them to operate.

C. Controlling access to websites.

Qualifying those eligible to access a website is one of the most bedeviling aspects of operating an Internet site. Qualification “screens” requiring the user to represent his or her age (by clicking a button) in order to access the content areas of the website (such as the product displays and price lists) are only effective to a point. While we recommend that beverage specific sites generally control initial access through the qualification button (“click here if you are over 21”), that doesn’t guarantee effective blocking. Anyone who has ever watched a ten-year-old operate a computer and click through sites at the speed of light understands this conundrum. The only effective way to prevent unauthorized access is to control the ability to place orders, and the ability to download items that are intended for adult use only.

Mechanisms that we have seen effectively used usually involve some form of mandatory registration as a condition of access to the sensitive areas of the site. Requiring detailed registration (and a credit card) generally restricts the ability of the casual web surfer to review your inventory. That is a negative. However, it also prevents persons who are ineligible from purchasing for reasons such as age, or residence in a state that prohibits fulfillment, from attempting to

compromise site security. Effective screening mechanisms include drop down screens that qualify products available by the state of residence of the registrant and qualify purchasers by asking for birth dates. It is certainly true that a minor could lie. However, the notation on every delivery invoice (and on the product being shipped) that an “adult signature is required” provides adequate additional security.

D. Rules of the Road – The General Principle

We recommend that the Internet be treated as a physical place for the purposes of conducting alcoholic beverage licensed businesses. A licensee should not undertake any act on the Internet that it would not undertake in its place of business, whether that place of business is a retail store, a winery tasting room or a brewery. In many ways, the Internet is a physical tool (like the telephone or the fax machine) in the sense that it offers the ability to communicate in real time over vast distances to a multitude of potential customers. It is a sales presentation that is always operating.

Customers to your site visit from all over the world. You can talk to them, answer their questions and, subject generally to the laws of whatever state or country they are actually in (and whatever licenses you happen to hold), sell them merchandise including the alcoholic beverage products you produce, wholesale or sell to consumers at retail.

II. ONLINE ORDER TAKING

A. The types of licenses required to accept orders.

Only licensees may actually accept orders from customers. The word “accept” is being used in its technical legal sense as the creation of a binding contract. Orders may be transmitted in many ways, including through third parties. However, only licensees may contract to deliver a particular alcoholic beverage product.

The license required to perform the act of delivery depends on the product being sold, and on the status of the purchaser. Only those with retail spirits licenses (i.e., in California an off-sale general license) may sell spirits to consumers. Wine and beer may be sold either by manufacturers (i.e., wineries and breweries) to those customers eligible to purchase from them (wholesalers, retailers and consumers), or by off-sale wine and beer retailers to consumers for consumption. Wholesalers holding federal basic permits and appropriate state wholesale licenses may contract to sell to eligible retailers within their particular states.

B. When is a license required to take an order?

A license is only required to “accept” an order. “Taking” an order refers to the more general concept of recording ordering information (and collecting payment data, such as a credit card number) for transmission to the licensee who is going to actually accept the order. “Unlicensed order points” abound on the Internet, and include some of the most popular sites. The distinction between accepting an order and transmitting an order to a licensee for acceptance is important, and should be spelled out in the fine print somewhere on the web site, typically in the “terms and conditions of sale” section of the site. And, even if a site is operated by a licensee, it may also be operating as an unlicensed order point for the purpose of transmitting orders to a licensee in another jurisdiction if the order is one intended to be fulfilled outside of the jurisdiction of the licensed operator of the website.

C. What states prohibit orders from being taken on the Internet?

Currently, only Minnesota has a specific prohibition on accepting orders over the Internet. However, many other states that either do not permit direct delivery from licensees or authorized sellers within the state to consumers within the state (approximately 20 states, including most of the control states), or that require a personal visit by the consumer to an out of state winery in order to be entitled to reciprocity rights (such as Colorado) implicitly prohibit Internet orders for delivery within their state. Of course, these states also implicitly prohibit orders from being taken by phone, fax or any other method of communication.

D. How do you legally get around those prohibitions?

If a customer resides in a jurisdiction (Utah and Pennsylvania are good examples for different reasons) that does not permit intrastate delivery of alcoholic beverages from a licensee to a consumer, then there is no lawful method of fulfilling an order to that customer at his or her place of residence or business within the state.

