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PRESSING WASHINGTON'S WINE INDUSTRY INTO THE TWENTY-FIRST CENTURY: RETHINKING WHAT IT MEANS TO BE A WINERY

Rebecca Thompson

Abstract: Washington's wine industry is growing, and the ways in which Washington winemakers craft and sell their product are changing. Traditional "brick and mortar" wineries coexist with so-called "virtual wineries," which typically purchase grapes from growers and contract with other wineries or custom crush facilities to access winemaking equipment. The virtual winery is an incubator model and contributes to the rich diversity of Washington's wine industry. Washington's current winery licensing statute, RCW 66.24.170, does not clearly apply to virtual wineries because it links the concept of a winery with a particular physical location and fails to delineate exactly what types of winemaking activities licensees must engage in. This statutory ambiguity causes confusion for winemakers and regulators. House Bill 1641, introduced in January 2011, seeks to remedy the confusion by dividing the current winery licensing statute into two classes: one for traditional wineries, and one for virtual wineries. The latter would be licensed not as producers of wine but as retailers. While well-intentioned, House Bill 1641 could negatively impact Washington's wine industry by limiting virtual wineries' access to consumers via interstate direct shipment. Unlike licensed wine producers, wine retailers presently lack Commerce Clause protection from state laws discriminating against direct shipment of out-of-state wine. Thus, this Comment argues that Washington should follow the example of Oregon and enact legislation amending RCW 66.24.170 to clearly license virtual wineries as producers.

INTRODUCTION

*Like fights about most regulation, those about wine rules are about economic interests. And, as in fights about most product regulation, the overlooked constituencies are consumers and mom-and-pop businesses.*¹

Washington is home to a robust and growing wine industry. In 2010, Washington grape growers produced 160,000 tons of more than thirty wine grape varieties, a record high.² These 160,000 tons of grapes yielded approximately twelve million cases of wine.³ According to the

1. Susan Lorde Martin, *Wine Wars—Consumers and Mom-and-Pop Wineries vs. Big Business Wholesalers: A Citizens United Example*, 21 KAN. J. L. & PUB. POL'Y 1, 1 (2011).

2. *State Facts*, WASH. WINE COMM'N, <http://www.washingtonwine.org/wine-101/state-facts> (last visited July 28, 2012).

3. *Id.*

Washington Wine Commission, the total statewide economic impact of Washington's wine industry is \$3 billion.⁴ The Washington wine industry has undoubtedly come a long way since its humble origins at Fort Vancouver in 1825.⁵ The coming of age of Washington's wine industry manifests itself not only in sheer numbers but also in the changing ways that Washington winemakers craft, market, and deliver their product to consumers.

Many people may associate winemaking with a villa or château set against a hillside lined with row upon row of lush vines, a barn or cellar housing stacked barrels of aging wine, and an on-site tasting room. While this traditional "estate" or "brick and mortar" model still exists in Washington today, it is not the only model. Of the total 120,000 tons of Washington grapes crushed in 2006, only 35,275 were estate grown—the rest were either purchased or custom crushed.⁶ These figures indicate that not all Washington winemakers grow and crush the grapes they produce. Rather, some winemakers purchase grapes from growers and crush them at their own facility.⁷ So-called "virtual wineries" purchase grapes and arrange to have them crushed at someone else's facility.⁸ The latter production model has gained recent popularity among Washington's smaller, start-up wine operations.⁹

The rapid growth in the American wine industry over the past four decades¹⁰ has sparked increased competition, prompting wineries to develop new methods of reaching and retaining consumers.¹¹ According to the Federal Trade Commission (FTC), American wine consumers increasingly desire "individualistic, hand-crafted wines."¹² The FTC

4. *Id.*

5. *History*, WASH. WINE COMM'N, <http://www.washingtonwine.org/wine-101/history> (last visited July 28, 2012). Members of the Hudson's Bay Company planted Washington's first wine grapes. *Id.*

6. U.S. DEP'T AGRIC., NAT'L AGRIC. STATISTICS SERVS., PRELIMINARY WASHINGTON WINERY REPORT 2006, 4 (2007) (hereinafter USDA). At the time of this writing, the 2006 statistics are the most recent compilation available.

7. *See id.*

8. *See* THE BUSINESS OF WINE: AN ENCYCLOPEDIA 265 (Gerald Brostrom & Jack Brostrom, eds., 2009).

9. Paul Franson, *Directory: Custom Crush Facilities*, WINE BUS. MONTHLY (July 15, 2011), <http://www.winebusiness.com/wbm/?go=getArticle&dataId=91624>.

10. *See* Jeff Gordon, *Future of Farming 2008—Wine Industry Perspective*, WASH. STATE DEP'T OF AGRIC., 1, available at <http://agr.wa.gov/FoF/docs/Wine.pdf> (last visited Nov. 11, 2011) (describing growth in Washington's wine industry since the 1970s).

11. *See* USDA, *supra* note 6, at 2 ("With the wine industry growing at a fast pace, competition has increased, forcing wineries to offer unique products and find niche markets.").

12. FED. TRADE COMM'N, POSSIBLE ANTICOMPETITIVE BARRIERS TO E-COMMERCE: WINE 6 (2003).

links this shift in consumer preferences with the emergence of more and more small wineries.¹³ However, small, start-up wineries face greater difficulty finding distributors than do their established, large-scale counterparts.¹⁴ As a result, many small wineries rely in part on direct-to-consumer sales, including through internet-based wine clubs and other forms of e-commerce.¹⁵ In 2006, Washington wineries sold 42,000 cases of wine direct to consumers online.¹⁶ Though direct-to-consumer sales represent a small percentage of total wine sales in Washington,¹⁷ these sales are often a small winery's "cash cow."¹⁸

Despite the growing diversity of wine production and sales methods, Washington still only offers one domestic winery license.¹⁹ Section 66.04.010(46) of the Revised Code of Washington (RCW) currently defines a domestic winery as "a place where wines are manufactured or produced within the state of Washington."²⁰ However, no statute defines "manufactured" or "produced."²¹ This vague definition links the concept of a winery to a particular physical location, which Washington's virtual wineries lack.²² It also results in confusion for winemakers and liquor board enforcement officials as to which winemaking activities licensees must conduct on their licensed premises.²³

House Bill 1641, introduced in the January 2011 state legislative session, seeks to remedy points of confusion in Washington's winery licensing regime by splitting the current domestic winery license into "Class A" and "Class B" categories.²⁴ The Class A license would

13. *Id.*

14. *Id.*

15. Lance Cutler, *Industry Roundtable: Wine Clubs*, WINE BUS. MONTHLY (Jan. 15, 2010), <http://www.winebusiness.com/wbm/?go=getArticle&dataId=71559>.

16. See USDA, *supra* note 6, at 7.

17. See USDA, *supra* note 6, at 7.

18. See Cutler, *supra* note 15.

19. WASH. REV. CODE § 66.24.170 (2010) ("There shall be a license for domestic wineries.") (emphasis added). In contrast to the RCW, federal law offers numerous options for entering the wine industry through different business models. See *infra* Part II.A.

20. WASH. REV. CODE § 66.24.170. Federal regulations account for winemaking activities ranging from fermentation on the permitted premises to amelioration, fortification, and processes to make wine sparkling. See *infra* Part II.A.1.

21. See WASH. REV. CODE § 66.04.010 (2010) (providing no definition of "manufactured" or "produced").

22. Peter Mitham, *Will Washington Legalize Virtual Wineries?*, WINES & VINES (Aug. 24, 2010), <http://www.winesandvines.com/template.cfm?section=news&content=77761&htitle=Will%20Washington%20Legalize%20Virtual%20Wineries%3F>.

23. *Id.*

24. H.B. 1641, 62nd Leg., Reg. Sess. (Wash. 2011).

correspond to the traditional production model, while the Class B license would correspond to non-traditional wine production models associated with virtual wineries.²⁵ Though House Bill 1641 may appear at first blush a clear solution to a simple problem of statutory ambiguity, in application it could prove problematic by removing virtual winemakers from the legal realm of wine production altogether, licensing them instead as wine retailers.²⁶

If enacted in either its original or substitute forms,²⁷ House Bill 1641 could place Washington's small wineries, particularly its virtual wineries, at a competitive disadvantage both within and outside Washington. On the state level, many already operating wineries would be required to either switch to the new license²⁸ and lose certain rights and privileges they presently enjoy, or spend more money to produce enough wine by fermentation to qualify for the new Class A license.²⁹ On the national level, virtual and other alternative wineries licensed as retailers rather than producers would be vulnerable to protectionist state laws regarding direct-to-consumer shipping.³⁰ While the U.S. Supreme Court case of *Granholm v. Heald*³¹ extended Commerce Clause protection to wine producers,³² the federal circuit courts have thus far declined to extend this protection to wine retailers and wholesalers.³³ The U.S. Supreme Court recently denied certiorari on the issue, leaving

25. *Id.* Essentially, the Class A license would correspond to traditional wineries because it allows for production of wine by fermentation on the licensed winemaking premises. This would not be a feasible option for virtual wineries because they do not own winemaking premises to license.

26. *Id.*

27. While in committee, two substitute versions of House Bill 1641 were introduced. *See infra* Parts III.A, B.

28. STATE GOV'T & TRIBAL AFFAIRS COMM., H.B. 1641 BILL ANALYSIS, INDIVIDUAL STATE AGENCY FISCAL NOTE, 62nd Leg., Reg. Sess., at 2 (Wash. 2011) (estimating that 30 percent of existing wineries would have to switch to the new license).

29. H.B. 1641, 62nd Leg., Reg. Sess. (Wash. 2011); H. 62-3855.4/12, Reg. Sess. (Wash. 2011) (as introduced by Rep. Hunt); H. 62-334, Reg. Sess. (Wash. 2011) (as introduced by Rep. Condotta) (all requiring holders of class A licenses to produce a set quantity of wine by fermentation).

