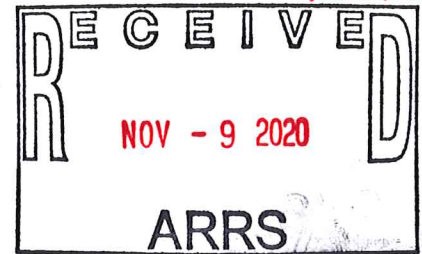




DISTILLED SPIRITS COUNCIL
OF THE UNITED STATES

November 9, 2020



The Honorable Stephen West, Co-Chair
The Honorable David Hale, Co-Chair
Administrative Regulation Review Subcommittee
700 Capital Ave.
Frankfort, KY 40601

Re: Kentucky Department of Alcoholic Beverage Control: 804 KAR 4:415. Direct Shipper License

Dear Senator West and Representative Hale:

This submission is made on behalf of the Distilled Spirits Council of the United States, Inc. (DISCUS), a national trade association representing producers and marketers of distilled spirits and importers of wines sold in the United States. We welcome the opportunity to provide our views regarding the Kentucky Department of Alcoholic Beverage Control's (ABC) rules implementing and administering the direct shipper license. DISCUS worked closely with members of the Legislature during the session for enactment of the underlying legislation, H.B. 415 (2020), and similarly worked with the ABC during the rulemaking process. We appreciate Commissioner Taylor's and General Counsel Newton's consideration of our views and appreciate the effort invested in developing and issuing the direct ship license regulation, 804 KAR 4:415.

We generally support the direct ship rules and expect various producers and suppliers to apply for direct ship licenses under this scheme. There are provisions, however, that we will continue to oppose and our plans include seeking legislative changes in the near future. An underlying basis for our major objections to these provisions is that they are contrary to the basic principle of federalism that states should not govern extraterritorially. The provisions cited below impose restrictions with a practical impact beyond the borders of the Commonwealth of Kentucky that are, in our view, unjustifiable, excessive and serve only to undermine the ability of industry to direct ship products to Kentucky consumers and to enable these consumers to obtain products that may not be available to them otherwise.

The provisions in the direct ship license rules that we believe warrant change include:

- (1) Requiring an out-of-state direct ship applicant or licensee to have "ownership or possession" of its direct ship licensed premise from which it ships or proposes to ship alcohol beverages to Kentucky consumers. (804 KAR 4:415(1)(4)/Qualifications.)

As we made clear during the rulemaking process, use of third-party logistical fulfillment providers and their facilities is common practice throughout the

industry to meet consumer demand in a timely, efficient, cost-effective manner, without unnecessary disruption. The ABC acknowledged this widespread nationwide practice in its Statement of Consideration included with the proposed rules (at p. 25).

We disagree with the ABC that regardless of this marketplace reality, KRS § 243.220 (Premises that may not be licensed for sales at retail) requires the ABC to impose a requirement that a direct shipper's licensed (or proposed licensed) direct ship location from which it ships product to Kentucky consumers must be owned or leased by the direct shipper. We do not believe that direct-to-consumer shipping was contemplated to fall within KRS § 243.220 when enacted or amended. Similarly, there is nothing in the language or legislative history of H.B. 415 to suggest that KRS § 243.220 was considered or intended to apply to an out-of-state premise utilized by direct shippers to ship product directly to consumers in the Commonwealth. (Note also that the direct ship law, at KRS § 243.027(1), states that it "shall supersede any conflicting statute in KRS Chapters 241 to 244.") For the same reasons (other than the extraterritorial issue), we also object to imposing the ownership/lease requirement for direct ship licensed premises located in the Commonwealth.

Applying this unrelated premise requirement serves no purposes other than to frustrate the objective of the direct ship law to facilitate direct shipping into the Commonwealth and to deny opportunities for Kentucky consumers to obtain alcohol beverage products that otherwise may be unavailable to them.

- (2) Prohibiting direct ship applicants or licensees or direct shippers' independent contractors from having a substantial ownership interest in a retail alcohol business (such as a restaurant) in another state that is allowed under the other state's laws. (804 KAR 4:415(2)/Prohibited substantial interests and 804 KAR 4:415(6)/Independent contractors.)

No justification exists for denying or revoking a direct ship license to an otherwise qualified producer or supplier, or prohibiting a person from being an independent contractor for a direct shipper simply because it has a substantial ownership interest in a retail business in another state, such as a licensed restaurant, that is permitted in that state. Such an interest also has no connection to or impact upon the Kentucky market or consumers. Similar to our above comment, we believe that penalizing direct shippers or independent contractors for business interests allowed in another state constitutes jurisdictional overreach, and only frustrates the objectives of the Commonwealth's direct ship law to enhance opportunities for direct shipping to Kentucky consumers and expand the selection of alcohol beverage products available to these consumers.

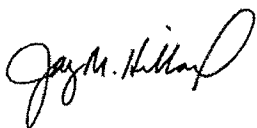
Hon. Stephen West, Co-chair
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- (3) Requiring out-of-state distillers to meet the minimum production requirements applicable only to distillers in the Commonwealth, regardless of the direct ship law requiring the issuance of direct ship licenses to out-of-state distillers holding valid producer licenses in their states. (804 KAR 4:415(4)/Minimum production.)

The ABC's prohibition on participation by distillers in another state that produce less than 600 gallons annually (as required only for in-state distiller licenses under KRS § 243.120(2)) is inconsistent with KRS § 243.027(2), which expressly provides that the Department "shall issue a direct shipper license to a successful applicant that...[i]s a manufacturer located in this state or any other state..." holding "a current license, permit, or other authorization to manufacture alcoholic beverages in the state where the manufacturer is located...." The new law does not give the ABC any discretion to prohibit out-of-state licensed manufacturers of alcohol beverages from obtaining or holding direct ship licenses based on any minimum production requirement.

We again commend the ABC for their efforts to develop the direct ship license regulation and express our appreciation for this additional opportunity to express our views about these rules. If you have any questions, please do not hesitate to call.

Sincerely,



Jay M. Hibbard
Vice-President Government Relations

cc: Sen. Julie Raque Adams
Sen. Alice Forgy Kerr
Sen. Reginald Thomas
Rep. Deanna Frazier
Rep. Mary Lou Marzian
Rep. Tommy Turner

1 PUBLIC PROTECTION CABINET

2 Department of Alcoholic Beverage Control

3 (Amended After Comments)

4 804 KAR 4:415. Direct shipper license.

5 RELATES TO: KRS 243.027, 243.028, 243.029, 243.030(33), 244.050, 244.440, 244.585;
6 804 KAR 4:015, 804 KAR 4:100, 804 KAR 4:410.

7 STATUTORY AUTHORITY: KRS 241.060, KRS 243.027

8 NECESSITY, FUNCTION, AND CONFORMITY: KRS 243.027 authorizes the
9 Department of Alcoholic Beverage Control to set forth the requirements and the form for a direct
10 shipper license application. KRS 243.027(3)(c) authorizes the Department to establish through
11 regulation what information the Department determines to be necessary to implement and
12 administer the direct shipper license. KRS 243.027(6)(a) authorizes the department to reduce
13 unlicensed deliveries and shipments of alcoholic beverages in the state. **KRS 241.060(1)**
14 **authorizes the Department to promulgate reasonable administrative regulations governing**
15 **procedures relative to application for licenses as well as the supervision and control of the**
16 **trafficking of alcoholic beverages.** To protect the public health and safety of Kentucky citizens,
17 this administrative regulation establishes requirements for the direct shipper license and the
18 privileges and responsibilities of a direct shipper license.

19 Section 1. Qualifications. To qualify for a direct shipper license, the applicant shall:

1 (1) Hold either a current license, permit, or other authorization to manufacture alcoholic
2 beverages in the state where it is located or a current license in this state under KRS 243.212 or
3 243.215 to supply alcoholic beverages;

4 (2) Hold a current permit or authorization under the Federal Alcohol Administration Act
5 as follows:

6 (a) If a manufacturer other than a brewery, a basic permit to produce or manufacture
7 beverage alcohol;

8 (b) If a manufacturer that is a brewery, a brewer's notice to produce or manufacture malt
9 beverages; or

10 (c) If an importer, **wholesaler, or distributor** licensed as a supplier under KRS 243.212
11 or 243.215, a basic **importer's**~~importers]~~ permit **for the purpose of directly shipping only**
12 **those products for which the applicant is designated the primary source of supply under the**
13 **applicant's supplier license**~~[to import beverage alcohol];~~

14 (3) Complete the online direct shipper license application via the department's licensing
15 portal at <https://abc-portal.ky.gov/s/kyabcnewlicensetype>;

16 (4) Provide the address and a description of the premises from which the applicant will
17 ship alcoholic beverages to consumers, **and documentation showing ownership or possession**
18 **of the premises under a written agreement**;

19 (5) Pay the annual license fee established in KRS 243.030(33);

20 (6) Disclose all of the applicant's current alcohol-related licenses, permits, and
21 authorizations granted by this state, the federal government, and, if applicable, the state in which
22 the applicant manufactures alcoholic beverages;

1 (7) Disclose all convictions for violations of alcoholic beverage laws, or misdemeanors
2 directly or indirectly attributable to the use of alcoholic beverages or the use or trafficking in
3 controlled substances, in the last two (2) years in any state, by the applicant or the applicant's
4 officers, directors, or members or managers as defined in KRS 275.015;

5 (8) Disclose all convictions or sentences served for felonies of any kind by the applicant or
6 the applicant's officers, directors, or members or managers as defined in KRS 275.015, in the last
7 five (5) years;

8 (9) Complete all registration requirements with respect to payment of any applicable excise
9 tax, state or local sales or use tax, local regulatory license fee, or other tax owed in this state to
10 directly ship alcoholic beverages to consumers in this state; and

11 (10) Consent to the jurisdiction of the Commonwealth of Kentucky for purposes of
12 enforcement of KRS Chapters 241 to 244.

13 Section 2. Prohibited substantial interests. A direct shipper license applicant and direct
14 shipper licensee shall comply with 804 KAR 4:015 and for that purpose shall be considered a
15 "manufacturer" as defined in 804 KAR 4:015.

16 Section 3. Licensed Premises.

17 (1) The licensed premises described in a direct shipper license application may be different
18 from the premises where the applicant is licensed, permitted, or otherwise authorized to
19 manufacture or supply alcoholic beverages.

20 (2) If the direct shipper licensee will use the licensed premises described in the direct
21 shipper license application for storage of alcoholic beverages incidental to shipment, such premises
22 shall also comply with the laws of the jurisdiction in which it is located in order to store~~be~~
23 ~~licensed or otherwise authorized for storage of~~ the alcoholic beverages to be shipped.

1 (3) Direct shipper licensees may engage in transportation of their products as
2 permitted by their~~[If, as described in subsection (1), the licensed premises described in the~~
3 ~~direct shipper license application is different from a direct shipper licensee’s manufacturing~~
4 ~~or supplying premises, the direct shipper licensee may transport alcoholic beverages between~~
5 ~~the licensed premises described in the direct shipper license application and the licensee’s~~
6 ~~manufacturing premises, subject to the constraints of the direct shipper’s]~~ license, permit, or
7 authorization to manufacture or supply alcoholic beverages.

8 Section 4. Minimum Production. A manufacturer that is either a direct shipper license
9 applicant or a direct shipper licensee, and who intends to ship wine or distilled spirits, shall meet
10 the minimum quantities of production set forth in KRS 243.155(2) and KRS 243.120(2)(a) as
11 applicable.

