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How New York Drinks: If and How Third-Party Providers can Integrate with the Three-Tier System

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IF AND HOW THIRD-PARTY PROVIDERS CAN INTEGRATE WITH THE THREE-TIER SYSTEM

INTRODUCTION

The leaders of the American temperance movement are surely turning in their graves. Today, a New York consumer need not directly interact with a brick-and-mortar establishment to purchase alcohol. A slew of new companies with names like Drizly, Minibar, Swill, and Thirstie, as well as giants like Amazon, enable convenience or novelty-seeking city dwellers to order drinks for delivery through their websites and apps.[1] These companies have come to be known as third-party providers (TPPs) because they do not themselves hold a state license to sell alcohol, but work with retailers that do,[2] in order to bring customers the convenience of ordering a bottle of Bordeaux from bed. TPPs purport to make the alcohol buying experience easier by providing a platform for license-holding retailers to list their inventory online for purchase.[3]

Alcohol sales in the United States reached over $220 billion in 2016, and the alcohol industry directly employs more than 4.5 million people,[4] but strangely, the laws governing this burgeoning industry are still largely influenced by Prohibition-

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[1] *See About*, TEAM MINIBAR, https://minibardelivery.com/about [https://perma.cc/Q8VY-TXAE]; *About*, THIRSTIE, https://thirstie.com/about [https://perma.cc/VDX8-TXFB]; *About Us*, DRIZLY, https://drizly.com/about-us/e-594c4a6ff3342911 [https://perma.cc/46EF-ZR5T]; Christian de Looper, *Amazon Brings One-Hour Alcohol Delivery to Prime Customers in New York*, TECH TIMES (Dec. 10, 2015, 7:23 PM), http://www.techtimes.com/articles/115286/20151210/amazon-brings-one-hour-alcohol-delivery-prime-customers-new-york.htm [https://perma.cc/W7FZ-672Z]; *What is SWILL?*, SWILL, https://swill.zendesk.com/hc/en-us/articles/213015507-What-is-SWILL- [https://perma.cc/3SUD-DYS7].

[2] *See* Alana Lenore Joyce, Note, *Wine Online: Fermenting the Role of Third Party Providers from California to New York*, 48 U.C. DAVIS L. REV. 2035, 2037 (2015).

[3] *See id.*

[4] *Economic Contributions of the Distilled Spirits Industry*, DISCUS, http://www.discus.org/economics/ [https://perma.cc/MQW5-6TVG]; *Total alcoholic beverage sales in the United States from 2006 to 2016*, STATISTA, https://www.statista.com/statistics/207936/us-total-alcoholic-beverages-sales-since-1990/ [https://perma.cc/XS4E-LDK7].

era principles.[5] Even after the repeal of Prohibition, many American constituencies believed that alcohol caused degeneracy and was contrary to progressive American ideals.[6] Repeal-era lawmakers therefore sought to make alcohol hard to obtain, while simultaneously trying to fill the state coffers.[7] They accomplished this by implementing either a state monopoly over alcohol distribution or a "system of licensing and taxation."[8]

In states that adopted a three-tier licensing and taxation system, participants at each tier generally may be involved in only one major stage of bringing an alcoholic beverage to market.[9] There are, however, many nuances and exceptions that vary from state to state.[10] At the production tier, a licensee makes the liquid, bottles it, and sells it to a licensed wholesaler.[11] The licensee at the wholesale tier may only purchase the product from the producer and sell it to retailers, but not to the general public.[12] Finally, a licensee at the retail tier who has no involvement in either of the first two tiers is the only party that may sell to the general public.[13] Retailers can be "restaurants . . . , bars, and retail stores that sell beer, wine and liquor."[14] In theory, the system rejects vertical integration,[15] although in practice state systems can derogate from this general principle since, after all, alcohol regulation is a state prerogative.

"[T]he temperance ideal and the culture that produced it have all but vanished"[16] from modern politics, but not from the law. Those sensibilities live on in the Alcohol Beverage Control (ABC) Laws, as many states have adopted versions of the three-

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5 *See* DEBORAH M. GRAY, EXPORTER'S HANDBOOK TO THE U.S. WINE MARKET 10 (2015); LISA MCGIRR, THE WAR ON ALCOHOL: PROHIBITION AND THE RISE OF THE AMERICAN STATE 247 (2016).

6 *See* MCGIRR, *supra* note 5, at 20, 249. The dry era came to an end largely due to the economic concerns ushered in by the Great Depression, as well as popular support for action against organized crime, which may not have risen to such infamy and influence without a black market for moonshine and illicit liquor. *Id.* at 244, 249.

7 *See* GRAY, *supra* note 5, at 10.

8 William E. Spellman & Mark R. Jorgenson, *The Social and Revenue Effects of State Alcoholic Beverage Control*, 41 AM. J. ECON. & SOC. 77, 77 (1982).

9 NAT'L ALCOHOL BEVERAGE CONTROL ASS'N, TIED-HOUSE LAWS: POLICY, EXEMPTIONS, AND LEGAL CHALLENGES: A PRESENTATION TO THE 24TH ANNUAL SYMPOSIUM ON ALCOHOL BEVERAGE LAW AND REGULATION 4 (2017), www.nabca.org /Resources/MaterialsDownload.aspx?eid=7932; *see also* Roni A. Elias, *Three Cheers for Three Tiers: Why the Three-Tier System Maintains Its Legal Validity and Social Benefits After* Granholm, 14 DEPAUL BUS. & COM. L.J. 209, 211–12, 216–17 (2015).

10 RAYMOND B. FOSDICK & ALBERT L. SCOTT, TOWARD LIQUOR CONTROL 34 (1933).

11 Elias, *supra* note 9, at 212.

12 *See id* at 216–17.

13 *See id.* at 213, 216–17.

14 *Id.* at 213.

15 NAT'L ALCOHOL BEVERAGE CONTROL ASS'N, *supra* note 9, at 4.

16 W.J. RORABAUGH, THE ALCOHOLIC REPUBLIC: AN AMERICAN TRADITION 221 (1979).

tier system and established state alcohol regulatory agencies.[17] Thus, the regulatory structure of the temperance era remains in place throughout the country.

Regardless of its efficacy, the three-tier system is likely here to stay.[18] Until the advent of the third-party-provider model, there had been few push-backs on the system. The only major challenge to the three-tier system has been whether it violates the dormant commerce clause in the context of direct shipping,[19] and the Supreme Court resolved that issue in 2005. In *Granholm v. Heald*, the Court held that state creation of an exception to the three-tier system that advantages in-state economic interests and burdens out-of-state interests—such as allowing an in-state producer to bypass a wholesaler—constitutes discrimination against interstate commerce in violation of the dormant commerce clause.[20] The Court further stated in dicta that the three-tier system is "unquestionably legitimate,"[21] thereby answering any lingering questions about the Court's opinion of the system itself. Therefore, this note proceeds on that assumption and analyzes how TPPs fit into this unquestionably legitimate system.

Although the architects of the three-tier system created a durable framework, they could not have anticipated modern technology and how it could substantially affect consumer behavior related to the purchase and consumption of alcohol.[22] TPPs unquestionably challenge the structure of the three-tier system. The new function of TPPs is relatively simple, but because it could only be possible for unlicensed entities like TPPs to participate in the sale of alcohol by working with a licensee, regulators must ask if TPPs are really availing themselves of retailers' licenses.[23] TPPs purposely refrain from identifying as "disruptor[s]"[24] in order to avoid the inference that

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17 *See* Elias, *supra* note 9, at 216.

18 This note does not aim to analyze the true efficacy of the three-tier system itself, but rather to identify a workable solution within it.

19 *See* Granholm v. Heald, 544 U.S. 460, 466 (2005).

20 *Id.* at 493.

21 *Id.* at 489 (quoting North Dakota v. United States, 495 U.S. 423, 432 (1990)).

22 *See E-Commerce Task Force Meeting*, N.Y. ST. LIQUOR AUTH. 1:25–1:43 (Apr. 11, 2016), http://abc-state-ny.granicus.com/MediaPlayer.php?view_id=2&clip_id=981 [https://perma.cc/S9T5-RMZR].

23 *See* discussion *infra* Section IV.A.

24 *See, e.g.*, Nicholas Rellas, *Why I Started An Alcohol Delivery Company In A City With No Happy Hours*, LINKEDIN (Sept. 28, 2015), https://www.linkedin.com/pulse/why-i-started-alcohol-delivery-company-city-happy-hours-rellas [https://perma.cc/H3WU-ETWK]. The term "disruptor" is commonly understood to refer to a company that alters the status quo of an industry in such a way that "successfully challenge[s] established incumbent businesses." Clayton M. Christensen et al., *What is Disruptive Innovation?*, HARV. BUS. REV. (Dec. 2015), https://hbr.org/2015/12/what-is-disruptive-

their businesses overstep the privileges of licensees, but they are arguably engaging in activities that are an integral part of the three-tier system.[25] For this reason, a few states have attempted to provide guidance regarding regulatory compliance to these types of businesses. New York, for example, has done so through declaratory judgments issued by the state regulatory body.[26] Despite those efforts, competing interests—including states' ambitions to become technology hubs, traditional brick-and-mortar retailers' interests in retaining the privileges of their licenses, and entrepreneurs' interests in capitalizing on innovation and trends in consumer demand—have created a lack of consensus and direction that, together, have blocked sincere regulatory effort.[27]

In its declaratory judgments, the New York State Liquor Authority (NYSLA)[28] has articulated its position as to the appropriate role of third parties and their obligations to licensees.[29] The NYSLA, however, has repeatedly failed to apply its own rules uniformly, thus creating a hazy regulatory landscape where it is possible, and probable, that TPPs avail themselves of retailer licenses by overstepping the boundaries of the rights and duties of the licensee.[30] In order to avoid availment and unfair competition problems, it is incumbent upon the NYSLA to take concrete action. The issuance of a third-party permit would most effectively address the concerns of state regulators, licensed retailers, and TPPs themselves.

Part I illustrates the overarching legal framework that governs liquor law, from the authority granted to states by the Twenty-First Amendment and complementary law on the federal level, to state implementation of that authority and big-picture rationale supporting the three-tier system ultimately implemented. Part II explains the local framework specific to

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innovation [https://perma.cc/X6XW-GKLF]. Business theorists attribute more nuance to the concept of disruption than is required for the purposes of the discussion in this note. *See id.*

[25] Joyce, *supra* note 2, at 2037.

[26] *See* discussion *infra* Section III.B.

[27] *E-Commerce Task Force Meeting*, *supra* note 22, at 12:44–13:01, 18:09–21:18. (While brick and mortar liquor store owners accept that there is consumer demand for services provided by TPPs, they believe that TPPs create unfair competition by being permitted to engage in the sale of alcohol without the barriers to entry and responsibilities incumbent upon licensees. TPPs, on the other hand, see themselves as mere technology providers. Combined with the state interest in generating economic activity, but also in responsible regulation, industry participants have not been able to agree on a way forward.).

[28] The New York State Liquor Authority is the agency responsible for regulating the alcohol trade in the state of New York. *Agency Mission Statement*, N.Y. ST. LIQUOR AUTH., https://www.sla.ny.gov/agency-mission-statement [https://perma.cc/NB7C-YDNR].

[29] *See* discussion *infra* Sections III.B, V.C.

[30] *See* discussion *infra* Sections III.B, IV. A, IV.B.

New York State, including the role of the NYSLA and state-specific treatment of the three tiers. Part III discusses treatment of the third-party-provider problem, including the different ways in which they can conduct business, how the NYSLA has adjudicated different applications for approval through declaratory judgments, and the resulting hazy regulatory landscape. Part IV addresses the problems and consequences of third-party interaction with the traditional model. Part V evaluates possible solutions, and concludes that the creation of a third-party permit would provide the most effective solution by addressing the concerns of each interest group involved.

