

2009 TTB Expo Presentation

Federal Alcohol Administration Act Trade Practice Law and Regulations

Presented by:

Robert Angelo, Steve Taylor, and Michael Desrochers,
Trade Investigations Division, and
Brian Wissman and Carrie May, TTB Counsel



Overview

- Background:
 - History
 - Federal Alcohol Administration Act (FAA Act)
- Basic Permit Requirements
- Trade Practice Provisions
- FAA Act Permit Proceedings

Background

History

- Pre-Prohibition problems and excesses
- Prohibition (18th Amendment)
- Repeal (21st Amendment)
- Congress did not want a return to excesses of Pre-Prohibition problems in the alcohol industry:
 - Solution

Federal Alcohol Administration Act

- 27 U.S.C. 201 *et seq.* – Goals:
 - Keep criminal element out of alcohol industry using permit system (§§ 203 and 204)
 - Regulate formulation, labeling, and advertising of alcohol beverages (§ 205(e) and (f))
 - Regulate promotional and marketing trade practices that might lead to corruption or excessive consumption (§ 205)
 - Protect the consumer

FAA Act — Constitutional Authority

- Commerce Clause:
 - The Congress shall have the power to “regulate commerce with foreign nations and among the several states ...”
 - Interstate commerce nexus for FAA Act — broad nexus that generally includes interstate commerce activities between two or more States

Basic Permit Requirements

Basic Permit Requirements

- Basic permits are required for all:
 - Importers and wholesalers of all beverage alcohol products
 - Producers of wine and distilled spirits (§ 203)

Basic Permit Requirements (Continued)

- Application for basic permit will be denied if the Administrator finds that:
 1. The applicant has been convicted of any felony under Federal or State law within last 5 years or convicted within 3 years of a misdemeanor under Federal law relating to liquor, including the taxation thereof (§ 204(a)(2)(A));

Basic Permit Requirements (Continued)

2. Proposed operations violate State law in the State where they are to occur (§ 204(a)(2)(C));
3. “Such person, by reason of his business experience, financial standing, or trade connections is not likely to commence operations within a reasonable period or to maintain operations in conformity with Federal law” (§ 204(a)(2)(B))

Trade Practice Provisions

Trade Practice Provisions

- Purposes:
 - Prevent wholesaler, importer and producer control over retailer (and accompanying corruption and over-consumption)
 - To help keep the playing field level among industry members

Prohibited Trade Practices

- There are four trade practices that are prohibited for producers, wholesalers, and importers:
 - Exclusive Outlet
 - Tied House
 - Commercial Bribery
 - Consignment Sales