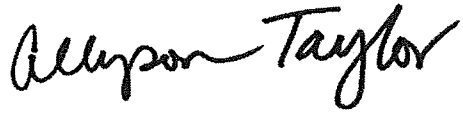
12 Section 5. Brand Registration. In accordance with 804 KAR 4:410, a direct shipper licensee
13 shall register with the department all brands the licensee intends to ship to consumers in~~[or into]~~
14 this state~~[that the licensee has not already registered under another license issued by the~~
15 ~~department]~~.

16 Section 6. Independent Contractors. A direct shipper licensee shall not contract with an
17 independent contractor or agent who has, or would have, a substantial interest prohibited under
18 804 KAR 4:015 if the independent contractor or agent is treated as a “manufacturer” as defined in
19 804 KAR 4:015.

20 Section 7. Records. A direct shipper licensee shall comply with the record retention and
21 audit requirements set forth in 804 KAR 4:100, except a licensee shall maintain such records for a
22 minimum of three (3) years. The licensee shall make available for inspection all records regarding
23 direct shipment to Kentucky consumers at the request of the department.

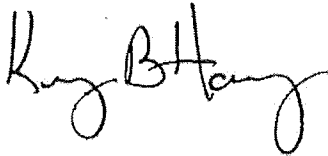
1 Section 8. Minimum Price. A direct shipper licensee shall sell alcoholic beverages at a
2 price no less than the cost of production~~current wholesale price, if a current wholesale price~~
3 ~~is available,~~ in accordance with KRS 244.050.

804 KAR 4:415
READ AND APPROVED



Allyson C Taylor, Commissioner
Department of Alcoholic Beverage Control

10/15/2020
Date



Kerry B. Harvey, Secretary
Public Protection Cabinet

10/15/2020
Date

REGULATORY IMPACT ANALYSIS AND TIERING STATEMENT

Regulation: 804 KAR 4:415

Contact Person: Joshua Newton, (502) 782-0770, joshua.newton@ky.gov

(1) Provide a brief summary of:

(a) What this administrative regulation does: This administrative regulation establishes the requirements and process to apply for the license to ship alcoholic beverages direct to consumers created by House Bill 415, Ky Acts ch. 80, passed in April 2020, and places restrictions upon licensees that follow from that act and other Alcoholic Beverage Control laws under KRS chapters 241 to 244.

(b) The necessity of this administrative regulation: KRS 243.027 requires that the department promulgate a regulation to set forth the requirements for a direct shipper license application and to describe any other information the department determines to be necessary to implement and administer the direct shipper licensing program.

(c) How this administrative regulation conforms to the content of the authorizing statutes: This administrative regulation provides detailed requirements to file an application for a direct shipper license as well as other information necessary to implement and administer the program. Additional restrictions included in the regulation bring the requirements for direct shipper licensees into conformity with the requirements of other licenses issued by the Department, per the KRS 243.027(5)(f) direction that licenses are held contingent on obeying all laws and administrative regulations of the origin state and destination state, and the KRS 243.027(4) requirement that the Department use the same standards relating to causes for license denial as those it uses for similarly situated in-state applicants.

(d) How this administrative regulation currently assists or will assist in the effective administration of the statutes: This administrative regulation is required for the issuance of direct shipper licenses, as it describes the requirements for the successful application for a direct shipper license and provides additional restrictions and requirements that will assist in reducing unlicensed shipments and promulgating reasonable administrative regulations relative to applications for licenses and governing the supervision and control of traffic in alcoholic beverages as required by KRS 243.027(6)(a) and KRS 241.060(1).

(2) If this is an amendment to an existing administrative regulation, provide a brief summary of:

(a) How the amendment will change this existing administrative regulation: NA

(b) The necessity of the amendment to this administrative regulation: NA

(c) How the amendment conforms to the content of the authorizing statutes: NA

(d) How the amendment will assist in the effective administration of the statutes: NA

(3) List the type and number of individuals, businesses, organizations, or state and local governments affected by this administrative regulation: The direct shipper license affects an unknown number of individuals, businesses, and organizations. Forty-four (44) states including Kentucky now permit some form of direct shipping of alcoholic beverages, and the direct shipper license may affect them all, along with an unknown number of local governments. The administrative regulation potentially affects all of the Department's approximately 1,300 licensed alcoholic beverage manufacturers and suppliers as well as any of thousands of licensed alcoholic beverage manufacturers or suppliers outside of Kentucky by providing them with the means to apply for a license and requirements they must meet under the license to ship direct to consumers alcoholic beverages under brands they own or for which they have exclusive license. It also affects all alcoholic beverage consumers in Kentucky and in other states that permit direct-to-consumer shipping by creating licensure and other requirements by which alcoholic beverage manufacturers and suppliers in and out of Kentucky may become licensed to ship alcoholic beverages directly to them. Additionally, it affects the Department of Alcoholic Beverage Control, and local alcoholic beverage control boards.

(4) Provide an analysis of how the entities identified in the previous question will be impacted by either the implementation of this administrative regulation, if new, or by the change, if it is an amendment, including:

(a) List the actions each of the regulated entities have to take to comply with this regulation or amendment: Regulated entities will not be required to undertake any action to comply with this regulation unless they apply for a direct shipper license. Regulated entities who wish to ship alcoholic beverages direct to consumers will have to complete an online application, pay an annual license fee, disclose a number of documents, including **proof of ownership or possessory interest in the premises to be licensed under a written agreement**, their criminal background checks, their alcoholic beverage licenses issued by Kentucky, the federal government, and their home state if not Kentucky, provide an address and description of the premises to be licensed, and register with all states and localities to which they intend to ship to pay appropriate taxes and fees to ship to them. Regulated entities who wish to ship will also need to register the brands they intend to ship **to consumers** in ~~and into~~ Kentucky with the Department, and out-of-state regulated entities will need to meet minimum production requirements that in-state regulated entities must meet, as well as other restrictions that prohibit interlocking substantial interests, contracting with independent contractors with prohibited interlocking substantial interests, and pricing alcoholic beverages for shipment at less than the price at which the alcoholic beverage **costs to produce**~~at wholesale~~. Additionally, the regulation puts requirements on the duration regulated entities must retain records and clarifies potential ambiguity regarding the location of a regulated entity's licensed premises.

(b) In complying with this administrative regulation or amendment, how much will it cost each of the entities: Compliance with this administrative regulation will cost each entity at least the amount of the application fee under KRS 243.030(33), but additional costs are unknown at this time.

(c) As a result of compliance, what benefits will accrue to the entities: If the regulated entities comply with the regulation, they will have submitted a complete application for a direct shipper license, which, if granted, will result in the issuance of a license to ship limited quantities of alcoholic beverages directly to consumers in Kentucky. Further, by complying with the regulation, regulated entities who are granted direct shipper licenses may avoid enforcement actions by the Department that may affect their direct shipper license.

(5) Provide an estimate of how much it will cost the administrative body to implement this administrative regulation:

(a) Initially: There has been no additional cost for the Department to implement this regulation initially, as the work to gather requirements, develop, and test the implementation of the online application was performed by existing employees and contractors.

(b) On a continuing basis: The Department does not know at this time how much it will cost to implement this regulation on a continuing basis.

(6) What is the source of the funding to be used for the implementation and enforcement of this administrative regulation: Enforcement of this administrative regulation will be funded by the statutory licensing fees paid by applicants under this regulation.

(7) Provide an assessment of whether an increase in fees or funding will be necessary to implement this administrative regulation, if new, or by the change if it is an amendment: At this time, no increase in fees or funding will be necessary to implement this administrative regulation.

(8) State whether or not this administrative regulation established any fees or directly or indirectly increased any fees: This administrative regulation did not establish any fees, and did not directly or indirectly increase any fees.

(9) TIERING: Is tiering applied? Explain why or why not. Tiering is not applied because this will affect all regulated entities equally.

FISCAL NOTE ON STATE OR LOCAL GOVERNMENT

Regulation: 804 KAR 4:415

Contact Person: Joshua Newton, (502) 782-0770, joshua.newton@ky.gov

(1) What units, parts or divisions of state or local government (including cities, counties, fire departments, or school districts) will be impacted by this administrative regulation? The Department of Alcoholic Beverage Control and local Alcoholic Beverage Control administrators.

(2) Identify each state or federal statute or federal regulation that requires or authorizes the action taken by the administrative regulation. KRS 243.027, 243.028, 243.029, 241.060(1).

(3) Estimate the effect of this administrative regulation on the expenditures and revenues of a state or local government agency (including cities, counties, fire departments, or school districts) for the first full year the administrative regulation is to be in effect. If specific dollar estimates cannot be determined, provide a brief narrative to explain the fiscal impact of the administrative regulation.

(a) How much revenue will this administrative regulation generate for the state or local government (including cities, counties, fire departments, or school districts) for the first year? The specific dollar estimate of revenue this administrative regulation will generate cannot yet be determined. However, potentially thousands of producers in Kentucky and across the country may seek to engage in direct shipment and if so must each pay the current \$100 fee for a direct shipper license.

(b) How much revenue will this administrative regulation generate for the state or local government (including cities, counties, fire departments, or school districts) for subsequent years? The specific dollar estimate of revenue this administrative regulation will generate cannot yet be determined. However, the current \$100 fee for a direct shipper license must be paid annually and thus will continue to generate revenue.

(c) How much will it cost to administer this program for the first year? Costs to administer this program are currently unknown. The Department will have costs associated with modification and maintenance of the online direct shipper application and database for accepting applications. The Department will also have unknown costs to develop enforcement protocols and procedures and enforce the regulation. The Department does not know if these costs will exceed current budgetary estimates.

(d) How much will it cost to administer this program for subsequent years? Costs to administer this program in the future are currently unknown.

Note: If specific dollar estimates cannot be determined, provide a brief narrative to explain the fiscal impact of the administrative regulation.

(4) Revenues (+/-):

(5) Expenditures (+/-):

(6) Other Explanation:

STATEMENT OF CONSIDERATION RELATING TO
804 KAR 4:415 – “Direct Shipper License”

Public Protection Cabinet
Department of Alcoholic Beverage Control
(Amended After Comments)

I. On Tuesday, September 22, 2020 at 9:00 a.m., the Department of Alcoholic Beverage Control (“ABC”) held a public hearing on the proposed administrative regulation 804 KAR 4:415, entitled “Direct Shipper License.” The meeting was open to the public viewing on the ABC’s YouTube channel. The meeting was also open to commenters via Zoom. The ABC received public comments on 804 KAR 4:415 at the public hearing and received written comments on 804 KAR 4:415 during the public comment period. The public comment period began when 804 KAR 4:415 was filed with the Regulations Compiler on July 14, 2020, and ended at 11:59 p.m. on September 30, 2020.