I. OVERARCHING LEGAL FRAMEWORK OF THE ALCOHOL INDUSTRY

After the failure of national prohibition, control over alcohol regulation returned to the states. The most commonly adopted framework was, and remains, what we now call the three-tier system.

A. Prohibition, Repeal, and the Federal Interest

The passage of the Eighteenth Amendment represented the culmination of an American religious and social movement that had been mounting for decades against the perceived "degeneracy" caused by alcohol.[31] It prohibited the "manufacture, sale, or transportation of intoxicating liquors within, the importation thereof into, or the exportation thereof from the United States."[32] A national political tilt toward progressive reform combined with a wartime sense of sacrifice and patriotism eventually garnered broad congressional support for the amendment, and led to swift state ratification.[33] Policymakers and proponents of Prohibition hoped that it would usher in a new era of cultural improvement.[34] While Prohibition helped decrease consumption rates, "draconian new fines and penalties" were imposed,[35] usually upon poor people found violating the law,[36] and crime rates associated with bootlegging and mob violence soared due to the market for illicit liquor.[37] With the arrival of the Great Depression in the early 1930s, and the need

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[31] *See* MCGIRR, *supra* note 5, at 14–21.
[32] U.S. CONST. amend. XVIII § 1.
[33] MCGIRR, *supra* note 5, at 35.
[34] *Id.* at 20.
[35] *Id.* at 234.
[36] *Id.* at 71.
[37] *See id.* at 53–54, 57.

to prioritize economic stimuli, many Americans were ready to repeal the Eighteenth Amendment as quickly as they had enacted it.[38]

Prohibition made Americans both more skeptical and more tolerant of federal regulatory power.[39] Many of the alternative regulatory schemes that emerged during the post-Prohibition debate over liquor control reflected a soberer consciousness regarding the "promises and perils of federal regulatory power."[40] Still, the most popular proposals granted the federal government significant, if not absolute, authority to regulate the alcohol industry.[41] Shortly after taking office, Franklin D. Roosevelt famously stated, "It's time the country did something about beer."[42]

The first section of the Twenty-First Amendment repealed the Eighteenth Amendment and the second section "forbids the transportation of intoxicants into any state for delivery or use in violation of the laws of that state."[43] Congress thereby returned to the states the power to regulate the alcohol industry within its borders.[44] The enthusiasm to remain dry in some states eventually faded,[45] but lingering support for the moral principles behind Prohibition lived on in state regulation both through state monopolies, and through the three-tier system adopted by most states.[46]

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[38] *Id.* at 233.

[39] *Id.* at 247.

[40] *Id.*

[41] *Id.* at 247. Two of the proposed alternative liquor control models were the Gothenburg system and the Quebec plan. *Id.* The hallmark of the Gothenburg system was the issuance of one retail license to a company that would be held as a trust. *Gothenburg Public Houses*, SCOTTISH MINING WEBSITE, http://www.scottishmining.co.uk/18.html [https://perma.cc/C78Q-E7TA]. The trust was responsible for administering use of the license in a way that discouraged excessive drinking, and for administering 95 percent of the profits for the benefit of the community. *Id.* The American version would likely have allowed the federal government to retain influence over the industry through administration of the trust. *See id.*; *see also* MCGIRR, *supra* note 5, at 247. A Quebec-style plan implies a government monopoly. MCGIRR, *supra* note 5, at 247.

[42] *Id.* at xiii.

[43] FOSDICK & SCOTT, *supra* note 10, at 25 (citing U.S. CONST. amend. XXI).

[44] *See id.* at 17–18, 25. It is Section Two that has caused much debate with respect to the conflict between the Twenty-First Amendment and the dormant commerce clause, particularly in the context of direct shipment of wine. *See* Granholm v. Heald, 544 U.S. 460, 460 (2005); Amy Murphy, Note, *Discarding the* North Dakota *Dictum: An Argument for Strict Scrutiny of the Three-Tier Distribution System*, 110 MICH. L. REV. 819, 821 (2012).

[45] *See* MCGIRR, *supra* note 5, at 249.

[46] S*ee* Spellman & Jorgenson, *supra* note 8, at 77, Elias, *supra* note 9, at 216. Washington State is unique in that voters by referendum recently elected to allow producers to sell directly to retailers, as well as other provisions that increase freedom of movement. Melissa Allison, *Voters Kick State Out of Liquor Business*, SEATTLE TIMES, Nov. 8, 2011, http://old.seattletimes.com/html/localnews/2016720231_elexliquor09m.html [https://perma.cc/XEZ2-878N].

The modern regulatory landscape for alcohol sales in the United States consists of an intricately woven thicket of federal and state laws, and state programs must conform with some degree of federal oversight.[47] Until the Alcohol and Tobacco Tax and Trade Bureau (ATTB) was created in 2003 under the umbrella of the Treasury Department, the federal government regulated different parts of the alcohol business through a patchwork of individuals representing numerous agencies.[48] The role of the ATTB is to collect federal taxes on alcohol and ensure compliance with federal law regulating the alcoholic beverage industry.[49] While just a small sliver of the overall budget, the government raises approximately $5.6 billion per year through excise taxes on sales of alcohol.[50]

B. State Regulation and the Three-Tier Rationale

Once within the power of the states, the direction of liquor regulation became subject to the "moralistic assumptions" of the new liquor authorities and their local constituencies.[51] Each state liquor authority could independently develop its own rules controlling "how the trade should operate, with hours of sale, location with respect to schools and churches, advertising, the character of retail outlets, the degree of visibility of the interior from the street," and so on.[52] More socially conservative states adopted monopoly regimes by which the government maintained full control over retail, or distribution and retail.[53] The majority of states, however, developed a three-tier system to license private dealers.[54]

To illustrate, in 1933, Governor Pinchot of Pennsylvania, a monopoly-control state, purportedly stated that the newly minted Liquor Control Board would "discourage the purchase of alcoholic beverages by making it as inconvenient and expensive as possible."[55] Although the state has recently loosened its grip,

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[47] *Granholm*, 544 U.S. at 466.

[48] *The TTB Story*, ALCOHOL AND TOBACCO TAX AND TRADE BUREAU, https://www.ttb.gov/about/history.shtml [https://perma.cc/JAD8-PYUN].

[49] *Id.*

[50] *How Much is the Government Making off of Alcohol?* TURBOTAX BLOG, (July 5, 2010), https://blog.turbotax.intuit.com/taxes-101/how-much-is-the-government-making-off-of-alcohol-3418/ [https://perma.cc/6RL7-TZ4S].

[51] MCGIRR, *supra* note 5, at 248–49.

[52] *Id* at 248.

[53] Murphy, *supra* note 44, at 824.

[54] *See id.*

[55] GRAY, *supra* note 5, at 10.

particularly on wine retail,[56] the Pennsylvania Liquor Control Board has been the only entity that may purchase wine and spirits from producers, set prices for wine and spirits, and sell wine and spirits through state-run stores.[57] To contrast, in California, where alcohol comprises an important portion of state revenue, the regime is more loosely constrained and allows importers to function on all three tiers of the system.[58] This has allowed the Californian wine industry alone to produce $57.6 billion in economic activity for the state.[59]

Although the specific regulations may differ from state to state, most eventually adopted some version of a "three-tier[ed]" distribution system.[60] A hallmark of the system is prevention of "vertical integration" by prohibiting or limiting single ownership of any of the three alcohol industry tiers—product manufacturing, wholesale-distribution, and product retail—depending on the state's variations on the general principle.[61] The state may exercise more control or less control depending on local priorities.[62] Post-Prohibition regulators and private citizens alike were primarily interested in both discouraging alcohol abuse and rebuilding the economy in the wake of the Great Depression. A three-tier distribution system accomplishes this by creating operation costs, thereby producing state revenue by taxing at each level.[63] It also prevents alcohol prices from sinking

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[56] *Pennsylvania Wine Law Primer*, WINESCHOOL, https://www.vinology.com/new-wine-laws-plcb/ [https://perma.cc/AM7U-WUKN].

[57] *See* 47 PA. STAT. AND CONS. STAT. ANN.§ 3–301 (West 1997); *see also* Emma Snyder, Note, *Privatization in Pennsylvania: How Reforming the Pennsylvania Liquor Code Would Benefit the Commonwealth and its Citizens*, 119 PENN STATE L. REV. 279, 285–86 (2014) (citing 47 PA. STAT. AND CONS. STAT. ANN. § 2–207).

[58] GRAY, *supra* note 5, at 12.

[59] WINE INST., THE ECONOMIC IMPACT OF THE CALIFORNIAN WINE AND WINEGRAPE INDUSTRY (2015), http://www.wineinstitute.org/files/Wine_Institute_2015_Economic_Impact_Highlights.pdf [https://perma.cc/5WHV-MMGE].

[60] Elias, *supra* note 9, at 216.

[61] Granholm v. Heald, 544 U.S. 460, 466 (2005); FED. TRADE COMM'N, POSSIBLE ANTICOMPETITIVE BARRIERS TO E-COMMERCE: WINE 5 (2003), https://www.ftc.gov/sites/default/files/documents/reports/possible-anticompetitive-barriers-e-commerce-wine/winereport2_0.pdf [https://perma.cc/TCD2-G2R6]; Elias, *supra* note 9, at 210.

[62] *See* GRAY, *supra* note 5, at 11.

[63] Three-tier distribution creates not only state income, but also income for the private dealers who participate in the industry. Elias, *supra* note 9, at 221–22. Economic data shows that the scheme benefits the industry overall through its use of wholesalers as intermediaries. *Id.* While wholesalers benefit from being able to sell a large quantity of merchandise in a "relatively small number of transactions," retailers also benefit because they do not need to maintain such an expansive inventory as is available on the market and can tailor their purchasing behavior to their customers' needs as they change. *Id.* Estimates predict that "'wholesaler activities reduce retailers' costs by almost $52.00 for every $1,000.00 in retailer sales, for a national savings in retailer operating costs of $7.2 billion per year." *Id.* (quoting DAVIS S. SIBLEY & PADMANABHAN SRINGARESH, DISPELLING THE MYTHS OF THE THREE-TIER DISTRIBUTION SYSTEM 15 (2008), http://

too low, a phenomenon that commentators have historically correlated with increased rates of alcohol abuse.[64]

Proponents of the three-tier system argue that it remains a viable modern-day framework for a number of reasons. Alcohol is still considered more dangerous than "ordinary commodit[ies]" and many believe that it should be subject to heavier regulation.[65] Additionally, the three-tier system's local flexibility empowers communities to "tailor [their] rules to local conditions" via the state regulatory authority, and it is inherently enforceable thanks to a built-in proximity to law enforcement and accountability to the community.[66] The use of wholesalers[67] also "makes it possible to funnel the wide variety of available products to different market niches with [an] efficiency that would not be available in a marketplace without wholesalers."[68] This reduces transaction costs, and ultimately, costs to consumers.[69] Finally, limited vertical integration and price minimums can, contrary to popular belief, promote competition.[70]

There are plenty of opponents to the three-tier system, particularly since the advent of the Internet, as the Internet has been nothing if not a disrupter of traditional ways of doing business. Some of the opponents' complaints include that producers, particularly small wineries, are often barred from market entry because they outnumber wholesalers licensed to distribute within the state; that the three-tier system limits consumer choice; and that the three-tier system precludes retailers from maximizing profits in many cases by barring direct shipment.[71]

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www.five-star-wine-and-spirits.com/includes/archivos/about_five_start/pdf/three_tier_01.pdf [https://perma.cc/2EW3-68XU]).

[64] RORABAUGH, *supra* note 16, at 89–90.

[65] Elias, *supra* note 9, at 218–19 (quoting THOMAS BABOR ET AL., ALCOHOL: NO ORDINARY COMMODITY (2003)).