30. *See, e.g.,* *Siesta Vill. Mkt. LLC v. Steen*, 595 F.3d 249 (5th Cir. 2010), *abrogated by* *Wine Country Gift Baskets.com v. Steen*, 612 F.3d 809 (5th Cir. 2010); *Wine Country Gift Baskets.com v. Steen*, 612 F.3d 809 (5th Cir. 2010), *cert. denied*, ___ U.S. ___, 131 S. Ct. 1602 (2011) (upholding Texas law that prohibited out-of-state retailers from shipping wine directly to consumers but allowing in-state retailers to do so); *Lebamoff Enters., Inc. v. Snow*, 757 F. Supp. 2d 811 (S.D. Ind. 2010) (upholding Indiana law prohibiting out-of-state wine dealers from using common carriers for consumer deliveries; in-state wine dealers were allowed to use common carriers).

31. 544 U.S. 460 (2005).

32. *Id.* at 493.

33. *See, e.g.,* *Siesta Vill. Mkt.*, 595 F.3d at 261; *Wine Country Gift Baskets*, 612 F.3d at 821; *Brooks v. Vassar*, 462 F.3d 341, 352 (4th Cir. 2006).

the circuit court decisions undisturbed.³⁴ Thus, if passed, House Bill 1641 could place Washington's virtual wineries in economic and competitive jeopardy and might even hamper the growth and diversification of Washington's wine industry as a whole.

California and Oregon provide virtual winery licensing models that Washington might follow. Under the California model, virtual wineries are licensed separately from traditional wineries as retailer-wholesalers.³⁵ California's approach gives virtual wineries limited access to consumers, relative to their traditional counterparts.³⁶ Under the Oregon model, by contrast, virtual and traditional wineries are able to hold the same license.³⁷ This model maximizes virtual wineries' ability to ship directly to consumers in other states.³⁸

This Comment argues that the Washington Legislature should amend current RCW 66.24.170 based on Oregon's winery licensing scheme, designating virtual wineries as "wineries" rather than retailer-wholesalers. Part I describes the current wine production industry in Washington. Part II discusses federal and Washington winery licensing laws and their various points of confusion. Part III examines Washington's House Bill 1641 as a proposed solution. Part IV describes the connection between state winery licensing laws and the federal protectionism jurisprudence. Part V evaluates California and Oregon winery licensing laws as alternatives to Washington's House Bill 1641. Finally, Part VI argues that Oregon's law is the optimal model because it provides regulatory clarity and maximizes virtual wineries' access to consumers.

I. WASHINGTON IS HOME TO A ROBUST AND GROWING WINE INDUSTRY COMPRISING BOTH TRADITIONAL AND VIRTUAL WINERIES

As the second-largest producer of wine in the nation after California, Washington boasts an economically significant and increasingly prestigious wine industry.³⁹ Formerly regarded as a "cottage industry," Washington wine now has an estimated economic impact of \$3 billion

34. *Wine Country Gift Baskets.com v. Steen*, __ U.S. __, 131 S. Ct. 1602, 1602 (2011).

35. *See infra* Part V.A.

36. *See infra* Part V.A.

37. *See infra* Part V.B.

38. *See infra* Part V.B.

39. WASH. WINE COMM'N, *supra* note 2; *see also* Gordon, *supra* note 10, at 1.

statewide and \$4.7 billion nationwide.⁴⁰ Over the past four decades the industry has expanded and diversified at a rapid pace, growing from fewer than twenty wineries in the late 1970s to 762 licensed domestic wineries today.⁴¹ The industry also continues to gain in reputation, with Washington wines increasingly ranked among the finest in the world.⁴²

Washington's wine industry comprises both traditional and non-traditional business models.⁴³ The traditional business model, commonly referred to as a "bricks-and-mortar" winery, is one option available to aspiring vintners.⁴⁴ Traditional vintners typically own and operate a complete, one-shop winery, including a vineyard and winemaking facility.⁴⁵ Some purchase land and develop a brand-new winery, while others opt to acquire or lease an existing winery instead.⁴⁶ Industry experts generally agree that the traditional business model requires significant start-up capital.⁴⁷

While the traditional model continues to exist in Washington, the industry has evolved over the years to encompass non-traditional business models as well.⁴⁸ Only about thirty percent of Washington wine

40. WASH. WINE COMM'N, *supra* note 2; *see also* Gordon, *supra* note 10, at 1 (Washington's wine industry "had been viewed as a 'cottage' industry by the other elite growing areas around the world," but is now "being viewed as a major player and even a threat to market share").

41. *See* Gordon, *supra* note 10, at 1; *see also* License Type—Washington Domestic Winery, WASH. STATE LIQUOR CONTROL BD., <http://liq.wa.gov/taxreporting/licensee-list> (last visited Aug. 11, 2012).

42. PAUL GREGUTT, WASHINGTON WINES & WINERIES: THE ESSENTIAL GUIDE 249 (2d ed. 2007).

43. U.S. DEP'T OF AGRIC., NAT'L AGRIC. STATISTICS SERVS., GRAPE RELEASE (2011) (hereinafter GRAPE RELEASE), available at http://www.nass.usda.gov/Statistics_by_State/Washington/Publications/Fruit/grape11.pdf (last visited Aug. 4, 2012) (dividing the 2011 Washington wine grape crush into three different source categories: "Estate Grown Grapes," "Purchased Grapes," and grapes "Crushed for other Wineries"); *see also* Cathy Fisher, U.S. Wineries Grow 9% to 6,785, WINE BUS. MONTHLY (Feb. 15, 2011) <http://www.winebusiness.com/wbm/?go=getArticle&dataId=85190> (reporting twenty virtual wineries in Washington); THE BUSINESS OF WINE: AN ENCYCLOPEDIA, *supra* note 8, at 253 (reporting forty virtual wineries in Washington).

44. RICHARD MENDELSON, WINE IN AMERICA: LAW AND POLICY 149 (2011).

45. *See id.* at 149–50.

46. *See id.* at 150–56.

47. *See id.* at 161; THE BUSINESS OF WINE: AN ENCYCLOPEDIA, *supra* note 8, at 265 ("grand" brick-and-mortar wineries are "inevitably" built "with a fortune raised in some other field of endeavor, such as banking or technology").

48. *Hearing on H.B. 1641 Before the H. Comm. on State Gov't & Tribal Affairs*, 2012 Leg., Reg. Sess. (Wash. Jan. 25, 2012) (hereinafter *Hearing on H.B. 1641*) (statement of Jean Leonard), available at http://www.tvw.org/index.php?option=com_tvwplayer&eventID=2012011223; GRAPE RELEASE, *supra* note 43; *see also* Fisher, *supra* note 43; THE BUSINESS OF WINE: AN ENCYCLOPEDIA, *supra* note 8, at 253.

grapes crushed in 2010 were estate-grown;⁴⁹ the remainder consisted of grapes either purchased from or crushed for another winery.⁵⁰ Purchasing grapes and contracting with crushing facilities in order to make wine are hallmark practices of the non-traditional, or virtual, wine business model.⁵¹

In general terms, a virtual winery can be defined as a wine brand without its own physical winery.⁵² A typical virtual winery purchases grapes from a grower and then contracts with a traditional winery or special custom crush facility⁵³ to access crushing and bottling equipment or services.⁵⁴ Virtual wineries generally produce at least one commercially distributed brand, have their own management and winemaker, and control all of the winemaking decisions.⁵⁵

The control that virtual winemakers exercise over the wine crafting process distinguishes them from *négociants*, another non-traditional player in the wine business.⁵⁶ As opposed to virtual winemakers, *négociants* generally do not participate in any phase of wine crafting; rather, they purchase bulk finished wine to bottle and sell under their own brand name.⁵⁷ Accordingly, some virtual wineries prefer to be called “micro-vintners” or “micro-wineries” in order to distance themselves from *négociants*, who exercise little to no control over winemaking.⁵⁸

One significant reason why winemakers entering the industry choose

49. The term “estate-grown” generally indicates that the winery grew the grapes on its on-site vineyard. Paul Gregutt, *Know Your Wine Words: The State of Estate and More*, THE SEATTLE TIMES (Oct. 8, 2011), http://seattletimes.nwsources.com/html/wineadviser/2016348589_pacificadviser09.html.

50. GRAPE RELEASE, *supra* note 43.

51. See THE BUSINESS OF WINE: AN ENCYCLOPEDIA, *supra* note 8, at 253.

52. See *id.* at 253; see also Fisher, *supra* note 43.

53. Custom crush facilities generally are existing wineries that produce wine from clients' grapes on a contract basis. Ken English, Connor Massey & Bruce Miroglio, *Starting a Virtual Winery*, WINE BUS. MONTHLY (Apr. 2009), <http://www.winebusiness.com/wbm/?go=getArticle&dataId=64552>. Artifex Winery in Walla Walla is an example. See Paul Franson, *Washington Custom Crush Facility Opens: 36,000-case Artifex Winery in Walla Walla Processes First Fruit*, WINES & VINES (Sept. 17, 2007), <http://www.winesandvines.com/template.cfm?section=news&content=50438>.

54. See THE BUSINESS OF WINE: AN ENCYCLOPEDIA, *supra* note 8, at 265.

55. See *id.*; see also Fisher, *supra* note 43; Mary-Colleen Tinney, *Number of U.S. Wineries Tops 6,000*, WINE BUS. MONTHLY (Feb. 15, 2008), <http://www.winebusiness.com/wbm/?go=getArticle&dataId=54414>.

56. See THE BUSINESS OF WINE: AN ENCYCLOPEDIA, *supra* note 8, at 253 (*Négociants* are “opportunistic buyers and have no control over their raw material.”).

