COMMISSION AUTHORIZED

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COMMENT OF THE STAFF OF THE FEDERAL TRADE COMMISSION

The staff of the Federal Trade Commission[1] offers this comment to the Bureau of Alcohol, Tobacco and Firearms in its rulemaking to define "exclusion" as the term is used in the federal statutes and regulations applicable to relationships between suppliers and retailers in the alcoholic beverage industry. One proposal, that exclusion of a supplier should not be found unless a threat to retailer independence is demonstrated, would be consistent with efforts to promote a competitive marketplace if the reduction in retailer independence would be due to another supplier's exercise of market power. We recommend that BATF not define exclusion by reduction in purchases from the supplier's competitors, because that fact will always be ambiguous.

The Federal Trade Commission is an independent administrative agency charged with maintaining competition and safeguarding the interests of consumers. The FTC enforces the Federal Trade Commission Act, which declares unlawful unfair methods of competition and unfair or deceptive acts or practices in or affecting commerce.[2] The legal understanding of "unfair methods of competition" and related principles under other antitrust laws that the

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[1] These are the views of the staff of the Federal Trade Commission and are not necessarily those of the Commission or of any Commissioner.

[2] 15 U.S.C. §§ 41 et seq.

Commission enforces, notably the Clayton Act,[3] are analogous to the "unfair trade practices" provisions of the Federal Alcohol Administration Act that govern the present rulemaking.[4]

I. Description of Proposal

This rulemaking[5] implements the provisions of the Federal Alcohol Administration Act[6] that prohibit certain practices — exclusive dealing, commercial bribery, and "tied house" relationships — if they require or induce retailer purchases of the offending supplier's products "to the exclusion in whole or in part" of the products of some other supplier. Relationships that are considered to amount to a tied house include holding an interest in a retailer's license or property, furnishing it equipment or fixtures, paying for its advertising or distribution, guaranteeing its loans, extending it unusual credit, or setting sales quotas for it. BATF has announced its intention to promulgate a framework for characterizing exclusion under the FAA Act, to identify promotional practices that result in control of retailers and in exclusion, and to identify practices that fall in safe harbors.[7]

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[3] 15 U.S.C. §§ 12 *et seq.*

[4] The staff of the Commission has commented to the BATF previously about advertising and labeling issues, including a comment in 1979 about comparative advertising, and comments in 1986, 1987, and 1988 about non-alcoholic and "light" beers. On those subjects, too, the Commission's statutory authority concerning advertising and marketing parallels the provisions of the FAA Act.

[5] Notice of Proposed Rulemaking, 59 Fed. Reg. 21698 (April 26, 1994).

[6] 27 U.S.C. §§ 203(a), (b), and (c) ("FAA Act").

[7] The proposal also deals with consignment sales, which are also regulated by the FAA Act, 27 U.S.C. § 203(d), but which are not subject to the exclusion requirement.

BATF proposes to add new rules about exclusion to the CFR sections dealing with tied houses, exclusive dealing, and commercial bribery.[8] The same basic definition would be used for each statutory category. Exclusion in whole or in part would occur when a practice by a supplier places retailer independence[9] at risk, by a tie or link between the supplier and the retailer or by any other means of supplier control over the retailer, and the practice results in the retailer purchasing less than it would have of a competitor's product. The rules corresponding to each statutory category would also include criteria for determining whether a practice places retailer independence at risk.[10] The criteria would include whether (a) the practice restricts or hampers the retailer's free economic choice of products or quantities, (b) the retailer is obligated to participate in a promotion as a condition of obtaining the supplier's products, (c) the retailer has a continuing obligation to buy or promote the supplier's products, (d) the retailer commits not to terminate its purchases of the supplier's products, (e) the practice involves the industry member in the retailer's day-to-day operations, such as decisions about purchases, prices, and display, or (f) the practice is not offered to all retailers in the local market on the same terms without business reasons to justify differences in treatment.[11]

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[8] Proposed 27 C.F.R. §§ 6.151, 8.51, and 10.51.

[9] Or, in the case of commercial bribery, exclusion would occur when the independence of a trade buyer is placed at risk.

[10] Proposed 27 C.F.R. §§6.153, 8.54, and 10.54.

