

WINE BUSINESS MONTHLY

Business & Technology

Issue: April 2009, Page 90-91

Starting a Virtual Winery

Follow a group of lawyers as they document their progress and tackle the important legal aspects of the winery business. The first step? Choosing and forming an entity.

By Ken English, Conor Massey and Bruce Miroglio

Ken English, Conor Massey are members of the Wine Industry Group at Gaw, Van Male, Smith, Myers & Reynolds PLC based in the Napa Valley office. The Wine Industry Group provides legal advice in the areas of compliance, vineyard and winery acquisition, land use, financing, trademark protection, litigation, and business succession and exit strategy. Members of the Wine Industry Group can be reached at 707-252-9000.

SO WE HAVE DECIDED to start our own winery. Now a bunch of lawyers getting together for a common purpose, outside of the practice of law, never produces good results, e.g., Congress. However, we are confident that, as a group, we have the necessary fortitude and knowledge to at least get the regulatory side of this nut cracked with some success; now for the winemaking side, that may be a completely different story.

We intend to create a virtual winery that will, with a little luck, turn out a decent product that we hope to sell in the local market. We invite you to come along on this exercise we have cooked up. Throughout the next year we will be documenting our progress and explaining in detail our decisions—and the alternatives. You can follow our progress at our website www.gvmwine.com

Below we discuss the most basic aspect of starting our virtual winery, the formation of the entity. Indeed, this step is necessary in all but the smallest of businesses; but the choices of forms of entities and the advantages and disadvantages of each are often misunderstood, or worse, understood through common knowledge (common knowledge being defined as knowledge understood by all to be true which is false”).

is the potential for significant personal liability, and partners must accept the fact that they are liable for the debts of the general partnership regardless of whether another partner was responsible for creating the debt on behalf of the general partnership.

For our purposes, the key disadvantage of general partnerships is the lack of limited liability protection afforded to the partners. Most wine-related entities are formed in part to protect the underlying owners from personal liability and exposure of their personal assets in the event that a claim arises against the business. Therefore, for the same reason that we advise our clients to utilize the limited liability protection afforded under California law, in forming our winery, we will also avoid the General Partnership format in favor of an entity

“Throughout the next year we will be documenting our progress and explaining in detail our decisions—and the alternatives. You can follow our progress at our website www.gvmwines.com.”

GENERAL PARTNERSHIP

A general partnership is a business entity made up of two or more co owners or partners who agree to establish a business designed to earn profit. General partnerships can take many forms due in part to the limited formation requirements. Unlike most other entities, there are no filing requirements, and the partners are not even required to prepare a written agreement regarding their respective rights and obligations. While the lack of written documentation is not advisable due to the potential for conflict between partners, it highlights the fact that general partnerships are relatively easy to form and operate under for new businesses.

One of the primary benefits of general partnerships is the fact that the partnership is not taxed at the state or federal level; instead, all income and losses flow through to the individual partners based on their respective partnership interests. However, from a liability standpoint, general partnerships provide limited protection to the partners. All of the partners in a general partnership are personally, jointly and severally liable for the debts and obligations of the general partnership. In addition, all of the partners are treated as agents for the general partnership and have a right to enter into binding agreements on behalf of the general partnership. Therefore, there

LIMITED PARTNERSHIP

that provides more protection.

Unlike general partnerships which can be formed without any formal documentation, limited partnerships require a filing with the California Secretary of State’s office called a Certificate of Limited Partnership. By filing the certificate, a limited partnership provides the limited partners with protection from personal liability for the debts and obligations of the limited partnership. The State of California assesses limited partnerships with an annual tax of \$800.

Although limited partnerships afford limited liability protection to the limited partners, there must be at least one general partner in each limited partnership, and that general partner (s) is personally and jointly and severally liable for the limited partnership’s debts and obligations. Although limited partnerships can provide additional liability protection where the general partner is another limited liability entity, such as a limited liability company or corporation, setting up multiple entities would increase the administrative costs and expenses for our winery. Therefore, a limited partnership is not a worth while option given the other limited liability entities available.

