

STATE OF WISCONSIN
DEPARTMENT OF REVENUE

City Brewing Company, LLC

925 South Third Street
La Crosse, WI 54601,

and

Wisconsin Brewing Company, LLC

1079 American Way
Verona, WI 53593,

Petitioners,

v.

Wisconsin Department of Revenue

2135 Rimrock Road
Madison, WI 53713,

Respondent.

DECLARATORY RULING

PRELIMINARY RECITAL

This Ruling is issued in response to a Petition for Declaratory Ruling received November 16, 2022, under § 227.41(5)(a), Wis. Stats., by City Brewing Company, LLC and Wisconsin Brewing Company, LLC ("Petitioners"). The Petitioners seek a ruling on whether properly permitted rectifiers may enter into co-packing agreements and alternating proprietorship agreements relating to intoxicating liquor and if anything in § 125.52, Wis. Stats., or other Wisconsin law prohibits the rectification of intoxicating liquor under such agreements.

Section 125.52(3), Wis. Stats., reads:

Persons eligible. Except as provided under s. 125.69, a manufacturer's or rectifier's permit may be issued to any person who holds a valid certificate issued

under s. 73.03(50) and who is qualified under s. 125.04(5), except a foreign corporation, a foreign limited liability company or a person acting as an agent for or in the employ of another. Notwithstanding s. 125.04(5)(a)5., a person is not required to complete a responsible beverage server training course to be eligible for a permit under this section.

The Department has taken the position that § 125.52(3), Wis. Stats., prohibits these types of production agreements because they create relationships whereby one producer is acting as an agent for or in the employ of another.

STATEMENT OF FACTS

1. City Brewing Company ("City") is a Wisconsin-based beverage producer and packer and is headquartered in La Crosse, WI.

2. Wisconsin Brewing Company ("WBC") is a Wisconsin-based brewer that operates a beverage production facility and taproom and is headquartered in Verona, WI.

3. City, through its parent company, holds a brewer's permit under § 125.29(1), Wis. Stats., and a rectifier's permit under § 125.52, Wis. Stats.

4. WBC holds a brewer's permit under § 125.29(1), Wis. Stats.

5. Petitioners contract with other breweries to produce and package other breweries' beer products.

6. Production agreements generally take one of two forms: "contract production" or "alternating proprietorship."

7. The contract producer (or "co-packer") acts as a service provider to a customer, typically a third-party brewer, distiller, manufacturer, or rectifier.

8. The contract producer's services include producing and packaging alcohol beverages under the recipe producer's brand and specifications.

9. In contract production, all operations take place under the contract producer's permit.

10. Alternating proprietorship agreements involve two (or more) businesses operating at the same premises, but alternating control of space and equipment.

11. In alternating proprietorship agreements, each proprietor obtains its own FEIN, federal and state authorizations, and produces its own products.

12. In alternating proprietorship agreements, it is designated which proprietors control operations at specific times on specific days.

13. City's operations include the production and packaging of spirits-based "ready to drink" beverages, which are pre-mixed cocktails packaged in a can or bottle.

14. The Department issued City a rectifier's permit on October 19, 2009, as no. 313-1020421364-09.

15. WBC wishes to expand its operations to include the production of "ready to drink" beverages.

16. WBC does not hold a rectifier's permit but would like to apply for one.

17. City is currently party to co-packing agreements with multiple customers in which City has agreed to rectify intoxicating liquor that is branded, formulated, and sold by City's customer.

18. City is also party to an alternating proprietorship agreement with an independent distiller.

19. Petitioners have discussed the legality of co-packing and alternating proprietorship agreements with the Department and the Department informed Petitioners these agreements were in violation of § 125.52(3), Wis. Stats.

20. Petitioners filed a Petition for Declaratory Ruling regarding permissibility of co-packing and alternating proprietorship agreements on November 16, 2022.

21. Department employee Tyler Quam submitted an Affidavit dated February 1, 2023, in Response to the Petition for Declaratory Ruling summarizing the Department's position.

22. The Department held a public hearing on February 2, 2023, during which the Petitioners and their witnesses testified before the hearing examiner.

23. The Department also accepted written testimony from the public until February 16, 2023. All submissions received were in support of Petitioners' position.

