

**Department of
Alcoholic Beverage Control**

INITIAL STATEMENT OF REASONS

**PROPOSED ADOPTION OF REGULATIONS FOR
TRUST APPLICATIONS**

PROPOSED ADOPTIONS TO TITLE 4, CHAPTER 6: APPLICATIONS:

SECTION 35

PROBLEM STATEMENT AND PURPOSE

The Department of Alcoholic Beverage Control (ABC) has determined a need to modernize, streamline, and unify the ABC license application processes in preparation for taking the process online. This will require ABC to adopt a large set of regulations to notify applicants, licensees, the public, and ABC staff the requirements of applying for an ABC license. This regulation is the first of many to address this need over the coming months and years.

ABC has had a long history of granting ABC licenses of all types to various trusts based on the definition of person in Business and Professions Code section 23008. However, there is little specific statutory guidance from the legislature on the licensure of trusts compared to other entities such as limited liability companies, partnerships, or corporations. Recently, trust entities applying for licenses have become increasingly complex, and often are created with the intent of circumventing tied house laws by hiding disqualifying interests held by those either settling property into a trust, those controlling a trust, or those benefiting from a trust.

This regulation seeks to uniformly address applications for ABC licenses to be held by trusts in whole or in part. It lays out the unique requirements for an application for an ABC license to be held by a trust, which persons within a trust need to be qualified for a trust to receive a license, and which persons within a trust need to be checked for disqualifying interests. In addition, this regulation makes clear the duty upon trust license holders, as with all ABC license holders, to ensure continued compliance with the regulatory requirements as it continues to hold an ABC license.

BENEFITS

ABC has experienced a rising trend of applicants using trusts to circumvent statutory limitations upon disqualifying interests in other ABC licenses or other alcoholic beverage licenses issued by other states or countries. These disqualifying interests are prohibited to ensure an orderly and fair market for alcoholic beverages, often referred to as the three-tier system or tied house laws. This regulation will uniformly enforce the same rules for all trust applicants, and ensure applicants, licensees, the public and ABC staff can understand how and why a trust may be granted an alcoholic beverage license. This

uniformity will lead to more streamlined issuance of licenses, and more complete enforcement of the statutorily mandated three-tier system.

AUTHORITY

Authority cited:

Section 25750, Business and Professions Code; Section 22 Article XX California Constitution

Reference:

Sections 23008, 23394, 23396, 23396.1, 23396.2, 23396.3, 23816, 23818, 23821, 23826, 23826.5, 23836.7, 23836.9, 23826.10, 23826.12, 23836.13, 23836.14, 23827, 23950, 23951, 23952, 23953, 23954, 23954.6, 23959, 23961, 24070, Business and Professions Code.

NECESSITY

The specific purpose for each proposed section is as follows:

Section 35(a)

This subsection establishes a wide array of legal definitions and terms to notify applicants, ABC licensees, the public, and ABC staff what varying terms within the regulation, or found in trusts seeking to obtain an ABC license should mean. This subsection is necessary to establish definitions for use in discussing trust applications for alcoholic beverages licenses. Common definitions will ensure that various legal language used in the creation of trusts in various jurisdictions remain constant in their enforcement and understanding throughout the application process for the purpose of obtaining or holding an ABC license in a trust. These definitions are also necessary to aid the drafters of a trust organized to hold an alcoholic beverage license in California as to what terms are appropriate to speed and streamline the application process for a trust to hold an ABC license.

Section 35(a)(1)

This subparagraph establishes the definition for the word “beneficiary” which means any person who directly benefits from the trust assets held by the trust, including an ABC license. It excludes contingent beneficiaries who will at some point in the future benefit from the trust once some executing event occurs. This definition is necessary to establish which persons are considered beneficiaries for the rules regarding disqualifying interests and persons needing to be qualified in subsequent subsections. This definition is also necessary because every trust is not required to use the same language in drafting and the term beneficiary can be used in other ways in the drafting of a trust.