One other point regarding limited partnerships is that while the limited partners are shielded from personal liability, such protection is only afforded to the extent the limited partners do not actively participate in the management of the limited partnership. In our winery, we anticipate all of the participants to be actively involved, and therefore, a limited partnership is not recommended based on our business model.

CORPORATION

Corporations are a viable business entity choice for a winery from the standpoint that each of the shareholders of the corporation is generally shielded from personal liability for the corporation's debts and obligations. In California, corporations are formed upon the filing of Articles of Incorporation with the Secretary of State, paying the requisite filing fee and preparing corporate bylaws to govern the corporation. Upon formation, the shareholders may also file an S corporation tax election with the IRS, provided that there are less than 100 shareholders, each of the shareholders is a U.S. resident and there are not multiple classes of stock.

From a tax standpoint, C corporations are usually avoided to the extent that the corporation qualifies for S corporation treatment. Income earned by C corporations is taxed at two levels. Initially, corporate income is taxed to the extent earned by the corporation. In addition, upon distribution to the shareholders of the C corporation, they will also be subject to taxes for such income, which is commonly known as "double taxation."

Unlike C corporations, the income and losses of S corporations are passed through to the shareholders of the corporation, and therefore, the result is that despite the same corporate structure of a C corporation, the taxation of S corporations is similar to that of a partnership. California law requires S corporations to pay an annual franchise tax of at least \$800 as well as an additional tax in the amount of 1.5 percent of the corporation's net income.

Corporations must operate under a certain structure and observe certain corporate formalities. For example, there must be a board of directors subject to certain election procedures; shares must be issued to the shareholders; the directors and shareholders must hold annual meetings and prepare minutes for such meetings; the corporation must recognize certain voting rights; and there must be officers elected to manage the day-to-day operations of the corporation. While the observation of such corporate formalities is not insurmountable by any means, a corporation is not the most suitable entity choice for our proposed winery.

LIMITED LIABILITY COMPANY

As with corporations and limited partnerships, the formation of a limited liability company (LLC) requires the filing of articles with the Secretary of State (Articles of Organization) and the payment of a filing fee. The owners of the LLC, known as the members, typically enter into an "operating agreement" describing their relative rights and responsibilities. Similar to a corporation's by-laws, the operating agreement generally describes the purpose of the LLC, the voting rights of the members, the responsibilities of the LLC's manager (s), the allocation of the LLC's profits and losses and distribution of any income,

the members' rights to transfer their interests in the LLC (known as membership interests) and the dissolution of the LLC.

Since California authorized the formation of LLC's, the LLC has become a very popular form of entity. This popularity is attributable in large part to the fact that members of LLC's are afforded the limited liability protection that the corporate model provides, and the partnership tax benefits (i.e., no double taxation) while retaining flexibility in the LLC's structure and management. California law has some requirements regarding the structure, management and operation of LLC's particularly regarding voting rights and dissolution). However, there are far fewer formalities that must be observed (i.e., meetings and preparation of annual minutes are not required), and the operating agreement can be tailored to meet the needs and interests of the members.

For our winery, by forming an LLC, each of the participants can be members of the LLC, and we can determine the appropriate management structure. This may consist of a single manager, a group or "board" of managers; or we could elect to have all of the members involved in the management of the company.

From a taxation standpoint, the profits and losses of the LLC will be allocated to each of the members in proportion to their respective membership interest (which is generally based on capital contributions or other contributions to the LLC at the outset). If the LLC is successful, profits can be distributed to each of the members in proportion to their respective membership interests, and at the conclusion of our venture, we can dissolve the LLC.

LLC's are subject to an annual tax in California. The minimum annual tax is \$800 although LLC's that earn substantial income will be subject to an elevated tax based on their annual gross receipts. However, the increased tax is relatively insignificant until an LLC's annual gross receipts exceed 500,000. Therefore, the tax consequences are relatively insignificant and generally comparable in amount to the tax California S corporation must pay.

Given the favorable limited liability treatment, the tax structure and the flexibility, we have decided to form a limited liability company for our winery. The first step will be to determine an appropriate name, file the necessary paperwork and prepare the operating agreement—at which point we will officially be in business!

"If the LLC is successful, profits can be distributed to each of the members in proportion to their respective membership interests, and at the conclusion of our venture, we can dissolve the LLC."