II. The following individual(s) or group(s) submitted written comments:

<u>Name and Title</u>	<u>Agency/Organization/Entity/Other</u>
Charles George	Executive Director, Wine and Spirits Wholesalers of Kentucky
Sara Schorske	Compliance Service of America
Jason Baird	Executive Director, KY Malt Beverage Council
Drew Murphy	General Manager/Owner, Party Town
Bob Wagner	Wagner Wine & Spirits & The Smoke Shop
Patti Murphy	
David Page	
Whitney Fischer Frommeyer	General Manager One Stop Liquors & Tobacco
Starr Handy	Owner/Operator, Starr’s Liquor
Tracy Gallenstein	
T. Forrester	
Eric Bollman	Cork n Bottle
Perry Colliver	

Meghal Patel	Springhill Liquor
Jeffrey Oldham	
John S. Oldham, Jr., MD	Medical Director of Metabolic & Bariatric Surgery, Baptist Health Louisville
Chris Zaborowski	Westport Whiskey & Wine
Sam Phillips	
Jahn Owens	Deer Park Elementary School
Gene McLean	Executive Director, Kentucky Beer Wholesaler's Association
Karen Thomas Lentz	Executive Director, Kentucky Association of Beverage Retailers
David S. Samford	General Counsel, Kentucky Guild of Craft Brewers, Inc.
Stacy Kula	Steptoe & Johnson, PLLC, on behalf of certain brand owners whose products are produced in Kentucky
Shannon Stiglitz	Senior Vice President of Government Affairs, Kentucky Retail Federation
Matt Dogali	President & CEO, American Distilled Spirits Alliance
Jacob Hegeman	Assistant General Counsel, Wine & Spirits Wholesalers of America
Kellie Duhr	Vice President, State Government Relations, Sazerac Company, Inc.
L. Hunter Limbaugh	Southeastern Counsel, Wine Institute
Jay Hibbard	Vice President, Eastern Region, Distilled Spirits Council of the United States (DISCUS)
Steven G. Amato	Outside Counsel, Kentucky Distillers' Association (KDA)

III. The follow individual(s) submitted comments at the public hearing:

<u>Name and Title</u>	<u>Agency/Organization/Entity/Other</u>
Charles George	Executive Director, Wine and Spirits Wholesalers of Kentucky
Karen Thomas Lentz	Executive Director, Kentucky Association of Beverage Retailers
Chairman Adam Koenig	Kentucky General Assembly, co-chair of the Interim Joint Committee on Licensing, Occupations, and Administrative Regulations
L. Hunter Limbaugh	Southeastern Counsel, Wine Institute

IV. The following individual(s) from the promulgating administrative body responded to the written and public comments:

<u>Name and Title</u>	
Joshua Newton	General Counsel, Department of Alcoholic Beverage Control

V. Summary of Comments and Responses

(1) Subject Matter: Section 1(2)(c), regarding supplier licensees and importers

(a) Comment: This section by far received the most comments. The most common among these comments was that permitting importers to be issued a direct shipper license was contrary to the legislative intent of HB 415, and that the direct shipper license was meant to be for producers only. This comment was shared in some form by Charles George, Executive Director of the Wine and Spirits Wholesalers of Kentucky (WSWK); Karen Lentz, Executive Director of the Kentucky Association of Beverage Retailers (KABR); Jason Baird, Executive Director of the KY Malt Beverage Council (KMBC); Gene McLean, on behalf of the Kentucky Beer Wholesalers Association (KBWA); Jahn Owens; John S. Oldham Jr., MD; Jeffrey Oldham; Meghal Patel; Perry Colliver; Eric Bollman; T Forrester; Tracy Gallenstein; Starr Handy; Whitney Fischer Frommeyer; David Page; Patti Murphy; Bob Wagner; Drew Murphy; Chris Zaborowski; and Sam Phillips.

Mr. George, on behalf of WSWK, expanded upon this comment, arguing that the will of the legislature was to allow *bona fide*, domestic manufacturers to be able to ship their own exclusively-licensed domestic products directly to consumers and to prohibit retailer shipping. Mr. George stated that importers and imported products were never mentioned, and Ms. Lentz, speaking on behalf of KABR, pointed to comments made during committee testimony on March 11, 2020, on the House floor on March 18, 2020, and in the Senate Licensing and Occupations Committee and

on the Senate floor on March 26, 2020, where she claimed it was repeatedly stated by legislators that HB 415 was a “producer-only bill.” She also claimed that Representative Koenig stated that he removed retailers, wholesalers, and distributors from the bill because they did not want out-of-state wholesalers, distributors, and retailers to be licensed to ship directly into Kentucky. Mr. George echoed this statement in written comments. Instead, Ms. Lentz stated KABR’s understanding of the inclusion of the provision permitting supplier licensees under KRS 243.212 and KRS 243.215 in HB 415 was to ensure out-of-state producers and manufacturers that hold supplier licenses were not prevented from holding direct shipper licenses due to incompatibility. In written comments submitted after the public hearing, Ms. Lentz added that the original bill included wholesalers, distributors, and retailers, but that those entities were removed from the bill by Chairman Koenig with House Floor Amendment 8 in order to make the bill “producer-only.” Mr. George’s comments comport with KABR’s, stating that while in committee, Rep. Jerry Miller asked Chairman Koenig to tighten the language in the bill to ensure that only producers were allowed hold direct shipper licenses and Chairman Koenig agreed.

Chairman Adam Koenig, the primary sponsor of HB 415, stated in his comments during the public hearing that HB 415 was meant to be a producer-only bill, and that including out-of-state suppliers is consistent with a producer-only bill because many products come into the United States only through importers, and into Kentucky through out-of-state suppliers. However, Mr. George asserted that the reference in HB 415 to KRS 243.212 and KRS 243.215 meant *only* out-of-state importers, not in-state importers, could be issued a direct shipper license. Chairman Koenig also stated that, under HB 415, out-of-state wholesalers and distributors would be included only when they are the primary source of supply. Ms. Lentz, writing on behalf of KABR after the public hearing, appreciated this clarification by Chairman Koenig in the public hearing and recommended that the regulation more clearly state that only suppliers that are the “primary sources of supply” be permitted to apply for a direct shipper license by amending the regulation to include a subsection in Section 1 stating: *“A supplier licensed under KRS 243.212 or 243.215 shall be the primary source of supply as defined in KRS 241.010(45).”*

Gene McLean, on behalf of the Kentucky Beer Wholesalers Association, offered that amending the regulation to add “manufacturer” immediately before “importer” in Section 1(2)(c), would eliminate the possibility of distributors, wholesalers, and other non-manufacturer, supplier licensees from obtaining a direct shipper license. Chairman Koenig stated that the definition of “manufacturer” was expanded in HB 415 and eligible applicants for direct shipper licensees should include what manufacturers are included under that definition. In later written comments, Mr. McLean commented in agreement with Chairman Koenig, drawing support from KRS 243.027(2)(a) that only an entity that is the “primary source of supply” is eligible for a direct shipper license.

Mr. McLean expanded upon that definition with respect to malt beverages, stating that limiting direct shipper licensees to “primary sources of supply” has the effect of permitting only the brewer or producer of U.S.-produced malt beverages to apply for and receive direct shipper licenses, and similarly permitting only the “prime importer” or “exclusive agent” for foreign malt beverage producers to apply for and receive direct shipper licenses. Mr. McLean stated that this means distributors cannot be direct shippers for domestic malt beverages, whether located in or out of the state, because the distributor “is not the ‘brewer’ or ‘producer’ (and therefore not the ‘primary

source of supply’)' of U.S.-produced malt beverages. Mr. McLean further stated that a malt beverage distributor can only directly ship foreign-produced malt beverages if it is the “*exclusive importer* for such foreign-produced malt beverages.”

Shannon Stiglitz, Senior Vice President of Government Affairs for the Kentucky Retail Federation, also stated that a supplier should not be allowed to ship directly to consumers unless they are the “primary source of supply” for a particular alcoholic beverage. Ms. Stiglitz echoed the comments of Ms. Lentz and Mr. George that retailers were removed from the bill as a compromise, and added that the removal was meant to prevent unfair competition from out-of-state retailers who may not be as limited as in-state retailers in the types of products they sell and may therefore have been able to ship. Ms. Stiglitz requested clarification whether importers and out-of-state suppliers issued direct shipper licenses will be able to ship only the products for which they are the primary source of supply.

Matt Dogali, the President & CEO of American Distilled Spirits Alliance, stated he had “grave concern about how Kentucky can control and regulate international spirits being imported into Kentucky,” though he did not take issue with the inclusion of importers as eligible to be issued direct shipper licenses to ship imported products. He stated that KRS 243.212 is “far more inclusive” than the legislature intended, because “as drafted and proposed, any international entity could partner with a US entity that meets the broad Kentucky definition” under KRS 243.212 and ship from an international location into Kentucky. Mr. Dogali stated that this would circumvent our importation process, allow illicit and counterfeit alcoholic beverages to enter the U.S. market, and permit federal tax avoidance.

Mr. Dogali stated that ADSA had spoken to U.S. Customs and the federal Alcohol and Tobacco Tax and Trade Bureau (TTB), and both agencies agreed that HB 415 permits international spirits suppliers to ship directly to consumers in Kentucky. Mr. Dogali offered that the Department could limit issuance of direct shipper licenses to “brand owners” who can provide proof of brand ownership rather than “primary sources of supply.” Alternatively Mr. Dogali offered that the Department could require a licensee to hold the Certificate of Label Approval (COLA) for the products it intends to ship and require that all such products originate from a shipping location in the U.S.

Jacob Hegeman, Assistant General Counsel for Wine & Spirits Wholesalers of America, stated in written comments that HB 415 limited shipping privileges to manufacturers, and cited the language of KRS 243.027(2)(a)(2) in support of that argument.

Kellie Duhr, Vice President, State Government Relations for the Sazerac Company, Inc., also stated in written comments that the legislature did not intend for importers to get direct shipper licenses, but stated that it was “unclear” how to prohibit importers from shipping imported alcoholic beverages under the definition of “supplier” pursuant to KRS 243.212. Additionally, Ms. Duhr asked how the Commonwealth can, in practice, restrict consumer shipment originating out-of-state.

Jay Hibbard, Vice President of the Eastern Region for Distilled Spirits Counsel of the United States (DISCUS), stated in written comments his support for Section 1’s inclusion of foreign product

importers within the ambit of potential direct shipper licensees. In support of this inclusion, Mr. Hibbard pointed to language in KRS 243.037(2)(a) which states that manufacturers “or” suppliers licensed under KRS 243.212 or 243.215 may be issued direct shipper licenses. However, Mr. Hibbard suggested that Section 1(2)(c) be revised to permit issuance of direct shipper licenses to importers of domestic products into Kentucky without a federal basic permit, because federal basic permits do not exist for importers for domestic producers.

Steven G. Amato, an attorney writing on behalf of the Kentucky Distillers’ Association (KDA), stated that this provision needed to be clarified to state that “wholesalers or importers ... may obtain direct shipper licenses to enable them to sell and ship only those products for which they are the registered primary source of supply in Kentucky.” Mr. Amato also claimed that wholesalers should have to provide a copy of their federal permit in order to apply for a direct shipper license. He proposed an amendment to Section 1(2)(c) as follows:

“(c) If an importer, wholesaler, or distributor licensed as an out of state [sic] supplier under KRS 243.212 or KRS 243.215, a basic importer or wholesaler permit, for the purpose of directly shipping only those products for which they are designated the primary source of supply under their out of state [sic] supplier licenses.”

(b) Response: The Department acknowledges the concerns of wholesalers and retailers, as well as some producers, like Ms. Duhr who wrote on behalf of Sazerac Company, Inc., and Mr. Dogali, who wrote on behalf of the American Distilled Spirits Alliance, at the inclusion of importers among the eligible applicants for direct shipper licenses pursuant to KRS 243.027. The wholesalers and retailers who commented all agreed that HB 415 passed the legislature as a “producer-only bill.” Mr. George explained that he had understood “producer-only” to have meant “*bona fide*, domestic manufacturers” shipping “their own, exclusively-licensed domestic products.” Ms. Lentz agreed, and stated she appreciated Chairman Koenig’s comment that HB 415 was a “producer-only” bill. Chairman Koenig stated that “producer-only” could also include licensed suppliers who, by definition, are the “primary source of supply” for alcoholic beverages sold in the Commonwealth. *See* KRS 241.010(45).