[11] In addition to these general rules, specific practices would be identified as placing retailer or trade buyer independence at risk under each statutory category. For the tied house prohibition, these practices would be resetting shelves for other suppliers' products, paying slotting fees (if the result was to reduce space available for competitors' products), partial (but not complete) ownership of a retailer, and tying. Proposed 27 C.F.R. § 6.152. (BATF also proposes to treat slotting allowances as consignment sales.) For exclusive dealing, practices that would result in exclusion would be threats (or acts) of physical or economic harm or contracts

II. Competition policy and the FAA Act

The Notice states that "the goal of regulating trade practices in the alcoholic beverage industry has been identified as healthy competition in order to insure the best possible price, quality and selection for the consumer and to prevent formation of a corrupt black market."[12] The Congress that passed the FAA Act in 1935 was concerned about preventing monopoly and unfair competitive practices and promoting a competitive market, among other things.[13] Post-Prohibition industry concentration seemed high[14] and prices were high enough to make bootlegging attractive and a threat to tax revenues. Thus, one goal was to bring prices down by eliminating practices that were considered to be monopolistic.[15] The legislative history shows

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that expressly restrict the retailer's purchases from others. Proposed 27 C.F.R. § 8.52. For commercial bribery, the rules would bar promotional arrangements involving payments of money or some other premium to retailer employees without the knowledge of the employer in exchange for the employee's agreement to order from the supplier. Proposed 27 C.F.R. § 10.52. Except as noted below, this comment does not address these specific proposed rules or the other aspects of the BATF proposal.

[12] 59 Fed. Reg. 21700.

[13] *See National Distributing Co. v. BATF*, 626 F.2d 997 (D.C. Cir. 1980).

[14] The levels might not seem high by current antitrust standards. In 1934, the largest firm's share of the whisky market was 23 percent, and the top nine totalled 81 percent. These figures suggest that the HHI, the measure now used in merger analysis as a threshold screening for competition concerns, might well have been about 1000, which is the level below which a market is now considered unconcentrated. Moreover, concentration apparently fell the next year as more firms began production; the top firm's share dropped to 16 percent. *See National Distributing Co.*, *supra* n. 13, 626 F.2d at 1006.

[15] Congress was also concerned to prevent pre-Prohibition problems believed to be connected with "tied houses," including political corruption and excessive consumption.

that the FAA Act's provisions about unfair competition and unlawful practices were understood to be "analogous" to the prohibitions of the antitrust laws.[16]

The analogous antitrust laws would have included the Sherman Act's prohibition of contracts and combinations in restraint of trade and monopolization[17] and the Clayton Act's provisions concerning exclusive dealing and tying.[18] The substance of these provisions is also encompassed by the Federal Trade Commission Act's general prohibition of "unfair methods of competition."[19] The FAA Act's unfair trade practice provisions, unlike those of the Clayton Act, contain no express requirement that the practice at issue cause or threaten an adverse effect on competition. Instead, the FAA Act's "effects" standard relates to interstate commerce: the prohibited acts must occur in interstate commerce, "substantially" restrain or prevent transactions in interstate commerce, or have the "direct effect" of preventing, deterring, hindering, or restricting other persons' efforts to make sales in interstate commerce. Although these terms do not explicitly include the concept of effect on competition, they are consistent with an application intended to promote competitive markets.

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16 Federal Alcohol Control Administration, Legislative History of the Federal Alcohol Administration Act, Appendix II, p. 143 (report of the House Committee on Ways and Means) (1935).

17 15 U.S.C. §§ 1, 2.

18 15 U.S.C. § 14.

19 15 U.S.C. § 45. Some provisions of the Robinson-Patman Act, concerning promotional allowances and services and "dummy brokerage," are also analogous to FAA Act issues, but the Robinson-Patman Act was passed a year later.

Recent court decisions have encouraged viewing the FAA Act's "unfair competition" standards as ways to promote the kind of conduct normally encountered in competitive markets. The Court of Appeals for the D.C. Circuit has required that exclusion under the FAA Act result from direct action by the supplier, not from the retailer's free economic choice, because to find exclusion when the retailer has exercised a free choice could hinder legitimate competition. *Fedway Associates, Inc. v. BATF*, 976 F.2d 1416 (D.C. Cir. 1992). Thus, in language that is echoed in the proposed rules, the court required that the forbidden conduct be associated with some tie or link between supplier and retailer that threatened the retailer's independence. The court said that competition should lead to lower prices and would promote Congress's intentions in regulating the alcoholic beverage industry, observing that free competition "helps deter the formation of a corrupt black market."[20]

III. Proposed policies about exclusion

One of the two basic concepts BATF proposes for the definition of exclusion, impairment of retailer independence, could be responsive to the concern to promote free competition if it

[20] The Court of Appeals for the Seventh Circuit has reached a similar conclusion, in *Foremost Sales Promotions, Inc. v. BATF*, 860 F.2d 229 (7th Cir. 1988), finding that participation in a cooperative advertising program, with no requirement to refrain from purchasing products of other suppliers, cannot by itself constitute a tied house violation.

is applied judiciously.[21] The other, diminution in the sales of the supplier's competitors, may be irresolvably ambiguous and adds little to the first.

