

STATE OF NEW YORK: LIQUOR AUTHORITY

Application of Six88 Solutions, Inc. d/b/a
ShipCompliant for a determination on legality
of internet advertising platform

DECLARATORY
RULING
2013- 01006A

Preliminary Statement

Section 98.1 of the Rules of the State Liquor Authority, (9 NYCRR subtitle B) provides that any person may submit a request to the Authority for a declaratory ruling with respect to the application of the Alcoholic Beverage Control Law ("ABCL"), or the Rules of the Authority, to any person, property or state of facts. Hinman & Carmichael, LLP (John Hinman, Esq., of counsel) on behalf of an unlicensed entity (Six88 Solutions, Inc. d/b/a ShipCompliant "ShipCompliant") has submitted such a request (the "Request") to ascertain whether, under the facts presented, ShipCompliant's alcoholic beverage business model and compliance system, referred to as the MarketPlace Platform, violates the ABCL or applicable Authority Rules.

As described below, this ruling relates to ShipCompliant's MarketPlace Platform sales conducted through New York's three-tier system, referred to in the Request as "3T." ShipCompliant also provides its services to out-of-state wineries that hold ABCL §79-c direct shipper licenses, under its "Producer Direct" program. Because its Producer Direct program was not the subject of ShipCompliant's Request, it is not addressed in this Ruling.

At the time the Request was received, the Authority was conducting an inquiry into the relationships among certain licensees, ShipCompliant and an advertiser who, working together, were engaged in the sale of wine to New York consumers through an internet website. In light of the facts developed up to that point in the inquiry, as well as the interest from the alcoholic beverage industry in the questions raised by both the inquiry and this Request, the Members of the Authority conducted a special Full Board meeting on January 17, 2013. The purpose of the meeting was to allow a full discussion of ShipCompliant's Request, and afford industry members, and other interested parties, an opportunity to be heard on the issue of Internet sales.

Request to be considered

As set forth in the Request made by Mr. Hinman in his December 14, 2012 letter, ShipCompliant is an unlicensed technology and regulatory compliance services company that has developed a business model and compliance system called the "MarketPlace Platform." As described in the Request, the MarketPlace Platform is a mechanism for facilitating sales of wine to consumers by licensed sellers who utilize the services of Internet advertising platforms. In New York State, such sellers could include licensed package and wine stores, licensed wineries and farm wineries, and out-of-state wineries that hold a direct shipping license (hereinafter referred to collectively as "licensed sellers").

As further explained in the Request, the MarketPlace Platform allows licensed sellers to utilize the services of advertising entities (hereinafter "advertisers"), such as internet marketing portals, online magazines and specialty websites. These advertisers do not have licenses to sell alcoholic beverages. Consumers can view wines advertised by licensed sellers on an advertiser's website and then place an "order request." The advertiser, using the MarketPlace Platform, conveys that "order request" to the licensed seller, who "must either accept or reject the order request." If the seller accepts the order request, the seller then "directs" the fulfillment of the order. According to ShipCompliant's Request, "the advertiser and ShipCompliant both receive a fee from the licensed seller for each sale."

The Request states that the MarketPlace Platform was designed to "work within the four corners of all state and federal alcoholic beverage laws" and "to be compliant with New York law."

The Request further states that:

Key to the system is the fact that the Licensed Seller controls all aspects of each transaction, including decisions concerning the selection of alcoholic beverages to advertise or offer for sale, the pricing of those beverages, and the ultimate acceptance and fulfillment of each order.

With respect to wine sold by a licensed retailer, the Request represents that such products are sold in accordance with New York's three-tier system.

At the time of the January 17, 2013 Full Board Meeting, ShipCompliant's business associates in New York included a licensed wholesaler, a licensed retailer, and an Internet advertiser. Pursuant to various agreements, the parties were using the MarketPlace Platform to sell wine to New York consumers.

The facts developed during the Authority's inquiry and at the Full Board meeting indicate that ShipCompliant's Request does not provide an accurate or complete description of the actual relations among these business associates.

Contrary to the representations made in the Request regarding the control exercised by the licensed seller, the Authority found that, in fact, the business model among the participating entities placed the licensed sellers in a passive role.