The Department does not believe suppliers were only included in HB 415 to ensure that out-of-state manufacturers were not prevented from applying for direct shipper licenses due to incompatibility between direct shipper licenses and the supplier licenses they must hold in order to sell alcoholic beverages in the Commonwealth. *See e.g.* KRS 243.212. HB 415 did not amend KRS 243.110 to include such an exception to incompatibility between direct shipper licenses and supplier licenses, nor did it write KRS 243.027 only to allow *bona fide* domestic manufacturers to apply for direct shipper licenses.

First, HB 415 amended KRS 243.110 to except distillery, winery, and small farm winery licenses from incompatibility with direct shipper licenses, but did not similarly except supplier licenses issued under KRS 243.212. *See* KRS 243.110(3). Supplier licenses issued under KRS 243.212 remain incompatible with direct shipper licenses under KRS 243.110, since both licenses are enumerated under KRS 243.030 and not excepted under KRS 243.110(3). Second, HB 415 contains no language limiting direct shipper licenses to manufacturers. As Mr. Hibbard indicated in his comments, the legislature enacted KRS 243.027 with language permitting manufacturers

located in the Commonwealth or any other state *or* suppliers licensed under KRS 243.212 or 243.215 to apply for a direct shipper license. This disjunctive precludes the Department from limiting direct shipper license applicants to “manufacturer importers” as recommended by Mr. McLean.

As KRS 243.110 states each kind of license listed in KRS 243.030 is incompatible with every other kind listed in that section, and both out-of-state distilled spirits and wine supplier licenses issued under KRS 243.212 and direct shipper licenses are listed in KRS 243.030, they are incompatible. However, KRS 243.027 specifically states that suppliers licensed under KRS 243.212 may apply for a direct shipper license. When two statutory provisions conflict, the Department must take care to “harmonize any conflicting provisions and give effect to both sections if possible.” *Reisinger v. Grayhawk Corp.*, 860 S.W.2d 788, 790 (Ky. App. 1993). Here, where the general statement of incompatibility under KRS 243.110 renders supplier licenses issued under KRS 243.212 incompatible with direct shipper licenses, but KRS 243.027 specifically permits issuance of direct shipper licenses to qualifying supplier licensees under KRS 243.212, harmonizing the statutes means “the more specific regulation controls the more general one.” *Reisinger*, 860 S.W.2d at 790. Thus, KRS 243.027 must permit supplier licenses and direct shipper licenses to be compatible, despite their general incompatibility under KRS 243.110.

The Department understands Chairman Koenig’s comment that it was the intent of the legislature to permit an importer that is the “primary source of supply” for an alcoholic beverage to apply for a direct shipper license to ship that alcoholic beverage direct to consumers in Kentucky if the importer is licensed as a supplier for that alcoholic beverage. This comment is supported by the language of KRS 243.027(2)(a) allowing licensed suppliers to apply for a direct shipper license even if they are not manufacturers. However, in keeping with the “producer-only” reach intended by this bill, the Department also understands that direct shippers should be limited to shipping *only* those products for which they are the primary source of supply, and not any alcoholic beverage they may import.

The Department notes that Mr. George is correct in his comments that limiting eligible applicants for direct shipper licenses to manufacturers licensed in this state or another state and suppliers licensed under KRS 243.212 and 243.215 would preclude in-state importers from applying for a direct shipper license. Supplier licenses issued under KRS 243.212 and 243.215 may be issued only to out-of-state entities. However, the Department does not issue importer licenses, only supplier licenses and distributor licenses, the latter of which permits distributors to import foreign malt beverages “from an importer or wholesaler registered with the Kentucky Department of Revenue.” KRS 243.180(1)(b). Under those circumstances, the licensed distributor would not be the primary source of supply and thus would be ineligible for a direct shipper license.

According to comments by Ms. Lentz and Mr. George, wholesalers, distributors, and retailers were eligible for direct shipper licenses under an earlier iteration of HB 415, but were removed. Ms. Stiglitz stated that this was to preclude “unfair competition” from out-of-state retailers. Whatever the reason, Kentucky-licensed wholesalers, distributors, and retailers are not able to apply for direct shipper licenses. However, under KRS 243.212 and 243.215, out-of-state wholesalers and distributors may be licensed as suppliers if they are the primary source of supply for an alcoholic beverage. Although Mr. George commented that treating direct shipper licensees as

“manufacturers” when reviewing their potential interlocking interests in accordance with 804 KAR 4:015 under Section 2 of this regulation may prevent out-of-state wholesalers from applying for direct shipper licenses, the interlocking substantial interests that 804 KAR 4:015 prohibits for “wholesalers” is limited only to wholesalers located in this state. *See* 804 KAR 4:015, §1(4); *cf.* 804 KAR 4:015, §1(1) and (2).

The Department can find no statutory or regulatory bar to prevent out-of-state wholesalers and distributors licensed as suppliers from applying for a direct shipper license to ship the alcoholic beverages for which they are the “primary source of supply” as defined by KRS 241.010(45). Mr. McLean is correct that there are relatively limited avenues for wholesalers and distributors to be licensed as suppliers, but the statute includes as a “primary source of supply” for domestic alcoholic beverages the “owner of the commodity at the time it becomes a marketable product” and “the authorized agent of the brand owner,” neither of which are *necessarily* the entity or entities that produced the alcoholic beverage.

The Department therefore will amend the regulation to adopt language similar to that offered by Mr. Amato, including requirements for out-of-state wholesalers and distributors applying for a direct shipper license in Section 1(2)(c) to submit their federal wholesaler permit and to limit what they may ship only to those alcoholic beverages for which they are the primary source of supply. The Department is uncertain to what Mr. Hibbard referred in his comment requesting the Department permit “out-of-state importers of domestic products” to apply for a direct shipper license. However, the Department believes that the language of Section 1(2) as amended will give domestic producers the means required to apply for a direct shipper license to ship alcoholic beverages for which they are the primary source of supply.

Finally, the Department shares Ms. Duhr’s concerns about the practical difficulties in restricting shipments of alcoholic beverages originating from out-of-state locations, but will work with what tools the Department has been given to protect the health, safety, and welfare of Kentucky consumers. The Department discusses in its response to comments regarding Section 5 of the regulation about brand registration as a means to ensure that direct shipper licensees ship only those alcoholic beverages that meet the criteria under KRS 243.027(2)(a)(2) or for which they are the primary source of supply.

(2) Subject Matter: Section 1(6), regarding disclosure of alcohol-related licenses, permits, and authorizations, and Section 1(7) & (8), regarding disclosure of convictions for violations of alcoholic beverage laws, misdemeanors directly or indirectly related to the use of or trafficking in alcoholic beverages or controlled substances, and or any felonies by the applicant, or the applicant’s officers, directors, or members or managers.

(a) Comment: Charles George, Executive Director of Wine and Spirits Wholesalers of Kentucky, and Jason Baird, Executive Director of KY Malt Beverage Council, stated that a direct shipper license applicant should be required to disclose all alcohol-related licenses held in any other state, not just licenses in other states where it manufactures alcoholic beverages. Mr. George stated in

written comments that this would help the Department of Alcoholic Beverage Control (ABC) determine whether the applicant has a prohibited substantial interest in line with the intent of the legislature.

Karen Thomas Lentz, Executive Director of Kentucky Alliance of Beverage Retailers, noted that differences in state laws may permit an applicant to hold a manufacturer or supplier license in one state that would qualify it for licensure in Kentucky, but hold a retail license in another state, which is incompatible in Kentucky. Ms. Lentz recommended that the regulation be amended to delete “the state in which the applicant manufactures alcoholic beverages” and append “another state where the applicant holds an alcohol-related license.”

Jay Hibbard, Vice President of the Eastern Region for Distilled Spirits Counsel of the United States (DISCUS), wrote in public comments that this provision was not clear because it did not indicate to whom or under what circumstances the disclosure requirement applied and also that it was overly broad in how many licenses it required to be disclosed. Mr. Hibbard suggested that this requirement be limited only to manufacturer applicants, and the disclosure be limited only to licenses, permits, and authorizations granted to it to manufacture alcoholic beverages that the licensee intends to ship into Kentucky. Mr. Hibbard claimed this suggestion would ensure that the Department had the information it needed to determine whether the applicant qualified as a manufacturer eligible for a direct shipper license.

Steven G. Amato, an attorney writing on behalf of the Kentucky Distillers’ Association (KDA), stated that this provision imposes a greater degree of disclosure than applicants for other licenses issued by the Department. Mr. Amato therefore proposed deleting this subsection (as well as Sections 1(7) and (8)) and substitute two new sections:

“(6) Produce a copy of the applicant’s manufacturer’s license issued by its home state or its Kentucky out of state [sic] supplier license and its federal TTB Permit or notice.

(7) Provide such information as the Department requests under KRS 243.390;”

(b) Response: The Department does not agree with Mr. Hibbard that the only licenses, permits, and authorizations that applicants should be required to disclose are those concerning the manufacture of alcoholic beverages the licensee intends to ship into Kentucky. KRS 243.027(5)(f) states that direct shipper licensees shall “hold the license contingent on obeying all laws and regulations of both the origin state and the destination state.” The Department is concerned with ensuring, to the greatest extent manageable, that it does not discriminate in its treatment of Kentucky licensees concerning production and trafficking in alcoholic beverages, whether they are located inside or outside the Commonwealth. To that end, the regulation requires disclosure only of those licenses an applicant holds in Kentucky and the state in which the applicant manufactures alcoholic beverages if that state is not Kentucky.

The Department understands comments requesting greater disclosure than required under the regulation as currently drafted. In order to more completely ensure that no direct shipper license applicant holds interlocking substantial interest prohibited by Kentucky statute or regulation, it would be necessary for the Department to review all alcoholic beverage licenses the applicant held

in any state. However, the administrative burden of reviewing potentially dozens of licenses—and what they authorize—from each direct shipper applicant anywhere in the country would be great, and still would not result in complete parity with in-state licensees applying for direct shipper licenses.

However, the Department also recognizes, as noted by Mr. Amato, that the regulation may require a more significant degree of disclosure than do other license applications. This greater degree of disclosure is not without reason. Though the direct shipper license is not the first license issued to out-of-state entities, it is the first license to allow out-of-state producers to transact business directly with Kentucky consumers. This direct connection between producer and consumer exposes Kentucky consumers to potential threats to their health, safety, and welfare, and the disclosures required under Section 1(6)-(8) will help to protect consumers from those potential threats.

(3) Subject Matter: Section 2, regarding interlocking substantial interests

(a) Comment: Charles George, Executive Director of Wine and Spirits Wholesalers of Kentucky (WSWK), Karen Lentz, Executive Director of the Kentucky Association of Beverage Retailers (KABR), and Shannon Stiglitz, Senior Vice President of Government Affairs for the Kentucky Retail Federation, commented in support of this provision. Mr. George also stated with approval that this provision may prevent out-of-state wholesalers and distributors from holding a direct shipper license. Ms. Stiglitz stated that this provision “operates in fidelity with the legislative intent of HB 415” and ensures that out-of-state wholesalers will not be able to unfairly compete with Kentucky retailers.

Jay Hibbard, Vice President of the Eastern Region for Distilled Spirits Counsel of the United States (DISCUS), stated that this provision should exempt a direct shipper applicant with a “substantial interest” in a retailer in another state “where such an interest is lawful in that other state” because out-of-state manufacturers or suppliers “should not be precluded from direct shipping to Kentucky consumers based upon compliance with the laws of another state governing activities in that state” and the Department “has no interest in out-of-state activities that have no bearing on direct shipping into Kentucky and no impact on or connection to the Kentucky market.”

