

STATE OF NEW YORK: LIQUOR AUTHORITY

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Internet Sales Operation  
by Connoisseur Encounters Company, Inc.

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DECLARATORY  
RULING  
2014-02148E

**Preliminary Statement**

Section 98.1 of the Rules of the State Liquor Authority, (9 NYCRR subtitle B) provides that any person may request that the Authority issue a declaratory ruling on the applicability of the Alcoholic Beverage Control Law ("ABCL"), or the Rules of the Authority, to any person, property or state of facts.

By letter dated January 28, 2014, a request was submitted by E. Joshua Rosenkranz, Esq. of Orrick, Herrington & Sutcliffe, LLP, on behalf of Connoisseur Encounters Co., Inc. ("CEC"), a licensed New York State retailer who does business as The Wine Cellar at Rye Ridge in Rye Brook, New York. Mr. Rosenkranz asks the following five questions on behalf of his client regarding the operation of four branded Internet wine clubs ("clubs") operated by CEC.

1. Does the ABC Law prohibit CEC, as a licensed retailer, from paying for fulfillment services performed by a supplier or distributor outside the State of New York, the cost of which is passed along to CEC by a New York-licensed wholesaler?
2. Does the ABC Law prohibit CEC, as a licensed retailer, from working exclusively with a single licensed wholesaler in connection with its internet sales?
3. Does CEC's business relationship with its third-party service provider violate Section 111 or any other provision of the ABC Law?
4. Does the ABC Law prohibit CEC from conducting limited activities outside New York?
5. Does the ABC Law prohibit CEC, as a licensed retailer, from operating and maintaining some of its inventory on a "just-in-time" basis, by ordering and receiving products from the wholesaler as they are needed based on customer demand?

CEC's petition is a condition from the application to remove their license from Carmel, Putnam County to Rye Brook, Westchester County. CEC was the subject of a disciplinary action (case 72996) where the licensee submitted a conditional no contest plea to the charges of: Unauthorized Corporate Change; Availing; Aiding and Abetting; and Non Bona Fide. The charges stemmed from the operation of the clubs discussed below. In order to operate a bona fide store, CEC sought the Authority's permission to remove the license from Carmel to Rye Brook. On June 5, 2013, the Full Board conditionally granted the removal application. One of the conditions upon which the removal application was

granted was that CEC, within four months, submit a petition for a declaratory ruling detailing their Internet sales operations. After two requests for adjournments and one substitution of counsel, CEC submitted this request on January 28, 2014.

### **Statement of Facts**

The facts developed during the Authority's review of CEC's petition and the Full Board meeting demonstrates that CEC's petition does not provide an accurate or complete description of the clubs' operations. As stated in Declaratory Ruling 2013-01006A, when the Members evaluate the arrangements between licensed and unlicensed entities, the Authority will not only consider the relevant written agreements, but will also evaluate the actual, day-to-day functioning of the arrangements.

Since September 2013, CEC has operated a bona fide package store in Rye Brook, New York. CEC also operates four clubs which are the subject of the request. The clubs are WSJ Wines, Zagat Wine, Virgin Wine and Laithwaite's Wine. Mr. Rosenkranz states that all four operate within New York State's three tier system. CEC is the retailer for all four clubs and Lionstone International ("Lionstone") is the sole wholesaler for each club. Lionstone operates out of Illinois while maintaining an empty New York office in Putnam County adjacent to a warehouse permitted to CEC. Additionally, to operate the clubs, CEC utilizes the services of a third party service provider, Direct Wines Inc.

Prior to October 2013, Direct Wines Inc. was owned by DW USA Holdings, Inc., the same company that then owned (and still owns) Lionstone. DW USA Holdings, Inc. was then and is still wholly owned by Direct Wines International Limited which is wholly owned by Direct Wines Holdings Limited. The Laithwaite family owns 100% of Direct Wines Holdings Limited.

Prior to October 2013, Direct Wines Inc. obtained trademark rights from Dow Jones & Company for WSJ Wine. Direct Wines Inc. also obtained trademark rights for Zagat Wine. Via their parent company, Direct Wines International Limited, Direct Wines Inc. obtained sublicense rights to Virgin Wine and Laithwaite's Wine.