27 U.S.C. 205

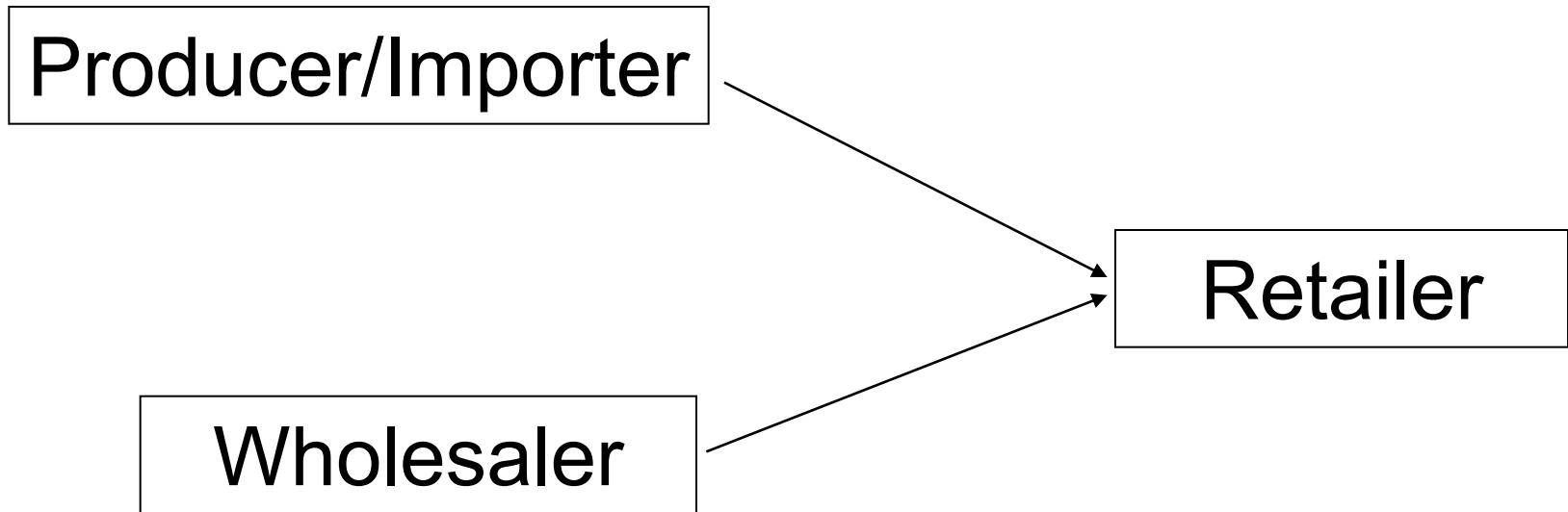
Exclusive Outlet

Exclusive Outlet

- Industry members may not require, “by agreement or otherwise” a retailer to purchase alcohol from that industry member to the exclusion of alcohol sold or offered for sale in interstate commerce by others

27 U.S.C. 205(a)

Exclusive Outlet (Continued)



Exclusive Outlet — Examples

- Contracts
- Coercion through acts or threats of violence

Exclusive Outlet – Contract Example

ABC-Wholesaler enters into a sales contract with The Pub, a liquor retailer, in which The Pub agrees to purchase all of its alcohol beverages exclusively from ABC to the exclusion of alcohol beverages offered for sale by others in interstate commerce. In exchange, ABC will sell its products to The Pub at a very favorable cost.

Exclusive Outlet (Continued)

- Interstate Commerce requirements:
 - Primary — Competitor's products must be sold or offered for sale in interstate commerce, **and**
 - One of the other three interstate commerce requirements of § 205(a) must be met
- Similar State law (malt beverage)

Trade Practices — Terms

- **Similar State Law** — If the excluded product is a malt beverage (beer), there must be a similar State law to enable application of the FAA Act:
 - Similar means similar, not same
 - Broad interpretation of similarity

Trade Practices — Terms (Continued)

- **Exclusion** — Element of proof in exclusive outlet, tied house and commercial bribery cases:
 - i.e., requirement or inducement to purchase one person’s alcohol must be “to the exclusion, in whole or in part” of alcohol sold by others