Steven G. Amato, an attorney writing on behalf of the Kentucky Distillers’ Association (KDA), wrote that the KDA does not believe that having an interlocking substantial interest in another state where such interests are permitted should preclude a manufacturer from being issued a direct shipper license. Mr. Amato stated that instead of the current Section 2, the regulation should read: “A direct shipper license applicant and direct shipper licensee shall comply with 804 KAR 4:015 as it relates to any interests it may have in Kentucky-licensed businesses and with the requirements of KRS 243.027(2)(a)(2)(a), (b), and (c).”

Gene McLean, Executive Director of the Kentucky Beer Wholesalers’ Association, stated his support for this section as it “carr[ies] out the legislative intent to prohibit malt beverage distributors from obtaining a direct shipper license.” Mr. McLean grounded this statement in the regulation treating all direct shipper applicants as “manufacturers” under 804 KAR 4:015, which Mr. McLean noted cannot have or acquire a substantial interlocking interest in a “wholesaler.”

Thereafter, Mr. McLean stated that malt beverage distributors are included in the definition of “wholesaler” under 804 KAR 4:015 §1(4), and since direct shippers are considered “manufacturers,” the regulation “effectively precludes malt beverages from applying for and acquiring a direct shipping license.”

(b) Response: As the Department has recognized the legislative intent of HB 415 was to allow “producers only” to ship alcoholic beverages directly to consumers, the regulation treats direct shippers as manufacturers within the three-tier structure that Kentucky recognizes to regulate alcoholic beverages. As explained in the Necessity, Function, and Conformity section of 804 KAR 4:015 “Interlocking substantial interest between licensees prohibited”:

The control of alcoholic beverages in the Commonwealth of Kentucky, as codified in Chapters 241 - 244 of the Kentucky Revised Statutes, has been established by the Kentucky legislature as a “three tiered” system. The three (3) tiers of this system are designated as manufacturer/producer, wholesaler/distributor, and retailer. Each of these three (3) levels operates separately, distinctly, and apart from each other for the purpose of control. In order for this control to be effectively administered by this board, it is necessary to prevent any type of interlocking substantial interest by and among the three (3) separate tier levels.

While the direct shipper license permits limited direct-to-consumer sales of alcoholic beverages by manufacturers or producers, and therefore permits some circumvention of the three-tier system, the legislature gave the three-tier system explicit support in HB 415 when it amended KRS 243.240 to permit quota retail package licensees to purchase distilled spirits and wine from Kentucky licensees authorized to sell it at retail, “but only if the distilled spirits and wine have first gone through the three (3) tier system.” KRS 243.240(2)(b).

Some commenters stated that the Commonwealth has no interest or should have no concern for interlocking substantial interests held by licensees in other states, so long as those licensees comply with the laws of those states. However, 804 KAR 4:015 prohibits Kentucky-licensed manufacturers from having or acquiring substantial interests in retailers “whether located within or without this state,” and Kentucky-licensed retailers from having or acquiring substantial interests in manufacturers, “whether located within or without this state.” See 804 KAR 4:015, §§ 1, 2, and 4.

The legislature having explicitly supported the three-tier system, which requires for its function prohibitions on interlocking substantial interests by Kentucky licensees between producers and retailers “located within or without this state,” the Department adopted this section of the regulation in order to support Kentucky’s regulatory structure for all Kentucky licensees. That includes direct shipper licensees, which the legislature intended to be “producers.”

Contrary to Mr. George’s and Mr. McLean’s comments, the Department does not interpret the inclusion of this section to prohibit out-of-state wholesalers and distributors licensed as suppliers from applying for a direct shipper license. Unlike “manufacturers” and “retailers,” 804 KAR 4:015 prohibits only “wholesalers” *located within this state* from having or acquiring substantial interlocking interests with manufacturers and retailers. Compare 804 KAR 4:015 §§ 1, 2, and 4.

(4) Subject Matter: Section 3, regarding licensed premises

(a) Comment: L. Hunter Limbaugh, Southeastern Counsel for Wine Institute, estimated that 90% of wine is shipped using fulfillment houses. Mr. Limbaugh described the process by which out-of-state wineries ship alcoholic beverages through fulfillment houses. He stated that a fulfillment house is a business that stores wine for wineries to directly ship. When an order is made to a winery, the winery notifies the fulfillment house of the order, to whom it is to be shipped, and the product that is to be shipped to fulfill the order. The fulfillment house then “picks and packs,” retrieving the wine from their warehouse, packing it and arranging for shipment to a consumer. Mr. Limbaugh stated that some wineries use one fulfillment house, but others use two or up to three fulfillment houses and that it is rare that more would be used than that. Mr. Limbaugh asserted for that reason that direct shipper licensees should be permitted more than one licensed premises per license. He suggested that the regulation should permit direct shipper licensees to list the locations from which they ship wine and the Department permit those locations to be licensed premises, assigning tracking numbers to shipments, if needed, in order to source shipments to a particular licensed premises.

Mr. Limbaugh followed up his comments at the hearing with written comments in which he further defined a fulfillment house as storing wine owned by wineries and shipping that wine at the direction of the winery. “At no time does ownership of the wine reside in anyone other than the winery or the consumer.” He again suggested that the definition of “licensed premises” permit a licensee to identify a number of addresses and to permit those addresses all “to be subsumed” within the “licensed premises,” and stated there was “no functional difference in available information” and that permitting this would “reflect and accommodate the way the market actually functions.”

Sara Schorske, writing on behalf of Compliance Service of America, stated that “a single order may be divided between two shipment locations” and that requiring a direct shipper licensee to report shipments separately from each shipping location would create an issue for the licensee to determine how to divide invoices or orders between different licenses. Ms. Schorske also stated that requiring the licensed premises to be the shipping point would only complicate the Department’s ability to enforce Kentucky alcoholic beverage laws because it would “result in dozens and perhaps hundreds of licenses at the same address” (*i.e.*, the fulfillment house, which may contract with numerous wineries, some of whom do not hold a direct shipper license). Ms. Schorske’s solution comported with Mr. Limbaugh’s: direct shipper licensed premises should not be required to be located at the shipping point, but rather that licensees should be permitted to provide a list of shipping locations by affidavit, or permit the production location to be the licensed premises and describe the shipping locations in the application, assigning tracking numbers for shipments if necessary.

Charles George, Executive Director of the Wine and Spirits Wholesalers of Kentucky, stated that a direct shipper licensed premises should be limited to the same state as the direct shipper’s manufacturing premises in order to prevent licensees from setting up operations in border areas and manipulating different licenses held in different states.

Jacob Hegeman, Assistant General Counsel for Wine & Spirits Wholesalers of America, stated in written comments that the regulation should specifically prohibit the use of fulfillment centers, as he interpreted HB 415's language stating "a direct shipper licensee may ship alcoholic beverages to a consumer only from the premises described in its direct shipper license application" to preclude the use of fulfillment centers as they are not part of the direct shipper's licensed premises.

Jay Hibbard, Vice President of the Eastern Region for Distilled Spirits Counsel of the United States (DISCUS), wrote public comments in support of Section 3(1) permitting the direct shipper licensed premises to be different from the applicant's manufacturing premises. However, he opposed Section 3(3), arguing that it "would limit transportation by direct ship licensees to those with a different direct ship licensed premise [sic] and manufacturer's or supplier's premise [sic]" because it "does not allow any transportation of product to or from a non-manufacturing supplier's premises nor does it provide any flexibility for transportation and shipping needs that may arise." He stated these limitations were without justification and stated that "direct ship licensees should be allowed to engage in transportation of their products that is permitted under their manufacturer's or supplier's license."

Finally, Mr. Hibbard requested in comments that Section 3(2) be amended from requiring a direct shipper licensee be "licensed or otherwise authorized" for storage to permitting use of the direct shipper licensed premises for storage if "allowed by and in compliance with the laws of the jurisdiction in which it is located." Mr. Hibbard stated in support of his request that other states do not require logistical companies or fulfillment centers to obtain licenses or other formal authorizations to store alcoholic beverages, and this change would permit direct shipper licensees in other states to continue to use third-party logistical companies and not be precluded from shipping to Kentucky consumers.

Steven G. Amato, an attorney writing on behalf of the Kentucky Distillers' Association (KDA), wrote in public comments that, like DISCUS, the KDA also supports Section 3(1)'s permission for direct shipper licensees to license a separate premises to engage in direct shipping, but believes that the regulation should ensure that direct shipper licenses "can use one or more fulfillment centers to effectuate direct shipping" by permitting applicants to "designate multiple premises as direct shipping premises." Also, Mr. Amato requested clarification on "licensed or otherwise authorized" in Section 3(2), and requested that "otherwise authorized" be deleted. Finally, Mr. Amato asserted there was a "material omission" in Section 3(3), and that it should include "or supplying" when referring to the applicant's licensed premises.

(b) Response: The Department had written Section 3 with a mind to permit direct shipper licensees to use fulfillment centers' premises as their licensed premises. However, this is barred by KRS 243.220, which states, "No license shall be issued for any premises unless the applicant for the license is the owner of the premises or is in possession of the premises under a written agreement or a permit for a term of not less than the license period." Although KRS 243.220 is entitled "Premises that may not be licensed for sales at retail," the language limiting its coverage to licenses "for the sale of alcoholic beverages at retail" was removed by amendment in 2017. *See* 2017 Ky Acts, Ch. 62 (HB 183). The title of the statute "do[es] not constitute any part of the law." KRS 446.140.

Therefore, the only premises that a direct shipper may license is one that the direct shipper either owns or is in possession of by written agreement or permit. This does not limit the licensed premises to the applicant's manufacturing or supplying premises, as acknowledged with support by Mr. Hibbard, but does preclude the use of fulfillment centers as licensed premises. As Mr. Hegeman commented, KRS 243.028(8) states, "A direct shipper licensee may ship alcoholic beverages to a consumer *only* from the licensed premises described in its direct shipper license application." (emphasis added). Since direct shippers must own or be in possession of the premises described in their application, and can only ship from that premises, direct shippers are precluded by statute from using fulfillment centers insofar as fulfillment centers are separate businesses from the direct shipper.

The Department cannot overcome this statutory restriction to implement Mr. Limbaugh's suggestion that direct shipper licensees provide a list of addresses from which they will ship that are subsumed by or part of the licensed premises. Nor can the Department permit any other premises to be the shipping point as suggested by Ms. Schorske. The Department "may not seek to amend, alter, enlarge, or limit terms of legislative enactment" by regulation. *Ruby Const. Co., Inc. v. Department of Revenue, Com. ex rel. Carpenter*, 578 S.W.2d 248, 252 (Ky. App. 1978). The statute is plain. KRS 243.028(8) prohibits direct shippers from shipping alcoholic beverages to consumers from any premises other than the licensed premises. Even contracting with other parties to perform shipping activities—permissible under KRS 243.020(1)—cannot obviate this restriction.

In light of this restriction, Department sees no reason at this time to further limit a direct shipper's licensed premises to the same state as its manufacturing (or shipping) premises, as suggested by Mr. George. However, the Department will amend the regulation to require that direct shipper license applicants provide documentation demonstrating their ownership or possession of the premises to be licensed in accordance with KRS 243.220.