57. MENDELSON, *supra* note 44, at 164–65.

58. See THE BUSINESS OF WINE: AN ENCYCLOPEDIA, *supra* note 8, at 265.

the virtual winery business model over the traditional model is reduced capital requirements.⁵⁹ Virtual wineries are often (but not always) small boutique operations run by winemakers “scrambling to make ends meet.”⁶⁰ Avoiding the cost of building, acquiring, or maintaining a physical winery thus permits virtual winemakers to enter the industry at a relatively low cost, crafting quality wines that can then be marketed and sold through e-commerce and direct shipment.⁶¹

As of 2007, *Wine Business Monthly* reported that forty virtual wineries existed in Washington.⁶² However, this figure is dated and may not be exact; industry experts remark that virtual wineries are difficult to track, partly because they are not subject to the same federal permitting and reporting requirements as traditional wineries, and partly because they frequently transition to a traditional model once they have grown enough to afford the investment.⁶³ Overall, however, the number of virtual wineries tends to increase with the number of traditional wineries.⁶⁴

II. ALL WASHINGTON WINERIES ARE SUBJECT TO FEDERAL AND STATE LICENSING LAWS

Whether virtual or traditional, all Washington wineries must comply with applicable federal and state regulations.⁶⁵ The federal agency responsible for regulating the wine industry is the Alcohol and Tobacco Tax and Trade Bureau (TTB).⁶⁶ The equivalent state agency is the Washington State Liquor Control Board (WSLCB).⁶⁷ Unlike the WSLCB, the TTB offers permits corresponding to various models of

59. *See id.* at 253.

60. Chris Rauber, *Wine, Without the Vine*, S. F. BUS. TIMES (May 28, 2004), <http://www.bizjournals.com/sanfrancisco/stories/2004/05/31/story6.html?page=all>.

61. *See* THE BUSINESS OF WINE: AN ENCYCLOPEDIA, *supra* note 8, at 253.

62. *See* Tinney, *supra* note 55. It should be noted that the author did not disclose the criteria used in classifying wineries as “virtual” or “bonded.”

63. *See id.*; *see also* THE BUSINESS OF WINE: AN ENCYCLOPEDIA, *supra* note 8, at 253 (Reported numbers of virtual wineries “fluctuate as players enter and exit the market.”).

64. *See* THE BUSINESS OF WINE: AN ENCYCLOPEDIA, *supra* note 8, at 253.

65. MENDELSON, *supra* note 44, at 149.

66. *See* 6 U.S.C. § 531 (2006) (establishing the TTB within the Treasury Department and charging the TTB with the administration and enforcement of chapters 51 and 52 of U.S.C. title 26, sections 4181 and 4182 of title 26, and title 27).

67. WASH. REV. CODE §§ 66.08.012, .030 (2010); *About Us*, WASH. STATE LIQUOR CONTROL BD., <http://liq.wa.gov/about/main> (last visited Nov. 11, 2011) (The WSLCB was formed in 1933 under the Steel Act to “regulate the importation, manufacture, distribution, and sale of alcohol”).

wine production.⁶⁸

A. *The TTB Offers Several Permit Options for Participating in the Wine Industry*

The TTB is charged with regulating the production and sale of alcohol under the Internal Revenue Code,⁶⁹ the Webb-Kenyon Act,⁷⁰ the Federal Alcohol Administration Act,⁷¹ and the Alcoholic Beverage Labeling Act.⁷² The TTB's stated mission is to "collect[] Federal excise taxes on alcohol, tobacco, firearms, and ammunition" and to "assur[e] compliance with Federal tobacco permitting and alcohol permitting, labeling, and marketing requirements to protect consumers."⁷³

To this end, TTB regulations require anyone seeking to produce, blend, rectify, warehouse, or bottle wine in the United States for commercial purposes to first obtain a basic permit.⁷⁴ In order to qualify for a basic permit, applicants must simply be "likely to commence operations as a distiller, warehouseman and bottler, rectifier, wine producer, wine blender, importer, or wholesaler."⁷⁵ Before commencing such operations, applicants must file a bond with the Secretary of the Treasury in an amount "necessary to protect the revenue" in the event that the licensee fails to pay his or her taxes.⁷⁶

The TTB basic permit is available to both traditional and non-traditional wineries.⁷⁷ Variations on the basic permit include: bonded wineries, bonded wine cellars, alternating proprietorships, and wholesalers.⁷⁸ Bonded winery and bonded wine cellar permits generally

68. See *infra* Part II.A.

69. 26 U.S.C. §§ 5001–08, 5010–11, 5041–45, 5051–56, 5061–62, 5064–67 (2006).

70. 27 U.S.C. § 122 (2006).

71. *Id.* §§ 201–08, 211.

72. *Id.* §§ 213–19(a).

73. *About Us*, ALCOHOL & TOBACCO TAX & TRADE BUREAU, <http://ttb.gov/about/mission.shtml> (last visited Aug. 4, 2012).

74. 27 C.F.R. § 1.21 (2012). However, adult persons who wish to produce wine solely for personal use need not apply for a TTB permit. *Id.* § 24.75(a). TTB regulations allow any adult to produce up to one hundred gallons of wine per year for individual consumption, or up to two hundred gallons per year for consumption by two or more adults within the same household. *Id.* § 24.75(b).

75. *Id.* § 1.24. Applicants must also not have been convicted of any felony under federal or state law in the past five years, or any federal misdemeanor relating to alcohol in the past three years. The proposed activity must not be in violation of state law. *Id.*

76. 26 U.S.C. §§ 5351, 5354 (2006).

77. See *infra* Part II.A.1.

78. See *infra* Parts II.A.1, 2.

correspond to traditional wineries, whereas alternating proprietorship and wholesaler permits correspond to virtual and other non-traditional wineries.⁷⁹

1. *The TTB Offers Permits for Bonded Wineries and Bonded Wine Cellars*

Persons seeking to produce or blend untaxpaid wine⁸⁰ must apply for a basic permit.⁸¹ Holders of basic permits may be designated as bonded wineries if they engage in “production operations,” “production of wine,” or “production processes involving the use of wine” on the permitted premises.⁸² Otherwise, they are designated as bonded wine cellars.⁸³ However, the precise distinction between a bonded winery and a bonded wine cellar is unclear because neither the federal alcohol statutes nor TTB regulations define production operations, production of wine, or production processes involving the use of wine.

For its regulatory purposes, the Internal Revenue Code defines “own production” with respect to wine in a bonded wine cellar as wine “produced by *fermentation* in the same bonded wine cellar.”⁸⁴ By contrast, TTB regulations pertaining to wine labeling define the term “produced” as indicating that one of three activities occurred at the address listed on a wine label: (1) *fermentation* of at least seventy-five percent of the labeled wine, (2) *fortification* or *amelioration* of the labeled wine, or (3) a process to make the labeled wine *sparkling*.⁸⁵ Similarly, TTB regulations pertaining to tax credits available to small wineries define “production” as including not only *fermentation* but also *amelioration*, *wine spirits addition*, *sweetening*, and *formula processing*.⁸⁶ As a result of these contrasting definitions of wine production, some members of Washington’s wine industry disagree over what exactly is required to qualify as a bonded winery under the federal permitting scheme.⁸⁷

79. See *infra* Parts II.A.1, 2.

80. As opposed to “taxpaid wine,” which is wine “on which the tax imposed by law has been determined.” 27 C.F.R. § 24.10 (2012).

81. 26 U.S.C. § 5351.

82. *Id.*; 27 C.F.R. § 24.107 (2012).

83. See *supra* note 82.

84. 26 U.S.C. § 5392 (2006) (emphasis added).

85. 27 C.F.R. § 4.35 (2012).

86. *Id.* § 24.278.

87. Compare *Hearing on H.B. 1641*, *supra* note 48 (statement of Jean Leonard that federal law requires bonded wineries to produce wine by fermentation on the permitted premises), and GRAPE

2. *The TTB Also Offers Permits for Alternating Proprietorships and Custom Crushing*

Holders of TTB basic permits to blend and/or produce wine also have the option of operating as alternating proprietors. Alternating proprietors are individual winemakers who own independent space within a single host winery.⁸⁸ Like a sole proprietor of a bonded wine cellar or bonded winery, each alternating proprietor is required to obtain a basic permit and file a bond with the Secretary of the Treasury.⁸⁹ Each alternating proprietor is responsible for keeping his or her own records for tax reporting purposes.⁹⁰ In essence, alternating proprietors are wineries within a winery. Each alternating proprietor has designated space within the host winery, and the alternating proprietor(s) and host winery share use of the various winemaking equipment.⁹¹

In addition to allowing for the non-traditional production of wine through an alternating proprietorship, the TTB also offers a custom crush permit in the form of a federal wholesaler's basic permit.⁹² This permit allows holders to purchase wine at wholesale and resell it, either directly to consumers or through a distributor.⁹³ According to the TTB, the custom crush permit is designed for companies that own grapes or other winemaking materials and wish to have them made into wine by a host traditional winery or custom crush facility.⁹⁴

As discussed above, custom crushing (buying grapes and hiring the services of a crushing and/or bottling facility) is a signature practice of virtual wineries.⁹⁵ In a typical custom crush arrangement, the host traditional winery or custom crush facility holds a TTB bonded winery basic permit whereas the custom crush client (e.g., the virtual winemaker) holds a custom crush basic permit allowing for wholesale of

RELEASE, *supra* note 43, with *Hearing on H.B. 1641*, *supra* note 48 (statement of Paul Beveridge that federal law does not require bonded wineries to produce by fermentation).

88. MENDELSON, *supra* note 44, at 165 ("The alternating proprietorship model is conceptually similar to a residential condominium development consisting of commonly owned areas for the enjoyment of all condominium owners as well as separate, independently owned living spaces.").

89. 27 C.F.R. § 24.136 (2012).

90. *Id.*

91. See MENDELSON, *supra* note 44, at 165.

92. 27 C.F.R. § 1.22 (2012).

93. *Id.*

94. *What Are My Options for Entering the Wine Industry*, ALCOHOL & TOBACCO TAX & TRADE BUREAU, http://www.ttb.gov/wine/entering_wine_industry.shtml (last visited Aug. 6, 2012).