Although it is not disclosed in CEC's petition, the Authority learned that as of October 2013, Direct Wines Inc. changed its name to Archway Partnerships ("Archway"), and sold a portion of its business to Muggoch Holdings Limited which took the name Direct Wines Inc. The Authority has been informed that Archway retained the trademark rights for the clubs and Direct Wines Inc. performs the logistics, marketing and operational aspects of the clubs. Archway sublicenses the trademark rights to Direct Wines Inc. These statements were made to the Authority by a Direct Wines Inc. employee and an Archway principal. However, despite requests, the Authority has not received any documentation which evidences: (1) the sale to Muggoch Holdings Limited; (2) the terms of the sale; or (3) the sublicensing agreement or operating agreement between Archway and Direct Wines Inc.

On January 23, 2014 CEC and Direct Wines Inc. executed an "Integrated Technology/Logistics/Marketing Services Agreement" ("Integrated Agreement"). The Integrated Agreement grants CEC the use of the aforementioned trade names as well as that of "Four Seasons Wine." It also states the services which Direct Wines Inc. will provide for CEC. The services include but are not limited to:

- (1) Use of the trademarks;
- (2) Assisting in the design, hosting and maintenance of the clubs' webpages;
- (3) Collecting credit card information and other customer information;
- (4) Logistics information regarding CEC's deliveries;
- (5) Assisting with customer invoices and labels;
- (6) Providing data between CEC and its wholesalers;
- (7) Providing 1-800 customer service assistance;
- (8) Suggesting marketing programs;
- (9) Suggesting all of the wines to be offered;
- (10) Suggesting prices for all of the wines offered;
- (11) Providing web, email and social media platforms.

As explained to the Authority by CEC, Lionstone, Direct Wines Inc. and Archway representatives, the clubs operate in the following manner. Lionstone and Direct Wines Inc. use a computer system by which Direct Wines Inc. reviews Lionstone's inventory. This inventory is not inventory specific to Lionstone as a New York State wholesaler, but to Lionstone in general as an entity with operations in numerous states. Direct Wines Inc. reviews Lionstone's national inventory and then makes recommendations to CEC regarding which wines CEC should purchase several months prior to the actual time CEC intends to purchase the wine. Direct Wines Inc. makes recommendations to CEC not only for the New York clubs, but for all seventeen states where CEC operates the clubs as part of an overall plan to create a uniform national program. Direct Wines Inc. also suggests how CEC should market the wines via the clubs. The recommendations sent by Direct Wines Inc. contain the prices at which Lionstone purchased the wine - a protocol which is contrary to standard industry practice - but it does not contain the prices which Lionstone will later post in New York via the wholesaler to retailer schedule.

CEC President, Matthew Booker, while in his Illinois office, reviews these suggestions submitted by Direct Wines Inc., and "decides" whether or not to adopt them. It is worth noting that, at no time during the three years that Mr. Booker has reviewed the Direct Wines Inc. suggestions, has he ever rejected a suggestion made by Direct Wines Inc. Mr. Booker relays his acceptance to Direct Wines Inc. which, in turn, informs Lionstone of his decision and places a "reservation" for the wines with Lionstone on behalf of CEC. Lionstone, in turn, accepts this "reservation," and at the agreed upon time ensures that the product is price posted in New York State.

CEC then purchases the product at the appropriate time, placing email orders with Lionstone in Illinois. CEC does not purchase the product prior to offering it for sale via the

clubs, but places orders on a just-in-time basis.<sup>1</sup> Direct Wines Inc. then provides specific instructions to Lionstone on how the wine should be packaged along with the customer mailing information to be placed on each package. Lionstone contracts with a company called Exel to provide the actual packaging and labeling of CEC's orders<sup>2</sup>. These services are all performed at Lionstone's Illinois facility. Lionstone (as of the date of CEC's petition)<sup>3</sup> passes on the cost for these packaging services to CEC by building it into the posted price on the New York wholesaler to retailer schedule.

Direct Wines Inc. on behalf of Lionstone arranges and often pays for the products to be shipped into New York State.<sup>4</sup> The wine is individually packed into a box for each customer and some boxes bear the trade name of the branded wine club. All boxes include an invoice listing CEC as the retailer, and promotional materials for the clubs and, at times, other alcoholic and non-alcoholic products. All boxes are labeled with the customer's shipping address and CEC's return address. The boxes arrive via truck at the Lionstone office in Putnam County. They are signed for by a Lionstone employee and then signed for by a CEC employee from the CEC warehouse adjacent to the Lionstone office.<sup>5</sup> The truck then leaves with the product which is delivered to a common carrier, and the cost of transportation to the common carrier is billed to Direct Wines Inc.