The Department understands the concerns of commenters that fulfillment centers are widely utilized by direct shippers nationwide and to prohibit their use may significantly diminish participation by smaller producers that cannot afford to build the capacity necessary to directly ship to Kentucky consumers themselves. Notably, any producer or supplier who ships from a number of their own premises may have any number of direct shipper licenses, each with its own licensed premises from which they may ship alcoholic beverages. KRS 243.110(4).

Mr. Hibbard notes that other states do not require fulfillment centers or logistical companies to obtain licensure in order to store alcoholic beverages. In Kentucky, KRS 243.020(1) permits contractors acting on behalf of a licensee to engage in alcoholic-beverage-related activities under the authority granted by that licensee's license. However, a direct shipper license grants only the permission to sell and to ship alcoholic beverages directly to consumers. KRS 243.028(1). Storage on the licensed premises and transportation between a licensee's licensed premises are authorized by Kentucky manufacturer licenses, but not supplier licenses. *Compare* KRS 243.120 and KRS 243.212. Storage and transportation of alcoholic beverages are activities that a licensee may assign to a contractor in accordance with KRS 243.020(1), but the locations of licensed premises cannot. *See* KRS 243.220.

The purpose of Sections 3(2) and 3(3) was to highlight how direct shipper licensees may store or transport alcoholic beverages, respectively, since the direct shipper license does not grant the licensee permission to do so. In doing so, the Department acknowledges the ambiguity that Mr. Hibbard and Mr. Amato highlighted in the phrase “licensed or otherwise authorized” in Section 3(2) and notes that “allowed by and in compliance with the laws of the jurisdiction in which it is located” as suggested by Mr. Hibbard, comes closer to conveying what the Department intended. The Department will amend Section 3(2) accordingly.

In Section 3(3), the Department agrees the language was perhaps too granular, and instead could and should read much as Mr. Hibbard suggested, “Direct ship licensees may engage in any transportation of their products permitted under their manufacturer’s or supplier’s license.” The Department will amend Section 3(3) accordingly.

(5) Subject Matter: Section 4, regarding minimum production amounts of distilled spirits and wine required for direct shipper licenses.

(a) Comment: Charles George, Executive Director of the Wine and Spirits Wholesalers of Kentucky, commented in support of this provision, stating that it is necessary to protect public health and safety and prevent sham wineries and distilleries, which try to circumvent state and local laws by obtaining a manufacturing license while operating a retail business.

Jacob Hegeman, Assistant General Counsel for Wine & Spirits Wholesalers of America, commented in support of this provision. He stated that it was a “strong safeguard to ensure the intention of the legislature to allow only manufacturers to ship,” but recommended limiting the definition of “production” allowed under a direct shipper license to “products of the manufacturer’s **own production**” (emphasis in original), which he clarifies to mean “the license holder’s own brands, which it has had a role in the manufacturing.” In further support of limiting the definition, Mr. Hegeman stated that without such limitation, manufacturers might also act as retailers of other brands under more relaxed standards permitted by other state licenses.

Jay Hibbard, Vice President of the Eastern Region for Distilled Spirits Counsel of the United States (DISCUS), stated that this provision would preclude smaller manufacturers from holding a direct shipper license, which he stated was contrary to the express language that the ABC “shall” issue a direct shipper license to a manufacturer licensed in another state. Mr. Hibbard stated that HB 415 does not give the Department any discretion to prohibit licensed manufacturers from being issued a direct shipper license.

Steven G. Amato, an attorney writing on behalf of the Kentucky Distillers’ Association (KDA), stated that this section should be deleted because manufacturers that engage in direct shipping likely already meet such minimum production standards in their home state and risks limiting future reciprocity with those states.

(b) Response: The legislature amended KRS 243.120 and KRS 243.155 this year to set or change limits on minimum and maximum production of alcoholic beverages by distilleries and small farm wineries, respectively. Under current Kentucky law, a licensed distillery must manufacture at least 600 gallons of distilled spirits, KRS 243.120(2)(a), and a small farm winery must manufacture at

least 250 gallons and no more than 500,000 gallons, KRS 243.155(2)(a), annually in order to maintain a license. This should not pose a significant obstacle to licensure for manufacturers that engage in direct shipping, but the relative ease of meeting these requirements does not justify deleting the section.

The Department agrees with Mr. George's comments that these amounts were adopted in order to protect public health and safety from "sham" wineries and distilleries who obtain manufacturing licenses to take advantage of the limited retail permissions they grant without producing or manufacturing any alcoholic beverages. The same public health concerns also apply to direct shipper licenses. The Department shares Mr. Hegeman's concerns that "sham" manufacturers might attempt to act as retailers of brands they do not produce under more relaxed standards other state licenses may permit. However, because the statute specifically permits manufacturers to ship alcoholic beverages other than "the license-holder's own brands, which it has had a role in the manufacturing," the Department cannot adopt the definition of "production" that Mr. Hegeman proposed.

The Department disagrees with the interpretation of KRS 243.027 offered by Mr. Hibbard, who stated that the legislature intended to strip the Department of its discretion to prohibit any licensed manufacturer applicants from being issued direct shipper licenses. KRS 243.027(2) reads, in relevant part, "The department shall issue a direct shipper license to a successful applicant that ... is a manufacturer located in this state or any other state or an alcoholic beverage supplier licensed under KRS 243.212 or 243.215." Mr. Hibbard draws support from the legislature's use of "*shall*" but ignores that the statute only requires the Department to issue licenses to "successful" applicants. *See id.* Later in the statute, the legislature directed the Department to "set the requirements and form for a direct shipper license application through the promulgation of an administrative regulation." KRS 243.027(3); *see also* KRS 241.060(1). While the statute provides two necessary inclusions, a description of the premises to be licensed and the applicant's license to manufacture or supply alcoholic beverages—the legislature gave the Department broad discretion to determine what additional information the application can require, including "[a]ny other information the department determines to be necessary to implement and administer the direct shipper licensing program." KRS 243.027(3)(a)-(c). An applicant's failure to meet any of the requirements the Department is authorized to set may mean the applicant is not "successful" under KRS 243.027(2) and the Department would not therefore be obligated to issue the applicant a direct shipper license.

(6) Subject Matter: Section 5, regarding registering with the Department all brands a direct shipper intends to ship in or into Kentucky that the licensee has not already registered under another license issued by the Department.

(a) Comment: Charles George, Executive Director of the Wine and Spirits Wholesalers of Kentucky, commented in support of this provision, but added that the direct shipper licensee should be required to register all products they intend to ship, whether they have already registered the product under another license or not. Mr. George says that this may be as simple as having the licensee notify the Department that they are also shipping a brand that is registered, as well as selling through other means. Jason Baird, Executive Director of the KY Malt Beverage Council,

agreed that all products should be registered, regardless of whether they are already registered under the existing distribution system.

Mr. George further stated in written comments that direct shipper licensees should also be required to hold the COLA for the products they ship in order to tie their production operations or their exclusive license to their state manufacturing licenses. Mr. George stated that the regulation “should clarify that a direct shipper’s [sic] licensee can only ship the products it is producing at the licensed premises that holds the federal basic permit, or if the product is exclusively licensed, that the product is produced at a facility with a federal basic permit.” Mr. George asserted that requiring the COLA alone would not be enough without a “tie-in” among the direct shipper license, the federal basic permit, and the products the direct shipper licensee ships, because a producer could otherwise hold the COLA to multiple brands, including imported brands, and ship them without the products being produced at a facility that has a direct shipper’s license, state manufacturing license, or federal basic permit.

Gene McLean, Executive Director of the Kentucky Beer Wholesalers’ Association, wrote in agreement with Mr. George’s suggestion. Mr. George, however, admitted that “a COLA requirement would prevent domestic products from being shipped where a subsidiary or parent company of the direct shipper holds the COLA” and that such a situation is counter to HB 415’s intent.

Jacob Hegeman, Assistant General Counsel for Wine & Spirits Wholesalers of America, suggested that the Department require direct shipper licensees to certify they will only ship alcoholic beverages for which they are the holder of the COLA and provide a copy of the COLA when requested. Mr. Hegeman claimed such a requirement would “ensure accurate identification of *bona fide* manufacturers.”

Kellie Duhr, Vice President, State Government Relations for the Sazerac Company, Inc., also suggested in written comments that the Department require a direct shipper licensee to hold the COLA for any products it intends to ship.

L. Hunter Limbaugh, Southeastern Counsel for Wine Institute, commented that Section 5 as written “fails to account for a specific situation that is fairly common in the marketplace,” wherein some wineries may want to ship alcoholic beverages that they have contracted to be sold through a third party to wholesalers to be sold at retail. Under Section 5 as written, such wineries may not be allowed to ship their wine direct to consumers in the Commonwealth if the brands have been registered by these third parties to be sold at wholesale in the Commonwealth. Mr. Limbaugh suggested amending the regulation by altering the language of Section 5 to remove the reference to “licensees” as follows: change the language from brands “that the licensee has not already registered” and replace it with a reference to brands “that have not already been registered.” Mr. Limbaugh stated that this change would ensure that “all brands sold in Kentucky, whether direct to consumer, to wholesale, or both, are registered ... without causing unnecessary upset to the market or unnecessary administrative work for anyone in the system.”

Jay Hibbard, Vice President of the Eastern Region for Distilled Spirits Counsel of the United States (DISCUS), requested two changes to this section in written comments, claiming that brand

registration requirements were designed to apply to 3-tier distribution of alcoholic beverages. First, Mr. Hibbard requested that the Department remove the requirement currently in the Department's brand registration system that registrants designate a wholesaler, since direct shippers may directly ship products that are not also sold through wholesalers. Second, echoing Mr. Limbaugh's comments, Mr. Hibbard stated that applicants that use one of their companies for three-tier sales and an affiliated company for direct to consumer sales would have a duplicate brand registration requirement and instead direct shipper licensees should be able to rely upon the brand registration of the affiliated company, with their approval or consent.

Steven G. Amato, an attorney writing on behalf of the Kentucky Distillers' Association (KDA), also requested in written comments that the Department's brand registration system be adjusted to accommodate direct shippers without requiring that they designate a wholesaler.

Stacy Kula, writing on behalf of certain brand owners of alcoholic beverages produced in Kentucky, stated in comments relevant to this Section that "produced" under KRS 243.027(2)(a)(2)(a) be defined as "any significant stage of the production process, including distillation/brewing/winemaking, blending and aging." Further, Ms. Kula stated that "exclusively licensed to the manufacturer" under KRS 243.027(2)(a)(2) should be defined to mean that the brand is "exclusively licensed to the manufacturer to use the brand name, to produce product under the brand name and/or to direct ship the brand to the consumer." In support of her argument, Ms. Kula stated that multiple manufacturers often produce products for one brand owner, and that multiple manufacturers are involved in various stages of production—distilling, blending, aging, bottling, etc.—for some products. Ms. Kula stated that so long as a direct shipper licensee has participated in at least one of these production activities as a manufacturer, the licensee should be able to sell the branded product under their direct shipper license. Ms. Kula stated that this clarification is representative "of how the industry operates and gives more flexibility to Kentucky manufacturers."

(b) Response: The Department recognizes that the legislature made efforts to permit only producers to be able to ship. To that end, KRS 243.027 permits manufacturer applicants only to ship alcoholic beverages for which they own the brand name or the brand name is exclusively licensed to them. Further, even if the manufacturer owns an alcoholic beverage's brand or the brand name is exclusively licensed to them, the manufacturer may only ship the alcoholic beverage if they produce it, it is "[p]roduced by or for them under an existing written contract with another manufacturer," or "it is produced and bottled for" them. KRS 243.027(2)(a)(2)(a)-(c). Suppliers may only directly ship those alcoholic beverages for which they are the "primary source of supply" as defined under KRS 241.010(45). Taken as a whole, the Department understands the legislature to have intended the number of entities shipping any particular alcoholic beverage direct to a consumer to be one, whether it is the brand owner or exclusive licensee, manufacturer or supplier.