95. See THE BUSINESS OF WINE: AN ENCYCLOPEDIA, *supra* note 8, at 253–54.

the finished wine under the client's brand name.⁹⁶ While the average consumer may be unable to differentiate custom crushed wine from traditionally produced wine, one way to identify a custom-crushed wine is by its label—the TTB will not permit custom crush clients to use the term “winery” as part of their brand name.⁹⁷ Accordingly, custom crush clients may describe themselves as a “cellar” instead of a “winery.”⁹⁸

B. The WSLCB Currently Offers a Single Domestic Winery License

The WSLCB, created in 1933 by the Steele Act,⁹⁹ is charged with regulating the “importation, manufacture, distribution, and sale of alcohol.”¹⁰⁰ The WSLCB issues liquor licenses, including the domestic winery license under section 66.24.170 of the RCW, and is responsible for regulating the alcoholic beverages industry.¹⁰¹ The WSLCB's mission is to “[c]ontribute to the safety and financial stability of our communities by ensuring the responsible sale, and preventing the misuse of, alcohol and tobacco.”¹⁰²

Unlike the TTB, which offers numerous permit options for entering the wine industry, the WSLCB offers only one domestic winery license.¹⁰³ Currently, a domestic winery license costs \$100 if the winery produces less than 250,000 liters per year, and \$400 if the winery produces more than 250,000 liters per year.¹⁰⁴ As described by the WSLCB, the domestic winery license under RCW section 66.24.170 allows for the “manufacture [of] wine in Washington State from grapes or other agricultural products.”¹⁰⁵ Holders of a domestic winery license are also permitted to act as distributor and retailer of wine “of their own

96. See MENDELSON, *supra* note 44, at 161–62 (“In the custom crush model . . . the host winery will adopt the client's trade name by adding it to the host winery's federal basic permit.”); ALCOHOL & TOBACCO TAX & TRADE BUREAU, *supra* note 94; 27 C.F.R. § 4.35 (2012).

97. See 27 C.F.R. §§ 4.33, .35; MENDELSON, *supra* note 44, at 162.

98. MENDELSON, *supra* note 44, at 162.

99. WASH. STATE LIQUOR CONTROL BD., *supra* note 67.

100. *Id.*; see also WASH. REV. CODE § 66.08.030 (2010) (listing each of the Board's regulatory powers).

101. WASH. STATE LIQUOR CONTROL BD., *supra* note 67.

102. *Vision, Mission, Goals, Values*, WASH. STATE LIQUOR CONTROL BD., <http://liq.wa.gov/careers/vision> (last visited Nov. 11, 2011).

103. WASH. REV. CODE § 66.24.170(1) (2010) (“There shall be a license for domestic wineries”) (emphasis added).

104. *Non-Retail Liquor License Description and Fee Information Sheet*, WASH. STATE LIQUOR CONTROL BD., 2, <https://www.liq.wa.gov/publications/Liq18150.pdf> (last visited Nov. 11, 2011).

105. *Id.*

production.”¹⁰⁶ Finally, licensed domestic wineries are permitted to operate two tasting rooms separate from their production or manufacturing sites at no additional charge.¹⁰⁷

Section 66.04.010(16) of the RCW defines a “domestic winery” as “a place where wines are manufactured or produced within the state of Washington.”¹⁰⁸ Yet section 66.24.170(2) states only that the domestic winery license “allows for the manufacture of wine in Washington.”¹⁰⁹ Significantly, no provision of Title 66 of the RCW defines “produced,” “production,” or “manufactured” for purposes of winemaking or obtaining a domestic winery license.¹¹⁰ Section 66.04.010(27) does define “manufacturer” as “a person engaged in the preparation of liquor for sale, in any form whatsoever,”¹¹¹ yet the statute contains no definition of preparation.¹¹²

In response to confusion regarding the exact definition of a winery in Washington, WSLCB deputy director Rick Garza recently stated that in order to hold a domestic winery license a company must either “crush, age, bottle, or blend wine at its facility.”¹¹³ Thus, in Garza’s opinion wineries with a single barrel of aging wine on the licensed premises are “not meeting the requirements of what an in-state winery needs to do to [maintain] that license.”¹¹⁴

According to Jean Leonard, director of the Washington Wine Institute, the requirements for holding a domestic winery license are far from clear—in reality, wineries “don’t know” and law enforcement officials “are confused” about how licensing rules apply to virtual wineries, which creates a risk of “uneven enforcement.”¹¹⁵ Furthermore, according to Leonard, Washington wineries that do not actually produce wine by fermentation on the licensed premises run afoul of the requirements of a federal basic bonded winery permit.¹¹⁶

106. WASH. REV. CODE § 66.24.170(3).

107. *Id.* § 66.24.170(4); *see also* WASH. STATE LIQUOR CONTROL BD., *supra* note 104, at 2.

108. WASH. REV. CODE § 66.04.010(16) (2010).

109. *Id.* § 66.24.170(2).

110. *See id.* § 66.04.010(1)–(49).

111. *See id.* § 66.04.010(27) (emphasis added).

112. *See id.*

113. Steve Wilhelm, *Washington Wine: Ferment over Defining a ‘Winery?’*, PUGET SOUND BUS. J. (Apr. 15, 2011), <http://www.bizjournals.com/seattle/print-edition/2011/04/15/source-of-ferment-whats-a-winery.html?page=all>.

114. *Id.*

115. Mitham, *supra* note 22.

116. *Hearing on H.B. 1641*, *supra* note 48.

In light of this statutory ambiguity and resulting confusion, the WSLCB enlisted the aid of the Washington Wine Institute in crafting legislation that would both clarify Washington domestic winery license requirements and bring all Washington wineries into compliance with federal law.¹¹⁷

III. HOUSE BILL 1641 PROPOSES TO AMEND WASHINGTON'S WINERY LICENSING LAWS TO LICENSE VIRTUAL WINERIES AS RETAILER-WHOLESALEERS

Following discussions between the WSLCB and wine industry stakeholders, Representatives Samuel Hunt, David Taylor, and Eric Pettigrew introduced House Bill 1641 in the January 2011 legislative session. House Bill 1641 seeks to amend various provisions of RCW Title 66 pertaining to the domestic winery license.¹¹⁸

First, the bill would amend RCW sections 66.04.010(16) and (27) to define a “domestic winery” as “a premises licensed under RCW 66.24.170” and a “manufacturer” as “a person engaged in the production or other preparation of liquor.”¹¹⁹ Second, the bill would add a new section to RCW 66.04.010 defining “production” with respect to wine as “the creation of wine by fermentation in or on the premises licensed under RCW 66.04.010.”¹²⁰ House Bill 1641 would thus clearly associate wine production with fermentation as opposed to other winemaking processes like crushing and blending.

In addition to its proposed definitional changes, House Bill 1641 seeks to divide the current domestic winery license into Class A and Class B categories.¹²¹ Crucially, the Class A license would allow for production, not manufacture, of wine.¹²² Because House Bill 1641 defines wine production as fermentation, all Class A licensees by definition would be required to produce wine on their premises by fermentation.¹²³ In addition, there would be a 200-gallon per year minimum production requirement, and wine purchased from another Class A winery could not count toward this total.¹²⁴ Class A licensees

117. *Id.*

118. H.B. 1641, 62nd Leg., Reg. Sess. (Wash. 2011).

119. *Id.* § 1.

120. *Id.*

121. *Id.* § 2.

122. *Id.* § 2(2).

123. *Id.*

124. *Id.*

would be allowed to use common carriers to deliver up to one hundred cases of wine per month directly to licensed Washington retailers.¹²⁵ They would also be able to sell their wine directly to consumers at qualifying farmers' markets.¹²⁶ The Class A license would be unavailable to virtual wineries because they lack physical premises to manufacture wine in or on.¹²⁷ It would also be unavailable to wineries that principally blend wine rather than produce it by fermentation.¹²⁸

Unlike the Class A license, the Class B license would not allow for production of wine.¹²⁹ Rather, it would allow for the purchase and resale of wine produced from grapes or other agricultural products by Class A licensees or by approved out-of-state producers.¹³⁰ While Class B licensees would be able to sell wine produced for or purchased by them at retail, they would not be permitted to use common carriers for deliveries or to sell their wine at farmers' markets.¹³¹ Should House Bill 1641 pass, a significant percentage of current wineries (estimated at thirty percent or more) would be required to transfer to the Class B license.¹³²

House Bill 1641 was assigned to the State Government & Tribal Affairs Committee on January 27, 2011.¹³³ On five occasions the bill was reintroduced and retained in its present status.¹³⁴ A public hearing was held on January 25, 2012, in which wine industry stakeholders made statements both for and against the bill.¹³⁵ As of this writing, House Bill 1641 remains in committee.¹³⁶

125. *Id.*

126. *Id.* § 4(1).

127. *See* THE BUSINESS OF WINE: AN ENCYCLOPEDIA, *supra* note 8, at 253 (“[A] virtual winery is a brand without a winery.”).

128. *See* H.B. 1641, § 2(2). This is because House Bill 1641 requires wineries to produce an average of 200 gallons of wine per year *by fermentation*, and wine purchased from another Class A winery could not count toward this total. *Id.*

129. *Id.* § 2(3)(a)(ii).

130. *Id.* § 2(3).

131. *See id.* §§ 2(3), 4(1).

132. STATE GOV'T & TRIBAL AFFAIRS COMM., *supra* note 28.

133. *Id.*

134. *Id.*

135. *Id.*

136. *See id.*

A. *Original House Bill 1641 Prompted Opposition from Family Wineries of Washington State*

In its original form, House Bill 1641 prompted considerable opposition from Family Wineries of Washington State (FWWS), an industry advocacy organization concerned with clarifying and protecting the rights of Washington's small wineries.¹³⁷ Among FWWS's chief objections to House Bill 1641 are its provisions creating two classes of wineries, setting a minimum annual output requirement, and defining wine production to necessarily include fermentation.¹³⁸

According to FWWS, there is no basis in federal law for these new provisions, despite proponents' stated goal of bringing Washington wineries into compliance with such law.¹³⁹ Overall, FWWS fears that House Bill 1641 would result in harm to Washington's "tiny artisan wineries" by forcing them to either spend more money in order to produce enough wine by fermentation to qualify for a Class A license, or switch to the Class B license and find themselves at a competitive disadvantage as "second class wineries."¹⁴⁰

While FWWS does not object to creating a new license recognizing the rights of "non-manufacturing wholesalers" (i.e., virtual wineries), it does oppose the imposition of fermentation requirements on small wineries that "choose to manufacture wine by blending or other methods allowed by federal law."¹⁴¹ To this end, FWWS suggests removing all instances of the words "produced" and "production" in House Bill 1641 pertaining to the Class A license and replacing them with "manufactured" or "manufacture."¹⁴² Because the term manufacture is broader than production—it encompasses methods of winemaking other than fermentation—FWWS's proposed changes would expand the definition of a Class A winery to allow wineries that make wine by

137. See *What We Do and What We Stand For: A Small Winery's Bill of Rights*, FAMILY WINERIES OF WASH. STATE, <http://familywineriesofwashington.com/rights.html> (last visited Aug. 23, 2012); FAMILY WINERIES OF WASH. STATE, FWWS OPPOSES H.B. 1641 (hereinafter FWWS OPPOSES) (on file with Washington Law Review).