[66] *Id.*

[67] As a general term, "wine and spirits wholesalers . . . purchase goods on their own account for resale." *Id.* at 212. States may assign different rights to wholesalers, and for example in New York, wholesalers are defined as "those licensees manufacturing, storing and distributing alcoholic beverages for sale to licensed retailers." *Licensing Information*, N.Y. ST. LIQUOR AUTH., https://www.sla.ny.gov/licensing-information-0 [https://perma.cc/7XNG-W9RS].

[68] Elias, *supra* note 9, at 220–22.

[69] *See id.* at 220.

[70] *Id.* at 224 ("When a supplier has an exclusive agreement with a distributor, and when that agreement includes prescriptions about a minimum price for a product, such arrangements can reduce intrabrand competition and stimulate the distributor's marketing efforts. This is because, in a territory where a distributor has exclusive rights in a particular brand, that distributor does not compete with any other provider of that brand in its territory, but it does have an incentive to invest in its brand in order to compete vigorously against distributors of competing brands.").

[71] Murphy, *supra* note 44, at 825.

II. NEW YORK STATE FRAMEWORK

New York is one of the majority states that adopted a three-tier licensing system, as opposed to a monopoly system post-Prohibition. The New York Legislature created the New York State Liquor Authority to regulate the alcohol industry within the state.[72]

A. New York State Liquor Authority

In 1934, New York State created the NYSLA as its overarching regulatory body.[73] The New York Legislature's intent in creating the NYSLA was to:

> regulate and control the manufacture, sale and distribution within the state of alcoholic beverages for the purpose of fostering and promoting temperance in their consumption and respect for and obedience to law; for the primary purpose of promoting the health, welfare and safety of the people of the state, . . . and, to the extent possible, supporting economic growth, job development, and the state's alcoholic beverage production industries and its tourism and recreation industry; and which promotes the conservation and enhancement of state agricultural lands; provided that such activities do not conflict with the primary regulatory objectives of this chapter.[74]

Interestingly, the NYSLA still publicly espouses as its priorities promotion of temperance, health, welfare, and safety within the state. Economic growth is a secondary concern that may be pursued only if not at the expense of the former.[75] The NYSLA's Division of Alcoholic Beverage Control (DABC) implements the mission of the NYSLA primarily by determining eligibility for, and issuance of, "licenses and permits for the manufacture, wholesale distribution and retail sale of all alcoholic beverages."[76] The DABC is also responsible for inspecting licensee premises, investigating violations, ensuring compliance with the ABC Law, and conducting disciplinary proceedings that can result in revocation of a license if required.[77]

In the event that any party is unsure of, or wants to dispute, the application of an NYSLA rule, the NYSLA also "issues administrative decisions, known as declaratory rulings,

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[72] N.Y. ALCO. BEV. CONT. LAW § 2 (McKinney 2014).

[73] *Historical Overview*, N.Y. ST. LIQUOR AUTH., https://www.sla.ny.gov/historical-overview [https://perma.cc/7J9Q-65MZ].

[74] N.Y. ALCO. BEV. CONT. LAW § 2.

[75] *See id.* (Making a distinction between a primary purpose and other goals of the NYSLA "to the extent [they are] possible.").

[76] *Historical Overview*, *supra* note 73.

[77] *Id.*

on the proper application of state wine laws. The rulings can bind any person, property, or set of facts in New York."[78] NYSLA adjudication is available to anyone who requires "a ruling on the application of certain facts to an ABC law or SLA rule."[79] The NYSLA consists of three commissioners, one of whom serves as chairman, who are appointed by the governor, with the "advice and consent of the senate."[80] These commissioners are responsible for issuing declaratory rulings interpreting ABC Law,[81] and it is through these declaratory rulings that the NYSLA has shaped its policies on the operation of TPPs.[82]

B. Three-Tier Framework in New York State

The government aims to keep the space between barley, apple, or grape to glass three steps removed through its liquor laws, which divide the industry into three tiers: production, wholesale, and retail.[83] Alcohol is governed by "overlapping state and federal regulations," which "limit vertical integration between tiers" by prohibiting an entity from occupying more than one tier.[84] In New York, this means that (1) producers may not have an economic interest in wholesale or retail operations, (2) wholesalers may not have an economic interest in production or retail operations, and (3) retailers may not have an economic interest in production or wholesale operations.[85] Occupants of each tier must apply for and obtain different permits or licenses.[86]

The production tier consists of both importers, who bring "distilled spirits, wine, or malt beverages" into the United States for sale to licensed wholesalers, as well as producers, or makers "in the business of distilling distilled spirits, producing wine, rectifying or blending distilled spirits or wine, or bottling, or warehousing and bottling, distilled spirits."[87] In short, the production tier generally consists of importers, distilleries,

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[78] Joyce, *supra* note 2, at 2046 (footnotes omitted).

[79] *Id.* at 2049 (footnote omitted).

[80] N.Y. ALCO. BEV. CONT. LAW §§ 10, 11 (McKinney 2014).

[81] *See id.* (Defining the state liquor authority as its chairman and two commissioners.)*; see also* N.Y. COMP. CODES R. & REGS. tit. 9, § 98.1 (2017) "Any person may apply to the Authority for a declaratory ruling with respect to the applicability . . . of any rule of statute enforceable by the Authority." *Id.* at § 98.1. "Petitions for a declaratory ruling shall . . . [b]e addressed to Counsel, State Liquor Authority." *Id.* at § 98.2. "Declaratory rulings will be issued only in the discretion of the members of the Authority." *Id.* at § 98.3. "Declaratory rulings shall be binding on the Authority . . . ." *Id.* at § 98.5.

[82] *See* discussion *infra* Section III.B.

[83] *See* discussion *supra* Section I.B.

[84] Granholm v. Heald, 544 U.S. 460, 466 (2005).

[85] *See id.*

[86] *Id.*

[87] 27 U.S.C. § 203 (2012).

wineries, breweries, cideries, and other such establishments. To become an importer or a producer in the United States, an individual or entity must apply for "a basic permit from [the federal government via] the Alcohol and Tobacco Tax and Trade Bureau."[88] "After obtaining the permit, the [importer or] producer may sell its products to any wholesaler that is located in the state and has obtained a state license to distribute alcohol."[89]

The wholesale or distribution tier is generally in the business of acquiring or "manufacturing, storing and distributing alcoholic beverages for sale to licensed retailers." [90] In addition to conforming with the requirements for obtaining the wholesaler's license itself, the wholesale tier is subject to further statutory restrictions on how sales are to be recorded, and how the liquors or beverages themselves are to be transported and delivered.[91] The wholesaler of alcoholic beverages may not engage in any other business on its premises, except for the sale of certain items enumerated in the statute.[92] These exceptions include the sale of snacks, soft drinks, candy, tobacco products, picnic supplies, and even "non-refrigerated salsa."[93] If the wholesaler is acquiring goods for sale, it must do so from a licensed producer (or importer), located in the same state.[94] The wholesaler itself must always maintain a location within the state.[95]

The retail tier consists of vendors, or retailers, who must acquire a license to "purchase, stock and sell alcoholic beverages for consumption on or off-premises."[96] Like occupants of the other tiers, retailers must maintain a location within the state in order to deliver directly to consumers within the state,[97] and may only purchase products to sell to consumers from licensed wholesalers.[98] Retailers are also further subject to compliance with "a set of highly detailed regulations governing the location,

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[88] FED. TRADE COMM'N, *supra* note 61, at 5–6.

[89] Murphy, *supra* note 44, at 824.

[90] *Licensing Information*, *supra* note 67; *see also* N.Y. ALCO. BEV. CONT. LAW § 104 (McKinney 2014).

[91] N.Y. ALCO. BEV. CONT. LAW § 104.

[92] *Id.*

[93] *Id.*

[94] Murphy, *supra* note 44 at 824.

[95] *Id.* at 824–25.

[96] *Licensing Information*, *supra* note 67; *see also* N.Y. ALCO. BEV. CONT. LAW § 104-a (McKinney 2014).

[97] *See* Arnold's Wines, Inc. v. Boyle, 571 F.3d 185, 188 (2d Cir. 2009) ("Out-of-state retailers without an in-state operation cannot obtain a New York retail off-premises license."). "Because New York's three-tier system treats in-state and out-of-state liquor the same, and does not discriminate against out-of-state products or producers, . . . New York's ABC Law[s] . . . do not run afoul of the Commerce Clause." *Id.* at 191–92.

[98] *See* FED. TRADE COMM'N, *supra* note 61, at 5.

physical characteristics, and operating hours of their premises, as well as their financial relationships with producers and wholesalers, and the manner in which they keep books and records for all their transactions."[99] States benefit from retail sales through the applicable sales tax that retailers are required to collect and transfer to the state government.[100]

III. TREATMENT OF THE THIRD-PARTY-PROVIDER PROBLEM

The last decade has seen a proliferation of startup companies aimed at delivering convenience, primarily to urban young professionals, in the form of task management,[101] housekeeping,[102] grocery shopping,[103] meal delivery,[104] and alcohol delivery.[105] The availability of these services has rapidly changed consumer behavior of that demographic. Indeed, TPPs "arguably engage in activities for which a license is mandated,"[106] and despite changing consumers' behaviors, state regulators of the alcoholic beverage industry have been slow to react. To date, the NYSLA has not mandated that TPPs apply for their own retail licenses.[107] The NYSLA has indirectly promulgated some guidelines as to the legality of TPPs' business practices by evaluating, on a case-by-case basis, the applications of new TPP-style companies seeking the NYSLA's approval. Without meaningful application of that guidance and further action, however, this is insufficient to mitigate tensions between TTPs and traditional industry players, to prevent illegal activity on the part of TTPs and their partners, and to create an environment conducive to economic growth within the industry and for the state overall.

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[99] *Arnold's Wines*, 571 F.3d at 188 (citing N.Y. ALCO. BEV. CONT. LAW § 105).

[100] FED. TRADE COMM'N, *supra* note 61, at 5; Murphy, *supra* note 44, at 825.

[101] *See, e.g.*, *About Us*, TASKRABBIT, https://www.taskrabbit.com/about [https://perma.cc/KA6M-6S69] ("Our same-day service platform instantly connects you with skilled Taskers to do your chores so you can be more productive, every day.").

[102] *See, e.g.*, *About Handy*, HANDY, https://www.handy.com/about [https://perma.cc/3VGM-ULPQ] ("Handy is the leading platform for connecting individuals looking for household services with top-quality, pre-screened independent service professionals.").

[103] *See, e.g.*, *About Us*, FRESHDIRECT, https://www.freshdirect.com/browse.jsp?id=about_overview [https://perma.cc/6X3N-UPTV] ("We're on a mission to deliver quality beyond question and convenience that adds something great to your day.").

[104] *See, e.g.*, *About Seamless*, SEAMLESS, https://www.seamless.com/about [https://perma.cc/B3AG-FUKF] ("Seamless is simply the easiest way to order food for delivery or takeout.").

[105] *See, e.g.*, *About Us*, DRIZLY, *supra* note 1 ("Transforming the way alcohol is shopped, sold and shared. . . . We demand convenience in all facets of life—shopping for clothes, groceries, furniture. Why should shopping for alcohol be any different?").

[106] Joyce, *supra* note 2, at 2037.

