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## Commerce & Gaming Committee

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### HB 2609

**Brief Description:** Modernizing and clarifying in-state distilled spirits production licenses and fees.

**Sponsors:** Representatives Tarleton, Young, Vick, Caldier and Sullivan.

#### Brief Summary of Bill

- Restructures the licensing scheme for distilleries and craft distilleries by eliminating those licenses and creating three new licenses for different business models: (1) distilled spirits producer; (2) distilled spirits brand owner; and (3) merchant bottler.
- Requires an operational premises permit for each facility (\$100 per year).
- Establishes annual licensing fees for the three new licenses, ranging from \$300 to \$5,000 depending on the license type and annual production.
- Provides that only the distilled spirits producer license includes the right to self-distribute to in-state retailers and sell direct at retail to consumers, or is eligible for additional endorsement privileges.
- Establishes new privileges related to the sampling, marketing, and sale of spirits and liquor, for licensed distilled spirits producers, including: (1) off-site tasting rooms; (2) selling beer and wine for on-premises and off-premises consumption; (3) warehousing; (4) hosting public and private events and advertising the events; (5) providing personal services to retailers; and (6) providing branded promotional items to retailers to be passed along to employees and patrons, and to nonprofit entities.
- Grants the Liquor and Cannabis Board authority to establish additional endorsement privileges through rulemaking or by petition.
- Changes the application of the 17 percent spirits retail license issuance fee and provides exemptions from the fee, including exemptions from the fee tied to the percentage of raw materials grown in Washington used in production by a distilled spirits producer.
- Establishes a \$0.25 per liter excise fee on merchant bottlers and distilled spirits brand owner in connection with the sale and transfer of finished bottled or packaged spirits.

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- Authorizes joint off-site tasting rooms for distilled spirits producers, breweries, and wineries, and authorizes distilled spirits producers, breweries, and wineries located in direct physical proximity to share a consumption area for customers.
- Specifies that nonprofits recognized by the Secretary of State may receive donated spirits, in certain circumstances.
- Makes additional changes to liquor statutes.
- Contains a contingent expiration provision.

**Hearing Date:** 1/23/18

**Staff:** Peter Clodfelter (786-7127).

**Background:**

Licensing of Spirits Producers.

The Liquor and Cannabis Board (LCB) licenses people engaged in distilling (which is deemed an agricultural practice) under different license types, including the following:

- **Distiller license.** The license is for a person engaged in distilling, including blending, rectifying, and bottling. The license fee is \$2,000 per year, unless a person meets a different specific category.
- **Craft distillery license.** The license is for distillers producing 150,000 gallons or less of spirits with at least half of the raw materials in the production grown in Washington. The license fee is \$100 per year.

The LCB also licenses commercial chemist stills, stills for educational purposes at universities, and fruit and wine distilleries. A person may alternatively manufacture spirits under a separate manufacturer's license.

License Privileges.

A distillery or craft distillery may sell spirits of its own production for consumption off the premises. A distillery may also contract distilled spirits for, and sell contract distilled spirits to, holders of distillers' or manufacturers' licenses, or for export. Additionally, distilleries and craft distilleries may sell or provide customers with free 0.5 ounce or less samples of spirits, or sell adulterated samples of spirits of their own production, water, and/or ice to persons on the premises of the distillery. A person is limited to sampling no more than a total of two ounces of spirits or alcohol on the distillery premises per day.

Any distiller or craft distillery may act as a retailer and distributor of spirits of its own production to retailers selling for on-premises or off-premises consumption. Generally, a distillery or craft distillery acting as a distributor and retailer must comply with laws and rules applicable to distributors and retailers. A distillery or craft distillery operating as a distributor may maintain a warehouse off the distillery premises for the distribution of bottled spirits of its own production to spirits retailers within the state and for bottled foreign-made spirits that the distillery may distribute. The warehouse must be within the United States and the LCB must approve the

location. The LCB issues a separate license for a spirits warehouse (\$100 fee), which is available to distillers and craft distilleries to operate an additional off-premises warehouse.