Examples were legion:

- The advertiser's agreement with the wholesaler provided that the wholesaler would receive a flat fee per bottle sold;
- The advertiser's initial agreement with the retailer provided that the retailer would receive a flat fee per bottle sold;
- The advertiser selected the wines to be sold through agreements with suppliers;
- The advertiser set the prices at which to sell the wine. While the retailer could request a different price, so far as the Authority is aware the retailer never did so;
- The retailer had no agreement with the warehouse to which the wine to be sold was delivered, and did not know where the warehouse was located;
- The advertiser had an agreement with the warehouse, which included terms relating to shipping the wine from California;
- All wine sold by the retailer through the MarketPlace Platform was sold from the warehouse. None was sold out of the retailer's store;

- Initially, the retailer could "accept" an "order request" by simply not rejecting it within a prescribed time. While the Authority understands that during the pendency of this request the process was changed to require a computer keystroke by the retailer, the Authority was further advised that the retailer never rejected an "order request."

During the Authority's inquiry, the advertiser's agreement with the retailer was revised to eliminate the flat fee per bottle sold. The advertiser then submitted monthly advertising bills to the retailer. However, the significant variation in the amounts of the advertiser's monthly bills, the lack of detail, and the retailer's lack of concern with the bills (as expressed during our inquiry), indicates that the arrangement likely remained, in its practical effect, a flat fee to the retailer per bottle sold. Notably, the retailer never reviewed or approved any advertisements prepared by the advertiser.

While many of the Authority's concerns relate to the relationship between the advertiser and the retailer, the agreement between ShipCompliant and the retailer also raises questions. The very detailed and restrictive "Control Account Instructions" governing "all access to the Retailer Control Account [i.e. the escrow account], including, without limitation, the deposit and disbursement of all funds into and out" of this account, calls into question what, if any, control the participating retailer exercised over funds paid for the alcoholic beverages.

The Authority also noted that the agreement between ShipCompliant and the retailer provides that when the retailer accepts an order request such that it becomes an "Order," "the retailer will be bound to the terms of that Order, including, as applicable, the Product, quantity, pricing, Fulfillment Agent and Wholesaler specified in the Order."

While such a provision might appear on its face to be reasonable, when combined with the passive role of the retailer and the pervasive role of the advertiser, it supports the view that, in their current operation in New York, the model of ShipCompliant and its business associates does not comply with the ABCL or applicable Authority Rules.

Determination of the Authority

ABCL §3(28) defines "sale" broadly as "any transfer, exchange or barter in any manner or by any means whatsoever for a consideration, and includes and

means all sales made by any person, whether principal, proprietor, agent, servant or employee of any alcoholic beverage.... 'To sell' includes to solicit or receive an order for, to keep or expose for sale, and to keep with intent to sell and shall include the delivery of any alcoholic beverage in the state." ABCL §100(1) requires any person engaged in the manufacture for sale or sale (at wholesale or retail) to obtain the appropriate license from the Authority. ABCL §111 prohibits a licensee from making its license available to a person who has not been approved by the Authority to hold that license. The question to be considered in this matter is whether the licensed seller utilizing the MarketPlace platform, in the manner found herein by the Authority, was making its license available to an unlicensed entity and allowing that entity to engage in the sale of alcoholic beverages.

The Members of the Authority are aware that the Authority's Office of Counsel has provided some guidance to licensees seeking to use the services of third parties to market and sell alcoholic beverages at retail and wholesale on the Internet. The Office of Counsel has offered the opinion that third parties may contract with licensees to host and maintain a licensee's website and/or provide related services. As suggested by the Office of Counsel, a third party may allow a licensee to advertise its products on the third party's website, provided that consumers are directed to the licensee's website to place an order. Under such circumstances, the Office of Counsel has advised that the third party's compensation must be limited to a flat fee that is not contingent on the number of sales or the amount sold.

The Members of the Authority, without formally adopting the opinion of the Office of Counsel, find that licensees may rely on that opinion until such time as the Members of the Authority address the issues raised by this request and, more generally, by the involvement of unlicensed parties in the Internet sale of alcoholic beverages to consumers in this state. The Members of the Authority have also issued declaratory rulings in two matters with respect to companies that offer online coupons that can be used for the purchase of alcoholic beverages. Those rulings stress the importance of restricting the involvement of such companies in the actual sale of alcoholic beverages.