### **Questions presented by CEC**

#### **1. Does the ABCL prohibit CEC, as a licensed retailer, from paying for fulfillment services performed by a supplier or distributor outside the State of New York, the cost of which is passed along to CEC by a New York-licensed wholesaler?**

First, the Members must address the use of the terms "supplier" and "distributor" used throughout CEC's petition. CEC uses each of these words to refer to Lionstone. Lionstone is a licensed New York wholesaler. As such, the Members will refer to it as a wholesaler. The entity licensed as Lionstone International<sup>6</sup> in New York is the same entity operating in Illinois. They are one corporation.<sup>7</sup> Therefore, the Members find the distinctions and statements made by CEC in their petition inaccurate. The petition states:

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<sup>1</sup> The only inventory CEC has at its warehouse in Carmel is club returns. Approximately 1,000 cases of such wine are typically at the warehouse. Those wines are then resold via the clubs or the store in Rye Brook.

<sup>2</sup> CEC's petition only states, "The customer's shipment is packed at a Lionstone facility in Illinois" and omits the participation of Exel.

<sup>3</sup> The Authority has been informed by counsel for Lionstone that as of May 2014, this is no longer Lionstone's practice but the Authority has not received any documentation to that point.

<sup>4</sup> The Authority has again been informed by counsel for Lionstone that as of May 2014, this is no longer the practice but no documentation to that point has been provided to the Authority.

<sup>5</sup> CEC's petition (page 10) states that the wines are "sold to Lionstone in New York and, accordingly arrive at Lionstone's warehouse facility in Carmel." This is incorrect as the wine is already owned by Lionstone prior to being price posted and shipped into New York State.

<sup>6</sup> Lionstone International is the DBA of SLJ Group, Inc.

<sup>7</sup> At the June 4, 2014 Board Meeting Mr. Rosenkranz conceded this and stated, "There is no distinction between Lionstone International and Lionstone New York... Lionstone International is the licensed wholesaler."

Wine Cellar buys its wine from Lionstone in its capacity as a New York-licensed wholesaler who in turn, obtains the prepackaged product from the Lionstone facilities in Illinois.... Lionstone - as a New York wholesaler - does not perform any fulfillment services.<sup>8</sup>

This statement is inaccurate because the wine is not purchased between two Lionstone corporate entities. The wine is all owned by Lionstone, a New York wholesaler who also does business in other states. Lionstone chooses to price post and sell certain wines in New York State while selling the same and different wines in other states. It is one company and as such it is Lionstone, a New York wholesaler that has packaging/fulfillment services performed at their Illinois location.

Although CEC's petition states that Lionstone performs the fulfillment services, counsel for both CEC and Lionstone later informed the Authority that a company called Exel, not Lionstone, performs the fulfillment services at the Lionstone Illinois facility.<sup>9</sup> Therefore, the appropriate question the Members will address is:

**Does the ABCL prohibit CEC, a licensed retailer, from paying for fulfillment services performed by a subcontractor of a New York wholesaler at the wholesaler's out of state premises, the cost of which is passed along to CEC?**

#### **ABCL Section 104.1(a)**

ABCL Section 104.1(a) states that no wholesaler shall be engaged in any other business on the licensed premises; this is often referred to as the "Second Business Rule." Though the Lionstone facility in Illinois is not part of the New York licensed premises, the Board has always held that a New York wholesaler cannot do something out of state that would be impermissible to do at their licensed premises within the state. To hold otherwise would permit New York wholesalers to operate premises outside of the state and perform services that in state wholesalers could not. It would place wholesalers with out of state facilities at an advantage over wholesalers with facilities in state, and would, therefore, encourage wholesalers to operate facilities outside of the state to circumvent the ABCL. The courts have addressed these issues and held that the laws of the State must apply to each member of each tier equally.<sup>10</sup>

Accordingly, the only business a wholesaler with a premises licensed in New York State may conduct at the licensed premises is the wholesale sale of alcoholic beverages unless otherwise permitted under ABCL Section 104. Under this plain reading, a

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<sup>8</sup> Page 18 of Mr. Rosenkranz's January 28, 2014 Petition for Declaratory Ruling.

<sup>9</sup> Statements made by Mr. Rosenkranz at the June 4, 2014 Board Meeting, and page 9 of Mr. Rosenkranz's June 13, 2014 letter, "Exel contracts directly with Lionstone, CEC's wholesaler, to provide the aforementioned fulfillment services at Lionstone's facilities in Illinois."

