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ABC ADVISORY OPINION 2022-002

August 22, 2022

Question: Does Kentucky law support a non-licensed entity holding a security interest in barrels of distilled spirits?

Requested by: Jason L. Hargadon, Esq.
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Syllabus: The transactions involved in the plan as articulated by the Requester do not implicate KRS Chapters 241 to 244 so long as none of the unlicensed entities involved in the transactions take possession of the barrels of distilled spirits.

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Authorities construed: KRS 243.020, KRS 244.240, KRS 244.604, and 804 KAR 4:015

Legal authority: KRS 241.060

Opinion of the Department of Alcoholic Beverage Control

The Department received a request for an advisory opinion asking several questions regarding a commercial transaction between a Lessor and a Lessee of barrels of distilled spirits. The background information for these questions is as follows:

> H&A, as Lessor, seeks to enter into a Capital Lease Agreement in which it will lease Equipment to the Lessor in exchange for periodic payments. The Equipment will be stored at a licensed Distillery pursuant to a Barrel Storage Agreement, and the Lessor will maintain ownership of the Equipment until the end of the lease. The Warehouse Receipt will be held by the Lessor until the purchase of the Equipment by the Lessee at the end

> of the lease. The Lessor may sell the Capital Lease Agreement to a bank or other financial institution in which case the bank or financial institution will be the Lessor and the Warehouse Receipt will be amended to reflect this new ownership.
>
> If the Lessee defaults under the terms of the Capital Lease Agreement, the Lessor intends to sell the Equipment to a third-party under the terms of the Agreement.
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> The Lessor's activities will be limited to financing and it will not engage in the manufacture, storage, sale, purchase, or transport of the Equipment. However, if there is a default, it will sell the Equipment to recover the purchase price plus fees and costs in accordance with the Capital Lease Agreement. whether the Entertainment Destination Center (EDC) license allows patrons of licensees within an EDC to leave a licensed premises or common area of the EDC and enter business premises that are not licensed for alcoholic beverage consumption. For the reasons outlined below, the Department must say it does not.

For the purposes of these questions, the "Equipment" consists of barrels of distilled spirits. The "Warehouse Receipt" is defined within the request as "a type of documentation used to evidence ownership of a particular commodity stored within an approved facility." Under KRS 355.7-201(2), a receipt for distilled spirits is considered a "warehouse receipt" even if the owner who issues it is not a warehouse.

The way the Department interprets the described transaction is that an unlicensed entity ("Lessor") is leasing a warehouse receipt evidencing title over a number of barrels of distilled spirits ("Equipment") stored at a licensed distillery. The lessee entity ("Lessee") may or may not be licensed but will come to own the warehouse receipt—and thus the barrels of distilled spirits—after a certain number of periodic payments are met under a Capital Lease Agreement. The lessor entity may sell the lease agreement to a bank or other financial institution. If the lessee entity defaults, then the lessor entity will sell the warehouse receipt to a third party.

The Department communicated with the Requestor regarding what exactly the Lessee is leasing, because according to the facts as stated, Lessee never takes possession of the barrels during the Capital Lease Agreement term and does not have possession of the warehouse receipt. Rather,

it appears that Lessee is making periodic payments to Lessor for the promise of ownership of the warehouse receipt at the end of the Capital Lease Agreement's term.

With that interpretation in mind, the questions are as follows:

> 1. On the basis of the facts above, would the ABC staff concur that the Lessor's (unlicensed) conduct does not violate KRS 243.020(1)?
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> 2. On the basis of the facts above, would the Lessor fall within the definition of a "Distributor" under KRS 244.604(1)?
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> 3. On the basis of the facts above, would the Lessor fall within the definition of a "Wholesaler" under 804 KAR 4:015 Section 1(4)?
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> 4. On the basis of the facts above, would the ABC staff concur that the Lessor's conduct does not violate KRS 244.240(1)?
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> 5. On the basis of the facts above, would the ABC staff concur that the Lessor does not require[sic] to be Licensed under KRS 241 to 244?
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> 6. On the basis of the facts above, would the ABC staff concur that the Lessor is not prohibited from selling the Equipment to a third party upon a bona fide default under the Capital Lease Agreement?

It is important to note that under KRS 243.130(7), "Nothing shall prohibit the purchase or sale of warehouse receipts by any person, but this subsection does not authorize the owner of a warehouse receipt to accept delivery of any distilled spirits unless the owner is a person who is permitted by law to receive the distilled spirits." Therefore, any transaction involving merely the sale or negotiation of title to the barrels by warehouse receipt is does not require a license. However, the movement and storage of the barrels when title is held by an unlicensed person is restricted to only those licensed to receive them.