FOLLOW US

As we pursue this exciting and, for a law firm, innovative project, we invite you to look over our shoulders as we tackle the important legal aspects of this business. By seeing how we approach each issue and sitting in on the process of making these decisions, we hope to provide an educational experience, have some fun and, hopefully, end up with some terrific Napa Valley product to share. Watch this space for further developments or come join us online at www.gvmwine.com

WINE BUSINESS MONTHLY

Business & Technology

Issue: July 2009, Page 78-80

Starting a Virtual Winery

Follow a group of attorneys as they tackle the important legal aspects of the winery business. In this second installment, they select a custom crush partner.

By Ken English & Bruce Miroglio

IN OUR QUEST to make the world's finest wine produced by a law firm on Main Street in Napa, we recognized the threshold question: where are we going to do this? As with all new businesses, start-up expenses and logistics can be devastating. These details cause many entrepreneurial concepts to vanish into thin air.

Fortunately, in the wine industry, current law permits an entity to get involved in the winemaking process without the expense of purchasing a bricks-and-mortar facility with all of the requisite equipment and supplies. Aside from the obvious expense of the land, building and equipment of such a stand-alone facility, legalities of regulation must be addressed—at the county level for permits, the state level for licensing and the federal level for bonding and regulatory provisions. Today's modern regulatory scheme provides a viable and much less costly alternative.

The most obvious alternative is an arrangement known

CUSTOM CRUSH VS. ALTERNATIVE PROPRIETORSHIP

as a "custom crush" operation. An entity can simply contract with an existing licensed facility to produce a wine from the customer's grapes. That facility already must possess the necessary county permit, state licensure and federal bond in order to operate. Many, if not most, wineries, utilize this option to supplement cash flow by using their excess capacity to make wine for others.

Custom crush contracts have varying terms and prices, depending upon the facility and the customer's requirements. Essentially, however, these arrangements call for the facility or the "custom crusher" to take responsibility for the grapes and use their own judgment to produce a wine that will be delivered at a designated time. The custom crusher takes on the responsibility for the winemaking, traditionally from crushing to bottling. While there may be some consultation with the customer, the facility usually produces the wine using its own staff and its own judgment. This is the simplest alternative but is fairly expensive and leaves little room for the customer to be involved in the winemaking process. However, many custom crush facilities do permit their customers to use a "consulting winemaker" to have a more direct input into the process. The other option is a regulatory scheme called an "alternating proprietorship." These

Ken English, Conor Massey are members of the Wine Industry Group at Gaw, Van Male, Smith, Myers & Reynolds PLC based in the Napa Valley office. The Wine Industry Group provides legal advice in the areas of compliance, vineyard and winery acquisition, land use, financing, trademark protection, litigation, and business succession and exit strategy. Members of the Wine Industry Group can be reached at 707-252-9000.

arrangements permit various individuals and entities to, in effect, share the licensed, bonded facilities owned by the producer or "host" for a period of time. The same work areas are "rented" to different "tenant" winemaking entities to complete their portion of the process for their wine. In this way, it is the client, rather than the owner of the facility, who is responsible for the winemaking process; the client merely uses the facility for a designated time. While the facility must have all the appropriate licenses and approvals, the customer must also hold a license from the state to operate a winery.

When one client is finished, the facility is then used by another alternating client. Most of the facilities so licensed will agree to perform certain winemaking functions on the clients' wines, but do so at the direction, control and risk of the client, not the facility. This allows the client to have full control over the product but also allows the client access to the machinery and equipment necessary to produce the wine. Since there is much less risk and burden on the owner, these contracts are typically less expensive for the customer. However, the separate licensing of the customer as a producer is a lengthy and expensive process.

As our merry little band includes some grape growers and individuals who have some experience in winemaking, we decided to see if we could find a facility that would be a good match for us.

Glenn and Gayle Cook own and operate Cook Family

"The contract specified the expected price to be paid and terms but also was clear about who was responsible for the wine at

LEGAL CONTRACT AND DOCUMENTS

Winery out of their Stoney Springs facility northeast of St. Helena. Their own G. Cook wines have enjoyed excellent reviews, and they have a very functional home-built facility that seems perfect for our project. Glenn is a wonderfully affable, charismatic retired dentist who loves to make wine. His equipment is well maintained and complete, and his facility is spotless.