Section 35(a)(2)

This subparagraph establishes the definition of the words “contingent beneficiary” to mean any person who will become a beneficiary in the future based on events outlined in the trust. This definition is necessary to establish the persons who must be qualified or must not have a disqualifying interest in the subsequent subsections. This definition is also necessary because every trust is not required to use the same language in drafting and the term contingent beneficiary can be used in other ways in the drafting of a trust.

Section 35(a)(3)

This subparagraph establishes the definition of the words “controlling person” to mean the trustee or any other person with control over trust assets, even if not given the title of trustee, and includes all persons with the power to direct the trustee or remove the trustee. This definition is necessary because individuals drafting trusts with intent to apply for ABC licenses were aware of ABC’s policy to qualify the trustee for the applied for license both for being qualified and holding disqualifying interests, so they gave other titles to persons with control over the trustee to conceal disqualified individuals within a trust. Although this expands upon the legal definition normally applied to the word trustee, all individuals with control over the trust should be treated the same as a trustee for qualification purposes, even if called something else within the trust document, if they are exercising control over the assets within a trust. This also extends to persons who can remove and replace a trustee to direct the trustee to act in the manner they wish. This definition is also necessary because the term trustee, or other terms for positions in a trust that have similar powers to a trustee, or positions that have power over the trustee can be used in various ways in drafting a trust and it provides a uniform definition to be used in an application for an ABC license to be issued to a trust.

Section 35(a)(4)

This subparagraph establishes the definition of the words “disqualifying interest” to mean an interest in another alcoholic beverage licensed business that is prohibited or not otherwise authorized by the Business and Professions Code. This creates a term for ensuring that applicants do not have an interest in another ABC license, an alcohol business, or an alcoholic beverage license issued by another state or country, that would be in violation of California’s tied house laws which protect the three-tier system. This subparagraph is necessary to provide context to the difference between disqualifying interests held by applicants, or persons affiliated that have interest in the applicant, and the qualification of persons by fingerprinting and background checks during ABC’s application investigation. In the past, the term “qualification” often was used to reference the dual process of ensuring an applicant was both qualified and had no disqualifying interests which have two different standards for application to persons under the application entity under the law. This definition is necessary to inform applicants, ABC licensees, the public and ABC staff that term “qualification” should be separated into the two different checks, both with different requirements and standards, done within the ABC license investigation into license holders.

Section 35(a)(5)

This subparagraph establishes the definition for the words “interest holder” to mean any person identified by a trust that receives, or may in the future receive, benefits of the trust assets and includes both beneficiaries and contingent beneficiaries. This subparagraph is necessary to provide a term that encompasses both beneficiaries and contingent beneficiaries for ease of drafting and discussing applications for ABC licenses to be held by a trust. This definition is also necessary because every trust is not required to use the same language in drafting and the term interest holder can be used in other ways in the drafting of a trust.

Section 35(a)(6)

This subparagraph establishes the definition for the words “natural person” to mean an individual, and not a legal entity such as a corporation, limited liability company, trust, or partnership. This definition is necessary to ensure that applicants using a trust cannot conceal individuals who cannot be qualified or who hold a disqualifying interest by creating a string of trusts, and legal entities so they do not have to name the individual controlling the trust or receiving benefits from a trust. This subparagraph is also necessary to provide a term that can be used during the ABC application process for a license to be held by a trust and an ABC license investigation into the trust applicant.

Section 35(a)(7)

This subparagraph establishes the definition for the word “person” to mean the same as the definition found in Business and Professions Code section 23008. This definition includes any individual, firm, copartnership, joint venture, association, corporation, estate, trust, business trust, receiver, syndicate, or any other group or combination acting as a unit, and the plural as well as the singular number. This is the definition of person that controls for the law pertaining to ABC. This subparagraph is necessary to ensure that the same definition of person is used both in this regulation, as is used throughout the Alcoholic Beverage Control Act.