It is the intention of the Authority to conduct public meetings and gather information to further explore these issues. The Authority's goal is to issue an advisory that will provide comprehensive guidance to the industry that, on one hand, recognizes the importance of licensing those who traffic in alcoholic beverages while, on the other hand, recognizing that developments in technology

must be taken into consideration when interpreting the law. Further details of the Authority's efforts will be provided on the agency's website.

Returning to ShipCompliant's Request, it is clear that the licensed seller who was doing business with the advertiser played little, if any, role in the sale of wine through the MarketPlace Platform. The licensee was not involved in choosing which brands of alcoholic beverages were to be sold or in determining the prices to be charged. These decisions were made at the discretion of the advertiser pursuant to contracts between the various entities involved in the chain of distribution. Likewise, the profit margin on each sale to be made by the licensed retailer and the licensed wholesaler was specifically set forth in contractual agreements with the advertiser. After the Authority learned this, the Advertiser altered its agreement with the retailer. But as stated above, the Authority found that the monthly advertising bills thereafter submitted by the advertiser to the retailer were of no interest to the retailer, giving rise to the inference that the retailer's profit remained predetermined regardless of the newly instituted billing procedures. In addition, the consumer credit card funds are contractually agreed upon to be processed by a third party financial institution, forwarded to an escrow account opened in the name of the licensed seller, and subsequently distributed to the entities in the chain of distribution according to strict escrow instructions – thereby leaving no discretion or control whatsoever in the hands of the licensed seller.

This method of operation allows an unlicensed advertiser to exercise a high degree of control over the business operations of the participating licensed seller via contractual arrangements with the entities in the chain of distribution. The contractual arrangements between the parties not only allowed the unlicensed advertiser to receive the predominant proportion of the proceeds from the sale of alcoholic beverages, which the Authority has generally considered a violation of ABCL §111, but also dictated to the licensed retailer and wholesaler the remuneration they derived from each sale conducted pursuant to their licenses. Due to the foregoing, the method of operation proposed in ShipCompliant's Request, as the Authority found it to be actually operating in New York, enables and, in fact, encourages licensed entities to make their licenses available to unlicensed entities in violation of ABCL §111.

Accordingly, the Members of the Authority find, based on the record, that the involvement of the unlicensed third party advertiser in the MarketPlace Platform constituted the sale by it of alcoholic beverages. Given that the advertiser

is unlicensed, the relationship between the advertiser and the licensed seller in the MarketPlace Platform system constitutes a violation of ABCL §111.

Pending the Authority's issuance of an Advisory providing more comprehensive guidance, the Authority finds that any of the following methods of operation are not permissible under the ABCL:

(1) where a licensed seller takes a passive role in the transactions and/or incurs no business risk in the arrangement;

(2) where an advertiser or other unlicensed party is permitted to perform retail functions, such as deciding: what products are to be sold; what prices are to be charged; how consumer funds are to be controlled and disbursed; or the retailer's profit margin; or

(3) where the compensation to a third party is a substantial portion of the sale or sales made.

Licenses 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.

In evaluating arrangements between licensed and unlicensed entities, the Authority will not only consider the relevant written agreements. It will, in addition, evaluate the actual, practical, day-to-day functioning of the arrangements.

Of related interest, all wines sold through the advertiser's website featured labels containing the word "Direct" in addition to the standard brand or trade name. By contract, each supplier was required to "...create, submit and register a secondary label with the Alcohol, Tobacco Tax and Trade Bureau (TTB) and...receive a Certification of Label Approval (COLA)" for the "Direct" version of its wine. The Authority investigation revealed that such secondary labels were never actually produced or utilized by ShipCompliant's business partners in New York. Instead, stickers featuring the word "Direct" were utilized to create such "secondary" labeled product from standard labeled product already in the chain of distribution. Each supplier thereafter designated as its Exclusive Brand Agent the wholesaler participating in the business model, who may or may not have been the Exclusive Brand Agent for the standard version of the wine. The "Direct" and standard versions of the wines were thus distributed in New York via different

distribution channels in violation of the ABCL, and possibly sold at different prices.

Guidance regarding marketing of the same brand or trade name and vintage of wine utilizing two or more labels (with or without the use of stickers) can be found in Authority Advisory 2013-3.

The foregoing Declaratory Ruling was formally approved by the Members of the Authority at a Full Board meeting held on April 9, 2013.



Jacqueline Held
Secretary to the Authority