In answer to Question 1, KRS 243.020(1) requires that anyone wishing to do any act authorized by an alcoholic beverage control license ("ABC license") hold the license to do that or be a contractor or agent of someone who holds such a license. ABC licenses are not required for *ownership* of distilled spirits, but rather for *possession* of them. Lessor's conduct is described within the facts as presented as owning barrels of distilled spirits stored on the premises of a distillery. This is possible without a license under KRS 243.130(7) if the ownership is evidenced

by a warehouse receipt and Lessor does not possess the barrels of distilled spirits themselves. In fact, none of the transactions described require any of the entities who own the warehouse receipt—Lessor, Lessee, or third-party institution—to take possession of the barrels of distilled spirits and merely involve the negotiation or sale of the warehouse receipt evidencing ownership of the barrels. Therefore, Lessor's conduct as described would not run afoul of KRS 243.020(1).

Regarding Question 2, KRS 244.604(1) defines a "distributor" as "any person who distributes or sells at wholesale malt beverages for the purpose of being sold at retail." Lessor's conduct as described does not involve malt beverages in any way, so Lessor cannot be defined as a "distributor."

Question 3 refers to 804 KAR 4:015's definition of "wholesaler," which is a "person or entity who is a wholesaler, distributor, or who sells alcoholic beverages at wholesale, located within this state" and asks whether Lessor meets that definition. KRS 241.010(76) defines "wholesale sale" as "a sale to any person for the purpose of resale." Lessor's conduct is described as selling the Equipment—that is, selling barrels of distilled spirits. However, Lessor is not interpreted to possess the Equipment, but rather the warehouse receipt evidencing title to them. Lessor's sale therefore is not of the Equipment, per se, but of the warehouse receipt. This question therefore asks whether the sale of a warehouse receipt evidencing title over barrels of distilled spirits is a sale of those barrels of distilled spirits at wholesale.

The warehouse receipt and the barrels of distilled spirits are distinguished in law. KRS 355.7-205 states as follows:

> "A buyer in the ordinary course of business of fungible goods sold and delivered by a warehouse that is also in the business of buying and selling such goods takes the goods free of any claim under a warehouse receipt even if the receipt is negotiable and has been duly negotiated."

A warehouse receipt is a claim of title which can be defeated, not the barrels themselves. The sale or negotiation of a warehouse receipt is thus not a wholesale sale of the barrels. Therefore, if the

Lessor's conduct does not involve selling the barrels of distilled spirits themselves, Lessor's conduct does not make Lessor a "wholesaler" under 804 KAR 4:015.

Question 4 regards KRS 244.240(1), which proscribes certain conduct by distillers, rectifiers, wineries, and wholesalers. Lessor's conduct can only violate this statute if it is a distiller, rectifier, winery, or wholesaler, which we have already determined it is not.

Question 5 asks whether, as described, Lessor's conduct requires a license. Lessor's conduct is as follows:

A. Owning a warehouse receipt evidencing title to barrels of distilled spirits
B. Leasing the warehouse receipt via contract to Lessee
C. Accepting payments from Lessee
D. Selling the warehouse receipt and Capital Lease Agreement to a third party.

The conduct does not involve possession, transportation, or sale of the barrels of distilled spirits for which the warehouse receipt grants title. Therefore, Lessor's conduct as interpreted does not require a license.

Question 6 asks whether Lessor can sell the barrels of distilled spirits to a third party upon a bona fide default without a license. The answer to that question is no. KRS 244.440 requires that any owner of distilled spirits be licensed in order to sell alcoholic beverages in the state. However, the sale of the warehouse receipt is not the sale of the barrels of distilled spirits, per se, and therefore Lessor could sell the warehouse receipt to a third party upon default. If that third party is properly licensed, then it could take possession of and sell the barrels.

CONCLUSION

The Department's answers to Mr. Hargadon's questions depend upon an interpretation of the facts of the different transactions involved not requiring any of the parties to take possession of the barrels of distilled spirits (the "Equipment"). So long as the transactions only involve the negotiation or securitization of the warehouse receipt evidencing title to the Equipment, then the transactions do not implicate KRS Chapters 241 to 244 in accordance with KRS 243.130(7).

However, whomever wishes to sell, transport, or possess the Equipment, or bottle and sell the distilled spirits the Equipment contains, must be licensed by the Department.

Allyson Taylor
Commissioner
Department of Alcoholic Beverage Control