Section 35(a)(8)

This subparagraph establishes the definition for the word “qualified” to mean meeting all requirements of a license holder after a full investigation of a person for an application for a license, including fingerprinting and background checks. This definition is created in contrast to the disqualifying interest definition in Section 35(a)(4). In the past, the term “qualification” often was used to reference the dual process of ensuring an applicant was both qualified and had no disqualifying interests which have two different standards for application to persons under the application entity under the law. This definition is necessary to inform applicants, ABC licensees, the public and ABC staff that term “qualification” should be separated into the two different checks, both with different requirements and standards, done within the ABC license investigation into license holders.

Section 35(a)(9)

This subparagraph establishes the definition for the word “trust” to mean a legal entity created to hold legal title to assets on behalf of a person. The legal entity is managed by one or more controlling persons with a fiduciary duty to act for the benefit of specific interest holders. The legal entity must be formed in compliance with the law of the jurisdiction in which it is created. This subparagraph is necessary to ensure applicants, licensees, the public, and ABC staff understand what a trust is in the context of this regulation. The legal term “trust” can vary depending on the legal jurisdiction where it is created and can often be structured in any way the settlor, or person giving up title to assets, desires. This leads to often legally complex systems and varying rules that make it difficult to define what constitutes a trust, who controls the trust assets and how beneficiaries, or contingent beneficiaries, receive the benefits of the trust. This subparagraph is also necessary to ensure that other legal documents that do not specifically meet the definition of trust do not have the rules or exceptions within this section applied to them during an application investigation by ABC.

Section 35(b)

This subsection requires an applicant for an ABC license that is going to be issued in whole or in part to a trust to provide the full and complete trust document as a part of ABC’s investigation. It also establishes that the entire trust document provided to ABC as part of the investigation must be retained by ABC within the licensing file. This subsection also excludes simplified copies of a trust, often called a certificate of trust, to not comply with this requirement because they do not contain all the language pertaining to controlling persons and interest holders and how trust assets are to be managed. This subsection is necessary to ensure ABC staff can discern if a trust that is applying for an ABC license is qualified and does not hold any disqualifying interests. Without the full and complete trust document the investigation is incomplete, and a license cannot be issued. This subsection is also necessary because as a license holder a trust document must be on file for ABC to ensure the continued qualification of the trust remains the same over time, and if the license is unlawfully used in any way, ABC will know how to address the violation of the license with a trust. Further, the subparagraph is necessary to ensure an applicant does not attempt to use a short form of the trust, often called a certificate of trust, for compliance with the requirement the full document be provided and retained by ABC. The short form is incomplete as it does not include all language regarding various controlling persons, or interest holders of the trust, and therefore would not allow ABC to complete its thorough investigation required by statute.

Section 35(c)

This subsection requires all controlling persons for a trust to be qualified. This subsection is necessary to establish which persons within the trust structure must be qualified. This requirement includes that all controlling persons must be over the age of 21, and need not be specified since it is required elsewhere in law. This also extends to all persons who are not natural persons within the trust that are controlling persons. When coupled with Section 35(a)(3), this subsection makes it clear which persons need to

provide fingerprints and have a background check done when a trust is applying to be issued a license in whole or in part. This subsection is necessary because trust documents may be complex, and there are often questions from applicants, the public, and ABC staff to which persons included in a trust must be qualified. This subsection is necessary to provide a standard for all persons involved to know which persons must be investigated and meet the statutory and regulatory requirements to be qualified and the applied for license issued by ABC.

Section 35(d)

This subsection requires all interest holders and controlling persons to meet the requirements of holding the applied for license and not have any disqualifying interest for the license to issue. Combined with the definitions of “interest holder” in Section 35(a)(5) and “controlling person” in Section 35(a)(3), this subsection makes clear all persons associated with a trust that must not have a disqualifying interest for the license to issue. This subsection is necessary to both differentiate it from the persons that are to be qualified through the ABC investigation process, while still informing applicants, licensees, the public and ABC staff which persons associated with a trust must not have a disqualifying interest for the applied for license to be issued to the trust.