A distillery or craft distillery may accept orders for spirits from customers in person at a licensed location, by mail, telephone, or the Internet (if Internet-sales privileges are requested), or by similar methods, and deliver spirits to an adult age 21 or over subject to restrictions on hours of delivery, age-verification of the recipient, and packaging and labeling requirements.

A distillery or craft distillery may apply to the LCB for an endorsement to sell bottled spirits of its own production at a qualifying farmers' market (annual fee of \$75). No sampling of spirits is authorized at a qualifying farmers' market. For each month during which a distillery or craft distillery will sell spirits at a qualifying farmers' market, the distillery or craft distillery must provide the LCB or its designee a list of the dates, times, and locations at which bottled spirits may be offered for sale. Before authorizing a qualifying farmers' market to allow an approved distillery or craft distillery to sell bottled spirits at retail at its farmers' market location, the LCB must notify appropriate local governments and nearby public institutions. The LCB may withdraw any farmers' market authorization for any violation of liquor laws or rules. The LCB adopts rules to implement alcohol server permits requirements.

A distillery or craft distillery may apply to the LCB for up to 12 special permits per year, for events not open to the general public, where tasting and selling spirits of the distiller's own production is authorized. The permits fee is \$10 per event. The application for the permit must be submitted for private banquet permits prior to the event, and once issued, must be posted conspicuously at the event while the permit is in use.

#### Tied House Laws and Exceptions.

Business practices and financial interests of liquor industry business are restricted under the so-called tied house laws. The tied house laws generally prohibit an industry member from advancing and a retailer from receiving moneys or moneys' worth under an agreement, written or unwritten, or by means of any other business practice or arrangement. The tied house laws also generally prohibit one industry member from having a direct or indirect financial interest in another industry member or retailer, except for specific exceptions. The term "industry member" is defined as a licensed manufacturer, producer, supplier, importer, wholesaler, distributor, authorized representative, certificate of approval holder, warehouse, and any affiliates, subsidiaries, officers, directors, partners, agents, employees, and representatives of any industry member.

An exception to the tied house laws authorizes a distiller to hold a spirits, beer, and wine restaurant license for the purpose of selling liquor at a spirits, beer, and wine restaurant premises on the property on which the primary manufacturing facility of the licensed distiller is located or on contiguous property owned or leased by the licensed distiller. A similar exception exists for breweries and wineries.

However, distillers and craft distilleries do not have the same exception to the tied house laws to perform personal services as is provided for the beer and wine industries. In-state and out-of-state wineries and breweries may provide certain personal services like in-store pouring and tasting events, bottle signing events, and other informational or educational activities at the

premises of certain retailers (e.g., grocery stores or beer and/or wine specialty shops) with tasting endorsements and subject to restrictions.

Another exception to the tied house laws authorizes industry members to provide retailers branded promotional items that are of nominal value, singly or in the aggregate, subject to restrictions. Promotional items must be used exclusively by the retailer or its employees and may not be passed along to customers or be targeted to or appeal principally to youth. Also, domestic wineries and microbreweries may provide branded promotional items that are of nominal value, singly or in the aggregate, to a nonprofit charitable corporation or association exempt from taxation under Section 501(c)(3) of the Internal Revenue Code, for use consistent with the purpose(s) entitling the nonprofit to the exemption.

Distilleries, distributors, and other entities may donate spirits to nonprofit charitable corporations or associations exempt from taxation under Section 501(c)(3) or (6) of the Internal Revenue Code, for use consistent with the purpose(s) entitling the nonprofit exemption.