138. See FWWS OPPOSES, *supra* note 137.

139. Letter from Bd., Family Wineries of Wash. State, to Rep. Samuel Hunt, Chair, H. State Gov't & Tribal Affairs Comm. (on file with Washington Law Review).

140. See *id.* FWWS points out that Class B licensees would not have the right to ship via common carriers, would not be allowed to operate off-premises tasting rooms, or sell wine at farmers' markets. *Id.*

141. *Id.*

142. *Id.*

blending rather than fermentation to qualify for the Class A license.¹⁴³

B. Representative Hunt's Proposed Substitute House Bill 1641 Retains Key Features of Original House Bill 1641 and Has Prompted Similar Opposition from FWWS

While House Bill 1641 was in committee, Representative Samuel Hunt proposed Substitute House Bill 1641.¹⁴⁴ Hunt's substitute bill retains many of the original bill's key features.¹⁴⁵ It requires a 200-gallon annual production minimum, though compliance would be calculated on the basis of a three-year average as opposed to a single year's output.¹⁴⁶ Hunt's substitute bill also retains the original bill's definition of production as fermentation of wine "in or on" the licensed premises.¹⁴⁷

However, Hunt's substitute bill differs from the original version of House Bill 1641 in its approach to the new winemaking license category.¹⁴⁸ Whereas the original bill would divide the current domestic winery license into two sub-categories,¹⁴⁹ Hunt's substitute bill would retain the current single domestic winery license and create a new, entirely separate license for "nonproducing wine sellers."¹⁵⁰ Holders of the "nonproducer" license would be required to qualify as manufacturers of wine under section 66.04.010(27) of the RCW.¹⁵¹

Like the proposed Class B winery license, the proposed nonproducer license would allow for the purchase of wine for resale, but not for the production of wine.¹⁵² Also like the proposed Class B winery license, holders of the proposed nonproducer license would not be permitted to use common carriers for deliveries or to sell wine at farmers' markets.¹⁵³

143. *Id.*

144. H. 62-3855.4/12, Reg. Sess. (Wash. 2011) (as introduced by Rep. Hunt).

145. *Compare id.*, with H.B. 1641, 62nd Leg., Reg. Sess. (Wash. 2011).

146. H. 62-3855.4/12 §§ 3-4.

147. *Id.* § 8(35).

148. *See id.* §§ 4-5.

149. *See* H.B. 1641.

150. H. 62-3855.4/12 §§ 3(3), 4(3).

151. *Id.* § 5(5). Section 66.04.010(27) of the Revised Code of Washington defines a "manufacturer" as "a person engaged in the preparation of liquor for sale, in any form whatsoever." WASH. REV. CODE § 66.04.010(27) (2010).

152. H. 62-3855.4/12 § 5(2).

153. *See id.* § 5(3). As opposed to licensed "nonproducers," licensed domestic wineries would be allowed to use common carriers for deliveries of up to one hundred cases per month to licensed retailers, and to apply for an endorsement to sell wine at qualifying farmers' markets. *Id.* §§ 3(5), (7)(a).

Unlike original House Bill 1641, Hunt's proposed substitute bill identifies specific activities, in addition to resale, that would be permitted under the nonproducer license. These include blending or bottling wine purchased in bulk, serving samples of wine at the licensed premises, and donating wine to nonprofit organizations.¹⁵⁴ The substitute bill also specifies that the nonproducer license could be converted to a domestic winery license upon a finding by the WSLCB that "the licensee is capable of satisfying all of the requirements necessary for the issuance of such domestic winery license."¹⁵⁵

FWWS voiced opposition to Hunt's proposed Substitute House Bill 1641 on the same grounds that it objected to the original bill.¹⁵⁶ Specifically, FWWS opposes Substitute House Bill 1641's minimum annual production requirement and definition of wine production as fermentation only.¹⁵⁷ FWWS believes that these two provisions combined will force many small wineries that create wine by blending rather than by fermentation (i.e., by manufacturing not production) to switch to the nonproducers license, which will not carry the same privileges as the domestic winery license.¹⁵⁸ For instance, wineries licensed as nonproducers would lose their ability to ferment, to sell wine at farmers' markets, and to use common carriers for deliveries.¹⁵⁹

C. Representative Condotta's Proposed Substitute House Bill 1641 Addresses FWWS's Primary Concerns but Would Still License Virtual Wineries as Retailers

In response to Representative Hunt's substitute bill, Representative Cary Condotta presented his own Substitute House Bill 1641.¹⁶⁰ Unlike the first two versions of House Bill 1641, Condotta's substitute bill would address FWWS's primary concerns.¹⁶¹ Essentially, Condotta's substitute bill would preserve the current domestic winery license by eliminating the new definition of "production," using the term "manufacture" in place of "produce" in sections pertaining to the domestic winery license, and abolishing the minimum annual output

154. *Id.*

155. *Id.* § 5(4).

156. *See* Letter from Bd., Family Wineries of Wash. State, *supra* note 139.

157. *See id.*

158. *Id.*

159. *Id.*

160. H. 62-334, Reg. Sess. (Wash. 2011) (as introduced by Rep. Condotta).

161. *See id.*; *see also* Letter from Bd., Family Wineries of Wash. State, *supra* note 139.

requirement for domestic wineries.¹⁶² Thus, under Condotta's bill, domestic wineries would not be required to produce any quantity of wine by fermentation and would continue to be able to manufacture wine by methods like blending.¹⁶³ By striking the new definition of "production" and removing all instances of the term in provisions relating to the domestic winery license, Condotta's bill clarifies that winery licensees may produce by fermentation or by other methods included within the broader term of "manufacture" and rejects House Bill 1641's emphasis on production by fermentation as a hard-and-fast requirement of winery licensees.

Condotta's substitute bill mirrors Hunt's by creating a new license category separate from the domestic winery license, as opposed to a sub-category of the domestic winery license as in the original version.¹⁶⁴ However, Condotta's bill would rename the nonproducer license a *négociant* license.¹⁶⁵ As discussed previously, a *négociant* generally purchases finished wine in bulk for resale under the *négociant*'s brand name.¹⁶⁶ Unlike virtual winemakers, *négociants* typically do not control the winemaking process.¹⁶⁷

Holders of Condotta's *négociant* license would be permitted to engage in the same activities as holders of Hunt's proposed nonproducer license, namely to purchase wine for resale, serve samples at the licensed premises, and donate wine to non-profit organizations.¹⁶⁸ However, Condotta's *négociant* license differs from the original bill's Class B license and Hunt's nonproducer license in that holders would not be barred from producing wine.¹⁶⁹

IV. STATE WINERY LICENSING DECISIONS DIRECTLY IMPACT WINERIES' ACCESS TO CONSUMERS VIA INTERSTATE DIRECT SHIPPING

The impact of state winery licensing laws extends beyond local policy

162. H. 62-334.

163. *See id.*

164. *Id.* at 3–4.

165. *Id.*

166. THE BUSINESS OF WINE: AN ENCYCLOPEDIA, *supra* note 8, at 253 ("Négociants . . . are opportunistic buyers and have no control over their raw material."); MENDELSON, *supra* note 44, at 164–65.

167. THE BUSINESS OF WINE: AN ENCYCLOPEDIA, *supra* note 8, at 253.

168. *See* H. 62-334 §§ 1–3, 5.

169. *Id.* at § 3–4. Condotta's Substitute House Bill 1641 retains the original bill's definition of "production" as "fermentation." H. 62-334 § 2.

into the realm of interstate commerce.¹⁷⁰ This is because many states allow operations licensed as wineries to ship wine directly to in-state consumers but prohibit operations licensed as wholesalers or retailers from doing so.¹⁷¹ This distinction in treatment of wineries versus wine retailers or wholesalers for purposes of interstate direct shipping has thus far survived constitutional challenge in federal courts.¹⁷²

A. *Wineries Licensed as Producers Enjoy Commerce Clause Protection Under Granholm v. Heald*

In *Granholm v. Heald*,¹⁷³ a group of small wineries and wine consumers challenged New York and Michigan laws¹⁷⁴ permitting in-state wineries to ship wine directly to consumers but prohibiting out-of-state wineries from doing the same.¹⁷⁵ Under the challenged Michigan laws, both in-state and out-of-state producers of alcoholic beverages were permitted to distribute only through licensed in-state wholesalers, part of Michigan's three-tier system.¹⁷⁶ An exception to this requirement allowed in-state wineries to apply for a winemaker license that permitted "direct shipment to in-state consumers."¹⁷⁷ Out-of-state wineries, by contrast, could only sell wine to in-state wholesalers.¹⁷⁸ The challenged New York laws similarly exempted in-state wineries from New York's

170. See MENDELSON, *supra* note 44, at 163 n.58.

171. *Id.* (citing TEX. ALCO. BEV. CODE ANN. §§ 54.01, .03 (West 2010) as an example) (requiring holders of out-of-state winery direct shipment permits to hold state and federal licenses allowing for "winery" operation).

172. See *Siesta Vill. Mkt. LLC v. Steen*, 595 F.3d 249 (5th Cir. 2010), *abrogated by* *Wine Country Gift Baskets.com v. Steen*, 612 F.3d 809 (5th Cir. 2010); *Wine Country Gift Baskets.com v. Steen*, 612 F.3d 809 (5th Cir. 2010), *cert. denied*, ___ U.S. ___, 131 S. Ct. 1602 (2011); *Brooks v. Vassar*, 462 F.3d 341 (4th Cir. 2006).

173. 544 U.S. 460 (2005).