Section 35(e)

This subsection requires spouses of all interest holders and controlling persons to meet the requirements of holding the applied for license and not have any disqualifying interest for the license to issue. This subsection is necessary to inform applicants, ABC licensees, the public, and ABC staff that the spouses of both controlling persons and interest holders must meet the requirements to hold the applied for license and not possess a disqualifying interest for the applied for license to be issued to the trust. This subsection is necessary to conform the spouses of controlling persons and interest holders with the same standards as applied to other persons that apply for ABC license that must also ensure their spouses do not have disqualifying interests and keep the integrity of the three-tier system in California.

Section 35(f)

This subsection requires trusts who are licensees to notify ABC of any changes to controlling persons, interest holders, or their spouses within 30 days of the changes being made. This includes a contingent beneficiary becoming a full beneficiary, the change of a trustee or another named controlling party even if the trust document itself has not substantially changed, or a current controlling person or interest holder marrying. This subsection is necessary to ensure that trust license holders continue to meet the statutory and regulatory requirements for licensure. ABC cannot be expected to continually monitor all licensees for changes in their structure or leadership, especially when these changes are often private. This section does not create a new duty upon trust licensees, it restates the duty required of all ABC licensees to notify ABC of any changes in form or operation of the licensee.

Section 35(f)(1)

This subparagraph requires any new controlling person, interest holder, or their spouses added to a trust structure holding a license to meet the requirements of the proposed section. This will include not having a disqualifying interest and being qualified if required. This subparagraph is necessary to ensure a trust that is holding an ABC license remains in compliance with all laws and regulations to continue to hold that license. This subparagraph is necessary to hold license holders that are trusts responsible to ensure those that are added as controlling persons, interest holders, or their spouses meet the requirements to be in those positions for a trust that holds an ABC license in whole or in part.

Section 35(g)

This subsection requires a license applicant who is a trust with either a controlling person or an interest holder that is not a natural person, whether it be limited liability company, another trust, a trust company, financial institution, corporation, partnership, or other legal entity, disclose intervening entities and persons until it is revealed the natural person acting as a controlling person, or receiving the benefit of the trust. This subsection is necessary to ensure all controlling persons and interest holders meet the requirements under statute and regulation to hold a license. This is also necessary to ensure the trust structure is not being used to bypass laws and regulations in place for the license to be issued. ABC is aware that trusts have flexibility by their nature and are often used to circumnavigate the laws and regulations around licensure to conceal disqualifying interests in multiple alcoholic beverage licenses. This subsection is necessary to inform applicants, licensees, the public, and ABC staff that this practice of using trust documents to avoid the disclosure of disqualifying interests or a person who cannot be otherwise qualified will not be allowed by the thorough investigation statutorily mandated upon ABC.

Section 35(h)

This subsection requires all beneficiaries of a trust that is applying for a license to be the age of 21 or older. This subsection also provides as a narrow exception to section 35(d) that all interest holders meet all qualifications of a license holder which requires them to be 21 years of age or older. The exception in this subsection allows a trust contingent beneficiary to be under the age of 21, if that contingent beneficiary cannot become a beneficiary until after they are 21 years of age or older. This subsection is necessary to ensure that persons under the age of 21 do not hold an active interest in an ABC license and benefit from the sales and consumption of alcohol as prohibited by law. This subsection is also necessary to create a narrow exception allowing individuals to have an interest in a trust which holds an ABC license that are not yet 21 years of age, if the benefits are contingent upon them first reaching the age of 21 before they can obtain them. Many trusts have generational beneficiaries which can be under the age of 21, and sometimes are even not born when a trust is created or granted an ABC license. This subsection is necessary to inform applicants, licensees, the public, and ABC staff how trusts which hold or apply for an ABC license must treat those included to benefit from the trust who are not 21 years of age.