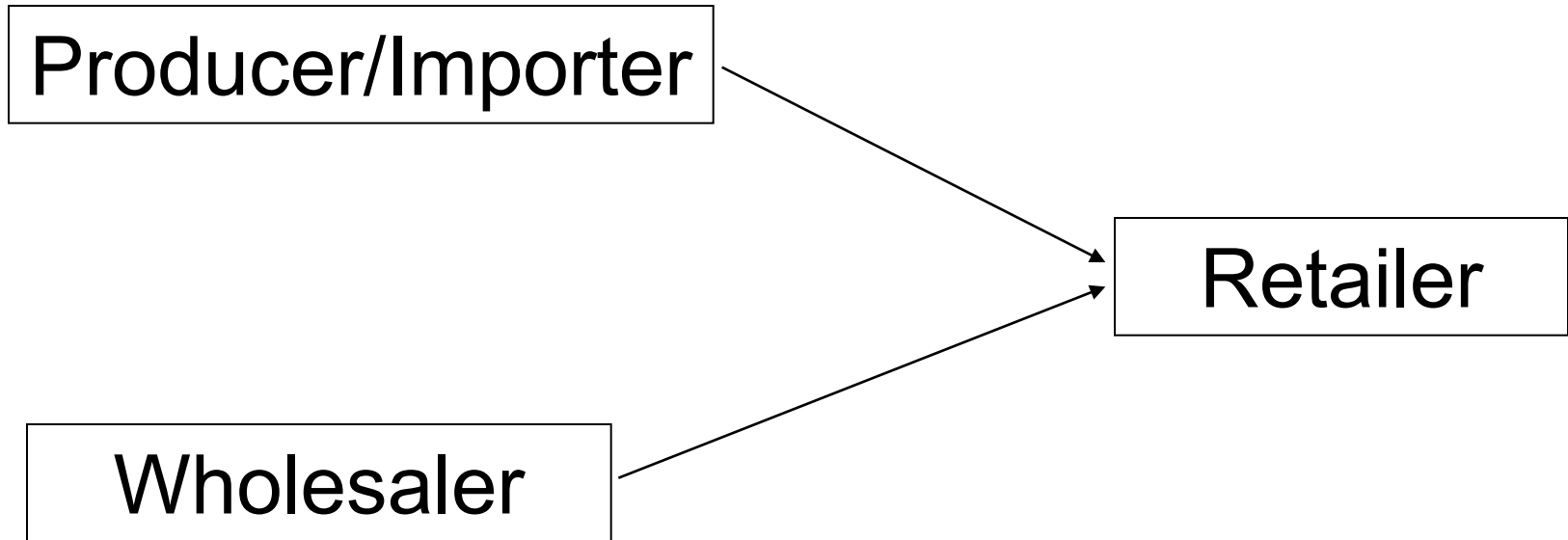
Tied House

Tied House

- Industry member may not induce, directly or indirectly, a retailer to purchase alcoholic beverages from the industry member to the exclusion of such products offered for sale by other persons
- Inducement must come through one of seven specifically enumerated means

27 U.S.C. 205(b)

Tied House (Continued)



Tied House — “Means to Induce”

1. Acquiring or holding any interest in any license with respect to premises of retailer
 - Note: TTB does NOT license retail dealers
2. Acquiring any interest in real or personal property owned, occupied, or used in the retailer’s business
 - Note: 100% ownership is not prohibited (§§ 6.27 and 6.33)

Tied House — “Means to Induce” (Continued)

3. Furnishing, giving, renting, lending, or selling to retailer, equipment, fixtures, signs, supplies, money, services, or other thing of value
 - Important exceptions in CFR
4. Paying or crediting retailer for any advertising, display, or distribution service
 - i.e., “Slotting fees”
5. Guaranteeing any loan or repaying retailer’s financial obligation

Tied House — “Means to Induce” (Continued)

6. Extending credit to a retailer for “a period of time in excess of 30 days from the date of delivery”
7. Requiring the retailer to take and dispose of a certain quota of alcohol beverages

Tied House — Examples

- Wholesaler purchases or rents display, shelf, storage, or warehouse space from a retailer (i.e., slotting allowance)
- Importer gave cases of free product to a retailer in exchange for product promotion and preferential display space within the retailer's premises

Tied House — Exceptions

Things of value that may be given to retailers:	Regulations (27 CFR)
Product Displays – provided displays do not exceed \$300 per brand at any one time in any one establishment	§ 6.83
POS & Consumer advertising - Posters, inside signs, clocks, calendars, menus, products list, etc; retailer must not be paid or credited by industry member in order to use these materials	§ 6.84
Temporary Retailers – Not engaged in business for more than 4 consecutive days per event and not more than 5 events per year	§ 6.85
Equipment & Supplies – (glassware, dispensing accessories, ice, etc.) sold to retailer for not less than cost and price is collected within 30 days	§ 6.88
Samples – 3 gallons of malt beverages, 3 liters of wine or distilled spirits (provided not purchased w/in previous 12 months)	§ 6.91
Newspaper Cuts	§ 6.92
Combination Packaging – Combining distribution and packaging of alcohol and non-alcoholic beverages	§ 6.93