<sup>10</sup> See *Arnold's Wine, Inc. v. Boyle* 571 F.3d 185 and *Granholt v. Heald* 544 U.S. 460.

wholesaler may not conduct or subcontract for fulfillment services at their licensed premises. Therefore, the Board finds that a New York wholesaler with their premises out of state is similarly restricted by the Second Business Rule and may not perform or subcontract for the performance of fulfillment/packaging services at their premises for their New York sales.

**ABCL Section 101.1(c)**

ABCL Section 101.1(c) prohibits manufacturers and wholesalers from making any gift or rendering any service, directly or indirectly, to any retailer which in the judgment of the Authority may tend to influence such retailer to purchase product from the manufacturer or wholesaler. Pursuant to a 101.1(c) analysis of CEC's question, the Members must examine the relationship between CEC and Lionstone.

The clubs operate in thirty-three states. In seventeen of those states CEC operates as the retailer. In New York, Lionstone is the only wholesaler that CEC purchases wine from for sale through the clubs. In New York, Lionstone does not employ solicitors. Lionstone does not list its price postings in Beverage Media, as most New York wholesalers do. Lionstone does not regularly staff its New York office or man the phone line for their New York phone number. Essentially, in New York, Lionstone does not attempt to do business with any retailer other than CEC.

Though evidence has been provided to the Authority to demonstrate that Lionstone will sell product to any retailer who places an order, the number of retailers other than CEC who purchase from Lionstone is *de minimus* at best.<sup>11</sup>

The transactions Lionstone engages in with CEC also vary greatly from their transactions with all other New York retailers. CEC places orders with Lionstone by emails sent to Lionstone employees in Illinois, while all other New York retailers must leave messages on an answering machine in Carmel, New York and fax orders to the Carmel office. Per the Lionstone website, Lionstone only accepts "full case orders of a single product," yet CEC regularly purchases one bottle of a product. Per the Lionstone website, all wine is delivered by FedEx or UPS, or must be picked up at Lionstone; however, Lionstone regularly delivers wine to CEC's warehouse. Finally, Lionstone's website lists their accepted methods of payment as "cash, cashier checks or money order," yet Lionstone regularly accepts non-cashier business checks from CEC. In short, Lionstone has one set of practices for CEC, and an entirely different set of practices for all other New York retailers. These accommodations alone constitute impermissible gifts or services in violation of ABCL Section 101.1(c).

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<sup>11</sup> Documents provided by Lionstone indicate that between November 2009 and April 2011 Lionstone sold to only nineteen other retailers in New York other than CEC.

Lionstone shares their inventory information, which includes the price they paid for the inventory, via a computer system with Direct Wines Inc. for use by CEC. According to Nicholas Lucca, principal of Lionstone, Direct Wines Inc. "reserves" wine for CEC months prior to the product being price posted in New York State. Mr. Lucca states that if an order for that wine is placed by another retailer prior to CEC's order, Lionstone will sell it to the other retailer.<sup>12</sup> However, the wine reserved for CEC is reserved for CEC to be sold in all seventeen states. When it comes to Lionstone's sales in New York, Lionstone does not actually price post a wine until the time they know CEC wishes to sell and market the wine via the clubs. This, coupled with the fact that Lionstone makes no efforts to obtain other New York customers, ensures that the products price posted in New York will always be available for CEC. Thus, while CEC need have no concerns that other New York retailers might pre-empt them in purchasing the wines they wish to obtain, all other New York retailers have the constant challenge of obtaining the product they desire.

The day-to-day operations of Lionstone, as a licensed New York wholesaler, are intended to serve CEC and CEC only. Even the prices posted by Lionstone on the New York wholesale to retail schedule include the cost of packing services for CEC. Lionstone does not offer or provide fulfillment services to any other New York retailer. Every price posting made by Lionstone in New York State is a posting specifically for CEC. Finally, Lionstone ensures the products are packaged according to CEC's specifications before being delivered to CEC. In the judgment of the Members, these actions aggregately influence CEC to purchase wine for sale through the clubs from Lionstone - and Lionstone only.

When determining if an action of a wholesaler is a gift or service which directly or indirectly influences a retailer in violation of ABCL Section 101.1(c), the Members ask whether or not the action is or can be performed by the wholesaler for all retailers. It is inconceivable that Lionstone would, or could, provide the following for every New York retailer as it does for CEC:

- 1) Share its national inventory;
- 2) Disclose the prices at which it obtained the inventory;
- 3) "Reserve" wines months in advance;
- 4) Price post wines at the times requested;
- 5) Package wines to each retailer's specifications;
- 6) Place an office next to each retailer.