[107] *Id.*

A. Appearance of Third-Party Providers

Technology has changed consumer behavior in ways that we may not have imagined even a decade ago, when meal delivery still required browsing neighborhood take-out menus collected and kept in a kitchen drawer, as well as an actual telephone call to a restaurant. Today, online food delivery giant Seamless attracts users with promises of zero interaction with people and secrecy with regards to the average city dweller's late night dumpling and doughnut ordering habit.[108] Similar to the transformation of food delivery, the shift in the alcohol industry began around 2008, when a web site called Wakozi started offering alcohol delivery services from Manhattan bodegas and wine and liquor stores.[109] The company listed neighborhood retailers' inventory on the Wakozi website and received online orders from customers. It then provided the retailers with order information so that the retailers themselves could fulfill the orders and make the deliveries.[110] Wakozi has since shut down, but a number of new companies operating on the same premise—TPPs—have risen in its stead.[111]

B. NYSLA Adjudication & Declaratory Judgments

The NYSLA's history of adjudication has created a hazy regulatory landscape for new companies that wish to operate in partnership with licensees.[112] While there is no affirmative duty on the part of new businesses dealing with licensees to seek adjudication, it is an available mechanism for ascertaining the NYSLA's opinion on the legality of a specific operation and avoiding an enforcement action.[113] Even so, only a few TTPs have

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[108] *About Seamless*, *supra* note 104 ("Seamless is simply the easiest way to order food for delivery or takeout. Whatever you're in the mood for, wherever you're in the mood for it, you've got it. No menus, no phone calls, no repeating yourself.").

[109] Erick Schonfeld, *Wakozi is Kozmo for Booze*, TECHCRUNCH (Mar. 28, 2008), https://techcrunch.com/2008/03/28/wakozi-is-kozmo-for-booze/ [https://perma.cc/DR3C-CNWC].

[110] *Id.*

[111] *See* Lauren Sheffield, *The Best Alcohol Delivery Services in NYC*, HARPER'S BAZAAR (Feb. 5, 2016), http://www.harpersbazaar.com/culture/travel-dining/a13852/alcohol-delivery-nyc/ [https://perma.cc/87N2-J3K8] (These companies, such as Drizly, Minibar, Swill and Thirstie, aim to act as intermediaries between retailers and consumers, and they are what have become known as third-party providers.). For the purposes of this discussion, "TPPs are independent persons or businesses that operate websites to market and advertise [alcoholic beverages] for sale from licensed producers and retailers." Joyce, *supra* note 2, at 2037.

[112] *See* discussion *infra* Section III.B.

[113] *See* N.Y. COMP. CODES R. & REGS. tit. 9, § 98.1 (2017). According to the Rules of the State Liquor Authority, "[a]ny person may apply to the Authority for a declaratory ruling with respect to the applicability to any person, property or state of facts of [the Alcohol Beverage Control Law or] any rule or statute enforceable by the Authority." *Id.*

sought adjudication, and, accordingly, the NYSLA adjudicators have used those opportunities to articulate the NYSLA's position on what constitutes legal TTP activity.[114] The adjudicators have repeatedly referenced those declaratory rulings in subsequent rulings as guidelines on its position regarding what constitutes an acceptable relationship between licensee and non-licensee.[115] The NYSLA adjudicators, however, also proceed to apply those standards broadly and inconsistently,[116] perhaps suggesting that the NYSLA hopes to keep the regulatory landscape in the fog until politics have had time to shift distinctly, and it can avoid rocking the proverbial boat.

TPP applications for declaratory rulings began to appear before the NYSLA after Groupon and Living Social—both companies that sell coupons on their websites for one price, which consumers can redeem for a higher amount—started offering deals that included discounts on alcoholic beverages.[117] The NYSLA generally approved of the Groupon operation because the company was careful to draw a hard line between the rights and responsibilities of the licensee and the limited, extrinsic role of Groupon.[118] It then applied its analysis of Groupon to Living

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Declaratory rulings represent the "discretion of the members of the Authority" and are "binding on the Authority and shall not be retroactively changed," as to that particular set of facts. *Id.* §§ 98.3, 98.5 (2017).

114 *See* Application of Six88 Solutions, Inc. d/b/a ShipCompliant for a Determination on Legality of Internet Advertising Platform, Declaratory Ruling 2013-01006A, at 7 (N.Y. Liquor Auth. Apr. 19, 2013) [hereinafter ShipCompliant Ruling] (listing three kinds of impermissible TPP-licensee relationships), https://www.sla.ny.gov/system/files/2013-01006A_-_Internet_Advertising_Platform.pdf [https://perma.cc/CU36-4X2K]; *see also* Operation of smartphone/web application Drizly, Declaratory Ruling 2013-02526, at 2 (N.Y. Liquor Auth. Sept. 25, 2013) [hereinafter Drizly Ruling], https://www.sla.ny.gov/system/files/2013-02526_-_Operation_of_smarphone-web_application_Drizly.pdf [https://perma.cc/ULD6-7V5L] (applying ShipCompliant Ruling through two-part inquiry).

115 *See, e.g.*, Operation of Smart Phone application "Century Club," Declaratory Ruling 2015-00074 (N.Y. Liquor Auth. Jan. 30, 2015) [hereinafter Century Club Ruling], https://www.sla.ny.gov/system/files/2015-00074_-_Operation_of_Smart_Phone_application_-_Century_Club.PDF [https://perma.cc/6562-2BWZ] (referencing Drizly, Lot 18, and Slingr Rulings and applying Drizly's two-part inquiry); Operation of Smart Phone application Slingr, Declaratory Ruling 2013-02826B, at 2–3 (N.Y. Liquor Auth. Oct. 22, 2013) [hereinafter Slingr Ruling], https://www.sla.ny.gov/system/files/2013-2826B_-_Operation_of_Smart_Phone_Application_Slingr.pdf [https://perma.cc/Z62C-QES4] (applying two-part inquiry set out in Drizly Ruling); Drizly Ruling, *supra* note 114 (condensing and applying the ShipCompliant Ruling via a two-part inquiry).

116 *See, e.g.*, Century Club Ruling, *supra* note 115; Slinger Ruling, *supra* note 115. *See* Operation of Mobile Phone Application Swill, Declaratory Ruling 2015-01557D, at 1 (N.Y. Liquor Auth. July 14, 2015), [hereinafter Swill Ruling], available at https://www.sla.ny.gov/files/2015-01557D_-_Operatin_of_Mobile_Phone_Application_Swill.pdf [https://perma.cc/R9AM-SUTV].

117 *Know the Law: Adjustments at the NYSLA: Social Media, Enforcement, NYS Brewers Among the Changes Affected*, BEVERAGE MEDIA GROUP (May 2, 2012), https://www.beveragemedia.com/2012/05/02/adjustments-at-the-sla-social-media-enforcement-nys-brewers-among-the-changes-affected/ [https://perma.cc/MY9R-NVXN].

118 *Id.*

Social's more flexible proposal.[119] Stressing the sensitivity of potential "economic interest[s] in the licensed establishment"[120] and that the "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,"[121] the NYSLA laid out its inaugural guidance on TPPs. Most notably, the ruling emphasized the importance of licensee control, placed a 10 percent of annual revenue cap on the amount a licensee may pay a TPP, and forbade the use of a percentage-based commission structure between licensees and TPPs.[122]

In its next major relevant declaratory ruling, the NYSLA found that a TPP–licensee relationship violated ABCL § 111 where the arrangement allowed an advertiser to engage in conduct constituting the sale of alcoholic beverages by an unlicensed entity.[123] ShipCompliant is a company that worked with an advertiser to provide licensees, such as wine stores and wineries, with a mechanism to sell their products online through unlicensed Internet advertising platforms, such as "internet marketing portals, online magazines and specialty websites."[124] ShipCompliant also purported that its model included built-in "regulatory compliance services," although it is unclear exactly how.[125]

The declaratory ruling in this case represents the conclusion of what had been an ongoing investigation, presumably due to a complaint from a community organization worried about the oversaturation of certain areas with liquor licenses and perceived unfair competition.[126] The investigation uncovered a number of material facts that had not been accurately represented to the NYSLA.[127] Although ShipCompliant's application for review noted that its product was designed to fit within the contours of the three-tier system, the Authority was ultimately swayed by the fact that the licensee in reality had very little control over sales in its relationship with the advertiser.[128] For example, the retailer

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[119] *Id.*

[120] Application of Alcoholic Beverage Control Law with respect to on-line coupon service by Living Social, Declaratory Ruling 2011-03527C at 2 (N.Y. Liquor Auth. Nov. 30, 2011) [hereinafter Living Social Ruling], https://www.sla.ny.gov/system/files/2011-03527C-On-line%20coupon-LivingSocial.pdf [https://perma.cc/9U5C-2C3H].

[121] *Id.*

[122] *Id.* at 3–4.

[123] ShipCompliant Ruling, *supra* note 114, at 5–6.

[124] *Id.* at 2.

[125] *Id.* at 2.

[126] Sara Mann, *New Marketing Model for New York—Lot 18 and the NYSLA*, HINMAN & CARMICHAEL LLP (May 1, 2014), http://www.beveragelaw.com/booze-rules/new-marketing-model-for-new-york-lot-18-and-the-nysla [https://perma.cc/XYL2-E9YC].

[127] ShipCompliant Ruling, *supra* note 114, at 1, 3.

[128] *See id.* at 6.

made a pre-determined profit, the advertiser made decisions regarding which products would be sold and at what prices, and instead of selling wines out of the retailer's store, the wine was actually being sold from a warehouse with which only the advertiser had a relationship.[129]

Framing ShipCompliant as an extreme case, the Authority went beyond the usual case-by-case analysis of declaratory rulings to establish several rules.[130] In light of the facts of ShipCompliant, the NYSLA designated three types of impermissible TPP-licensee relationships: (1) a licensee may not take a passive role and must incur some degree of business risk through the relationship; (2) an unlicensed party may not engage in retail functions that should be controlled by the store; and (3) the third party's profit may not be "a substantial portion of the sale or sales made."[131] The NYSLA continues to point to the ShipCompliant ruling, calling it "good guidance," instead of issuing definitive rules.[132] Although the NYSLA clearly applied these rules in the immediately subsequent Drizly ruling, further distilling them into a two-part inquiry, the NYSLA's application in following rulings is increasingly vague.[133]

In applying the ShipCompliant methodology to Drizly, the NYSLA applied a two-part inquiry derived from the ShipCompliant ruling to identify Drizly as a model example of TPP regulatory compliance.[134] Drizly is "a smartphone/web app

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[129] *Id.* at 3.

[130] *See id.* at 7.

[131] ShipCompliant Ruling, *supra* note 114, at 7.

[132] Mann, *supra* note 126.

[133] *But see* Application of the Alcoholic Beverage Control Law to Forbes Wine Club by Lot 18, Declaratory Ruling 2014-01059 (N.Y. Liquor Auth. May 6, 2014) [hereinafter Forbes Ruling], https://www.sla.ny.gov/system/files/2014-01059-Application_of_the_Alchoholic_Beverage_Control_Law_to_Forbes_Wine_Club_by_Lot18.pdf. [https://perma.cc/AW8T-5Y6Y]. Not all rulings have been inconsistent. *See id.* In adjudicating the application of Lot 18, the NYSLA appropriately found that an advertiser can properly function in partnership with a licensee when there is no question as to licensee control over inventory, fulfillment, payment and visibility. *Id.* Lot 18 is a brick-and-mortar package store with its own website that partnered with Forbes to market a wine club concept. *Id.* The Lot 18 judgment is consistent with prior guidance because, like Drizly, Lot 18 controlled all aspects of the retail sale of the wine on offer by selecting wines for the club and itself acquiring all inventory from New York State licensed wholesalers, by reviewing orders, and by receiving payments. *Id.* Although Lot 18 engaged another third party, We Ship, to fulfill the wine club orders, Lot 18 handled all communications and directions to the shipper. *Id.* Forbes' role was limited to providing use of its trademark for a flat fee, and marketing, for which it receives a flat fee per customer enrolled. Furthermore, the NYSLA determined that the use of Forbes' trademark did not constitute "deceptive or misleading advertising" because there was no question as to which entity operated the wine club. *Id.* Lot 18 was openly visible on the website, and the name of the product itself is "Forbes Wine Club by Lot 18." *Id.*

[134] *See* Drizly Ruling, *supra* note 114, at 2–3.

that enables customers to purchase alcoholic beverages," from licensed retailers, for delivery.[135] By structuring its operations such that the retailer retains complete control over "products, service and finances," Drizly managed to insulate itself and secured formal NYSLA approval.[136] The model set forth strictly follows the lessons of ShipCompliant: the licensed retailer selects products from its own inventory to sell via its app, selects the prices for these products, maintains its own credit card processing account, receives funds for the purchases directly, remits a flat fee to the third party, physically delivers the orders and, in doing so, confirms that the purchaser is of legal age.[137]

The NYSLA split the analysis into two inquiries—first, "whether the licensee is playing a passive role and if an unlicensed person is acting in their place," and second, whether "an unlicensed party ha[s] an ownership or financial interest in the licensed premises."[138] The passive role question takes into account the business risk incurred by the licensee, functional roles of the parties, and control over retail functions, including "products, services, and finances."[139] The ownership interest questions take into account control of funds and method of compensation.[140] Following this methodology, the NYSLA found Drizly to be an archetype for how TPPs may legally operate in conjunction with licensees.[141]

The NYSLA also pointed out that although the app advertises certain brands, "the ads do not mention or list specific retailers,"[142] which may indicate some forethought on the part of Drizly to combat the community block's concerns about competition. Notably, the NYSLA here mentioned that "there is no argument" on either the availment issue or the ownership issue,[143] based on these facts describing a retailer that maintains full control of its operation and pays a flat fee for strictly marketing services by Drizly.[144] The flat fee precludes any inference of a financial interest in the licensee because it is not

[135] *Id.* at 1.