Tied House — Exceptions (Continued)

Things of value that may be given to retailers:	Regulations (27 CFR)
Educational Seminars – Sponsored by industry member	§ 6.94
Consumer Tasting at Retailer Establishment	§ 6.95
Consumer Promotions (Coupons and Direct Offerings)	§ 6.96
Advertising Service – Where two or more unaffiliated retailers selling industry member products are listed in an advertisement	§ 6.98
Stocking Rotation & Pricing – Provided other industry members products are not altered or disturbed	§ 6.99
Participation in Retailer Association Activities	§ 6.100
Merchandise – Groceries, pharmaceuticals, etc., sold at fair market value; not combined with sale of alcohol beverages	§ 6.101
Outside Signs – Provided it bears conspicuous advertising matter about product/industry member and cost does not exceed \$400, and the retailer is not compensated	§ 6.102

Tied House — Recordkeeping Requirements

- For exception to apply, industry members must keep and maintain records on premises for certain items furnished to retailers:
 - Product displays
 - Equipment and supplies
 - Samples
 - Coupons
 - Participation in retailers association activities
 - Merchandise

27 CFR 6.81(b)

Tied House — Recordkeeping Requirements (Continued)

- Required records for certain items furnished to retailers must be kept on premises and include:
 - Name and address of retailer
 - Date furnished
 - Item furnished
 - Industry member's cost of item
 - Charges to retailer (if any)

27 CFR 6.81(b)

Tied House (Continued)

- Interstate Commerce requirement:
 - Primary — Competitor's products must be sold or offered for sale in interstate commerce, **and**
 - One of the other three interstate commerce requirements of § 205(b) must be met
- Similar State law (malt beverages)

Commercial Bribery

Commercial Bribery

- An industry member may not induce any “trade buyer” (wholesaler/retailer) to purchase alcohol from the industry member to the exclusion of those sold by others by:
 - Commercial bribery, or
 - Offering or giving any bonus, premium, compensation, or other thing of value to employees, officers, or representatives of trade buyer

27 U.S.C. 205(c)

Commercial Bribery (Continued)

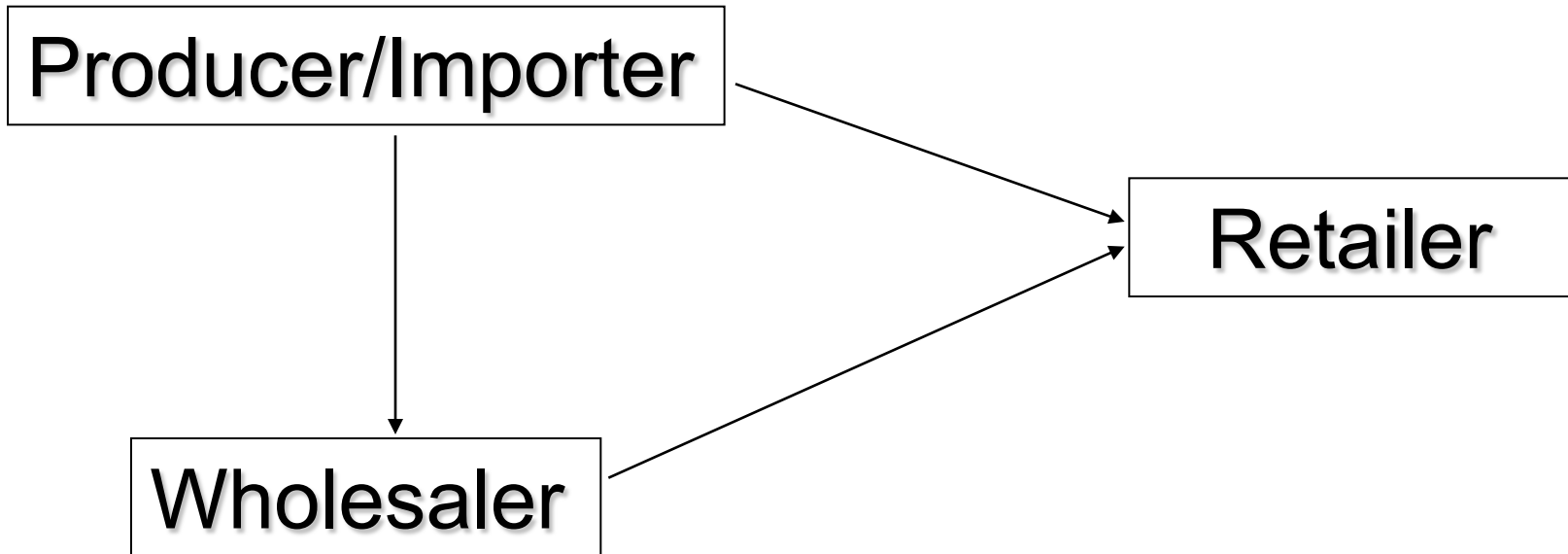
- “Commercial Bribery” under §205(c)(1) means:
 - The practice of sellers secretly paying money or making gifts to employees or agents to induce them to promote purchases by their own employers from the sellers offering the secret inducements.