If Lionstone permitted every retailer to determine when it offered/posted their wines for sale in New York, Lionstone would be turning over one of its essential tasks as a wholesaler to New York retailers. What if the requests of the retailers conflicted? If Lionstone operated in this fashion they would substitute the retailer's business judgment

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<sup>12</sup> Mr. Lucca stated in an interview that there have been instances where CEC in New York wanted to buy a product and it was already sold to someone else. Mr. Lucca did not provide documentation, but the Authority must conclude that Lionstone sold the product in another state because, as already stated, Lionstone's sales in New York to anyone other than CEC are *de minimus*.

for theirs. As it currently operates, although Lionstone determines what products it will obtain for its inventory, Direct Wines Inc. and CEC, through “reservations,” determine the majority of the products Lionstone will post in New York and when.

The Authority permits retailers to express advance interest in products; most frequently the practice is seen regarding limited availability items.<sup>13</sup> However, the vast majority of Lionstone’s sales in New York are based on CEC’s advance interest via the clubs. Lionstone’s New York price postings are personally tailored to CEC’s advance interest.

The Members cannot cite any other example of a wholesaler legally providing the customized services to a retailer that Lionstone provides for CEC. For all these services and wine selection Mr. Rosenkranz called Lionstone “one stop shopping”<sup>14</sup> for CEC. Mr. Rosenkranz stated that a hypothetical small restaurant or bar might choose to also shop from one hypothetical wholesaler and find all the wines and spirits they need there. However, that analogy is inaccurate because that hypothetical wholesaler is not providing the retailer with anything other than that which it provides to all retailers. That hypothetical wholesaler does not share their inventory with the retailer. They do not have a special means for receiving their orders to the exclusion of others. The hypothetical wholesaler does not post products at a time the retailer dictates, and they do not ensure that the product is custom packaged for the retailer. In Mr. Rosenkranz’s hypothetical scenario an independent retailer is independently choosing to buy from one wholesaler. What is not hypothetical, and is before the Members, is a situation where the totality of the customized services which Lionstone supplies to CEC, and CEC only, strongly influences CEC to purchase from Lionstone and Lionstone only. The subcontracting for fulfillment services at the Lionstone facility is part and parcel of those services, and in the opinion of the Members constitutes a gift or service that strongly influences CEC to purchase Lionstone’s product in violation of ABCL Section 101.1(c).

**2. Does the ABCL prohibit CEC, as a licensed retailer, from working exclusively with a single licensed wholesaler in connection with its Internet sales?**

This question overlaps with the previous question since it requires the Members to examine the relationship between CEC the retailer and Lionstone the wholesaler. As stated above, if a wholesaler does not provide an impermissible gift or service that induces the retailer to purchase from them, then there is no ABCL violation committed when a retailer purchases exclusively from only one wholesaler. However, if, as in the case of CEC and Lionstone, the retailer chooses to exclusively buy from the wholesaler because of

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<sup>13</sup> It is important to note that CEC’s “reservations” are not genuinely “advance interest” as the term is generally used in the industry. The term is generally applied to products a wholesaler has not yet obtained but may obtain so they note the advance interest of retailers in the product prior to obtaining the product in order to make a determination on the amount of product to obtain. CEC’s advance interest reservations are for products Lionstone already owns.

<sup>14</sup> Statement made by Mr. Rosenkranz at the June 4, 2014 Board meeting.

impermissible gifts and or services provided by the wholesaler, then there is a violation of ABCL Section 101.1(c).

CEC contends that they considered other wholesalers prior to selecting Lionstone as the exclusive wholesaler for the clubs.<sup>15</sup> However, the record demonstrates that, in fact, Direct Wines Inc., Lionstone, and DW USA Holdings chose CEC to be the retailer for the clubs, not vice versa. Direct Wines Inc.,<sup>16</sup> not CEC, is the signatory to the contracts with Dow Jones & Company, Inc. and Zagat Survey, LLC that created the clubs. When the clubs were created by the then Direct Wines Inc., Direct Wines Inc. was the sibling company to Lionstone. It was always the intention that Direct Wines Inc. would sell Lionstone's wine via the clubs.<sup>17</sup> It is also undisputed that CEC obtained a license in New York to be the retail licensee for the clubs. The purchase of Shermer by CEC,<sup>18</sup> the former retail licensee, transpired at the instigation of, and under the aegis of, Simon McMurtrie of Direct Wines Inc., Lionstone and DW USA Holdings. At the time CEC applied for and obtained a New York retail license, it was purely to conduct retail sales of Lionstone wine via the clubs. The record demonstrates that CEC was chosen by Direct Wines Inc., Lionstone and DW USA Holdings to employ their companies, to operate the clubs, and to buy wines from Lionstone.