#### Spirits Retail License Issuance Fee.

Initiative 1183 (2011) established a spirits retail license issuance fee. Each spirits retail licensee must pay to the LCB, for deposit into the Liquor Revolving Fund, a license issuance fee equivalent to 17 percent of all spirits sales revenues under the license, exclusive of taxes collected by the licensee and of sales of items on which a license fee has otherwise been incurred. Craft distilleries are exempted from paying the 17 percent fee on retail sales of their spirits, however, the law is applied to require distilleries to pay the 17 percent fee on retail sales of their spirits.

#### **Summary of Bill:**

##### Licensing of Spirits Producers and Related Entities.

A new licensing scheme is applied to businesses engaged in the production and marketing of spirits. The distillery and craft distillery licenses are replaced with the following licenses, which all must be combined with an operational premises permit that applies to each facility and costs \$100 per year:

- **Distilled spirits producer license.** This license is for a person whose primary business is distilling, redistilling, rectifying, blending, bottling, and warehousing of distilled spirits. The license fee is as follows: \$300 per year if the licensee produces 10,000 proof gallons or less of spirits per year; \$1,000 per year if the licensee produces more than 10,000 proof gallons but not more than 100,000 proof gallons of spirits per year; and \$5,000 per year if the licensee produces more than 100,000 proof gallons of spirits per year. With certain exception, a distilled spirits producer must distill or redistill no less than one-half of the stock keeping units of product that are traditionally made through distillation or redistillation of its own production and that it sells in its in-state tasting rooms, to in-state retailers, or to in-state distributors under its own brand.
- **Distilled spirits brand owner license.** This license is for a person or entity whose primary business is the marketing of one or more brands of distilled spirits without being substantially involved in the distillation, redistillation, rectification, blending, flavoring or merchant bottling of such spirits. The LCB must establish through rule what constitutes

being "substantially involved." The license fee is \$2,500 per year if the licensee sells 10,000 proof gallons or less of spirits in a year. The license fee is \$5,000 per year if the licensee sells more than 10,000 proof gallons in a year. The distilled spirits brand owner license includes the right to store product in a warehouse.

- **Merchant bottler license.** This license is for a person or entity whose primary business is to purchase distilled spirits in bulk from licensed distilled spirits producers for rectifying, diluting, blending, or flavoring such spirits and then packing the finished products into consumer bottles or packages without substantial additional distillation or redistillation by the licensee. Certain business models or practices are established as falling within the merchant bottler license category. The merchant bottler license fee is \$2,500 per year if the licensee bottles or packages 10,000 proof gallons or less of spirits in a year. The fee is \$5,000 per year if the licensee bottles and packages more than 10,000 proof gallons in a year. The merchant bottler license includes the right to store bulk and finished distilled spirits products in a warehouse. With limited exception, a prohibition is established on a merchant bottler using the word "distillery" or any derivative of the word in its brand or company name or on its distilled spirits products offered for sale in the state.

Licensees who held a valid in-state "distillery" or "craft distillery" license on the day before the effective date of the act, must automatically be granted the new permits, licenses, endorsements, and privileges afforded under the act, so long as the licensees can demonstrate to the LCB that they otherwise meet the new requirements.

#### License Privileges.

***Distilled spirits producers.*** An endorsement may be granted to any licensed distilled spirits producer (but not a licensed distilled spirits brand owner or licensed merchant bottler) for any number of allowed privileges to promote, market, serve, and sell distilled spirits products. Unless otherwise provided, each endorsement on a distilled spirits producer's license is \$100 per year.

Endorsements may grant one or more privileges to distilled spirits producers, including but not limited to the following:

- off-site retail locations for the sampling and service of spirits of the distilled spirits producer's production, or for the sale and service of other alcohol products. In the first two years the number of off-site retail locations allowed is half the amount authorized for wineries (wineries may have four), in the next two years the number of locations must be equal to the amount authorized for wineries (four), and after the first four years the LCB may authorize additional off-site retail locations by rule. At least 25 percent of the annual gross revenue generated in an on-site or off-site tasting room must come from bottle sales for off-premises consumption or the sale of other goods or services not associated with on-premises alcohol consumption. The fee for the first off-site tasting room is \$100 per year. The fee for every additional off-site tasting room is \$1,000 per year;
- unlimited warehousing for storage, blending, and bottling as authorized under the bonded spirits warehouse license;
- during the first 24-months after the effective date of the act, hosting 12 licensed or permitted events per year, during the second 24-months after the effective date of the act, hosting 24 licensed or permitted events per year, and thereafter hosting any number of additional licensed or permitted events as allowed by rule. All events may be held on or

off the licensed premises of the distilled spirits producer. All events may be for private guests by invitation or advertised to the public; and

- selling and serving samples and bottles at festivals and farmers' markets.

Any additional endorsements may be granted by rulemaking or by petition.

Distilled spirits producers may sell their spirits products as follows:

- at retail for off-premises consumption;
- at retail for on-premises consumption (may be sold or provided free as 0.5 ounce samples, or sold as servings). If sold or provided as samples, spirits may be adulterated with nonalcoholic mixers, mixers with alcohol of the distiller's own production, water, and/or ice. If sold as servings, spirits may be adulterated with water, ice, other alcohol entitled to be served on the licensed premises, or nonalcoholic mixers;
- under contract for and to holders of a distilled spirits producer, merchant bottler, or distilled spirits brand owner license, or to other entities licensed or permitted to purchase or handle such spirits;
- for export outside of the state; and
- at retail on the distilled spirit producers' premises.

In addition to selling their own products, a distilled spirits producer may sell any product made by any licensed Washington distilled spirits producer, winery, or brewery for on-premises or off-premises consumption.

An endorsement similar to the existing distillery and craft distillery license endorsement for farmers' market sales is established for distilled spirits producers. Spirits sampling is authorized, in addition to sales of spirits for off-premises consumption. The annual fee is \$25 per farmers' market.

The LCB may withdraw a distilled spirits producer's authorization to sell and sample spirits at a farmers' market. A farmers' market may elect to not allow sampling of spirits by a distilled spirits producer. Every person who participates in any manner in the service of spirits samples must obtain a class 12 alcohol server permit. Otherwise, the requirements are generally the same as the existing farmers' market requirements for spirits, beer, and wine.

Any in-state brewery, winery, distilled spirits producer, or any combination of these licensed entities with authorization for an off-site tasting room may jointly occupy and co-operate up to three off-site locations in which they sample, serve, and sell products of their own production. The licensees must maintain separate storage of products and separate financials.

Additionally, any in-state brewery, winery, or distilled spirits producer, or combination of these entities, whose property parcels or buildings are located in direct physical proximity to one another may share a standing or seated tasting area for patrons to use. Each licensee may sample, serve, and sell products of their own production for on-premises consumption in the jointly operated consumption area. Each licensee is responsible in the event of any enforcement issues, even if the enforcement issue is only due to one licensee's conduct.

The authority of existing distilleries and craft distilleries to accept orders for spirits from customers in person at a licensed location, by mail, telephone, the Internet, or by similar

methods, is changed to apply only to distilled spirits license holders. The requirement that an application for a private banquet permit must be submitted prior to the event is removed. References to craft distilleries and distilleries are changed to reference distilled spirits producers.

***Merchant bottlers and distilled spirits brand owners.*** Licensed distilled spirits brand owners and licensed merchant bottlers may sell their spirits products only as follows:

- through a licensed distributor;
- for export outside of the state, the product may be sold to a properly licensed entity; and
- if the product was produced under contract by a licensed in-state distilled spirits producer, then the product may be stored and sold through any approved distribution channel established by the distilled spirits producer for in-state wholesale or export transactions.