**American Distilling Co. v. Wisconsin
Liquors, 104 F.2d 582, 585 (7th Cir. 1939)**

Commercial Bribery (Continued)

- Things of value given to officers, employees, or representatives of trade buyers that promote sales of industry member's products can indirectly induce the trade buyers to purchase more of those products (§ 205(c)(2))
- Note: Industry member may give things of value to wholesale entity unless wholesaler is mere conduit to the employees (27 CFR 10.23)

Commercial Bribery (Continued)



Commercial Bribery— § 205(c)(1) Example

- An industry member contacts a purchasing agent for a chain of restaurants to buy and sell its alcoholic beverages in exchange for a weekly cash incentive of \$200. The purchasing agent agrees, and secretly receives the payment by check through the mail and also stops buying a competitor's product. The purchasing agent's employer doesn't know anything about it.

Commercial Bribery— § 205(c)(2) Example

- Sales Contests:
 - Industry member offers gift or bonus to trade buyer's employees to promote sales of industry member's products. This sales contest indirectly induces the trade buyer to purchase more of those products.

Commercial Bribery (Continued)

- Interstate Commerce requirement:
 - Primary — Excluded competitor's products must be sold or offered for sale in interstate commerce, and
 - One of the other three interstate commerce requirements of § 205(c) must be met
- Similar State law (malt beverages)