174. The laws at issue were: MICH. COMP. LAWS ANN. §§ 436.1109(9), .1113(9) (West 2001), §§ 436.1525(1)(e), .1537(2)–(3) (West Supp. 2004); MICH. ADMIN. CODE r. 436.1011(7)(b) (2003), 436.1719(5) (2000); N.Y. ALCO. BEV. CONT. LAW §§ 3(37), 76-a(3) (McKinney 2005). *Granholm*, 544 U.S. at 469–70.

175. See 544 U.S. at 465–66.

176. *Id.* at 469 (citing MICH. COMP. LAWS ANN. §§ 436.1109(1), .1305, .1403, .1607(1) (West 2000); MICH. ADMIN. CODE r. 436.1705 (1990), 436.1719 (2000)). A three-tier system generally involves "separate and distinct manufacturers, wholesalers, and retailers, with alcoholic beverages passing from one level to the next and ultimately to the consumer." MENDELSON, *supra* note 44, at 29.

177. *Granholm*, 544 U.S. at 469 (citing MICH. COMP. LAWS ANN. § 436.1113(9) (West 2001), § 436.1537(2)–(3) (West Supp. 2004); MICH. ADMIN. CODE r. 436.1011(7)(b) (2003)).

178. *Id.* (citing MICH. COMP. LAWS ANN. § 436.1109(9) (West 2001), § 436.1525(1)(e) (West Supp. 2004); MICH. ADMIN. CODE r. 436.1719(5) (2000)).

three-tier system, allowing them to make direct sales to consumers rather than to licensed wholesalers.¹⁷⁹ Out-of-state wineries were only permitted to ship directly to New York consumers if they established a physical presence in New York.¹⁸⁰

The three-tier system of alcohol distribution discussed in *Granholm* is designed to ease state regulation of liquor sales and to protect state tax revenues.¹⁸¹ The three tiers generally correspond to manufacturers, wholesalers, and retailers.¹⁸² In states utilizing the three-tier system, all alcoholic beverages must pass through all three tiers before ultimately reaching the consumer.¹⁸³ However, like Michigan and New York, some states made exceptions to the three-tier system requirements for in-state wineries (e.g., allowing them to sell wine directly to retailers) while subjecting out-of-state wineries to the burdensome three-tier process.¹⁸⁴ *Granholm* addressed the constitutionality of this disparate treatment. The Court held that the challenged New York and Michigan laws impermissibly discriminated against “interstate commerce in violation of the Commerce Clause.”¹⁸⁵

The Court reasoned that while the Twenty-First Amendment grants states the power to regulate liquor, it does not allow them to “ban, or severely limit, the direct shipment of out-of-state wine while simultaneously authorizing direct shipment by in-state producers.”¹⁸⁶ Rather, the Court held, “if a State chooses to allow direct shipment of wine, it must do so on even-handed terms.”¹⁸⁷

Michigan and New York argued that “any decision invalidating their direct-shipment laws would call into question the constitutionality of the three-tier system.”¹⁸⁸

In response to the states’ argument, the Court reasoned that although it had previously endorsed the three-tier system as an “unquestionably legitimate” exercise of states’ Twenty-First Amendment powers, the

179. *Id.* at 470 (citing N.Y. ALCO. BEV. CONT. LAW § 76-a(3) (McKinney 2005)).

180. *Id.* (citing N.Y. ALCO. BEV. CONT. LAW § 3(37) (McKinney 2005)).

181. See RICHARD MENDELSON, FROM DEMON TO DARLING: A LEGAL HISTORY OF WINE IN AMERICA 117 (2009) (“These requirements are designed to ensure market accountability and payment of taxes, minimize diversion, and insulate the in-state retailer from the out-of-state producer.”).

182. See *id.* at 116.

183. *Id.*

184. *Id.*

185. *Granholm*, 544 U.S. at 466.

186. *Id.* at 493.

187. *Id.*

188. *Id.* at 488.

Amendment does not protect state policies that treat liquor produced in-state differently from liquor produced out-of-state through exceptions to the three-tier system rules.¹⁸⁹ Thus, if Michigan and New York wished to allow their in-state wineries to bypass the three-tier system and sell directly to consumers, they would have to extend that privilege to out-of-state wineries as well.¹⁹⁰

In the years following *Granholm*, many states accordingly took an “all or nothing” approach—either allowing direct shipment of wine from both in-state and out-of-state wineries, or prohibiting direct shipment altogether.¹⁹¹ Currently, twelve states prohibit direct shipment entirely while the rest permit direct shipment generally or with certain restrictions (e.g., a reciprocity requirement between the sending and receiving state).¹⁹²

B. The Circuit Courts Have Refused to Extend Granholm to Licensed Wine Retailers and Wholesalers

After *Granholm*, wine retailers mounted Commerce Clause challenges to state laws impeding interstate direct sales and shipment of wine.¹⁹³ In *Brooks v. Vassar*,¹⁹⁴ decided one year after *Granholm*, Virginia wine consumers and out-of-state wine retailers challenged provisions of Virginia’s Alcoholic Beverage Control Act,¹⁹⁵ which limited the amount of alcohol consumers could carry into the state for personal use.¹⁹⁶ The plaintiff wine consumers and retailers argued that the Act’s “Personal Import Exception” violated the Commerce Clause by discriminating against out-of-state wine retailers in favor of in-state retailers.¹⁹⁷ Specifically, the plaintiffs argued that the Personal Import Exception discriminated against interstate commerce because it limited the amount of wine Virginia consumers could import from out-of-state wine retailers while permitting unlimited purchases of wine from

189. *Id.* at 489 (citing *North Dakota v. United States*, 495 U.S. 432, 432 (1990)).

190. *Id.*

191. Matthew Dickson, *All or Nothing: State Reaction in the Wake of Granholm v. Heald*, 28 WHITTIER L. REV. 491, 504–08 (2006).

192. FREE THE GRAPES!, <http://www.freethegrapes.org> (last visited Nov.11, 2011).

193. MENDELSON, *supra* note 181, at 116.

194. 462 F.3d 341 (4th Cir. 2006).

195. VA. CODE §§ 4.1-100–4.1-517 (2008).

196. *Brooks*, 462 F.3d at 349. The provisions challenged generally provided for a “Personal Import Exception” to the rule that all alcohol imported into the state pass through the three-tier system. *Id.* at 346.

197. *Id.* at 344–45.

Virginia retailers.¹⁹⁸

The Fourth Circuit reasoned that the plaintiffs' comparison of out-of-state versus in-state retailers' ability to sell wine to consumers in Virginia amounted to a challenge of "the three-tier system itself," which allows states to control alcohol sales within their borders, and which the Supreme Court upheld as "unquestionably legitimate" in *Granholm*.¹⁹⁹ Like many states, Virginia had amended its alcohol laws after *Granholm* to limit direct sales of wine to in-state licensed retailers only.²⁰⁰ According to the *Brooks* court's reasoning, because all wine (both domestic and out-of-state) had to pass through Virginia's three-tier system (except for limited amounts brought in under the Personal Import Exception), the State had abided by *Granholm's* requirement of regulating in-state and out-of-state wine even-handedly.²⁰¹ Thus, the court upheld Virginia's Personal Import Exception as a valid exercise of the State's Twenty-First Amendment power.²⁰²

In *Siesta Village Market LLC v. Steen*²⁰³ and *Wine Country Gift Baskets.com v. Steen*,²⁰⁴ both decided in 2010, the Fifth Circuit similarly declined to extend the holding in *Granholm* to wine retailers.²⁰⁵ In both cases, out-of-state wine retailers challenged various provisions of the Texas Alcoholic Beverage Code²⁰⁶ as unconstitutional under the Commerce Clause on the ground that they only permitted retailers with a physical presence in the state to ship wine directly to consumers.²⁰⁷

The court in *Wine Country Gift Baskets* reasoned that because *Granholm* only "prohibited discrimination against out-of-state products

198. *Id.* at 350.

199. *Id.* at 352 (reasoning that "an argument that compares the status of an in-state retailer with an out-of-state retailer—or that compares the status of any other in-state entity under the three-tier system with its out-of-state counterpart—is nothing different than an argument challenging the three-tier system itself").

200. *Id.* at 350.

201. *See id.* at 352 (noting that the plaintiffs' argument was foreclosed by the Twenty-First Amendment because "[a]s the ABC Act now stands, all out-of-state suppliers of wine are required by Virginia to sell in Virginia through the three-tier system . . . the Personal Import Exception does not favor in-state wineries") (emphasis in original).

202. *Id.* at 355.

203. 595 F.3d 249 (5th Cir. 2010), *abrogated by* *Wine Country Gift Baskets.com v. Steen*, 612 F.3d 809 (5th Cir. 2010).

204. 612 F.3d 809 (5th Cir. 2010), *cert. denied*, __ U.S. __, 131 S. Ct. 1602 (2011).

205. *See generally* *Siesta Vill. Mkt.*, 595 F.3d 249; *Wine Country Gift Baskets*, 612 F.3d 809.

206. The challenged provisions were TEX. ALCO. BEV. CODE §§ 6.01, 11.01, 22.01, 22.03, 24.01, 24.03, 37.01, 37.03, 41.01, 43.04, 54.12, 107.05(a), 107.07(a), (f) (2007). *Siesta Vill. Mkt.*, 595 F.3d at 261; *Wine Country Gift Baskets*, 612 F.3d at 821.

207. *See Siesta Vill. Mkt.*, 595 F.3d at 258–59, *Wine Country Gift Baskets*, 612 F.3d at 818–19.

or *producers*,”²⁰⁸ Texas had not violated *Granholm’s* holding by allowing in-state retailers to make deliveries but prohibiting out-of-state retailers from doing the same.²⁰⁹ Moreover, the courts concluded, because out-of-state retailers are “not similarly situated” to Texas retailers, they “cannot make a logical argument of discrimination.”²¹⁰ Specifically, as opposed to wine *producers*, wholesalers and retailers may legitimately be required under state law to maintain an in-state presence.²¹¹ Thus, the court concluded that “because of *Granholm* and its approval of three-tier systems . . . Texas may authorize its in-state, permit-holding retailers to make sales and may prohibit out-of-state retailers from doing the same.”²¹²

The holdings in the wine retailer cases demonstrate that courts distinguish between winery-to-consumer transactions and retailer-to-consumer transactions for Commerce Clause purposes because they view the latter as a normal part of state three-tiered distribution systems.²¹³ This is significant because the Supreme Court in *Granholm* endorsed three-tiered distribution systems as “unquestionably legitimate.”²¹⁴ Finally, in March 2011, the Supreme Court denied certiorari on *Wine Country Gift Baskets*, leaving the Fifth Circuit’s decisions undisturbed.²¹⁵ Given these developments in federal case law, wineries licensed as retailers or wholesalers are more vulnerable to protectionist wine sales and shipping laws than those licensed as producers.²¹⁶ Virtual wineries, in particular, face reduced access to out-of-state consumers via e-commerce.