EDITOR'S NOTE: The first article in this series appeared in the April 2009 issue of Wine Business Monthly.

Napa Location—1000 Main St 3rd floor
Fairfield Location — 1261 Travis Blvd Ste. 350
(707) 252-9000

When we described our project, he was enthused about working with us and proposed a contract for the production of our wine that seemed fair and exactly what we were looking for. The contract specified the expected price to be paid and terms but also was clear about who was responsible for the wine at each stage of the process. It set forth the expectations for sharing space, the anticipated needs, as well as the owners' rules of conduct and expectations as to our behavior at the facility. Clearly setting forth the expectations of the parties as to these elements allows the best chance for a successful relationship.

STARTING A VIRTUAL WINERY

We will bring the grapes we acquire into the facility. Glenn will crush them and go through the entire vinification process. We will act as our own consulting winemaker, which will allow us to select and supply the yeast and any and all supplies, and actually be involved in the process. After fermentation is complete, we will assist with pressing the wine and putting it into our barrels, which will be stored at the facility.

As a custom crush customer, we will need to obtain both a federal wholesaler's Basic Permit from the Alcohol and Tobacco Tax and Trade Bureau (TTB) and, as we expect to sell the product, a Special Occupational Tax Registration as a wholesaler. On the local level, we will need to have a business license and file a Fictitious Business Name Statement (designed to let the public know who the real owners of our brand are).

We may utilize the services of a further consulting winemaker—an expert who will work with us to help us select the style of wine and to help us produce a product in the chosen style. That consultant will be subject to yet another contract, clearly defining the expectations of each party to the arrangement.

Thus, our group has chosen the appropriate legal entity for our venture and is in the process of forming that with the state. We have selected a custom crush arrangement with a facility that we look forward to working with. In our next installment, scheduled for October, we will describe the process for the selection of a name and the legal protection of the intellectual property and trade and style that we will be using. Stay tuned as we venture through the process.



**Napa Location—1000 Main St 3rd floor
Fairfield Location — 1261 Travis Blvd Ste. 350
(707) 252-9000**

WINE BUSINESS MONTHLY

The Industry's leading Publication for Wineries and Growers

Issue: October 2009, Page 74-75

Starting a Virtual Brand

Follow a group of lawyers as they document their progress and tackle the important legal aspects of the winery business. In this third installment of the series, they create a virtual wine brand.



By Katja Loeffelholz

SO WE HAVE decided to start our own wine brand but what do we call it?

At Gaw Van Male, a Napa Valley Law Firm, we often advise businesses involved in the wine industry on how to do something. While modest in scope, we, as a firm, want to experience firsthand what our clients go through at each state of the custom crush and virtual winery creation. Toward that end, we have started our own wine brand allowing us to truly walk a mile in your boots.

If you have been following our progress at www.gvmwine.com, you know that we are forming a limited liability company and have contracted with a custom crush facility to create two wines. We are creating a red wine, a Merlot varietals, and a white wine based on Sauvignon Blanc grapes. We have created a virtual winery that will, with a little luck, turn out a decent product. Now it's time to name our wines.

The investment in our wine brand began with the realization that wine, without a name, is grape juice in a bottle. In other words, if you don't have a brand, you are an expendable commodity virtually indistinguishable from thousands of other bottles on the shelf. And if you haven't protected your brand, you are in jeopardy of losing your investment. Based on these premises, we began searching for the perfect name to call our wines.

The first step in selecting a protectable brand involves a review of what exactly makes a strong brand—from a legal standpoint. On the protection continuum, we have weak or non-protectable marks on one end and strong and protectable marks on the other. The generic name of a product, i.e., wine for wines, is not protectable. Words such as "vineyard," "estate," "cellar" and "red" describe a feature or characteristic of wines and are considered descriptive of wines and thus also not protectable. In fact, the **United States Patent and Trademark Office USPTO** examining attorney will generally request a "disclaimer" of such words, which means others selling wines are free to use the same type of descriptive wording in their brands to describe their wine product.