However, that does not prevent the consumer from placing an order for fulfillment in another, potentially friendlier, jurisdiction otherwise accessible by the consumer. An example of this would be the placing of an order by a resident of Salt Lake City for delivery to a wine locker in California. Even though the Utah resident is not permitted to ship the product in Utah (or even hand carry it into Utah inside baggage), he or she could certainly own or enjoy it in California. Similarly, the use of wine storage lockers in friendly locations under the control of consumers who do have personal importation privileges (to hand carry beverages into their states) is an increasingly popular way for the traveling public to comply with the restrictions on shipment.

E. The difference between “ordertaking” and “marketing.”

Marketing is the exposure to the public of information about a product or service through the use of communication devices (including the Internet). “Order taking” is either the acceptance of an order by a licensee, or the gathering of information concerning an order by an unlicensed order point for transmission to a licensee for acceptance and fulfillment.

F. How locator systems work, and Tied House concerns.

Producers (wineries, breweries and distillers) generally use locator systems for the purpose of identifying where potential retail purchasers (persons who have viewed the marketing information on their web site) may locate their products. A properly operating locator system will react to a query (usually the placing of a zip code in a question box) by calling up the names of the retailers in the identified zip code carrying the particular products. The tied house implications include either an implied endorsement of – or free advertising for – the particular retailer identified. Most state alcoholic beverage laws prohibit the furnishing of a thing of value from a supplier to a retailer.

There is no question that identification of a particular retailer as a location is a form of advertising, and is a thing of value to the retailer identified. For this reason, the federal government and many states (including California) have specifically exempted locator systems from their tied house laws, provided (essentially) that more than one retailer be identified in every relevant zip code and that the reference to the retailer by the system be relatively low key and limited to name and address.

III. USING “MARKETING SERVICE” [UNLICENSED] WEBSITES TO GENERATE ORDERS

A. Designing compensation provisions to ensure that the unlicensed website is being paid a marketing fee rather than a commission or a percentage of the profits.

The principle danger of using unlicensed order points to transmit ordering information involves the payment of compensation to the unlicensed marketing service. If the marketing service participates in the profits from the sale, it may be found to be part of the licensed business for which it is generating orders. If that happens, most state regulators will require the marketing service to obtain an appropriate retail license, or to join in on the license of the fulfillment entity actually accepting the order.

Avoiding this pitfall requires a carefully structured relationship that recognizes the distinctly different roles played by each participant. The marketing service should be paid a set fee for its service equal to the value it

provides to the transaction. Further, the fee should be independent of the sale price of the product. If the marketing fee is to be collected from the sale price (for example, when the order point is also acting as a collector and transmitter of funds), then the funds should be transmitted to the actual entity accepting the order as quickly and securely as current technology permits. The actual time periods involved between gathering of ordering data and funds and transmission of the same from the order point to the accepting licensee should never exceed (in our judgment) seven days. The period should be shorter if technology permits.

Finally, the terms and conditions of sale of the product to the consumer should clearly advise the consumer from whom the product is being purchased and against whom the consumer has recourse in the event that the product is defective.

B. Hyper links – be careful about having your security and customer qualification systems compromised.

A current danger on the Internet is the ability of systems to link into your site without having to go through your customer qualification systems. If a marketing site is connected to a licensed site by a direct link (or hyper link), we recommend that the connection be set up to the initial or home page of the licensed site rather than directly to an ordering page unless all purchaser qualification software resides on the ordering page.

IV. CONCLUSION

The Internet is a sword with two edges -- and both can be very sharp. It offers suppliers and retailers unprecedented access to existing and potential customers at a low cost. However, for merchants in the highly regulated alcoholic beverage industry, the extraordinary breadth and relative anonymity of the medium create considerable risks. Because many states view sales via the Internet as a direct threat to their tax base and to the three-tier distribution system, state governments are increasingly adamant (and vigilant) about prohibiting shipments from suppliers directly to consumers. A winery that inadvertently ships a bottle of wine into a prohibited state may end up facing hundreds or thousands of dollars in fines, taxes and penalties.

Despite the potential risks, the good news is that opportunities still exist for wineries and other alcoholic beverage businesses to increase their distribution and develop their businesses and brands via the Internet. Many states have not barred the door to out of state suppliers and may even have left it open a crack. The key is working within (or around) restrictive state laws, as described above, and not forgetting that the old rules (e.g., prohibitions against disparaging advertising, sales to minors, tied-house violations, etc.) still apply. For the vigilant, the rewards may be well worth the hassle.