Without more, the fact that one supplier's action results in a retailer buying less of another supplier's product implies nothing about whether competition has been hindered or even about whether the first supplier's act has excluded the competing supplier from access to the market. A reduction in a retailer's purchases from a supplier could be the result of the retailer's free economic choice, in a competitive market, of more attractive combinations of price and quality offered by other suppliers. Without knowing whether the purchase patterns result from a competitive market process or an exercise of market power, the fact of reduced purchases is fundamentally ambiguous. Without knowing more about the relative prevalence of competition and of anticompetitive exclusion, it is impossible to say whether a reduction in purchases results from one or the other, and thus it is impossible to know whether the fact of reduced purchases should be treated as economically significant.

It is unclear that the fact of reduced purchases is necessarily an element in the statutory violation. The FAA Act speaks of "exclusion, in whole or in part." This language may invite focus on the nature of the offending action, as preventing others from a fair opportunity to

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[21] As the courts have recognized, in language that is repeated in the Notice, the definition of exclusion should recognize "the value of pro-competitive wholesale promotions. This value derives not only from the traditional benefits of competition in terms of lower prices and improved quality, but also ... from the fact that a competitive alcohol market helps deter the formation of a corrupt black market." *Fedway*, *supra*, 976 F.2d at 1423. Assessment of market power to determine whether a practice promotes competition is explained at p. 10 below.

compete, rather than on the retailer's purchases. The fact of reduced purchases might be taken as some measure of actual effect, if there are other reasons to find that a supplier's actions offend statutory policies. But in the absence of such other reasons, the fact of reduced purchases may simply reflect healthy competition. To focus too much on this effect could discourage competition without advancing other policy goals. Any reduction in purchases from competitors should be considered relevant only as corroborating evidence that a practice already found, for other reasons, to have violated the statute has actually had some effect.[22]

The other part of the proposed definition, placing retailers' independence at risk, could be understood as consistent with promoting competition if the risk were due to a supplier's exercise of market power. Reduction in economic freedom through limitation of marketplace choices and prevention of robust price and product competition are the harms of monopoly power that antitrust enforcement seeks to correct and prevent. The focus on impairing economic independence is also supported in the language of the FAA Act, whose exclusion requirement can be construed to call for showing a particular means by which a supplier's actions override the retailer's otherwise free choice among competitively determined options.

Even in a competitive market, though, buyers and sellers might freely agree to arrangements that seem to constrain their freedom of action. Such arrangements can be efficient

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[22] Decisions such as *Fedway* have emphasized that the central concern is supplier control. If the reduced-purchases standard is retained, it should be construed to require showing a specific link between how the offending practice tends toward supplier control and how that control requires the retailer to reduce its purchase of other products.

and procompetitive. The FAA Act declares that a supplier cannot require that a retailer be its exclusive outlet, to the exclusion in whole or in part of other suppliers' products. The FAA Act thus speaks in terms of suppliers exerting power over retailers. But BATF proposes to extend that prohibition, so that a retailer could not, by its own free choice, offer and agree to be an exclusive outlet for a supplier, even in a competitive market.[23] Such a choice would presumably show that the retailer believed the arrangement would be beneficial to it. Determining whether it would be anticompetitive would require knowing more about the characteristics of the market.

Under the Clayton Act, an exclusive dealing arrangement is illegal only if the effect may be to substantially lessen competition or to tend to create a monopoly. The practices that are the subject of this rulemaking would be not considered *per se* illegal in antitrust analysis. On the contrary, in many circumstances they would be considered competitively neutral or even procompetitive. Only if more complete analysis disclosed actual or threatened anticompetitive effects in particular circumstances would antitrust law find them illegal. Thus, evaluating a particular exclusive dealing agreement requires understanding the nature of competition in the relevant product and geographic markets and the likely effect of the agreement in that context.[24]

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[23] Notice, p. 21699; Proposed 27 C.F.R. § 8.52(b).