#### Tied House Laws and Exceptions.

It is provided that nothing in the tied house laws restricting cross-tier financial ownership of businesses prohibits a distilled spirits producer from:

- selling spirits of its own production or from hosting on behalf of itself or for a guest, group, or entity, on or off its licensed premises, for free or for an admission fee, an event covered by a special occasion license or a private banquet permit; or
- being licensed as a spirits, beer, and wine restaurant license on the property on which the primary manufacturing facility of the distilled spirits producer or on contiguous property.

It is provided that nothing in the tied house laws restricting industry members from advancing and retailers from receiving moneys or moneys' worth prohibits:

- the performance of personal services offered by an in-state distilled spirits producer to an on-premises or off-premises retail licensee when the personal services are conducted at a licensed premises in conjunction with a licensed, permitted, or endorsed tasting event and intended to inform, educate, or enhance customers' knowledge or experience of the manufacturer's products (e.g., participation and pouring, bottle signing events, and other similar informational or educational activities); or
- an in-state distilled spirits producer from providing branded promotional items which are of nominal value, singly or in the aggregate, to a retail licensee for its use or for use by its employees or patrons or to a nonprofit or charitable corporation recognized by the Secretary of State or that is exempt from taxation under Section 501(c) of the Internal Revenue Code, for use consistent with the purpose(s) entitling the nonprofit to the exemption.

Nonprofits recognized by the Secretary of State are added to the specific types of nonprofit entities to which spirits producers, distributors, and other entities may donate spirits.

#### Spirits Retail License Issuance Fee and New Fees Related to Spirits Sales.

***Distilled spirits producers.*** It is established that the 17 percent spirits retail license issuance fee does not apply to retail sales of any of the following products by a licensed distilled spirits producer in the following circumstances:

- to any aging product put into barrels or other aging vessels prior to the effective date of the act by a distilled spirits producer who held a "craft distillery" license;

- during the first 24-months after the effective date of the act, to any distilled spirits product produced by, and in storage of, distilled spirits producers who held a "craft distillery" license;
- to any spirits product already in finished packages or bottles produced by a distilled spirits producer who held a "craft distillery" license;
- on or after the effective date of the act, to any newly licensed distilled spirits producer during its first 36-months of licensed operations so long as the amount of volume of products the licensee is making for aging or blending for future sales exceeds the amount of volume of finished products it samples, serves, and sells in its in-state tasting rooms that would otherwise not qualify for an exemption under one of the above three exemptions; and
- on or after the effective date of the act, to distilled spirits producers producing spirits with at least 90 percent of the raw materials used in the production being grown in Washington.

Additionally, distilled spirits producers producing spirits with less than 90 percent but at least 50 percent raw materials grown in Washington used in their production are allowed a credit of up to 75 percent against the 17 percent fee.

Further, distilled spirits producers producing spirits with less than 50 percent raw materials grown in Washington used in its production are allowed a credit of up to 50 percent against the 17 percent fee.

For purposes of calculating qualifying raw material percentages, the totals must exclude raw materials not commercially grown on a regular commercially available basis in Washington, as deemed by a finding by the Department of Agriculture, as well as water, creams, and sugar or syrup derivatives. However, such totals must include the raw ingredients used to make the base spirit of the finished product or the flavorings blended or added to make finished products.

***Merchant bottlers and distilled spirits brand owners.*** Each merchant bottler licensee must pay a monthly production excise fee of \$0.25 per liter of finished bottles or packages removed from bond tax determined or transferred in bond for its own sale. However, there is no production excise fee for distilled spirits bottled by a merchant bottler under contract for a distilled spirits producer licensed in Washington. Similarly, each distilled spirits brand owner must pay a monthly bond removal excise fee of \$0.25 per liter of finished bottles or packages removed from bond tax determined or transferred in bond.

A savings clause is provided. Additionally, if the exemptions from the 17 percent spirits retail license issuance fee provided to distilled spirits producers are found invalid in whole or in part by a court of competent jurisdiction, the majority of the act, except for the authorization for combined tasting rooms between distilled spirits producers, breweries, and wineries, expires.

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** The bill takes effect on June 1, 2018.