[136] *Id.* at 3.

[137] *Id.* at 1–2.

[138] *Id.* at 2.

[139] *Id.* at 3.

[140] *Id.* at 3.

[141] *See id.*

[142] *Id.* at 2.

[143] *Id.* at 3; *see* discussion *infra* Sections IV.A, IV.B. If Drizly does not "control[] any portion of the licensed business" then the questions of potential availment or joint venture are moot. Drizly Ruling, *supra* note 114, at 3; *see* discussion *infra* Sections IV.A–B.

[144] Drizly Ruling, *supra* note 114 at 3.

linked to sales or profits, but the specific and unique service rendered by the third party.[145]

The facts presented for declaratory rulings regarding TPPs after Drizly all fall somewhere on the sliding scale between the two extremes of ShipCompliant and Drizly. Despite the restrictions illustrated in ShipCompliant, the NYSLA has managed to declare valid every new TPP application since by making implied exceptions for varying degrees and kinds of infringement upon the original ShipCompliant rules.

In the adjudication of Slingr, the NYSLA found that the licensee retained sufficient control despite the TPP's significant control over collection of funds and its maintaining a physical presence on licensees' premises.[146] This is in direct conflict with prior rulings' emphasis on licensee control.[147] Slingr was a smartphone application that allowed friends to send each other deliveries, or "slings" of both alcoholic beverages and food from menus at licensed "on-premises" venue partners.[148] When an order was placed, the licensee was required to "accept or reject [the] order," and employees of the licensee then delivered the orders and ensured that the recipient was of "legal drinking age."[149] Slingr handled credit card processing, and each week made a payment to the venue partners consisting of the total amount for all purchases made at the venue through the app, minus a twenty-five cent fee for each order and 2.5 percent per transaction, which it paid to itself.[150]

In order for the system to function, Slingr installed its electronic hardware at the venues with which it partnered.[151] Although it did not charge for installation, the venue was responsible for electricity and Internet to support the system's functioning.[152] The NYSLA necessarily adopted a broad interpretation of ShipCompliant's rules to validate the Slingr model.[153] Even though Slingr took a percentage-based profit,

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145 *Id.*

146 Slinger Ruling, *supra* note 115, at 2–3.

147 *See, e.g.*, ShipCompliant Ruling, *supra* note 114, at 6 (Finding a TPP-licensee relationship violated the ABC Law where "[the] method of operation allows an unlicensed advertiser to exercise a high degree of control over the business operations of the participating licensed seller."); *see also* Drizly Ruling *supra* note 114, at 3 (finding a TPP-licensee relationship legal where "[a] retailer participating with [the TPP] retains total control of their products, services and finances.").

148 Slingr Ruling, *supra* note 115, at 1.

149 *Id.* at 1–2.

150 *Id.* at 2.

151 *Id.*

152 *Id.*

153 *Compare* ShipCompliant Ruling, *supra* note 114, at 5–6 ("find[ing] that licensees may rely on" NYSLA Office of Counsel's opinion that "the third party's compensation must be limited to a flat fee that is not contingent on the number of sales

had established a physical presence at the premises of its partner venues, and controlled collection and dispersion of the funds generated by the arrangement, NYSLA still found that the licensee retained "all essential controls" and that the third party did not obtain an ownership interest because the fee was insignificant.[154] Although the fee may have been insignificant for the licensee, 100 percent of Slingr's profits were apparently produced by these transactions.[155]

In its adjudication of Century Club (the Club), the NYSLA found, without examining the licensee's control over pricing, that the smartphone application for a discount membership club did not violate ABC Law.[156] Century Club could be considered a hybrid of Groupon or Living Social and Slingr. The company "intends to have members who pay a monthly fixed membership fee so that they may receive discounts of up to 50% on food and beverages at participating venues."[157] The company's web site advertises access to "50% off drinks, all day, every day."[158] Century Club members order via smart phone and redeem their discounted orders by showing a confirmation code to employees of the licensed on-premises venue.[159] Members can either pay directly for their purchase or with a credit card that the member has placed on file with Century Club.[160] When members pay with credit card through the app, the price of the purchase and a preset tip are deposited in an account accessible only to the licensee.[161] When members pay the Club directly, the Club collects the same price and tip, but remits it to the licensee within one week.[162] The Club's sole income is derived from membership fees, and it does not take any transaction fees or percentage of sales from the licensee.[163] Because "[t]he Club does

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or the amount sold," and finding that a TPP-licensee relationship invalid where "[the] method of operation allows an unlicensed advertiser to exercise a high degree of control over the business operations of the participating licensed seller"), *with* Slingr Ruling, *supra* note 115, at 3 (finding the TPP-licensee relationship valid where the TPP took a percentage-based profit, had established a physical presence at the premises of its partner venues, and controlled collection and dispersion of the funds generated by the arrangement).

[154] Slingr Ruling, *supra* note 115, at 3.

[155] *See id.* at 1–2 (describing Slingr's business model). Proving an unviable model, Slingr shut down in May 2016. @Slingr, Twitter (Apr. 28, 2016, 4:30 PM), https://twitter.com/Slingr/status/725829490086125569 [https://perma.cc/F3SB-ADA7].

[156] Century Club Ruling, *supra* note 115.

[157] *Id.* at 1.

[158] *Home*, CENTURY CLUB, http://www.centuryclubapp.com/#Home [https://perma.cc/PLP6-RVTY].

[159] Century Club Ruling, *supra* note 115 at 1.

[160] *Id.*

[161] *Id.*

[162] *Id.*

[163] *Id.* at 1–2.

not receive any portion of customer funds for alcoholic beverages . . . [it] is not engaged in the sale of alcoholic beverages and there is no violation of ABCL § 111."[164] Even so, the NYSLA failed to address the possibility that this model appeared to give subscribers access to alcoholic beverages at special prices not necessarily determined by the licensee. This oversight is in direct conflict with the ShipCompliant ruling, which specifically emphasized the importance of licensee control over pricing.[165]

In its adjudication of Swill, the NYSLA found the model compliant with the ABC Law without scrutinizing the fee structure for potential availment issues.[166] Swill operates much like Drizly, in that it is a smartphone application "that enables off-premises licensees to offer their products for sale on the app."[167] But where Drizly charges the licensee a flat fee solely for its marketing services,[168] Swill charges its $100.00 per month licensing fee, as well as "[$5.00] for every 'item' sold via the app."[169] For every bottle of wine or six pack of beer, the wine and spirits retailer or beer retailer each pay Swill $5.00 per item in transaction fees.[170] Retailers accept or reject the order, fulfill delivery and ensure sales are only made to those of legal drinking age.[171] Like Drizly,[172] Swill will also advertise liquor brands, but the ads direct consumers to manufacturers' websites, not the website of the participating retailer.[173] Based on the facts presented, NYSLA determined that

> Swill does not control traditional retail functions[,] and . . . licensees . . . retain control of their operations and sales. . . . The rate of $5.00 may be high proportionally to the price of the product actually sold but the consistent flat rate ensures that Swill's compensation is not a portion of the licensed premises' sales but rather a per transaction fee.[174]

In so ruling, the NYSLA elevated form over substance. The NYSLA has disfavored a percentage-based fee because there is a good case for availment under § 111 of the ABC Law where a third party's compensation composes a portion of the licensee's

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[164] *Id.* at 2.
[165] ShipCompliant Ruling, *supra* note 114, at 7.
[166] *See* Swill Ruling, *supra* note 116, at 1.
[167] *Id.* at 1; *see also* Drizly Ruling, *supra* note 114, at 2.
[168] Drizly Ruling, *supra* note 114, at 3.
[169] Swill Ruling, *supra* note 116, at 1.
[170] *Id.* The $100.00 licensing fee only accrues, however, if "the app generates at least $3,000 in sales for the retailer per month." *Id.*
[171] *Id.*
[172] Drizly Ruling, *supra* note 114, at 2.
[173] Swill Ruling, *supra* note 116, at 1.
[174] *Id.* at 2.

sales, and therefore a significant interest in the licensee's business.[175] A per transaction fee that can actually amount to a significant percentage of any particular sale and encourage the same interest-driven behavior that a percentage-based fee entails. If a liquor store sells a bottle of vodka for twenty dollars and Swill receives a five dollar fee from that transaction, it still amounts to a 25 percent cut of the transaction. Under a per transaction fee regime, the TTP will simply be more interested in sales volume than the quality of each individual order. Further, percentage-based fees concern regulators because they imply that a TPP is benefitting to a certain extent from use of the license, or that a percentage of sales generated by owning the license are remitted to a non-licensee.[176] The TPP thus acquires a sense of proprietary interest in increasing the sales of the licensee for its own benefit. Similarly, a per-transaction fee simply replaces percentage of sales with number of sales, in that a greater number of sales generated through ownership of a license will mean greater profits for the non-licensee.

Contrary to its stated intention of issuing a comprehensive advisory regarding TPPs,[177] the NYSLA continues to warn new companies of the rules set out in ShipCompliant, yet refuses to enforce them in earnest. In doing so, the NYSLA continues to create an unlimited number of exceptions with each new request for declaratory judgment, now becoming fewer and fewer as the NYSLA espouses an "anything goes" attitude toward TPP relationships with licensees. In fact, Amazon, one of the TPPs active on the NYSLA's own e-Commerce Task Force, began operating in New York without obtaining a declaratory judgment regarding its TPP model.[178]

Meanwhile, in developing their own responses to TPPs, other jurisdictions such as the District of Columbia and Texas have looked to the NYSLA for guidance of their own.[179] In doing so, they have interpreted the Drizly model as the proper illustration of a company following the restrictions laid out in ShipCompliant to create a practicable model.[180] The NYSLA is therefore not only creating a hazy regulatory landscape, but also

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175 *See* ShipCompliant Ruling, *supra* note 114, at 5 ("[F]ind[ing] that licensees may rely on" NYSLA Office of Counsel's opinion 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"); *see id.* at 7 (A TPP-licensee operation is impermissible "where the compensation to a third party is a substantial portion of the sale or sales made.").

176 *See E-Commerce Task Force Meeting*, *supra* note 22, at 6:56–7:36.

177 *See* ShipCompliant Ruling, *supra* note 114, at 7.

178 *E-Commerce Task Force Meeting*, *supra* note 22, at 2:19–3:06.

179 *See* discussion *infra* Section V.C.