Section 35(i)

This subsection creates a narrow exception to section 35(c) when a trust company is acting as trustee on behalf of another controlling person. If the trust company has no power to act without direction from another controlling person, they need not be qualified even though they are a named trustee of the trust. Trust companies are often named a trustee to do mundane tasks and move assets at the direction of other controlling persons. This subsection is necessary because ABC has determined that the burden of qualification for a trust company without power to act unilaterally outweighs the harm caused if they are not qualified if the trust company may only take actions based on other controlling persons who will be qualified. This subsection is necessary to provide a way for trust companies to aid controlling persons to manage trusts without being qualified when they are not given the power within the trust to act unilaterally.

Section 35(j)

This subsection creates a narrow exception to section 35(c) that banks and financial institutions chartered by a state or federal agency need not be qualified when acting as a trustee. Chartered financial institutions are heavily regulated and monitored by their chartering agencies and have a fiduciary duty to not break laws on behalf of their customers. ABC has determined that the burden of qualification for a chartered bank or financial institution would be great and would be ineffective at being more stringent than the regulation these financial entities are already subject to. In addition, the exception in this subsection mirrors similar exceptions for chartered banks and financial institutions already in statute for corporations, limited liability companies, and partnerships. This subsection is necessary to provide a narrow exception to the requirement that all controlling persons be qualified to remove the undue burden upon chartered banks and financial institutions that are regulated by other state and federal agencies and already prohibit their acting outside regulatory and statutory standards.

TECHNICAL, THEORETICAL, AND EMPIRICAL STUDY, REPORT, OR SIMILAR DOCUMENTS RELIED UPON.

Articles

There are no articles relied upon in the creation of these proposed regulations.

Department and Appeals Board Decisions

There are no Department precedential decisions or Appeals Board decisions that are relied upon for the creation of these proposed regulations.

ECONOMIC IMPACT ASSESSMENT/ANALYSIS

ABC has determined that these regulations have a negligible economic impact upon ABC's budget. Any cost associated with these regulations will be absorbed in the Department's current budget.

ABC concludes that it is (1) unlikely that the proposal will eliminate any jobs, (2) unlikely that the proposal will create an unknown number of jobs, (3) unlikely that the proposal will create an unknown number of new businesses, (4) unlikely that the proposal will eliminate any existing businesses, and (5) unlikely that the proposed regulations will result in the expansion of businesses currently doing business within the state.

ABC has determined that the proposed regulation has a minimal effect upon the current health and welfare of California residents.

ABC has determined this proposed regulation will have no effect upon the environment.

EVIDENCE SUPPORTING FINDING OF NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

ABC has determined that these regulations have a negligible economic impact. ABC anticipates no costs associated with implementing this proposed regulation on its budget, but if there are any unforeseen small costs associated with these regulations, they will be absorbed in ABC's current budget. The additional formal regulating of the trust application process will create a more transparent and efficient process, but it will not create or eliminate any jobs at ABC as this is a process that is currently in practice. In addition, the additional formal regulating of the trust application process will not create or eliminate any jobs in the alcoholic beverage industry. The further regulation of this process will not increase or decrease the number of alcoholic beverage licenses available, just create a more transparent process by which trust applications can be made, accepted, or rejected.

ALTERNATIVES TO THE PROPOSED REGULATIONS CONSIDERED BY THE DEPARTMENT

ABC has considered two possible alternatives to this proposed regulation.

The first alternative considered was the most restrictive and would prevent applicants to submit applications to ABC using trusts. This option would have eliminated a substantial amount of work from department staff and thus, would have saved money and decreased license processing time. While those aspects would have been beneficial to the ABC and applicants, it would have possibly created an unrealistic solution as many applications are submitted to ABC that utilize a trust structure. This would either eliminate the option for applicants to submit paperwork or require an alternative business structure on the part of the applicant.

A secondary consideration was not to propose any rulemaking action on this subject. This is problematic because the application process is unclear, leaving some confusion for applicants and ABC staff. This also could provide the opportunity for bad actors to use a trust business structure to obscure potentially disqualifying criteria within the trust. This is not favorable and could lead to problematic business practices.

REGULATORY MANDATES

This regulatory package creates no new duties or regulatory mandates for licensees, local governments, or the Department.