**3. Does CEC's business relationship with its third-party service provider, Direct Wines Inc., violate ABCL Section 111 or any other provisions of the ABCL?**

**ABCL Section 111**

ABCL Section 111 states that a license shall be available "only to the person therein specified, and only for the premises licensed and no other except if authorized by the authority." The intent of the statute is to prevent those "ineligible to secure a license from operating a liquor business."<sup>19</sup> In disciplinary case 72996, CEC was charged with violating ABCL Section 111 for making their license available to the company that, at the time, was operating as Direct Wines Inc. CEC submitted a conditional no contest plea to the charge and other included charges. Accordingly, pursuant to the acceptance of a conditional no contest plea on case 72996, the Members have already held that the relationship that existed between CEC and Direct Wines Inc., on or before June 1, 2011, violated ABCL Section 111.

It is worth noting that on or before June 1, 2011, Direct Wines Inc. was owned by DW USA Holdings Inc., which as previously stated, was ultimately owned by the Laithwaite family. On or before June 1, 2011 the Laithwaite family owned wineries (and still owns wineries today). Accordingly, because of this interest in wineries, in 2011, pursuant to the

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<sup>15</sup> Statements by Mr. Rosenkranz at the June 4, 2014 Board Meeting.

<sup>16</sup> This refers to the Direct Wines Inc. which existed prior to the October 2013 sale.

<sup>17</sup> Statements made by Lionstone principal Nicholas Lucca on April 16, 2014.

<sup>18</sup> The Shermer licensees were Rosemary Jack, wife of Lionstone principal Ed Jack, and Alice Lucca, wife of Lionstone principal Nicholas Lucca.

<sup>19</sup> See Specialty Restaurant Corp. v. Barry 262 A.D.2d 926 (1999)

tied house prohibitions contained in ABCL Section 101.1(a), Direct Wines Inc. would have been ineligible to hold a retail license in New York. Thus, the operations of Direct Wines Inc. and CEC permitted an ineligible entity to use a retail license in violation of ABCL Section 111 and 101.1(a).

In order to answer CEC's question, the Members must review what, if any, changes have occurred in the relationship between CEC and the current Direct Wines Inc. The standard by which the relationship will be reviewed was determined by the Members in declaratory ruling 2013-01006A regarding ShipCompliant. In the ShipCompliant ruling, the Members set forth guidelines for retailers utilizing third party providers for Internet sales. The guidelines were created based upon a review of the relationships between a third party provider, a retailer, and a wholesaler all utilizing ShipCompliant's services. The guidelines address, in part, whether a retailer is passive and permits the third party provider to execute retail functions. In the request put forth by ShipCompliant, the Members ruled that the retailer was passive, and the unlicensed third party provider was impermissibly operating a retail license in violation of ABCL Section 111.

When reviewing the relationship between CEC and Direct Wines Inc., the Members note numerous similarities to the relationship between the retailer and the third party provider under ShipCompliant. Both Direct Wines and the third party provider under ShipCompliant:

- 1) Provide trademark rights to the retailer;
- 2) Operate and maintain the branded clubs' websites;
- 3) Provide all marketing services for the clubs;
- 4) Provide all customer service for the clubs (Direct Wines Inc. subcontracts for these services);
- 5) Provide logistical services for the clubs (Direct Wines Inc. subcontracts for these services);
- 6) Recommend wines to be sold via the clubs and the selling prices (though both CEC and the retailer under ShipCompliant retained the right to reject any wine recommendation, neither ever did);
- 7) Only recommend wines from one New York wholesaler.

The Members note three significant, but in themselves not enough, changes to the CEC - Direct Wines Inc. relationship, made after disciplinary case 72996, which differentiate the CEC - Direct Wines Inc. relationship from that of the retailer and third party provider under ShipCompliant.

- 1) Customer payments now go into a bank account which can only be accessed by CEC. Under ShipCompliant the third party service provider had access to the account.