180 *See* discussion *infra* Section V.C.

potentially undermining its own authority within the industry itself. If the entity responsible for liquor control prefers to reference its past rulings as proper guidance instead of taking more concrete action while it waits for the political dust to settle on an approach to TPPs, it should apply those rulings thoughtfully and uniformly.

IV. CONSEQUENCES OF THE NYSLA'S APPLICATION OF THE LAW

Many TPPs have likely not requested NYSLA evaluation of their business models due to its lenient treatment of others on the past few years, but it is also likely that those companies are availing themselves of their partners' licenses to sell alcohol. Notably, the NYSLA has publicly acknowledged that it is more concerned about regulating off-premises retailer relationships because actors in such relationships are more prone to engage in potentially illegal conduct where there is no check on transparency and the identity of the licensed retailer is very possibly unknown to the consumer.[181] Likewise, it is probable that the control mechanisms that the three-tier system mandates must stay with the licensee are more regularly infringed upon in these kinds of arrangements.[182] The NYSLA's leniency toward availment may also have led to third-party arrangements that are truly joint ventures, meaning that TPPs should be responsible for owing their partners fiduciary duties. Finally, the way that some TPP business models operate may create unfair competition problems that shake the foundation of the three-tier system.[183] Although its critics argue against its utility in the modern world and decry its intrinsic anti-competitive nature,[184] the three-tier system does arguably function for the purposes it was set up for, and the Supreme Court has affirmed its constitutional validity.[185] Thus, it is imperative for the NYSLA to assert its jurisdiction over TTPs and regulate them in a meaningful way.

A. Availment

The New York ABC Law specifically states that a license "shall be available only to the person therein specified, and only

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[181] *E-Commerce Task Force Meeting*, *supra* note 22, at 4:07–5:13.

[182] *See id.*

[183] *See id.* at 17:45–19:40.

[184] *See* Murphy, *supra* note 44, at 825.

[185] *See* Granholm v. Heald, 544 U.S. 460, 466 (2005) ("States can mandate a three-tier distribution scheme in the exercise of their authority under the Twenty-first Amendment." (citation omitted)).

for the premises licensed and no other except if authorized by the authority."[186] In order to determine the existence of improper use of license by a non-licensee, or availment, the NYSLA applies a two-part inquiry: (1) whether the licensee maintains sufficient, active control over its retail business; and (2) whether, by virtue of the relationship, a TPP has acquired an ownership or pecuniary interest in the licensee's business.[187] For TPPs, this should mean that their licensed partners must incur some degree of business risk through the relationship, that TPPs themselves may not engage in retail functions that should be controlled by the licensee, and that the TPP's profit through the relationship may not be "a substantial portion of the sale or sales made."[188] The result of the NYSLA's loose application of this standard, however, undermines the state's ability to effectively regulate by license.

The policy behind the law limiting the use of a license solely to the licensee is twofold. First, and most obvious, the state has an interest in preventing "undesirable persons, ineligible to secure a license, from operating a liquor business through another licensee as a 'blind.'"[189] Otherwise, the legitimacy of the license itself would be compromised. Second, and at the same time, the community has an interest in preventing "an unsuitable person, whose business would have an adverse effect on community residents, from operating a liquor business through another licensee whose impact on the community was acceptable."[190] Certainly, many neighborhood brick-and-mortar retailers with their own reasons for either declining to work with a third party or not having the opportunity to work with a third party, would argue that these relationships are not acceptable to their community.[191]

While one way to look at these infringements is availment, another way to view them is as joint ventures. Because authorities are in conflict as to the elements constructing the precise legal relationship, a joint venture can be difficult to identify.[192] In general, it is understood to be a partnership entered into by two or more persons for a particular project, "as opposed to a general partnership for all business

[186] N.Y. ALCO. BEV. CONT. LAW § 111 (McKinney 2014).

[187] *See* discussion *infra* Section III.B.

[188] ShipCompliant Ruling, *supra* note 114, at 6–7.

[189] Cleveland Place Neighborhood Ass'n v. N.Y. State Liquor Auth., 268 A.D.2d 6, 11 (2000) (quoting Matter of Potter v. N.Y. State Liquor Auth., 37 A.D.2d 760 (1971)).

[190] *Id.*

[191] *See E-Commerce Task Force Meeting*, *supra* note 22, at 14:33–21:18.

[192] *Joint Venture*, BLACK'S LAW DICTIONARY (10th ed. 2014) (quoting HENRY G. HENN & JOHN R. ALEXANDER, LAWS OF CORPORATIONS 106 (3d ed. 1983)).

purposes."[193] The consensus is that there must be a showing of "(1) an express or implied agreement; (2) a common purpose that the group intends to carry out; (3) shared profits and losses; and (4) each member's equal voice in controlling the project."[194] This kind of partnership would clearly be impermissible between a licensee and a non-licensee,[195] unless the business venture did not make use of the license. A failure to regulate effectively creates a vacuum where these types of arrangements could be operating under the radar.

Although availment is the more immediate issue, the argument that these arrangements could be joint ventures may be harmful to TPPs in the event of future litigation. Arguments brought against startups in other heavily regulated industries may be instructive in predicting the outcome of such litigation. By providing a platform for hosts to list, and for guests to access, a market of short-term rentals online, for example, Airbnb functions within the rental real estate industry much like a TPP does in the alcohol industry.[196] Because the Airbnb-host relationship could be construed as a kind of legal partnership,[197] "[i]n *New Yorkers Making Ends Meet in the Service Economy v. AirBnb,* plaintiffs and former Airbnb hosts argued that the relationship between hosts and Airbnb constituted a joint venture," triggering a "reciprocal duty of loyalty—which would . . . prevent Airbnb from making the decision to release private, sensitive host information without the host's consent."[198] The issue was never fully litigated,[199] so it is unclear how such an argument may fare in the future, but the joint venture characterization is one that may hold water for purposes of litigation over TPP-licensee relationships.

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[193] Johanna Interian, *Up in the Air: Harmonizing the Sharing Economy Through Airbnb Regulations*, 39 B.C. INT'L & COMP. L. REV. 129, 143 (2016).

[194] *Joint Venture*, *supra* note 192.

[195] *See* N.Y. ALCO. BEV. CONT. LAW § 111 (McKinney 2014) ("[The 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.").

[196] *See About Us*, AIRBNB, https://www.airbnb.com/about/about-us [https://perma.cc/8DS4-Z4V4].

[197] Plaintiff's Memorandum of Law in Support of their Motion for a Preliminary Injunction at 5, New Yorkers Making Ends Meet in the Sharing Economy v. Airbnb, Inc., No. 158526/2014 (N.Y. Sup. Ct., Sept. 1, 2014) (characterizing the Airbnb-host relationship as a joint venture, a form of legal partnership).

[198] Interian, *supra* note 193, at 143.

[199] *See* Decision and Order on Motion, New Yorkers Making Ends Meet in the Sharing Economy v. Airbnb, Inc., No. 158526/2014 (N.Y. Sup. Ct., Oct. 7, 2015).

B. Unfair Competition Problem

New York courts generally recognize two kinds of unfair competition doctrine.[200] "Palming off" is "the sale of the goods of one manufacturer as those of another," even where the parties are not in direct competition.[201] A second theory, misappropriation, "concerns the taking and use of the plaintiff's property to compete against the plaintiffs own use of the same property."[202] Two of the most prominent TTPs, Amazon and Drizly, further illustrate some of retailers' major concerns about potential unfair competition.

Because TPPs do not usually inform the customer where the product is coming from, they may arguably be "palming off" the goods of the licensee as their own. Amazon, for example, works with licensed retailers, lists their inventory, and takes orders for alcohol that are then fulfilled by a licensed retailer.[203] When consumers make a purchase from Amazon, they believe that they are buying from Amazon, even though the law requires that they buy from the licensee.[204] Retailers argue that these customers cannot be the store's customers if the buyer doesn't even know where the product is coming from.[205] These perceptions are reinforced when TPPs handle the customer service. If an item is out of stock, for example, it is often an employee of the TPPs who contacts the customer to suggest a replacement.[206]

Additionally, all of the traditional brick-and-mortar retailers have had to acquire a license in order to conduct business in New York, and thus, many believe that allowing TPPs to operate without having to obtain a license themselves permits TPPs to misappropriate licenses, creating unfair competition.[207] Many of these long-standing community retailers are convinced that TPPs are truly availing themselves of their retail partners' licenses, thereby enabling them to act as "virtual liquor stores" and escaping regulation to the detriment of licensed retailers.[208] Because TPPs face very low barriers to entry without a licensing requirement, retailers argue that it is unfair that third parties are allowed to function as virtual liquor stores that can make an automatic profit through licensing

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200 ITC Ltd. v. Punchgini, Inc., 880 N.E.2d 852, 858–59 (N.Y. 2007).

201 *Id.* at 858.

202 *Id.* at 859 (quoting Roy Export v. Columbia Broad. Sys., 672 F.2d 1095, 1105 (2d Cir. 1982)).

203 *E-Commerce Task Force Meeting*, *supra* note 22, at 18:09–20:34.

204 *Id.*

205 *Id.*

206 *Id.* at 18:33–19:40.

207 *Id.* at 20:35–21:18.

208 *Id.* at 18:09–21:18.

software, transaction fees, and liquor brand advertising.[209] Retailers argue that TPPs are effectively soliciting and participating in the sale of alcohol, while exposing themselves to very minimal risk, when they profit from the sale of these products and services to licensees.[210] This is particularly true if the state allows politics to prevent it from enforcing its prior decisions.

Furthermore, some retailers may not have the opportunity to work with a TPP, even if they would like to. Some retailers argue that this creates an unfair playing field because the model would allow TTPs to work with one retailer in each neighborhood or delivery zone, to the exclusion of every other retailer in the area, even if more than one retailer is interested in working with the TPP.[211] Drizly is one such TPP that functions on this premise.[212] Drizly operates by working with local brick-and-mortar retailers, and listing the inventory the stores have selected to sell on Drizly on the web site and smartphone application.[213] Consumers enter their address, and therefore, depending on their location, different inventory will be available for purchase.[214] Drizly works with a limited number of stores in each area, so there is no confusion over which store will fulfill the order.[215] For retailers, this means that if Drizly has enough partners in any given neighborhood to meet its fulfillment needs, some retailers may not have the opportunity to work with Drizly.[216] TPPs are thereby exploiting the unclear regulatory landscape to frustrate the purpose of the New York's three-tier system.

V. INTEGRATING TPPS WITH A THIRD-PARTY-PROVIDER PERMIT

There are three possible solutions to the problems caused by the uncertainty of the regulatory landscape, but a unique permit for TPPs would best balance the needs and concerns of the different interest groups involved. Any solution must balance the interests of the state and its regulators, the

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[209] *Id.* at 18:09–21:18.

[210] *Id.*

[211] *Id.* at 20:35–21:18.

[212] *See How Drizly Works*, DRIZLY, https://drizly.com/how-it-works [https://perma.cc/CY2U-6X9G]. Drizly has recently transitioned to a "marketplace" model, which allows "consumers [to] simultaneously browse the inventories of multiple local retailers and compare prices between them." *Drizly Launches Online Marketplace for Beer, Wine & Spirits*, Drizly (Sept. 29, 2016), https://drizly.com/drizly-launches-online-marketplace-for-beer-wine-spirits/e-97721ff250e942ac [https://perma.cc/2X68-4L7L]. It is unclear, however, whether this model has affected the choice of licensees who would like to work with Drizly.

[213] *Id.*

[214] *Id.*

[215] *E-Commerce Task Force Meeting*, *supra* note 22, at 20:35–21:18.