Moving along the protection continuum, after non-protectable generic and descriptive follows suggestive marks. Suggestive marks are words that suggest something about a product or service without describing it, e.g., **Mobile®** gas station and **Suave®** shampoo. Finally, at the zenith of the

Katja Loeffelholz is a member of the Wine Industry Group at Gaw, Van Male, Smith, Myers & Reynolds PLC based in the Napa Valley office. Loeffelholz is a Registered Attorney with the United States Patent and Trademark Office. The Wine Industry Group provides legal advice in the areas of compliance, vineyard and winery acquisition, land-use, financing, trademark protection, litigation and business succession and exit strategy. Members of the Wine Industry Group can be reached at 707-252-9000.

continuum are found coined and arbitrary marks. A coined or fanciful mark is a word that is simply made up, such as Kodak® film. Arbitrary marks are real words that are arbitrarily applied to a good or service, e.g., Apple® computer. Apple is a real word; but when applied to computers, it does not conjure up an image that suggests anything inherent of computers.

We started our venture by throwing a "branding party" wherein all interested persons suggested possible names for our wine. As the interested parties were lawyers, we had a long list of Latin names, e.g., *Vino Lex*, *Veritas Vino*, *Lex Vino Lux*, *Habeas Corpus* and *Malum in Se*. In adopting a Latin term, we would need to translate the foreign words into English for availability search purposes and hope the prospective consumer would be able to pronounce it! For example, the name *Vino Lex* would translate into English as Wine Law. As *vino* translates into the word "wine" and is thus the generic and non-protectable name for the product wine, we would have had to disclaim that portion of the mark.

Another possibility was to name the wine after ourselves, i.e., Gaw Van Male. While the appeal of using one's own name may be seductive, it can create protectability issues as surnames or last names can be difficult to legally protect. Further, there may be issues of obtaining consent of living persons, and there is the possibility that other wine producers share the same last name. A potential legal quagmire!

By majority vote, we narrowed our list of potential names to five favorites for the purpose of conducting a preliminary trademark availability search. Naturally, a non-lawyer in our party thought of one of the few non-Latin names Disclaimer. The mark Disclaimer, as applied to wine, is arbitrary; thus, it would make a strong and protectable mark. We proceeded to conduct a preliminary availability search for our potential brand name Disclaimer covering wines. Fortunately, it appeared to be available for our use on or in connection with wines.

Editor's note: The first article in this series appeared in the April 2009 issue and the second one appeared in the July 2009 issue of Wine Business Monthly. Read the previous articles by searching the archives at www.winebusiness.com. Follow Gaw Van Male's progress at www.gvmwine.com.

Napa Location—1000 Main St 3rd floor
Fairfield Location — 1261 Travis Blvd Ste. 350
(707) 252-9000

One caveat, a search, no matter how well conducted, has certain limitations and is not a guarantee that there will be no problems with a brand.

We got lucky, and our favorite possible brand name made the grade, so no further search of “back up” names was deemed necessary. However, it is not unheard of that 14 or more names will be searched in the process of narrowing down the list of potentially protectable trademarks for wine. One just needs to peruse the grocery aisle to see that competition for names is at a fevered pitch with wines coming from all over the world, let alone the 50 United States. All players, foreigners and citizens alike, can and often do avail themselves of the U.S. Trademark Registration system, and it is getting crowded.

If you don't have a brand, you are an expendable commodity virtually indistinguishable from thousands of other bottles on the shelf.

The Lanham Act defines a trademark as follows: “A trademark is any word, name, symbol, or device or any combination thereof—(1) used by a person or (2) which a person has a bona fide intention to use in commerce and applies to register on the Principal Register.” The benefits of federal registration include the following:

- prima facie evidence of the validity of the mark, the registrant's ownership of the mark, and the registrant's exclusive right to use the mark in commerce in connection with the goods or services specified in the registration;
- right to use the registration symbol, i.e., ®;
- provides constructive notice that the mark is in use;
- ability to sue infringers in federal court and to recover multiple damages and attorney's fees; and
- ability to exclude infringing imports into the United States.