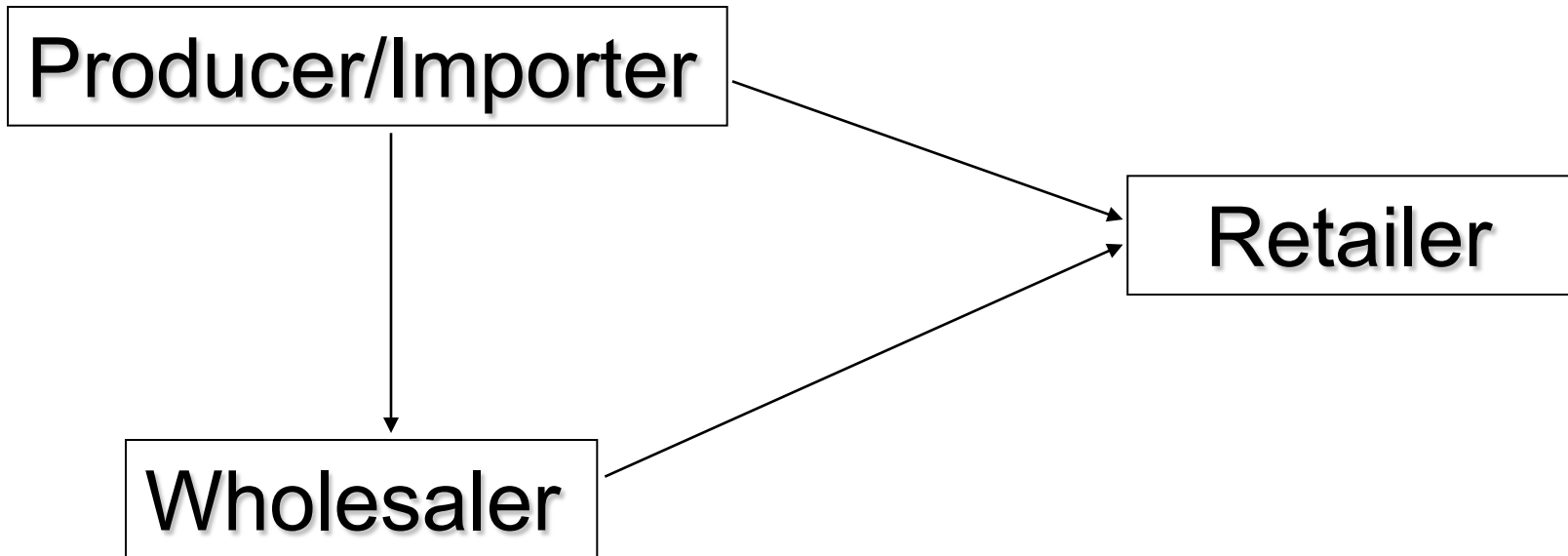
Consignment Sales

Consignment Sales

- Unlawful to sell or offer to sell alcohol beverages to trade buyer (or for trade buyer to purchase):
 - On consignment, or
 - Under conditional sale, or
 - With the privilege of return, or
 - On any basis other than a bona fide sale, or
 - Where any part of the transaction involves the acquisition of other wine, distilled spirits or malt beverages from the trade buyer
- Exception: Returns for ordinary and usual commercial reasons (27 CFR 11.32-11.39)

27 U.S.C. 205(d)

Consignment Sales (Continued)



Consignment Sales— Examples

- An industry member (wholesaler, importer) sells a retailer 300 cases of alcohol beverages with the understanding that if it is not sold, it may be returned
- Importer sells to wholesaler under condition that wholesaler is not required to pay for alcohol until sold to retailer

Consignment Sales (Continued)

- Merchandise returns for ordinary and usual commercial reasons do not constitute consignment sales, such as:
 - Error in delivery (§ 11.33)
 - Defective product (§ 11.32)
 - Product unlawful to sell (§ 11.34)
 - Termination of retail business (§ 11.35) or wholesale franchise (§ 11.36)
 - Change in product (§ 11.37)
 - Discontinued product (§ 11.38)
 - Seasonal dealer (§ 11.39)

Consignment Sales (Continued)

- Merchandise returns for reasons not considered ordinary and/or usual are considered consignment sales, such as:
 - Overstocked or slow-moving products
 - Seasonal products
- Similar State law (malt beverages)

Consignment Sales (Continued)

- Interstate Commerce:
 - One of the three interstate commerce requirements of § 205(d) must be met
- **No Exclusion Requirement** if the sale, purchase, offer, or contract is made in the course of interstate or foreign commerce

Exclusion

Exclusion

- Element of proof in trade practice cases (except for consignment sales):
 - The requirement or inducement must be “to the exclusion, in whole or in part” of alcohol sold by others

Exclusion (Continued)

- Historic interpretation:
 - Practice considered a violation of FAA Act if the induced or required purchases result in retailers purchasing less of competitors' alcohol beverages than they otherwise would have

Exclusion (Continued)

- Current interpretation:
 - Requires “something more” than the retailer purchasing less of a competitor’s products to show exclusion
- Two key cases are:
 - *Foremost Sales v. ATF*, 860 F.2d 229 (7th Cir. 1988)
 - *Fedway Associates v. U.S. Treasury*, 976 F.2d 1416 (D.C. Cir. 1992)