V. OREGON AND CALIFORNIA PROVIDE ALTERNATIVE LICENSING MODELS FOR VIRTUAL WINERIES

Both Oregon and California offer licensing options for virtual wineries. While California licenses virtual wineries separately from traditional wineries, Oregon accords the same license to both types of

208. *Wine Country Gift Baskets*, 612 F.3d at 820 (emphasis added).

209. *Id.*

210. *Id.*

211. *Id.*

212. *Id.* at 819.

213. MENDELSON, *supra* note 181, at 185–86.

214. *Granholm v. Heald*, 544 U.S. 460, 466 (2005); *see also* MENDELSON, *supra* note 181, at 185–86.

215. *Wine Country Gift Baskets.com v. Steen*, 612 F.3d 809 (5th Cir. 2010), *cert. denied*, ___ U.S. ___, 131 S. Ct. 1602 (2011).

216. *See* MENDELSON, *supra* note 44, at 163.

wineries.²¹⁷ The winery licensing laws of Oregon and California provide alternative models to those schemes currently proposed in the various versions of HB 1641.

A. *California Licenses Virtual Wineries Separately as Retailer-Wholesalers*

California is the nation's number one wine producing state.²¹⁸ Like Washington, California is home to both traditional and virtual wineries.²¹⁹ As of February 2012, virtual wineries accounted for roughly twenty-three percent of California's total wineries.²²⁰

California's Constitution and the Alcoholic Beverage Control Act (ABC Act) vest the Department of Alcoholic Beverage Control (ABC) with authority to license winery operations.²²¹ Under the ABC Act, traditional wineries must apply for a Type 02 winegrower's license.²²² The Type 02 winegrower's license allows holders to manufacture or produce wine.²²³ It also allows holders to conduct tastings on the licensed premises, sell wine to any licensed wine seller, sell wine to consumers for on- or off-premises consumption, and sell wine for exportation.²²⁴ In order to qualify for a Type 02 winegrower's license, applicants must own "facilities and equipment for the conversion of fruit into wine."²²⁵ Applicants must also hold a federal basic bonded winery permit "to produce and blend wine."²²⁶

In addition to the Type 02 winegrower's license, the ABC also offers a Type 22 wine blender's license.²²⁷ This license is intended for persons who hold federal basic bonded wine cellar permits but lack facilities or equipment for the conversion of fruit into wine and do not engage in the

217. *See infra* Parts V.A, B.

218. *US/California Wine Production*, WINE INST., <http://www.wineinstitute.org/resources/statistics/article83> (last visited June 17, 2012). On average, California produces 90 percent of the nation's wine. *Id.*

219. Cathy Fisher, *Number of U.S. Wineries: Count Reaches 7,116, Up 5 Percent in 2012 Compared to 9 Percent Year Before*, WINE BUS. MONTHLY, Feb. 2012, at 88, 88.

220. *Id.*

221. CAL. CONST. art. XX, § 22; CAL BUS. & PROF. CODE § 23300 (West 2009).

222. CAL. BUS. & PROF. CODE § 23356 (West 2009).

223. *Id.* California's ABC Act does not define "produce" or "manufacture" for purposes of qualifying for a Type 02 winegrower's license. *Id.* §§ 23000–47.

224. *Id.* §§ 23356.1, 23356, 23358.

225. *Id.* § 23013.

226. *Id.* § 23770.

227. *Id.* § 23013.5.

production of wine.²²⁸ Licensed wine blenders have the same privileges as licensed winegrowers, except that wine blenders may not crush and ferment fruit to produce wine; hold a duplicate license as a winegrower; buy, sell, receive, or deliver wine from persons other than authorized licensees; or sell and deliver wine to consumers for off-premises consumption.²²⁹

Finally, California virtual wineries that custom crush at a host winery may apply for a combination Type 17 beer and wine wholesaler's license and a Type 20 off-sale beer and wine license (known as a 17/20 license). The Type 17 license does not allow for production of wine, but allows for the sale of wine to other licensees for resale.²³⁰ It also allows for bottling, labeling, and exportation of wine.²³¹ The Type 20 license authorizes the sale of wine to consumers for off-premises consumption.²³² Holders of the 17/20-combination license are not allowed to conduct wine tastings, and have limited access to consumers in other states compared to licensed winegrowers.²³³

The ABC recently created a new license option—the Type 85 license—for virtual wineries that wish to sell wine exclusively via the internet.²³⁴ Before the creation of this Type 85 license, persons desiring to sell wine directly to consumers over the internet were required to hold the Type 17/20 combination license.²³⁵ The Type 85 license simply allows for the sale of wine via the internet without also requiring a Type 17 wholesaler's license.²³⁶ However, it is important to note that holders of the Type 85 license are limited to internet sales only.²³⁷ They are prohibited from maintaining premises open to the public and from conducting tastings.²³⁸

In sum, California licenses its virtual wineries separately from its traditional wineries.²³⁹ This bifurcated licensing regime affords virtual

228. *Id.*

229. *Id.* § 23356.5.

230. *Id.* § 23027.

231. *Id.* §§ 23378–79.

232. *Id.* §§ 23393–94.7.

233. *Id.* § 23356.1; *see also* MENDELSON, *supra* note 44, at 163.

234. CAL. ALCOHOLIC BEVERAGE CONTROL, INDUSTRY ADVISORY: LIMITED OFF-SALE WINE LICENSE (Dec. 22, 2011) (on file with Washington Law Review); CAL BUS. & PROF. CODE § 23393.5.

235. CAL. ALCOHOLIC BEVERAGE CONTROL, *supra* note 234.

236. *Id.*

237. *Id.*

238. *Id.*

239. *See supra* notes 221–38 and accompanying text.

wineries limited access to consumers relative to traditional wineries, both in terms of sales methods and ability to conduct tastings. Unlike California, Washington currently offers only one type of winery license.²⁴⁰ Both Hunt's and Condotta's substitute versions of House Bill 1641 would amend Washington's winery licensing regime to resemble California's by creating separate license categories for virtual and traditional wineries.²⁴¹

B. Oregon Offers the Same License to Both Traditional Wineries and Virtual Wineries

Until recently, Oregon's domestic winery statute provided that "in order to hold a winery license the licensee shall principally produce wine or cider in this state."²⁴² In June 2011, the Oregon State Legislature passed a law initiated by the Oregon Winegrower's Association (OWA)²⁴³ amending the statutory requirements for winery licensees.²⁴⁴ Under Oregon's new winery statute, licensees must either: (a) possess a valid producer and blender basic permit from the TTB at a bonded premises within Oregon; or (b) possess a valid wine blender or wine wholesaler basic permit from the TTB, and have a written contract with a winery licensed under (a) that authorizes the winery to produce a brand of wine that is under the licensee's control.²⁴⁵ The new law defines "control" as either owning the brand under which the wine is labeled, or performing, or having the legal right to perform, the acts of an owner of a trademark, license, or similar agreement.²⁴⁶

According to Farshad Allahdadi, Director of License Services at the Oregon Liquor Control Commission (OLCC), a primary objective of the winery legislation was to clarify the privileges and obligations of Oregon winery licensees, particularly the type of federal licenses they were

240. WASH. REV. CODE § 66.24.170(1) (2011) ("There shall be *a* license for domestic wineries.") (emphasis added).

241. *See supra* Parts III B, C.

242. OR. REV. STAT. ANN. § 471.223(3) (West 2003).

243. OWA is a "voluntary membership-based organization that provides legislative and regulatory advocacy and lobbying for the Oregon wine grape and wine industry." *About OWA*, OR. WINEGROWER'S ASS'N, <http://industry.oregonwine.org/oregon-winegrowers-association/about-owa> (last visited July 7, 2012).

244. *See* 2011 Or. Laws 1 2011 (though passed in June 2011, the amendments to ORS § 471.223 do not become operative until Jan. 1, 2014).

245. *Id.* at § 3(a), (b).

246. *Id.* at § 1.

required to hold.²⁴⁷ The OLCC had previously proposed a bill that would have created a separate license for Oregon virtual wineries.²⁴⁸ However, Allahdadi testified that the OLCC felt confident that its objectives could be accomplished with just one license type, and that the legislation “successfully balanc[ed] the interests of the wine industry and the regulatory needs of the state.”²⁴⁹

According to Dan Jarman, a lobbyist for the OWA, another primary objective of the winery legislation was to delineate the regulatory privileges and obligations of Oregon’s different winery operations without putting virtual wineries at a competitive disadvantage for purposes of interstate direct shipping.²⁵⁰ Jarman testified that the OWA wanted to make virtual winemaking a subcategory of the current winery license as opposed to creating a new custom crush license because some states do not recognize custom crush licenses and only allow licensed wineries to ship wine directly to residents.²⁵¹ Jarman also noted that virtual winemaking was a significant business in Oregon, with approximately 100 virtual wineries out of approximately 500 licensed wineries.²⁵² According to Jarman, the new winery licensing law would facilitate aspiring winemakers’ entry into the industry by allowing them to ship directly to more consumers.²⁵³

Similar objectives and concerns underlie the debates surrounding Washington’s House Bill 1641.²⁵⁴ As in Oregon, the emergence of new wine business models in Washington (such as custom crushing) necessitates revision and clarification of the former winery statute aimed at traditional wine production.²⁵⁵ And as in Oregon, industry stakeholders are concerned about the impact that new winery legislation

247. *Hearing on H.B. 2633 Before the H. Comm. on Bus. & Labor*, 2011 Leg., Reg. Sess. (Or. Mar. 9, 2011) (hereinafter *Oregon Hearing*) (statement of Farshad Allahdadi), available at <http://www.leg.state.or.us/listn/> (to access the speech, click “2011 Session” under “Audio Archives,” then “Archives of Committee Meetings from the 2011 Session,” then “Business and Labor” under “House Committees,” and finally, “03/09/2011”).