RULING

Based on extensive testimony, both verbal and written, including additional information received regarding industry best practices around production agreements, we find that the specific language in § 125.52(3), Wis. Stats., regarding agency does not explicitly prohibit production agreements for the rectification and manufacture of intoxicating liquor, such as alternating proprietorships and contract production, between two properly permitted rectifiers. The Department concludes that Petitioners' argument is correct, that requiring both parties to obtain permits ensures the transparency required for effective oversight and avoids concerns that "straw men" or agents would impermissibly obtain permits in violation of the statute. Rulemaking will be required to codify this decision and create a process for state oversight of this industry practice to ensure public safety, fairness across the industry, and proper tax payment.

ANALYSIS

Prior to this ruling, the Department had taken the position that intoxicating liquor co-packing and alternating proprietorship agreements are prohibited by state law. Section 125.52(3), Wis. Stats., states in part, "a manufacturer's or rectifier's permit may be issued to any person... except... a person acting as an agent for or in the employ of another." The Department had determined that these agreements created relationships where a person or entity was acting as an agent for or in the employ of another in violation of this section. Furthermore, the Department pointed out that the statutes relating to brewer's permits do not contain language regarding agency, and administrative law regulates the manufacturing of fermented malt beverages on contract between production brewers and recipe brewers.

The declaratory ruling process provided the Department with new and relevant information regarding co-packing and alternating proprietorship agreements as well as industry best practices. The Petitioners gave numerous examples discussing these contracts and their terms, which showed that the relationship between the entities do not automatically give rise to agency in every case. At the hearing, the Petitioners submitted additional exhibits including sample terms from these agreements, as well as testimony as to business practices relating to alternating proprietorships and contract production. Based on this newly available information and legal arguments from the Petitioners, the Department agrees that this subsection does not prohibit two separately permitted entities from entering into valid production agreements, such as co-packing or alternating proprietorship agreements, provided that all other laws and regulations are met.

Petitioners argue that the Department is interpreting a statute that places additional restrictions not contemplated by the legislature, and that action is unconstitutional. The Department cannot create additional restrictions not allowed by statute. When interpreting a statute, courts will generally give deference to an agency's interpretation when the agency has been charged with administering the statute: "The agency's interpretation entails its expertise, technical competence and specialized knowledge; and that through interpretation and application of the statute, the agency can provide uniformity and consistency in the field of its specialized knowledge." *Lisney v. Labor & Industry Review Commission*, 171 Wis. 2d 499, 493 N.W.2d 14, 16 (1992). However, a court does not give deference to an agency's interpretation of a statute when the court concludes that the interpretation is contradictory or otherwise unreasonable or without rational basis. *Id.*

The Department's position has been that the plain language of the statute prohibited co-packing or alternating proprietorship agreements because those types of agreements between two entities automatically means that one party is acting as an agent for or in the employ of another, creating the potential for a "straw man" to apply for permits. However, a court would likely

find this interpretation creates additional restrictions that contravene the plain language of the statute.

Petitioners argue that, under the law, the relationship is not one of agency or of being in the employ of the other party. In their Petition, Petitioners cite § Tax 8.87, Wis. Admin. Code, and state that the Department's regulations define "agent" as "a person who represents or acts, or who is empowered to represent or act, for another in conducting the other's business." They also cite *Westmas v. Creekside Tree Serv., Inc*, 2018 WI 12, 379 Wis. 2d 471, 907 N.W.2d 68, which states, "an agent is one who acts on behalf of and is subject to reasonably precise control by the principal for the tasks the person performs within the scope of the agency." Wisconsin courts have also defined agency as "a consensual, fiduciary relation between two persons, created by law by which one, the principal, has a right to control the conduct of the agent, and the agent has a power to affect the legal relations of the principal." See *Skrupky v. Elbert*, 189 Wis. 2d 31, 526 N.W.2d 264, 269 (Ct. App. 1994). Petitioners state that nothing in their agreements provide that one party has the ability to act for, conduct, or control the other party's business.

Petitioners' evidence showed that co-packing agreements do not always mean that one party is acting as an agent for or in the employ of another. Neither City or WBC is allowed or empowered by contract or by law to represent or act on behalf of their co-packing customers in any capacity. They cannot bind their customers to agreements with third parties and they cannot make representations to third parties on behalf of their customers. City states that the co-packing contracts themselves dispel any notion of an agency relationship between the parties as they expressly state that the parties have merely a contractual relationship and nothing more, "nothing contained in this Agreement shall be interpreted as creating a joint venture or other business association other than the contractual relationship...." Petitioners also state that alternating proprietorships do not create agency relationships either as the parties contract to take turns controlling a single premises and in each instance, the party uses its rectifier's permits to act on its own behalf, not as an agent for another.