- 2) Direct Wines Inc. is now paid a flat fee based upon the services provided pursuant to the Integrated Services Agreement. Under ShipCompliant the third party service provider received a flat fee for every bottle sold.
- 3) Since the submission of the petition for a declaratory ruling, CEC has reworded and redesigned the clubs' New York websites to more fully disclose that the wine is sold by CEC, a retail store in Rye Brook. Under ShipCompliant the retailer was not easily identified on the club's website.

In addition, while the Members note that CEC has opened and operates a brick and mortar store in Rye Brook, the operations, purchasing, pricing and marketing of the brick and mortar store are completely separate from their club sales. The opening of the brick and mortar store did not alter the relationship between CEC and Direct Wines Inc.; it did not alter the clubs' operations. The brick and mortar store simply permitted CEC to cure their prior violation of SLA Rule 53.1(d) for which they were prosecuted.

In ShipCompliant, the retailer was a pre-existing, bona fide licensee. Ironically, CEC attempts to distinguish its operation by noting that the retailer in ShipCompliant did not know where the wholesaler's warehouse was, whereas CEC states that they know exactly where the Lionstone office in New York is. Indeed, they do because it is purposefully adjacent to their Carmel, New York facility, which is part of the impermissible gifts and services violations discussed above.

CEC also attempts to distinguish the two operations by stating that CEC's President, Matthew Booker, actually reviews the wine suggestions made by CEC. Mr. Booker is, by all accounts, knowledgeable of the clubs' operations. He is a former employee of Direct Wines Limited UK and familiar with Direct Wines Inc. and Lionstone.<sup>20</sup> Based on that background, he was recommended for hire by Direct Wines Limited UK to CEC.<sup>21</sup> However, despite his background, when selecting the wine and prices to be sold via the clubs, Mr. Booker operates in a similar manner to the retailer in ShipCompliant, including acquiescing to all of Direct Wines Inc.'s product and pricing "suggestions." The only active roles in the club's operations taken by CEC employees are the routine acceptance of Direct Wines Inc.'s suggested wines, and the routine batch acceptance of orders that are sent to them by Direct Wines Inc. Thus, CEC abdicates the complete operation of the clubs to Direct Wines Inc., an unlicensed entity, which then assigns various tasks to subcontractors. Thus, retail functions are once, if not twice, removed from the licensee, i.e., under the CEC model, Direct Wines Inc. and other subcontractors all work together to sell wine at retail without holding a license.

ABCL Section 2 declares that the policy of New York, and the purpose of the Authority, is to regulate and control the manufacture, sale and distribution of alcoholic

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<sup>20</sup> At the June 4, 2014 Board Meeting, Mr. Rosenkranz claimed that, as a former employee, Mr. Booker was so familiar with the operations of Direct Wines Inc. that he did not need a written agreement regarding the use of the club trademarks.

<sup>21</sup> Statements made by Simon McMurtrie on May 14, 2014.

beverages for the protection, health, welfare and safety of the people of New York. Accordingly, the Authority regulates and monitors all licensees who traffic in alcoholic beverages. The club model as created by Lionstone, Archway, and the former Direct Wines Inc., permits the present Direct Wines Inc., an unlicensed entity, to traffic in alcoholic beverages. Thus, the Members find that, as described by Mr. Rosenkranz, CEC's relationship with Direct Wines Inc. violates ABCL § 111.

**Club Trademarks obtained by Archway**

**ABCL Section 101.1(c)**

One of the services Direct Wines Inc. provides to CEC is the use of the trademarks for WSJ, Zagat, Virgin and Laithwaite. Direct Wines Inc. does not own the trademarks; nor do they directly hold the rights to the trademarks. Direct Wines Inc. claims legal use of the trademarks through an agreement with Archway, an entity not referred to in CEC's petition.<sup>22</sup>

The Authority has reviewed the trademark agreements between Dow Jones Inc., Zagat Surveys LLC. and Archway.<sup>23</sup> Both agreements prohibit the sublicensing of the trademarks without the express permission of the trademark holder. The Authority has not received any documentation that: (1) reflects a written sublicensing agreement between Archway and Direct Wines Inc.; (2) indicates consideration received by Archway for the use of the trademarks; or (3) reflects express consent to the sublicensing of the trademarks by Dow Jones Inc. and Zagat Survey LLC. Nor has the Authority been given any reason to believe that such documentation exists. These trademarks are critical to the operation of the clubs and, therefore, make Archway a critical stakeholder in the clubs.<sup>24</sup>

Archway is owned by DW USA Holdings Inc., the same company that owns Lionstone. As described by Simon McMurtrie, President of DW USA Holdings Inc., "DW USA Inc. exists as something to own two businesses. It does not have employees, or meet whatsoever."<sup>25</sup> This common ownership structure renders the sublicensing of the trademark rights a gift or service indirectly provided by Lionstone to CEC. Accordingly, the Members must determine if this service is a gift or service which influences CEC to purchase from Lionstone in violation of ABCL Section 101.1(c).