248. *Id.* See also H.B. 2150, 76th Leg., Reg. Sess. (Or. 2011).

249. *Oregon Hearing*, *supra* note 247.

250. *Oregon Hearing*, *supra* note 247 (statement of Dan Jarman).

251. *Id.*

252. *Id.*

253. *Id.*

254. See *supra* notes 113–17, 138–40 and accompanying text.

255. *Hearing on H.B. 1641*, *supra* note 48 (statements of Jean Leonard and Rick Garza); cf. Theresa Van Winkle, Staff Measure Summary, H.B. 76-2633, (Or. 2011) (H. Comm. on Bus. & Labor) (both linking the emergence of new wine business models with a need to clarify the rights and obligations of winery licensees).

may have on their competitiveness both in and out of state.²⁵⁶ In Oregon, state regulators and wine industry groups compromised to create a revised winery statute that both clarifies the types of activities required of winery licensees and encompasses traditional and non-traditional methods of wine production under the same license.²⁵⁷

VI. WASHINGTON SHOULD ADOPT OREGON'S WINERY LICENSING MODEL BECAUSE IT PROVIDES REGULATORY CLARITY AND MAXIMIZES VIRTUAL WINERIES' ACCESS TO CONSUMERS

The Washington Legislature should amend RCW 66.24.170 to clearly encompass virtual wineries. To this end, the Legislature should replace HB 1641 with a bill adding a provision to the current statute that would allow custom crush clients (i.e., virtual wineries) to qualify for a domestic winery license. Specifically, Washington lawmakers should adopt the language in Oregon's newly revised winery statute in a new subsection to current RCW 66.22.170, stating that "in order to qualify for a domestic winery license under this section, an applicant must either (a) possess at a bonded premises within Washington a valid blender and producer permit from the TTB, *or* (b) possess a valid wine blender *or* valid wine wholesaler basic permit from the TTB *and* have a written contract with a winery licensed under paragraph (a) that authorizes the winery to produce for the licensee a brand of wine that is under the licensee's control."²⁵⁸

Oregon's winery licensing scheme is an appropriate model for Washington because it meets the regulatory objectives of clarity and consistency without compromising the interests of any of the diverse components of Washington's wine industry. First, adopting Oregon's approach to winery licensing would satisfy the Washington Wine Institute and WSLCB's objectives of promoting regulatory clarity and bringing all Washington wineries into compliance with federal law.²⁵⁹ Oregon's revised winery statute makes clear the types of federal licenses applicants must hold in order to qualify for a domestic winery license.²⁶⁰ Second, it also promotes transparency by acknowledging the reality that many wineries contract out production operations without prohibiting

256. *See, e.g.*, FWWS OPPOSES, *supra* note 137.

257. 2011 Or. Laws 1 2011.

258. *Id.*

259. *Hearing on H.B. 1641, supra* note 48 (statements of Jean Leonard and Rick Garza).

260. 2011 Or. Laws 1 2011.

such wineries from obtaining domestic winery status.²⁶¹ Moreover, because it encompasses holders of federal producer's, blender's, and wholesaler's basic permits, Oregon's winery statute does not provide any incentive for Washington winemakers to apply for a federal permit whose requirements they will be unable to meet, in order to qualify for a domestic winery license at home.

Oregon's approach to winery licensing also satisfies concerns voiced by FWWS on behalf of Washington's small artisanal wineries that principally manufacture wine by blending rather than by fermentation.²⁶² Whereas original House Bill 1641 and Rep. Hunt's substitute version would demote wine blenders that do not produce a yearly average of 200 gallons of wine by fermentation from their current status as domestic wineries to either Class B or non-producing wineries,²⁶³ Oregon's approach would allow wine blenders to retain their current status.²⁶⁴ The Oregon approach simply requires that licensees who only hold a federal basic permit to blend (not produce) maintain valid contracts with their sources of bulk wine and exercise control over the wine brands they market and sell—both of which are common business practices.²⁶⁵ Additionally, adopting Oregon's approach would allow small, artisanal wineries to make appropriate business choices in a given year without risk of violating the terms of their domestic winery license.²⁶⁶ For example, if the owner of a small winery that both blends and produces wine by fermentation decides that a given year's crop of grapes is not worth making into wine, he or she could opt to only blend bulk wine that year, without fear of penalty.²⁶⁷

Beyond satisfying the concerns of regulators and small, artisanal wineries, adopting Oregon's model would benefit Washington's virtual wineries more than any of the three versions of House Bill 1641. All three versions of House Bill 1641 would license virtual wineries separately from domestic wineries.²⁶⁸ Such a licensing scheme poses

261. *Id.*

262. See FWWS OPPOSES, *supra* note 137.

263. See H.B. 1641, 62nd Leg., Reg. Sess. (Wash. 2011); H. 62-3855.4/12, Reg. Sess. (Wash. 2011) (as introduced by Rep. Hunt); FWWS OPPOSES, *supra* note 137.

264. See 2011 Or. Laws 1 2011. This is because the Oregon model allows wine blenders to qualify for a domestic winery license, and does not require domestic winery licensees to produce any specific amount of wine per year by fermentation. *Id.*

265. See MENDELSON, *supra* note 44, at 163.

266. 2011 Or. Laws 1 2011. This is because the Oregon model does not specify a minimum quantity of wine that licensees must produce by fermentation per year. *Id.*

267. *Hearing on H.B. 1641*, *supra* note 48 (statements of Mike Sheridan and John Bell).

268. See H.B. 1641; H. 62-3855.4/12, Reg. Sess. (Wash. 2011) (as introduced by Rep. Hunt); H.

problems for virtual wineries by jeopardizing their access to out-of-state consumers via direct shipment.²⁶⁹ Oregon legislators recognized that virtual wineries are a vital component of the state wine industry, and that virtual wineries rely heavily on access to consumers via internet sales.²⁷⁰ Thus, for both regulators and industry members, the most desirable winery licensing regime was one that met the regulatory objectives of clarity and transparency while simultaneously maximizing virtual wineries' access to consumers.²⁷¹

Adopting Oregon's approach to winery licensing would benefit the Washington wine industry generally, as well as wine consumers nationwide. As in Oregon, virtual wineries play an important role in Washington's wine industry by providing an "incubator" model for small start-up operations that may one day grow into traditional wineries.²⁷² Given recent developments in Commerce Clause and Twenty-First Amendment jurisprudence, licensing virtual wineries as retailers or wholesalers (as opposed to domestic wineries) could stunt their growth by limiting their access to consumers via direct shipping.²⁷³ Many small wineries rely heavily on e-commerce and other forms of direct-to-consumer shipping because they are unable to find and retain a distributor.²⁷⁴ Likewise, many out-of-state wine consumers rely on e-commerce and direct-to-consumer shipping to experience new Washington wines from small wineries that cannot be found on retail shelves.²⁷⁵ Adopting Oregon's winery licensing model would provide a fertile ground for Washington's "incubator" wineries and benefit wine consumers by maximizing virtual wineries' ability to engage in direct shipment.

Finally, Washington's virtual wineries deserve more than a retailer's license. While specific practices may vary, virtual winemakers generally exercise sufficient control over wine crafting and branding to merit a winery license and its attendant privileges and protections.²⁷⁶ In the

62-334, Reg. Sess. (Wash. 2011) (as introduced by Rep. Condotta).

269. *Oregon Hearing*, *supra* note 247 (testimony of Dan Jarman).

270. *See id.*

271. *See id.*; *see also id.* (testimony of Farshad Allahdadi).

272. *See Hearing on H.B. 1641*, *supra* note 48 (testimony of Mike Sheridan).

273. *See MENDELSON*, *supra* note 44, at 163; *see also supra* Parts V.A, B.

274. FED. TRADE COMM'N, *supra* note 12, at 6; Cutler, *supra* note 15.

275. FED. TRADE COMM'N, *supra* note 12, at 6.

276. *See THE BUSINESS OF WINE: AN ENCYCLOPEDIA*, *supra* note 8, at 253 ("[M]ost industry members would agree that a virtual winery . . . has its own management and winemaker . . . and controls all of the winemaking decisions."); Franson, *supra* note 53.

context of custom-crush arrangements, virtual wineries may supply their own expert winemaker who makes all the decisions regarding blending, crushing, filtration, barreling, and aging.²⁷⁷ The owner of the custom-crush facility, on the other hand, simply provides “a service,” and does not “take responsibility for the winemaking.”²⁷⁸ Given these circumstances, the Washington legislature should amend state licensing provisions to encourage start-up wineries by leveling the regulatory playing field. Virtual winemakers merit a domestic winery license and its attendant privileges as much as the custom crush facilities that supply them with facilities and equipment.

CONCLUSION

For both economic and regulatory reasons, it is time to bring Washington’s winery licensing regime into the twenty-first century. This can be accomplished by amending the domestic winery license provided for under RCW 66.24.170 to include the diverse methods of wine production in operation on the ground: traditional production, blending, and virtual winemaking through custom crush arrangements. Adopting Oregon’s winery licensing model would allow persons engaging in all of the production models to qualify for a domestic winery license. It would also provide the necessary regulatory clarity and transparency to ensure that all winemakers are in compliance with both state and federal law. Moreover, adopting the Oregon model as opposed to the California model would maximize virtual wineries’ access to consumers by licensing them as wineries, not retailers or wholesalers.

The Washington Legislature should provide virtual wineries legal recognition and protection so that Washington’s wine industry may continue to grow and diversify, and so that Washington’s tiny start-up wineries may answer the call of wine lovers nationwide for “individualistic, handcrafted wines.”²⁷⁹

277. Franson, *supra* note 53.

278. *Id.*

279. FED. TRADE COMM’N, *supra* note 12, at 6.