[24] The proposal would also treat all forms of tying as violations of the FAA Act, without regard to the tying product's market share or the practice's competitive effect. Although tying has sometimes been described as a *per se* offense, thus requiring no showing of anticompetitive effect, the Supreme Court has required a showing of economic or market power in the tying product before imposing liability.

Antitrust analysis of a vertical restraint such as an exclusive dealing contract is concerned with whether the practice preserves or enhances the market power of existing firms and whether it shelters or facilitates collusion or anticompetitive coordinated behavior.[25] "Market power" can be defined as the ability to maintain prices above competitive levels for a significant period of time. In examining vertical restraints, market power issues are usually assessed by identifying relevant markets and market shares and by examining the conditions of competition among different brands, that is, the ability of consumers to purchase the competing products of other manufacturers at a competitive price. If this "interbrand" competition is healthy, so consumers retain this ability, then antitrust analysis does not usually object to manufacturers' restrictions on non-price aspects of product distribution that have procompetitive benefits. These restrictions on "intrabrand" competition may lead to efficiencies and promote interbrand competition. For example, nonprice vertical restrictions may discourage retailers from "free riding" by using one supplier's promotional efforts to promote the products of others. Such restrictions can thus benefit the ultimate consumer.

Some of the proposed criteria for identifying risk to retailer economic and competitive independence raise the possibility that risks to independence would be inferred from competitively neutral or even procompetitive behavior. The first criterion, that the practice restricts or hampers the retailer's free economic choice of products or quantities, is a restatement of the general principle. But the next three criteria might lead to objections to competitively neutral contracts. The proposed rule would find that a retailer's obligation to participate in a

[25] *See Beltone Electronics Corp.*, 100 F.T.C. 68 (1982).

promotion as a condition of obtaining the supplier's products, its continuing obligation to buy or promote the supplier's products, or its commitment not to terminate purchases of the supplier's products, would be considered evidence that the retailer's economic independence was threatened. Yet each feature could appear as an aspect of otherwise normal commercial relationships through which parties undertake to buy, promote and sell quantities over a period of time. Such transactions, which the BATF regulations apparently would prohibit,[26] are commonplace in other settings and in most circumstances are competitively benign and indeed may often be efficiency enhancing.[27]

Thus, even if the focus is on impairment of retailer independence, rather than effect on the sales of competing suppliers, achieving results that do not impair healthy competition may require careful analysis. Moreover, the analysis may depend on factors that vary from market to market. Because the alcoholic beverage industry is subject to many differing state and local regulations of pricing and entry, both at wholesale and retail levels, market and competitive conditions may vary greatly and the competitive significance of any general federal policy may be muted Still, BATF may wish to consider incorporating some principles from competition policy analysis and enforcement. The possibility of competitive entry into the relevant market is always an important consideration. If entry is not too difficult, for example, if exclusive territories are not mandated by law or contract, and if prices are not regulated, then BATF might

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[26] 27 C.F.R. § 8.22 prohibits agreements that have the effect of requiring purchases beyond a single sales transaction.

[27] A stringent rule might nonetheless be called for if there is reason to believe that such arrangements in this industry were likely to represent relationships that offended other policies.

be more willing to find that arrangements reflect free choices rather than anticompetitive conditions or loss of independence.

The FAA Act's prohibitions against exclusive outlets and tied houses may be intended to promote goals other than or in addition to market competition. Stringent restrictions of these practices, intended to promote those other goals, might well inhibit market competition. Under the antitrust laws, the practices are not ones that would normally be thought to require such tight regulation in order to protect competition in the market for other kinds of products. If BATF intends to use market competition as one means of accomplishing its statutory goals, we urge that its definition of "exclusion" be no broader than the FAA Act requires.

IV. Conclusion

BATF's proposal that exclusion under the FAA Act should not be found unless there is a showing of a threat to retailers' competitive independence could be consistent with promoting a competitive market if the threat to independence resulted from an exercise of market power by a supplier. A retailer could, consistently with healthy competition, choose an arrangement that constrained some of its independence. We recommend that BATF not define exclusion by reference to reduction in purchases from competitors, because that fact will always be ambiguous. Instead, the focus should be on acts by suppliers that exclude their competitors by unreasonably restraining retailers' choices.