Current Interpretation of Exclusion

- Two elements to exclusion:
 - The proscribed practice must place retailer independence at risk by means of a “tie or link” between industry member and the retailer or by any other means of industry member control, and
 - Such practice results in retailer purchasing fewer of competitors’ products than it otherwise would have

“Exclusion” Approach — Green, Red, and Yellow Lights

- TTB regulations enumerate specific practices that put retailer independence at risk:
 - **Green Light** — Are permissible; i.e., do not place retailer independence at risk (§ 8.53)
 - **Red Light** — Are not permissible; i.e., do place retailer independence at risk (§§ 6.152, 8.52, 10.52)
 - **Yellow Light** — Factors to consider in determining whether a practice other than specifically enumerated red light practices places retailer independence at risk (§§ 6.153, 8.54, 10.54)

Practical Exercises

Practical Exercise #1

ABC Wholesaler enters into a 9-month advertising contract with Speedy Racetrack, a retailer. Under the terms of the contract, Speedy Racetrack will receive \$50,000 and agrees to purchase ABC Wholesaler's XYZ malt beverages throughout the 9-month contract period. ABC Wholesaler will be able to put up signage throughout the racetrack advertising its XYZ malt beverage products.

Practical Exercise #1 (Continued)

Is this an exclusive outlet arrangement?

27 CFR 8.22 prohibits:

“Any contract or agreement, written or unwritten, which has the effect of requiring the retailer to purchase distilled spirits wine or malt beverages from the industry member beyond a single sales transaction.”

Practical Exercise #1 (Continued)

Does the practice place retailer independence at risk?

Not a “red light” practice (27 CFR 8.52):

- No direct or indirect threat of physical or economic harm by ABC — § 8.52(a)
- No requirement to purchase or express restriction on purchasing from another industry member — § 8.52(b)

Practical Exercise #1 (Continued)

- This contract is a “**yellow light**” practice:
 - Speedy Racetrack has a continuing obligation to purchase or otherwise promote ABC Wholesaler’s product — 27 CFR 8.54(c)
 - Speedy Racetrack has a commitment not to terminate its relationship with ABC with respect to purchase of ABC Wholesaler’s products — 27 CFR 8.54(d)
 - This practice may also hamper the free economic choice of Speedy Racetrack to decide which products to purchase — 27 CFR 8.54(a)

Practical Exercise #2

Wholesaler enters into a 12-month sales contract with a retailer of fine wines. Under the terms of the contract, the retailer, because of a very favorable price, agrees to purchase all of its French burgundy wines exclusively from the wholesaler for the duration of the 12-month period.

Practical Exercise #2 (Continued)

Is this an exclusive outlet arrangement?

Yes; contract clearly requires purchases beyond a single sales transaction — 27 CFR 8.22

Does this practice place retailer independence at risk?

“Contracts between an industry member and a retailer which require the retailer to purchase distilled spirits, wine or malt beverages from the industry member and expressly restrict the retailer from purchasing, in whole or in part, such products from another industry member.” — 27 CFR 8.52(b)

Practical Exercise #2 (Continued)

- This contract is a “**red light**” practice:
 - Requires the purchase of **all** French burgundy wines **exclusively** from the wholesaler

Practical Exercise #3

Wholesaler enters into a 12-month contract with a local tavern that caters to an affluent clientele. Under the terms of the contract, the wholesaler will provide several wines at a very favorable price throughout the contract period. The products are being supplied on an as needed basis and there are no minimum quantity purchase requirements.

Practical Exercise #3 (Continued)

Is this an exclusive outlet arrangement?

No. Contract meets the requirements of 27 CFR 8.53:

- Supply contract for 1 year or less
- Industry member agrees to sell on “as needed basis”
- No minimum quantity purchase requirements

This is a **“green light”** practice.