Some commenters stated that the Commonwealth should enter the direct shipping market as the market stands, and the Department should shape the regulation to interpret the statute as if the legislators intended the Commonwealth's participation in the market to be the same as those states already involved in the market. The Department believes that the regulation should support the legislative intent that only producers and primary sources of supply of alcoholic beverages be able to ship, which the Department understands may differ from the way the direct-to-consumer market

for alcoholic beverages currently operates. For instance, the legislation does not permit retailers to be able to ship, and Kentucky statute prohibits the production or trafficking in alcoholic beverages without a license to engage in the particular acts of production or trafficking undertaken. KRS 243.020(1).

As drafted, the regulation determines ownership or exclusive license of a brand by requiring the direct shipper to register all brands it intends to ship with the Department. However, how the Department may determine—and how a direct shipper may prove—whether a direct shipper owns or has been “exclusively licensed” a brand is a difficult standard to set. It is made even more difficult when the phrases “exclusively licensed” and “produced by” are up to interpretation.

Ms. Kula asks that the Department define “exclusively licensed” to mean that the brand is “exclusively licensed to the manufacturer to use the brand name, to produce product under the brand name and/or to direct ship the brand to the consumer.” The Department is concerned that too broad an interpretation of “exclusively” tends to undermine its inclusion and opens the door to multiple entities laying claim to the license to directly ship the same alcoholic beverage. However, defining “exclusively licensed” to mean that the manufacturer, if not the owner of the brand, is the sole licensee permitted to use the brand name to ship directly to consumers flows naturally from the phrase, limiting to one the number of potential licensees able to apply to ship any particular brand, and identifying the rights the licensee must have.

Similarly, Ms. Kula requested that the regulation define “produced by” to refer to “any significant stage of the production process, including distillation/brewing/winemaking, blending and aging.” Though the Department recognizes that the industry operates in such a way that multiple manufacturers may be involved in various stages of production, “manufacturer” is defined in statute to mean “a winery, distiller, rectifier, or brewer, and any other person engaged in the production or bottling of alcoholic beverages.” KRS 241.010(40). Notably, this definition distinguishes “production” from “bottling” which would exclude manufacturers only involved in the bottling of alcoholic beverages from participation in direct shipping under KRS 243.027(2)(a)(2)(a)-(c). Thus, the Department interprets “produced” to mean “engaged in activities to create the alcoholic beverage itself, as distinguished from activities which prepare the alcoholic beverage for market.” Under this definition, bottlers could still apply for direct shipper licenses if they owned or were exclusively licensed the brand in order to ship it, and the alcoholic beverages they intended to directly ship fit the criteria under KRS 243.027(2)(a)(2)(b) or (c).

Other commenters sought to restrict direct shipper licensees further than the legislature intended. These commenters requested that the Department require that any direct shipper licensee hold the Certificate of Label Approval (COLA) for any brand they intend to ship. However, this presents difficulties that Mr. George identified in his comments: “a COLA requirement would prevent domestic products from being shipped where a subsidiary or parent company of the direct shipper holds the COLA.” A general, one-size-fits-all rule to limit shipping in this way would have consequences that restrict the direct shipper license beyond what the legislature intended.

The Department recognizes and acknowledges the concerns of commenters that brand registration is an imperfect determinant of ownership or exclusive license, and their requests to require registration of all brands for direct shipment, whether or not the brand is already registered for sale

in the Commonwealth, are well taken. Especially considering that “exclusively licensed” is taken to refer to the “sole licensee permitted to use the brand name to ship directly to consumers,” it is important that a direct shipper applicant identify what brands it intends to ship into or out of Kentucky even if those brands are already registered. The Department therefore will amend the regulation to require registration of all brands the direct shipper licensee intends to ship to consumers in Kentucky, whether or not these brands are already registered under another license the direct shipper licensee holds.

The Department will undertake measures to update the brand registration system to ensure that direct shipper licensees can register the brands they intend to ship without requiring the licensee to identify a wholesaler as requested in comments by Mr. Hibbard and Mr. Amato. This will also assist the Department in preventing unlicensed shipments (*see* KRS 243.027(6)) since brands registered to be sold at wholesale would otherwise have no indication that they may also be sold via direct shipment or who is licensed to directly ship them.

(7) Subject Matter: Section 6, regarding the interlocking substantial interest prohibitions also applying to independent contractors of direct shipper licensees.

(a) Comment: Jacob Hegeman, Assistant General Counsel for Wine & Spirits Wholesalers of America, commented in support of this provision, but stated that permitting unlicensed entities could lead to compliance issues, as he claims that manufacturers use unlicensed fulfillment centers “to avoid compliance, recordkeeping, and reporting.” Mr. Hegeman suggested that all third parties engaged in the direct shipping of alcohol be subject to licensing and reporting requirements to which manufacturers must adhere.

Jay Hibbard, Vice President of the Eastern Region for Distilled Spirits Counsel of the United States (DISCUS), requested in written comments that the regulation “clarify” that independent contractors are not subject to 804 KAR 4:415 unless they are manufacturers. Mr. Hibbard stated that “there is no basis to subject independent contractors to a rule for manufacturers if they are not manufacturers” and that applying the tied-house ownership rule to independent contractors is improper.

(b) Response: The Department appreciates the support of Mr. Hegeman for this provision, but Kentucky statute does not require that unlicensed entities become licensed in order to contract with direct shippers to engage in acts authorized by the direct shippers’ licenses. In HB 415, the legislature amended KRS 243.020(1) to include independent contractors as able to do acts authorized by the alcoholic beverage license of the entity with which they are contracted. However, all direct shipper licensees are subject to the reporting requirements of this regulation and KRS 243.027-243.029, and contracting with another party to engage in activities under their direct shipper licenses does not absolve them of those requirements.

The Department declines to alter the provision as requested by Mr. Hibbard. The legislature intended HB 415 to be a “producer-only” bill and permitting “retailers” as defined by 804 KAR 4:015 to directly ship under a manufacturer’s or supplier’s license undermines that intention.

Further, it would also undermine the three-tier system, for which the legislature explicitly stated its support in HB 415 (*see* KRS 243.240(2)(b)).

(8) Subject Matter: Section 8, minimum pricing of alcoholic beverages directly shipped into Kentucky.

(a) Comment: Charles George, Executive Director of the Wine and Spirits Wholesalers of Kentucky, spoke and wrote in support of minimum pricing, arguing that “easily accessible alcohol at cheap prices results in dangerous consumption levels” and that minimum pricing standards have proven helpful in preventing excessive consumption. Mr. George also stated that since Kentucky retail licensees must abide by state minimum pricing standards, it would make little sense for the state not to apply this standard to direct shipper licensees located out of state. Mr. George stated that without minimum pricing standards, direct shipper licensees could offer “buy one, get one free” or other large discounts to lure customers or sell slow-moving products.

L. Hunter Limbaugh, Southeastern Counsel for Wine Institute, spoke against minimum pricing, arguing that HB 415 does not authorize the Department to set a minimum price. He also stated that there is no practical way for a direct shipper to determine a wholesale price, because wholesale price varies wildly across the country and products will be directly shipped to consumers in Kentucky that are not sold into the wholesale system in Kentucky. Mr. Limbaugh followed up his comments at the public hearing with written comments in which he stated that it was beyond the statutory scope of the Department’s authority to set a minimum price. For support, Mr. Limbaugh pointed to the “Necessity, Function, and Conformity” paragraph and stated that the reference to KRS 244.050 “reinforces the reality that limitations on pricing must be done by statute rather than regulation,” especially since such limitations “are complicated and multifaceted issues” that require more consideration than rulemaking permits. He also reiterated his comments from the hearing that the minimum pricing was “too vague and ambiguous for reasonable compliance or enforcement” in practice.

Chairman Adam Koenig also spoke against minimum pricing, stating that he is philosophically opposed to minimum pricing regulation, but also stated that direct shipper licensees will already have to comply with Kentucky’s minimum pricing statute, making the regulation redundant.

Karen Thomas Lentz, Executive Director of the Kentucky Association of Beverage Retailers (KABR), wrote in comments submitted after the public hearing that KABR supported the inclusion of this provision. She stated that “[w]hile KRS 244.050 sets the wholesale price as the minimum price, we believe it should be included in this administrative regulation to make it clear to businesses seeking licensure as a direct shipper and to the public that it applies to products being shipped to consumers.” Ms. Lentz “concurred” that since a direct shipper licensee is selling alcoholic beverages to the public, it is a retail licensee and subject to KRS 244.050. Finally, Ms. Lentz asserted that the inclusion of the minimum pricing provision affirms the comments by legislators that “shippers would be prevented from undercutting retailers on price.”

David S. Samford, General Counsel of the Kentucky Guild of Craft Brewers, Inc. (KGCB), wrote that “Section 8 is inconsistent with Kentucky Law and has no textual support within HB 415.” Mr.

Samford stated that KRS 244.050 sets a minimum price at either “(1) the amount paid; or (2) the current wholesale cost,” which he stated “are disjunctive and must therefore be read as equally acceptable and lawful pricing guidelines for alcoholic beverages,” citing *Bowlin Grp., LLC v. Sec’y of Labor, Com.*, 437 S.W.3d 738, 743 (Ky. App. 2014) and *Board of Nat’l Missions of Presbyterian Church in U.S. of America v. Harrel’s Tr.*, 286 S.W.2d 905, 907 (Ky. 1956). Mr. Samford also cited OAG 82-479 to state that “when the retailer and producer are one and the same” the threshold for minimum price is the “amount paid”—the alcohol producer’s cost of production. Mr. Samford stated the KGCB understood this interpretation to be the “long-standing interpretation of the [sic] KRS 244.050 with regard to malt beverages (beer) that has been consistently applied by the Department through successive administrations.” Mr. Samford cited *Revenue Cabinet v. Kentucky-Am. Water Co.*, 997 S.W.2d 2, 6 (Ky. 1999), to state that 804 KAR 4:415 “is at odds with the Department’s own interpretation of its statutes” and is therefore void.

Mr. Samford further stated that 804 KAR 4:415 places a legal limitation on direct shipper licensees that is more restrictive than that imposed by Kentucky law, which he stated was “plainly unlawful and unenforceable” under KRS 13A.130(1)(b), and cited to Kentucky case law prohibiting agencies from “exceed[ing] the scope” of statutory provisions, *Faust v. Commonwealth*, 142 S.W.3d 89, 98 (Ky. 2004), or “amend[ing], alter[ing], enlarge[ing], or limit[ing] the terms” of statutes, *Bd. Of Educ. Of Fayette County v. Hurley-Richards*, 396 S.W.3d 879, 889 n. 12 (Ky. 2013).

Finally, Mr. Samford stated that the minimum pricing provision is unconstitutional and “antithetical to the purpose of HB 415” as it interposes a barrier to commerce, namely wholesale prices, that he stated HB 415’s “self-evident objective” was to remove. Since the wholesale price is set by distributors, Mr. Samford stated that the regulation “enables and encourages” manipulation of the malt beverage market to harm Kentucky malt beverage producers, which Mr. Samford asserts do not have a similar minimum price rule. He agrees with Chairman Koenig that KRS 244.050 is sufficient, and Section 8 should be stricken as unnecessary or should be amended to conform to KRS 244.050 as interpreted by his comment.