[216] *Id.* at 18:09–21:18.

licensees, and TPPs. The state is primarily interested in maintaining legitimacy by enforcing its laws and collecting revenue, as well as protecting the health of its citizens by making sure that alcohol prices do not fall too low. Licensees, usually brick-and-mortar retail stores in this context, are concerned with maintaining their places in their communities and in maintaining a level playing field with their competitors. TPPs, usually entrepreneurial startups, prefer to avoid regulation and minimize costs. Operating in a regulatory vacuum can be advantageous in the short term, but that behavior can also be high risk in the long term.[217] While ideas such as bright-line legislation and a comprehensive advisory should also be considered, this note argues that the solution that best addresses the concerns of all of these interest groups is a third-party permit.

A. New York's Attempt to Problem-Solve TPPs: The NYSLA Task Force on E-Commerce

TPPs present industry complications that the NYSLA deals with on a daily basis. The parties involved all seem to agree that some form of guidance from the NYSLA is needed, but they have yet to come to a consensus on a practicable solution. In February 2016, Governor Andrew Cuomo tasked a group of policymakers with determining the best way forward.[218] Specifically, this task force was charged with proposing "a clear framework for regulating sales of alcoholic beverages through third party providers."[219] The group held two meetings where task force members and other interested parties and community members were invited to present and discuss issues surrounding TPPs.[220] The task force opened its first meeting with comments acknowledging TPPs as opportunities for market expansion that are "here to stay,"[221] but its second, and final, meeting opened with greater reservation, noting that the "three-tier system has fundamental principles that cannot and should not change

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[217] It can either be dangerous for companies, or force them to err unnecessarily on the side of caution, stifling innovation, when a regulatory body hangs the threat of impending regulation over the industry but for years fails to act on it.

[218] *Press Release: Governor Cuomo Announces Alcoholic Beverage Control E-Commerce Task Force*, NY.GOV (Feb. 24, 2016), https://www.governor.ny.gov/news/governor-cuomo-announces-alcoholic-beverage-control-e-commerce-task-force [https://perma.cc/QVK2-H75R]; *see also E-Commerce Task Force Meeting*, *supra* note 22, at 1:53–2:02.

[219] *Press Release: Governor Cuomo Announces Alcoholic Beverage Control E-Commerce Task Force*, *supra* note 218.

[220] *See generally E-Commerce Task Force Meeting*, *supra* note 22; *E-Commerce Task Force Meeting*, N.Y. ST. LIQUOR AUTH. (Feb. 29, 2016), http://abc-state-ny.granicus.com/MediaPlayer.php?view_id=2&clip_id=970 [https://perma.cc/EGU8-KCJJ].

[221] *E-Commerce Task Force Meeting*, *supra* note 22, at 0:24–1:02.

simply because of advances in technology."[222] Ultimately, the only consensus reached was that there was no consensus, particularly between TPPs themselves and the brick-and-mortar stores that either choose not to work with a TPP, or have not had the opportunity to do so.[223]

B. Amendments to ABC Law

For many years, legislatures resisted amending the ABC Law in response to TPPs, and will likely continue to resist because amending the law would result in an impractical result—imposing a generic law on a vast variety of business models that work with licensees.[224] In 2013, however, the New York State Senate proposed a bill that would have amended ABC Law § 111 to allow vendor licensees operating at large sport and entertainment venues to share their profits with the owner or operator of those venues, provided the venue is located on "real property owned by the state of New York or a political subdivision thereof."[225] The bill would have given owners and operators of stadiums the ability to profit from the sale of alcohol without themselves holding a license.[226] The bill never made it past the investigations committee,[227] but had it become law, such expansive access to use of a license may have influenced regulators and opened a flood gate that would be difficult to close. Although an attractive benefit of bright-line legislation is that it eliminates uncertainties, it is at the same time an inflexible option. In a rapidly evolving industry, where the cost of experimentation is not very dangerous, there is little justification for adopting such an inflexible solution. More important is finding a solution that balances competing interests and benefits the industry and the community overall.

C. Comprehensive Advisory

Another way to deal with the present regulatory ambiguity would be for the NYSLA to issue a comprehensive advisory. An NYSLA Advisory (Advisory) is a document that provides guidance to parties with the purpose of assisting them

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[222] *Id.* at 1:43–1:53.

[223] *Id.* at 12:44–13:01.

[224] *Id.* at 3:38–4:07.

[225] S. Investigations and Gov't Operations Comm., S5320, 2013–14 Reg Sess. (N.Y. 2013), http://legislation.nysenate.gov/pdf/bills/2013/S5320 [https://perma.cc/QD22-ELAY].

[226] *Id.*

[227] *Id.*

in complying with state liquor law.[228] The NYSLA has most recently issued advisories on issues such as brand label registration, improper marketing of wine, and wholesale summer shutdown periods.[229] California, Texas, and Washington, D.C., are the only other jurisdictions that have issued general advisories on TPPs engaging in partnerships with licensees, in general.[230] Together, the collective regulatory attempts of these three jurisdictions, along with New York, and their corresponding considerations, have established two main camps with respect to where to draw the fine line between retailer and third party; states either allow TPPs to collect payment to be remitted to the licensee or they require the licensee to collect payment directly. Although there are a number of factors at play, the bulk of regulators' attention has been focused on how parties handle money.

California, being the largest wine producer in the United States,[231] as well as the home of Silicon Valley and a still growing technology sector,[232] issued an advisory on TPP relationships with licensees in 2011.[233] This California Advisory defined TPPs as "unlicensed entities that are involved with the promotion, marketing, and facilitation of sales of alcoholic beverages by licensees over the internet."[234] Although only licensees can engage in the transaction of sales, the California Advisory does not expressly prohibit TPPs from taking part in the exchange of money.[235] Third parties may collect payments, if and only if, they

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228 *See Opinion*, BLACK'S LAW DICTIONARY (10th ed. 2014) (defining advisory opinion as "[a] nonbinding statement by a court of its interpretation of the law on a matter submitted for that purpose."); *see generally Bulletins, Divisional Orders and Advisories*, N.Y. ST. LIQUOR AUTH., https://www.sla.ny.gov/bulletins-divisional-orders-and-advisories [https://perma.cc/G5CC-L53Y].

229 *See* 2016 Wholesaler Summer Shutdown Periods, Advisory 2016-5 (Apr. 26, 2016), https://www.sla.ny.gov/system/files/Advisory_2016-5_-_2016_Wholesaler_Summer_Shutdown_Periods.pdf [https://perma.cc/4Z3X-Q735]; Brand Label Registration, Advisory 2016-3 (Apr. 12, 2016) https://www.sla.ny.gov/system/files/Advisory_2016-3_-_Brand_Label_Registration.pdf [https://perma.cc/NGV2-N5N5]; Improper Marketing of Wines, Advisory 2016-4 (Apr. 12, 2016), https://www.sla.ny.gov/system/files/Advisory_2016-4_-_Improper_Marketing_of_Wines.pdf [https://perma.cc/RPG3-4BTZ].

230 Sara Mann, *DC Weighs in Strongly on Third Party Marketer Delivery Services*, HINMAN & CARMICHAEL LLP (Sept. 9, 2014), http://www.beveragelaw.com/booze-rules/2014/9/9/dc-weighs-in-strongly-on-third-party-marketer-delivery-services [https://perma.cc/4SZ7-C82T].

231 *See Number of wineries in the United States in 2017, by state*, STATISTA (2017), https://www.statista.com/statistics/259365/number-of-wineries-in-the-us-by-state/ [https://perma.cc/FZ85-JL9A].

232 Andrew L. Wang, *The 10 best cities for tech jobs*, MARKETWATCH (Oct. 26, 2017), https://www.marketwatch.com/story/the-10-best-cities-for-tech-jobs-2017-10-26 [https://perma.cc/2SG3-TZVK].

233 CAL. DEP'T OF ALCOHOLIC BEVERAGE CONTROL, INDUSTRY ADVISORY: THIRD PARTY PROVIDERS (2011), https://www.abc.ca.gov/trade/IA%20Third%20Party%20Providers.pdf [https://perma.cc/S6BP-65MM].

234 *Id.*

235 *Id.*

remit the entire amount collected directly to the licensed retailer, effectively granting the licensed retailer full control over disbursement.[236] The third party cannot subtract its cut and send the rest to the licensee; instead the licensee must receive the full amount owed for the products sold and then make a payment to the third party for its services.[237] In Texas, the law requires a person to obtain a permit in order to "solicit or take orders for liquor."[238] The Texas Alcoholic Beverage Commission has weighed in on the TPP problem by adopting California's guidelines in their entirety.[239] It also restricts third parties from engaging in direct shipping and from storing alcohol in its own distribution centers.[240]

In contrast, the Alcoholic Beverage Regulation Administration (ABRA) in Washington, D.C., has adopted a more conservative view. In D.C., the retail license applicant must be "the true and actual owner of the establishment for which the license is sought, and he or she [must] intend[] to carry on the business for himself or herself and not as the agent of any other . . . ."[241] The sale of alcohol, including the solicitation of orders for sale, is prohibited to persons not license holders.[242] In 2013, the ABRA issued its first opinion with respect to TPPs when BeerRightNow.com requested industry guidance.[243] That ruling most notably concluded that a third party would be engaging in the illegal solicitation of sales by participating in the exchange of money between the consumer and the retailer.[244] Therefore, a TPP in D.C. may function legally only when the licensed retailer collects the funds or payment information directly from the customer.[245]

In crafting its more recent advisory, the ABRA interpreted strictly the prohibiting language that an online TPP should not obtain "a substantial interest in the exchange of

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[236] *Id.*

[237] *Id.*

[238] TEX. ALCOHOLIC BEVERAGE COMM'N, MARKETING PRACTICES ADVISORY—MPA056: WINE SHIPPING AND THIRD PARTY ADVERTISERS/ PAYMENT PROCESSING SERVICES (2013), https://www.tabc.state.tx.us/marketing_practices/advisories/MPA056.pdf [https://perma.cc/5YRA-HD5D].

[239] *Id.*

[240] *Id.*

[241] D.C. CODE § 25-301(a)(5) (2015).

[242] D.C. CODE § 25-102(a) (2015).

[243] BeerRightNow.com, LLC, t/a BeerRightNow.com, Advisory Opinion No. 2013-062, 1 (D.C. Alcoholic Beverage Control Bd. Mar. 20, 2013) [hereinafter BeerRightNow Ruling], https://abra.dc.gov/sites/default/files/dc/sites/abra/publication/attachments/BeerRightNow.com%20-%20March%2020%202013.pdf [https://perma.cc/JMT3-TH2A].

[244] *Id.* at ¶ 5.

[245] *Id.* at ¶ 6.

money between the consumer and the retailer,"[246] nor should it "accept or receive money, debit or credit card information, or other financial instruments on behalf of a retailer."[247] In doing so, D.C. relies not only on its original judgment in BeerRightNow, but also on that of New York's Drizly ruling, presumably read in tandem with the ShipCompliant ruling.[248] Further, the D.C. opinion borrows the strictest elements of other states' advisories, resulting in what is arguably the narrowest permissive regulatory scheme in the country. The ABRA found that

> Title 25 of the D.C. Official Code permits online third party providers to connect customers through the internet to a licensed off-premise retailer, as long as the transaction to purchase alcoholic beverages occurs between the consumer and the licensed retailer . . . . [F]unds for each sale [must go] directly from the customer to the licensed off-premise retailer.[249]

The ABRA also explicitly prohibits a number of activities, including collecting money from the customer, charging customers' credit cards, storing alcoholic beverages for sale, and fulfilling, shipping or delivering the orders.[250]

Although D.C. followed New York's lead in blocking third parties from collecting money from customers at all, the irony is that New York's relatively clear framework, set out by ShipCompliant, illustrated by Drizly, and adopted by the D.C. ABRA, has crumbled in subsequent rulings.[251] Perhaps this deconstruction can be attributed to the push and pull between the governor's interest in growing the tech industry in New York and the strong traditionalist community lobby. Likewise, in 2009 California, which now espouses the more liberal approach, issued a much stricter advisory that was later turned on its head.[252] The industry interpreted the earlier advisory to mean that the ABC considered any TPP "soliciting orders of alcoholic beverages for or on behalf of licensees is engaged in the 'sale' of alcoholic beverages and must hold a license issued by the

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[246] Online Third Party Advertisers, Advisory Opinion No. 2014-314, 4 (D.C. Alcoholic Beverage Control Bd. Aug. 13, 2014) (quoting BeerRightNow Ruling, *supra* note 243, at ¶ 5), https://abra.dc.gov/sites/default/files/dc/sites/abra/publication/attachments/Online_Providers_Ad_Opinion.pdf [https://perma.cc/85CM-8E33].