Accordingly, we will proceed to file a federal trademark application on intent to use basis at the United States Patent and Trademark Office (USPTO) for the mark Disclaimer covering wines in International Class 033. We will file on intent to use basis as we have not made any use in commerce or interstate commerce of the mark Disclaimer for wines, but we have a bona fide intention to do so, thus preserving our rights in the mark.

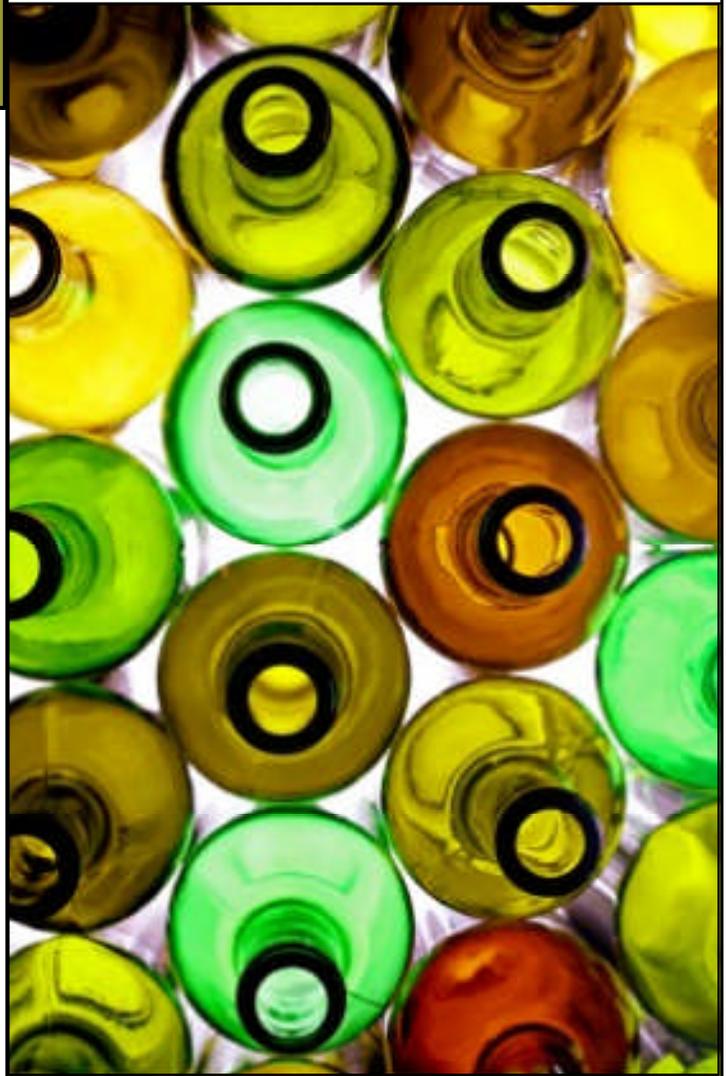
The federal registration process can take approximately 18 months. However, in about four months from the date of filing of our trademark application, we would initially hear back from the Trademark Office and have a pretty good idea as to the registerability of our applied for mark Disclaimer.

Upon learning of the acceptance of the proposed mark by the trademark office and provided our wine label is ready, we would proceed in applying for a Certificate of Label Approval (COLA). Too often people confuse a COLA approval with Trademark approval. Nothing could be further from the truth. The **Alcohol and Tobacco Tax and Trade Bureau (TTB), a Department of the U.S. Treasury**, does not and is not charged with conducting a trademark search or approval. Thus, one can find a variety of different producers using the same or similar wine brand. To avoid this, we searched the certificate Registry

and will apply for our trademark well in advance of applying for label approval.

Once we developed our wine label, it was time to consider other protectable aspects of the label design or the product packaging itself. Perhaps the wine label had additional protectable brands such as a vineyard designate, logo or slogan. Further, we would review collateral material, trade and press communications and website content for elements that could be protectable intellectual property. For example, our website content and advertising material may be protectable by copyright. And the non-functional and distinctive portion of our product packaging may be protected as trade dress.

In investing in trademarking our brand, we are not only safeguarding ourselves from infringing on someone else's brand but building valuable brand equity.



**Napa Location—1000 Main St 3rd floor
Fairfield Location — 1261 Travis Blvd Ste. 350
(707) 252-9000**