Shannon Stiglitz, Senior Vice President of Government Affairs for the Kentucky Retail Federation, wrote in support of the minimum pricing provision, arguing that the provision recognizes that direct to consumer sales are retail sales and should be subject to KRS 244.050.

Jay Hibbard, Vice President of the Eastern Region for Distilled Spirits Counsel of the United States (DISCUS), opposed this provision in written comments, claiming that HB 415 did not regulate pricing and did not authorize rulemakings that include pricing, and there is no basis for this provision.

Steven G. Amato, an attorney writing on behalf of the Kentucky Distillers’ Association (KDA), stated that this provision may limit reciprocity with other states by imposing Kentucky-specific requirements on out-of-state applicants, and that since products shipped directly to consumers do not pass through the three-tier system, there will be no wholesale cost to compare the price to. Mr. Amato therefore urged this section be deleted in its entirety.

(b) Response: The Department appreciates the support offered by Mr. George, Ms. Lentz, and Ms. Stiglitz in including this provision. The Department is authorized by KRS 241.060(1) “[t]o promulgate reasonable administrative regulations governing procedures relative to the applications for and revocations of licenses, the supervision and control of the use, manufacture, sale, transportation, storage, advertising, and trafficking of alcoholic beverages, and all other matters over which the board has jurisdiction.” The Department therefore did not require specific authorization within HB 415, as some commenters claimed, to include a minimum pricing provision in the regulation.

The Department acknowledges that Chairman Koenig, as primary sponsor of HB 415, did not intend for this provision to be included in the direct shipper license regulation and he stated that KRS 244.050 already applies to direct shipper licensees. However, HB 415 did not make that readily apparent. The Department agrees with Ms. Stiglitz that a minimum pricing provision is necessary to clarify that direct-to-consumer sales are retail sales which should be subject to KRS 244.050.

KRS 244.050 states, in relevant part, that “a retail licensee shall not sell, give away, or deliver any alcoholic beverage at retail in any quantity for less than paid or current wholesale cost, except ... as provided by KRS 243.0305, 243.0307, 243.155, and 243.157.” However, “retail licensee” is not defined in Kentucky statutes, and HB 415 amended the definition of “retailer” under KRS 241.010(54) to broaden its exclusion of producers to “*manufacturers* with limited retail sale privileges” and also to exclude direct shipper licensees. *See* 2020 Ky Acts Ch. 80 (HB 415). If not for the excepted statutes listed under KRS 244.050, three of which refer to statutes that authorize free sampling of alcoholic beverages by manufacturers, it would be impossible to know that Kentucky still considers manufacturers “retail licensees” subject to KRS 244.050 despite not being “retailers” according to KRS 241.010(54). Direct shipper license applicants will come from all over the country and, unfamiliar with Kentucky law, may feel justified in ignoring KRS 244.050 if it is not referenced in the regulation.

The Department therefore included a reference to KRS 244.050 in the regulation in order to clarify that KRS 244.050 applies to direct shipper licensees. Unfortunately, the Department perhaps overstepped its intention from mere clarification to increased restriction by applying “wholesale cost” as the minimum price of all alcoholic beverage sales by direct shipment. As Mr. Samford vigorously argued in his written comments, the minimum price under KRS 244.050 for retail sales of alcoholic beverages in Kentucky is either the amount paid *or* the wholesale cost. However, contrary to Mr. Samford’s assertion “when the retailer and producer are one and the same” the threshold for minimum price is not always the alcohol producer’s cost of production in Kentucky. Retail sales of alcoholic beverages in distillery gift shops require the transfer of alcoholic beverage products to “be invoiced from the distiller to the wholesaler and from the wholesaler to the distiller, and all of these transferred products shall be included in the wholesaler’s inventory and depletions for purposes of tax collections.” KRS 243.0305(2). Under these circumstances, the distiller is both the producer and the retailer, but Kentucky law interposes wholesalers, and the concomitant wholesale cost sets the floor of the price.

The Department disagrees with Mr. Samford that the elimination of wholesale pricing was the “self-evident” intention of HB 415. If that had been the intention, HB 415 would not have limited

the amount of alcoholic beverages per month a direct shipper can ship to a consumer, nor would it have required retailer-to-retailer sales of package distilled spirits and wine to have gone through the three-tier system. Rather, the intention of HB 415 was to permit producers of alcoholic beverages to ship limited amounts of their products directly to consumers.

Nevertheless, as KRS 244.050 has been interpreted to set the minimum price for producers making retail sales to their cost of production, and as Mr. Limbaugh stated, wholesale costs may vary widely across the country and some alcoholic beverages directly shipped to Kentucky consumers will never enter the wholesale system, the Department is persuaded that cost of production is the more appropriate minimum price to apply to sales by direct shipper licensees. Therefore, the Department will amend the regulation accordingly.

(9) Subject Matter: Amending the proposed regulation to require more detail in a direct shipper's quarterly report.

(a) Comment: Charles George asserted in written comments that direct shipper licensees should be required to provide shipment information by month on their quarterly reports to help the Department ensure that shipments do not exceed limitations HB 415 placed on the monthly amount direct shippers can ship to any individual. Additionally, Mr. George asserted that including local tax and fees information will provide another crosscheck allowing local governments to ensure local fees are paid.

(b) Response: The Department acknowledges this suggestion by Mr. George, but declines to adopt it at this time. The Department will monitor the reports it receives from direct shippers and may revisit this suggestion if it determines more information is needed in them.

(10) Subject Matter: Amending the proposed regulation to reference KRS 243.110 in the licensure application process

(a) Comment: Shannon Stiglitz, Senior Vice President of Government Affairs for the Kentucky Retail Federation, stated that KRS 243.110, which outlines incompatible Kentucky alcoholic beverage licenses, should be referenced in the application process for a direct shipper license. Ms. Stiglitz stated that state laws and alcoholic beverage licenses vary widely across the country and if the regulation does not clarify that KRS 243.110 applies to applicants for direct shipper licenses then a manufacturer from another state that also holds a retail license in another state could be issued a direct shipper license in Kentucky.

(b) Response: The Department declines to reference KRS 243.110 in the regulation, as KRS 243.110 applies only to Kentucky licenses enumerated under KRS 243.030 and KRS 243.040 and therefore would not apply to out-of-state direct shipper licensees even if they may have licenses that would be incompatible if Kentucky issued them.

The Department notes that KRS 243.110 does pose an issue of interpretation for direct shipper licensees with out-of-state distilled spirits and wine supplier licenses issued under KRS 243.212. KRS 243.110 generally establishes that each license enumerated under KRS 243.030 is incompatible with each other license under KRS 243.030, and the out-of-state distilled spirits and

wine supplier license and the direct shipper license are both listed under KRS 243.030 making them incompatible. However, KRS 243.027 specifically states that an out-of-state distilled spirits and wine supplier licensed under KRS 243.212 may apply for a direct shipper license. When two statutes conflict, “the more specific regulation controls the more general one.” *Reisinger v. Grayhawk Corp.*, 860 S.W.2d 788, 790 (Ky. App. 1993). Thus, KRS 243.027 must permit supplier licenses and direct shipper licenses to be compatible, despite their general incompatibility under KRS 243.110.

(11) Subject Matter: Amending the proposed regulation to distinguish “delivery” and “shipping”

(a) Comment: Jacob Hegeman, Assistant General Counsel for Wine & Spirits Wholesalers of America, suggested in written comments that “delivery” and “shipping” are often confused, and since retailers can deliver but not ship, and direct shippers can ship, but not deliver, the regulation should be amended to distinguish them. Mr. Hegeman distinguished “delivery” as “local” and “same-day,” while “shipment” is “long-distance/interstate” and “multi-day.” He offered the following as a potential definition of “delivery”: “‘Delivery’ is an activity carried out by a licensed, local retailer that occurs in close geographic proximity to the retail licensed premise, with the consumer receiving the purchased alcohol the same day it leaves the retail premises.”

(b) Response: The Department acknowledges and appreciates Mr. Hegeman’s comment and plans to issue or promulgate an interpretation of “delivery,” but does not believe that this regulation, which defines the requirements for a direct shipper license, is the appropriate place for that definition.

(12) Subject Matter: Amending the proposed regulation to include a provision requiring the Department to maintain confidentiality of information received in required reports

(a) Comment: Kellie Duhr, Vice President, State Government Relations for the Sazerac Company, Inc., suggested that the regulation be amended to include a provision that would require the Department to exempt information shared in reports required by the regulation from information that is publicly available under the Commonwealth’s open records laws.

(b) Response: The Department acknowledges Ms. Duhr’s comment but declines to amend the regulation to require information to be exempted. KRS 61.878(1)(a) already exempts personal information if its public disclosure would “constitute a clearly unwarranted invasion of personal privacy.” *See also Zink v. Commonwealth*, 902 S.W.2d 825 (Ky. App. 1994) (holding that personal telephone numbers, home addresses, and social security numbers are exempt from the Open Records Act.) Additionally, KRS 61.878(1)(c) protects “confidentially disclosed to an agency or required by an agency to be disclosed to it, generally recognized as confidential or proprietary, which if openly disclosed would permit an unfair commercial advantage to competitors of the entity that disclosed the records” as well as any such “confidential or proprietary” records submitted to the Department for “the grant or review of a license to do business.” The Department

believes that these protections are sufficient to protect records from disclosure that may do personal or commercial harm.

Summary of Statement of Consideration and
Action Taken by Promulgating Administrative Body

The public hearing on the proposed regulation 804 KAR 4:415 was held, and comments were received at the hearing. Additionally, written comments were received during the comment period. The Department of Alcoholic Beverage Control has responded to the comments and will amend 804 KAR 4:415 as follows:

Page 1

NECESSITY, FUNCTION, AND CONFORMITY paragraph

Line 13

After “state”, insert the following:

KRS 241.060(1) authorizes the Department to promulgate reasonable administrative regulations governing procedures relative to application for licenses as well as the supervision and control of the trafficking of alcoholic beverages.

Page 2

Section 1(1)(c)

Line 5

After “importer”, insert “, wholesaler, or distributor”.

Page 2

Section 1(1)(c)

Line 5

After “basic”, insert “importer’s”

Delete “importers”.

Page 2

Section 1(1)(c)

Line 6

After “permit”, insert the following:

for the purpose of directly shipping only those products for which the applicant is designated the primary source of supply under the applicant’s supplier license

Delete “to import beverage alcohol”.

Page 2

Section 1(4)

Line 10

After “consumers”, insert the following:

, and documentation showing ownership or possession of the premises under a written agreement

Page 3

Section 3(2)

Line 15

After “also ”, insert the following:

comply with the laws of the jurisdiction in which it is located in order to store

Delete the following:

be licensed or otherwise authorized for storage of

Page 3

Section 3(3)

Line 16

After “(3)”, insert the following:

Direct shipper licensees may engage in transportation of their products as permitted by their

Delete the following:

If, as described in subsection (1), the licensed premises described in the direct shipper license application is different from a direct shipper licensee’s manufacturing or supplying premises, the direct shipper licensee may transport alcoholic beverages between the licensed premises described in the direct shipper license application and the licensee’s manufacturing premises, subject to the constraints of the direct shipper’s

Page 4

Section 5

Line 4

After “ship”, insert “to consumers”.

Page 4

Section 5

Line 4

After “in”, delete “or into”.

Page 4

Section 5

Line 4

After “state”, delete the following:

that the licensee has not already registered under another license issued by the department

Page 4

Section 8

Line 15

After “than”, insert “the cost of production”

Delete the following:

current wholesale price, if a current wholesale price is available,