As discussed above, when engaging in an ABCL Section 101.1(c) analysis the Members ask if the gift or service provided by the wholesaler or manufacturer is available

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<sup>22</sup> This information was disclosed during interviews conducted subsequent to the filing of the request for a declaratory ruling. However, despite requests, the Authority has not received any supporting documentation.

<sup>23</sup> When the agreements were executed Archway was doing business as Direct Wines Inc.

<sup>24</sup> Pursuant to the Dow Jones and Zagat agreements, Archway pays Dow Jones Inc. and Zagat Survey LLC the fees for the trademarks.

<sup>25</sup> Statements made Simon McMurtrie on May 14, 2014.

to all retailers. It is conceded by CEC that they are the only retailer in New York State permitted by Direct Wines Inc. to use these trademarks.<sup>26</sup>

This requires the Members to then ask if the use of the trademarks is a gift or service which influences CEC to purchase from Lionstone.

The clubs in New York generate \$20,000,000<sup>27</sup> in sales annually. Based on figures from CEC's petition, CEC's brick and mortar store in Rye Brook generates approximately \$750,000 annually. Clearly, CEC relies almost entirely on the clubs' sales, as opposed to in-store sales, for its profitability. And, of course, the trademarks are essential to the success of the clubs.

Since the trademarks were obtained by Lionstone's parent company, via Archway, for the sole purpose of marketing and selling Lionstone's wine, it is inconceivable that if CEC stopped purchasing Lionstone's wine that Archway would continue the current sublicensing arrangements. Accordingly, Lionstone's indirect provision of the trademarks to CEC not only influences CEC to purchase wine from Lionstone but, in fact, binds CEC to Lionstone.

Based on the above analysis, CEC's relationship with Direct Wines Inc. violates ABCL Sections 101.1(c).

#### **4. Does the ABCL prohibit CEC from conducting limited activities outside New York?**

The ABCL does not require that every business decision be made at a licensed premises. However, ABCL Section 111 requires that sales be made from the licensed premises. In addition, ABCL Section 105.15 requires that books and records be maintained on the licensed premises, and SLA Rule Section 67.1 requires that all deliveries be made to the licensed premises or permitted warehouse. Generally, other functions may reasonably be conducted elsewhere.

#### **5. Does the ABCL prohibit CEC, as a licensed retailer, from operating and maintaining some of its inventory on a "just-in-time" basis, by ordering and receiving products from the wholesaler as they are needed based on customer demand?**

The ABCL does not regulate the amount of inventory a retailer holds at their licensed premises. However, a complete lack of inventory or *de minimus* inventory, as seen in CEC's prior Carmel location, will render a store non bona fide pursuant to SLA Rule 53.1(d). The Members find no authority within the ABCL or SLA Rules for the proposition that a retailer may not order product prior to a customer's demand or request for the

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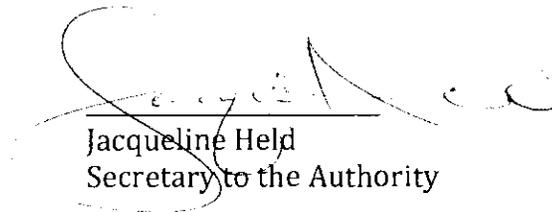
<sup>26</sup> Mr. Rosenkranz's June 13, 2014 letter, page 8.

<sup>27</sup> As stated in CEC's petition.

product. Accordingly, in general, the ABCL does not prohibit the ordering and receiving of products from wholesalers as they are needed based on customer demand.

Licensees are reminded that this ruling is limited to the facts set forth herein. This ruling should not be considered approval for any other proposal which deviates, in any respect, from the representations set forth above. Licensees are warned that entering into any arrangement, or continuing an existing arrangement that is deemed under this ruling to be prohibited by the ABCL may subject the licensee to disciplinary action by the Authority.

The forgoing Declaratory Ruling was approved by the Members of the Authority at Full Board meeting held on August 26, 2014.



Jacqueline Held  
Secretary to the Authority