Practical Exercise #4

ABC Wholesaler contacted several key retailers in the market area to motivate them to buy certain dual products (identical products sold by two wholesalers in the same market area). ABC Wholesaler advised the retailers that ABC would be implementing a new service policy for the next 6 months. ABC would provide free labor to stock and reset the stock of the retailers' entire liquor department for the 6-month period. Several retailers took advantage of ABC Wholesaler's service policy.

Practical Exercise #4 (Continued)

Is this a “tied house” arrangement?

- Yes. Free labor to reset the stock of the liquor department would be a thing of value under 27 CFR 6.41

Does it put retailer independence at risk?

- Yes. This arrangement is a “**red light**” practice
- “The act by an industry member of resetting stock on a retailer’s premises (other than stock offered for sale by the industry member)” is considered to be a practice that puts retailer independence at risk (27 CFR 6.152(a))

Practical Exercise #5

Inga's Imports USA, an importer of alcoholic beverages, sponsored a 10-day all expense paid trip to Puerto Rico for the top three sales people of ABC Wholesaler who sold the most Rummy's Rum products over the 3-month period of June, July, and August 2008. The value of the trip to each winner was approximately \$2,000.

Practical Exercise #5 (Continued)

Is this commercial bribery?

- There are no secret payments
§ 205(c)(1)
- “Sales contests sponsored by an industry member which offer prizes directly or indirectly to trade buyer officers, employees, or representatives are inducements within the meaning of the act.” (27 CFR 10.21 and 10.24)

Practical Exercise #5 (Continued)

Does it place the wholesaler's independence at risk?

- Could “hamper the free economic choice” of wholesaler to determine which products to buy (§10.54(a)), or
- Could be considered a continuing obligation to purchase or otherwise promote the importer's product (§10.54(c))

Practical Exercise #5 (Continued)

- Not a “red light” practice because the incentive to the trade buyer is not secret and there is no explicit requirement to buy product (§ 10.52)
- This is a **“yellow light”** practice

Practical Exercise #6

- Wine importer intends to give each of its wholesalers a wine refrigerator (retail value of \$120)
- Is this a potential trade practice violation?
 - Not a “tied house” (no retailer) — § 205(b)(3)
 - Not “commercial bribery” so long as the refrigerator will be used by the distributor

Practical Exercise #7

Corny Distiller, in order to introduce a new whiskey to the market, enters into an agreement with Rye Wholesaler. As part of the agreement, Corny accepts the return of 10 cases of a slow-moving wine from Rye, and Rye purchases 50 cases of Corny's new whiskey.

Practical Exercise #7 (Continued)

Is this a consignment sale?

Sale of the whiskey involves the industry member's acquisition of other products (the slow-moving wine) from the trade buyer
(27 U.S.C. 205(d); 27 CFR 11.21(e) and 11.23(a))

Remember: Proof of exclusion is not required for consignment sale if the sale is made in the course of interstate commerce

FAA Act Trade Practice Proceedings

FAA Act Permit Proceedings

- Permit may be annulled if Secretary finds it was obtained through fraud, misrepresentation, or concealment of material fact
- Permit may be revoked if permittee has not engaged in business for more than 2 years

FAA Act Permit Proceedings (Continued)

- Permit may be revoked or suspended if permittee willfully violates any conditions of its basic permit:
 - However, can only be suspended for first-time violation
- As an alternative to suspension or revocation, TTB can accept offers in compromise (27 U.S.C. 207)

Other Proceedings

- Violations of FAA Act Trade Practice prohibitions can result in criminal charges against any person who violates the Act:
 - Misdemeanor
 - \$1,000 fine for each offense
 - In consignment sale context, can include the retailer

Summary

- Trade Practice Prohibitions (Exclusive Outlet, Tied House, Commercial Bribery, Consignment Sales)
- Exclusion Element
- Current Interpretation of Exclusion
- Practical Exercises
- Potential Administrative Action

Contact Information

Michael Desrochers

**Program Manager, Trade Investigations
Division**

(978) 649-6943