[247] *Id.* (quoting BeerRightNow Ruling, *supra* note 243, at ¶ 6).

[248] *Id.* at 3–4.

[249] *Id.* at 4.

[250] *Id.*

[251] *See* discussion *supra* Section III.B.

[252] *See* CAL. ALCOHOLIC BEVERAGE CONTROL, INDUSTRY ADVISORY: UNLICENSED THIRD PARTY SERVICE PROVIDERS (2009), https://www.abc.ca.gov/trade/Advisory-Third%20Party.pdf [https://perma.cc/4KP6-ECFM].

agency." [253] To clarify, the 2011 advisory explained that this language did not mean that third parties were outlawed, or that they had to acquire a license that did not exist.[254] Rather, third parties could continue to function as long they adhered to certain restrictions, particularly reserving retail functions for the licensee, including distribution of funds.[255] It may be that this revision can be attributed to the influence of the booming West Coast tech industry.

New York and California have much in common, including that they have two of the biggest markets for alcohol sales in the country and also want to encourage growth in the technology sector. Even if the NYSLA takes a California-style approach, however, little is likely to change for TPPs in New York. An advisory does not provide the state with a mechanism for enforcement and the NYSLA would have to use its existing resources to investigate and ensure compliance. With so many political forces and interest groups involved, it is unlikely that such an advisory would have much impact beyond clarifying the NYSLA's position on TPPs. To contrast, regulators in D.C. cut their teeth on new TPPs by issuing cease and desist orders until they issued their comprehensive advisory.[256] Those companies then amended their business practices to comply with the regulations as explained in the advisory.[257] While this is an option available to the NYSLA, it is perhaps an impracticable one due to the large size of the industry and more favorable attitudes toward entrepreneurs. Furthermore, an advisory typically would not provide a mechanism for regulators to collect information on TPPs as a matter of course, and retail licensees would not likely find that this solution adequately addresses their own concerns.

D. Separate Third-Party Permit

At its final e-Commerce Task Force Meeting, the NYSLA noted that among other possible solutions, it plans to consider a

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[253] Paul Franson, *California Warns Internet Wine Sellers: Recent advisory says 'third parties' need a liquor license*, WINES & VINES (June 23, 2009), https://www.winesandvines.com/template.cfm?section=news&content=65546 [https://perma.cc/F2RQ-5RH3].

[254] *See* CAL. DEP'T OF ALCOHOLIC BEVERAGE CONTROL, *supra* note 233.

[255] *Id.*

[256] *See* Ultra, Order Lifting Cease and Desist No. 2014-317 (D.C. Alcoholic Beverage Control Bd. Aug. 15, 2014), https://abra.dc.gov/sites/default/files/dc/sites/abra/publication/attachments/Ultra%20-%20Order%20to%20Cease%20and%20Desist%20-%206%2025%202014.pdf [https://perma.cc/DCQ5-3WYR].

[257] *See id.*

separate permit for TPPs, and that it is in the process of reaching out to other states regarding how they are dealing with the third-party issue.[258] Considering how regulatory bodies within other rapidly evolving and highly regulated industries have implemented permits in response to the rise of entities that do not fit within the traditional mold may also be instructive.

Businesses that deal in virtual currencies, until recently, have been unregulated and operating on the fringes of the financial system. They remain unregulated in many parts of the country, but the New York State Department of Financial Services (NYSDFS) brought them within the state's regulatory regime by issuing a new law requiring these businesses to acquire and comply with the terms of a new, specific license.[259] There is some debate over the appropriate terminology, but in New York, a virtual currency is "any type of digital unit that is used as a medium of exchange or a form of digitally stored value."[260] The state treats a virtual currency as a unit that has obtained some sort of value not denominated in legal tender.[261] Virtual currencies therefore do not "touch [US] banks" or fall within the purview of the Federal Reserve.[262] Although virtual currencies may take various forms, the most prominent example is a cryptocurrency known as "Bitcoin," a kind of virtual currency that is produced by algorithm,[263] "at a mathematically-controlled rate, and with a supply subject only to free market demand."[264]

Although the currency itself is not regulated, NYSDFS has determined that businesses that engage in certain "Virtual Currency Business Activit[ies]"[265] fall within its supervisory

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[258] *See E-Commerce Task Force Meeting*, *supra* note 22, at 11:59–12:29.

[259] *See* N.Y. COMP. CODES R. & REGS. tit. 23, § 200.3 (2017).

[260] N.Y. COMP. CODES R. & REGS. tit. 23, § 200.2(p) (2017).

[261] *See* DONG HE, ET AL., IMF, TAXONOMY OF VIRTUAL CURRENCIES, VIRTUAL CURRENCIES AND BEYOND: INITIAL CONSIDERATIONS 8 (2016), https://www.imf.org/external/pubs/ft/sdn/2016/sdn1603.pdf [https://perma.cc/P9BM-YMG6].

[262] Pete Rizzo, *Federal Reserve Chair: US Central Bank Can't Regulate Bitcoin*, COINDESK (Feb. 27, 2014, 6:16 PM), http://www.coindesk.com/federal-reserve-chair-us-central-bank-cant-regulate-bitcoin/ [https://perma.cc/5E79-J24D] (alteration in original).

[263] *See Frequently Asked Questions: Who created bitcoin?*, BITCOIN.ORG, https://bitcoin.org/en/faq#how-are-bitcoins-created [https://perma.cc/9VN4-3WDJ].

[264] Andrew Wagner, *Digital vs. Virtual Currencies*, BITCOIN MAGAZINE (Aug. 22, 2014, 3:25 PM), https://bitcoinmagazine.com/articles/digital-vs-virtual-currencies-1408735507 [https://perma.cc/M3SX-FT66].

[265] N.Y. COMP. CODES R. & REGS. tit. 23, § 200.2(q) (2017). The business activities related to virtual currency now regulated by the NYSDFS are:

> (1) receiving Virtual Currency for Transmission or Transmitting Virtual Currency, except where the transaction is undertaken for non-financial purposes and does not involve the transfer of more than a nominal amount of Virtual Currency;

purview and thus has promulgated the "BitLicense,"[266] after the eponymous cryptocurrency. Proper acquisition of the BitLicense brings virtual currency dealers into compliance with the financial regulatory scheme in New York State. The application process requires payment of a $5,000 application fee[267] and preparation of a lengthy dossier, including reports prepared by an independent investigatory agency and documents detailing the company's management structure, policies and procedures, "banking arrangements," and "proposed, current, and historical"[268] business plans.[269] Awardees of licenses must then comply with a strict set of regulations, including maintenance of a compliance officer and related policies, certain capital requirements, programs for protection of customer assets, cybersecurity and anti-money laundering, as well as a record-keeping history that is stricter than under federal law.[270]

It is an expensive process, but proponents of the license argue that the companies that acquire it will likely build greater "consumer trust," and thus espouse industry investment and the trust of banks,[271] making it a worthwhile long-term investment. At the same time, the high cost of the application itself and subsequent compliance costs make the license feasible for only certain companies that have the ability to direct significant sums to compliance. One consequence of the licensing requirement was that many budding virtual currency companies

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(2) storing, holding, or maintaining custody or control of Virtual Currency on behalf of others;

(3) buying and selling Virtual Currency as a customer business;

(4) performing Exchange Services as a customer business; or

(5) controlling, administering, or issuing a Virtual Currency.

Id.

266 *See BitLicense Regulatory Framework*, N. Y. ST. DEP'T OF FIN. SERV., http://www.dfs.ny.gov/legal/regulations/bitlicense_reg_framework.htm [https://perma.cc/SLV8-XRD5].

267 N.Y. COMP. CODES R. & REGS. tit. 23, § 200.5 (2017).

268 *Id.* § 200.4.

269 *See generally id.* §§ 200.7–200.19 (2017).

270 Evan Weinberger, *BitLicense Fine Print Could Make Compliance Difficult*, LAW360 (June 3, 2015), https://www.law360.com/articles/663347/bitlicense-fine-print-could-make-compliance-difficult [https://perma.cc/XME2-BN66] ("BitLicense holders will be subject to record-keeping requirements on transactions for seven years under the final regulation. While that is a drop from the [ten] years the [Department of Financial Services] originally proposed, it is still two years longer than required under the Bank Secrecy Act, a 1970 federal law that has become a cornerstone of [anti-money laundering] enforcement.").

271 DAVIS POLK, NEW YORK'S FINAL "BITLICENSE" RULE: OVERVIEW AND CHANGES FROM JULY 2014 PROPOSAL 3 (2015), https://www.davispolk.com/files/2015-06-05_New_Yorks_Final_BitLicense_Rule.pdf [https://perma.cc/C4XQ-SVHD].

were forced to leave New York altogether.[272] Those opposed to the license complain that this type of regime not only stifles innovation, but also severely disadvantages these new businesses by imposing tighter rules than those imposed on traditional banking entities.[273]

Arguments for and against a TPP permit (or license) within the alcohol industry are similar to those within the financial sector—regulators and traditional industry players view licenses favorably, whereas new companies deride the idea as "burdensome" and "stifling of innovation."[274] In considering the third-party permit concept, the NYSLA stated that, "[s]uch a permit would enable retailers to engage TPPs with confidence and compliance. A permit would identify TPPs actually operating and permit the NYSLA to review operations, and their books and records for compliance."[275] Further, members of the three traditionally regulated tiers of the alcohol distribution system agreed that "a permit would be a benefit to the industry,"[276] presumably because regulated entities view it as a way to level what has become an uneven playing field.

Ultimately, support for, and practicability of a third-party permit will depend on the details of such a permit, but if the permit is kept proportional to the industry, it is unlikely that the costs of such a requirement would burden nascent companies the same way that the BitLicense costs could overwhelm a new virtual currency company in New York. Where virtual currency gives rise to the potential for a host of criminal activity for financial regulators to be concerned about, from money laundering to the sale of illicit drugs on the dark web, the insertion of a sub-tier into the three-tier system will likely do little to rock the boat, except perhaps respond to modern consumer preferences and perhaps at some point change the way we buy and sell alcohol.

CONCLUSION

If New York ultimately hopes to attract the innovators that will secure its future as a state with a thriving tech industry, it must find a way to accommodate ingenuity within

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272 Daniel Roberts, *Behind the "Exodus" of Bitcoin Startups from New York*, FORTUNE, Aug. 14, 2015, http://fortune.com/2015/08/14/bitcoin-startups-leave-new-york-bitlicense/ [https://perma.cc/UC3E-VAPL].

273 *See id.*

274 *E-Commerce Task Force Meeting*, *supra* note 22, at 10:36–11:28.

275 *Id.*

276 *Id.*

traditional models, like the three-tier system. At the same time, it must balance the interests of the brick-and-mortar retailers who built their livelihoods by the old rules, and evolve with changing consumer behaviors. An effective and enforceable solution would be to impose the requirement of a third-party permit upon those companies that aim to indirectly benefit from the sale of alcohol by working with a licensee.

As long as the requirements to obtain such a permit are not overly burdensome, this solution would create predictability and stability for new companies and remove the unfair advantage sensed by brick-and-mortar stores by adding barriers to entry for TPPs, while allowing regulators to better understand and adapt to changes in the industry. Regulation of TPPs need not be avoided, and in fact, would ultimately benefit all parties involved.

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