Additionally, context of the statutes does not require limiting the number of permittees for liquor manufacturers. At the hearing, Petitioners argued that both parties in the alternating proprietorship and co-packing contracts could obtain permits under the plain language of the statute, nullifying any straw man concerns. A careful review of § 125.52, Wis. Stats., shows no obstacle to permitting both participants in a transaction involving liquor manufacturing. The Department agrees that this is consistent with how it has handled similar arrangements under the brewing statute in order to avoid straw man concerns.

As the Department has previously noted, one of its historical concerns is that other alcohol licensing and permitting statutes prohibit issuing a license to a person acting as an agent for or in the employ of another. See e.g., §§ 125.26 and 125.29(1), Wis. Stats. This is to avoid issuing a license to a person acting as a straw man, concealing a hidden principal, where the principal would not qualify for a permit or license due to conviction records or prohibited ownership interests in another tier. However, Petitioners note that requiring both parties to be permittees removes the concern of a hidden principal. Furthermore, federal law already allows for these types of arrangements. See, e.g. TTB Industry Circulars 2005-2, 2008-4, and 2018-3 (May 15, 2018). The existence of both detailed agreements, such as those submitted by Petitioners, and applicable federal regulations address the normal sources of concern that might suggest the presence of a concealed principal - such as responsibility for taxes and expenses and who receives profits from such an arrangement.

Overall, § 125.52(3), Wis. Stats., is meant to prohibit otherwise ineligible individuals and entities from obtaining alcohol beverage permits. This subsection prohibits an entity from receiving a permit on behalf of another. The Department cannot issue a permit to an entity or a person that is an agent or otherwise acting on behalf of another who is otherwise ineligible. For example, this subsection would prohibit an unpermitted business from using another person or entity to obtain a permit that it otherwise could not. Consideration should and must be given to if a person is acting as merely a straw man for an otherwise ineligible business. However, requiring

both participants in the transaction to be permitted will safeguard the industry from disqualified persons who might seek to bypass Wisconsin's strict qualification standards for permits and licenses.

Therefore, after reviewing the request for declaratory ruling, as well as the new information, evidence, and legal arguments provided at the hearing regarding production agreements and industry best practices, the Department finds that § 125.52(3), Wis. Stats does not prohibit two separately permitted entities from entering into valid production agreements, such as co-packing or alternating proprietorship agreements, provided that all other laws and regulations are being met.

Dated at Madison, Wisconsin, this 11 day of May, 2023.

WISCONSIN DEPARTMENT OF REVENUE

By: 

Ann DeGarmo
Hearing Examiner

NOTICE OF APPEAL RIGHTS

Set out below is a list of alternative methods available to persons who may wish to obtain review of the attached decision of the Division. This notice is provided to ensure compliance with Wis. Stat. §§ 227.41(5)(a) and 227.48 and sets out the rights of any party to this proceeding to petition for rehearing and administrative or judicial review of an adverse decision.

1. Any person aggrieved by the attached declaratory ruling may within twenty (20) days after service of such declaratory ruling or decision file with the Department of Revenue a written petition for rehearing pursuant to Wis. Stat. § 227.49. Rehearing may only be granted for those reasons set out in Wis. Stat. § 227.49(3). A petition under this section is not a prerequisite for Wisconsin Tax Appeals Commission review under Wis. Stat. §§ 227.41(5) and 73.01(5)(a).

2. Any person aggrieved by the attached declaratory ruling is entitled to review by the Wisconsin Tax Appeals Commission by filing a petition therefore in accordance with the provisions of Wis. Stat. §§ 227.41(5)(a) and 73.01(5). Said petition must be filed with the Wisconsin Tax Appeals Commission, 101 E. Wilson St., Madison, WI 53703 within sixty (60) days after service of the agency decision

sought to be reviewed. The petitioner must pay a \$25.00 filing fee to the Commission at the time of filing of the appeal. If the person filing a petition with the Commission is appealing on behalf of a municipality, the petition must also establish that it has been authorized by an order or resolution of the municipality's governing body and that appeal must be verified by a member of that governing body as pleadings in courts of record are verified pursuant to Wis. Stat. §§ 227.41(5)(a), 73.01(5)(a). If a rehearing is requested as noted in paragraph (1) above, any party seeking review by the Commission shall serve and file a petition for review within sixty (60) days after service of the order disposing of the rehearing application or within sixty (60) days after final disposition by operation of law.