Understanding Trade Practice Laws Under the Federal Alcohol Administration Act

A Brief Guide and Overview to the Statutory and Regulatory Provisions

National Beer Wholesalers Association
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Introduction

Trade practice questions routinely arise in the daily operations of your business. In order to help you maintain a solid compliance effort, this guide explains some of the history of trade practice laws, why they are important for a properly regulated alcohol market, and examines the four unfair trade practices of exclusive outlet, tied-house, commercial bribery, and consignment sales contained in the Federal Alcohol Administration Act of 1935 (FAA Act). It provides an overview of the federal requirements as administered and enforced by the Alcohol and Tobacco Tax and Trade Bureau (TTB), Department of the Treasury. With this knowledge, you can better avoid pitfalls of participating in promotional practices that are unfair trade practices and facing penalties or suspension or revocation of your basic permit, the payment of offers in compromise to TTB, or even civil injunctions or criminal prosecutions.

This guide does not examine the various trade practice laws of each of the 50 states which are in many cases more detailed and more important to day-to-day business for beer distributors. Your state association will have the best resources to handle state law questions.

This guide is organized into several general sections. First, the guide explains the importance and history of unfair trade practice regulation. Then, it explains the type of conduct covered by the specific trade practice prohibition and points out how an industry member can directly or indirectly violate the provision. These explanations are based on regulations, industry circulars, and rulings by the Alcohol and Tobacco Tax and Trade Bureau (TTB), Department of the Treasury, or its predecessor bureaus which were the former Bureau of Alcohol, Tobacco and Firearms (ATF) or the Internal Revenue Service (IRS).

The statutory element of exclusion is covered separately. Exclusion of competitors' products is unique to the federal trade practice system because state regulations on trade practices often do not include it. Exclusion applies to three unfair trade practices – exclusive outlet, tied-house, and commercial bribery. It is not a statutory element for consignment sales which makes these cases much easier for TTB to sanction. Additionally, the similar State law requirement for malt beverages/beer applies to all four unfair trade practices and is explained.

Finally, "pricing arrangements" such as discounts and rebates are not necessarily regulated by the FAA Act and the guide has a separate discussion of the administrative guidance on what is a pricing arrangement. In other words, if the promotional practice is a legitimate pricing arrangement and not a subterfuge for violating one of the unfair trade practice provisions, then the conduct may not be a violation. Credit is considered an item of value and is not considered a "pricing" arrangement.

For further help, please see the list of resources available through the TTB website, www.ttb.gov.

Why the Regulation of Trade Practices Is Important

Beer distributors (and importers) are the only directly affected members of the beer industry that can have permits suspended or revoked for violation of federal trade practice law. Retailers have no federal permit or license. Brewers, unlike wineries and distilleries, are not required to obtain a federal basic permit under the FAA Act. That is why it is important for beer distributors to understand the basic framework of these regulations so that a distributorship can operate in compliance with the law.

Today's system of state-based alcohol regulation has stood the test of time since the repeal of Prohibition because it has effectively protected American citizens from the negative effects of alcohol while allowing for an orderly and competitive marketplace. An essential aspect of the alcohol regulatory system is the separation of the three-tiers of the alcohol industry – the first tier as the manufacturer (supplier), the second as the distributor, and the third as the retailer.

Brewers & Importers | Distributors | Retailers

Just as state beer franchise laws prevent brewers and importers from controlling or threatening the independence of the distributor, trade practice laws prevent suppliers and distributors from interfering with the independence of the retailer.

As a result, state three tier laws including trade practice laws have helped the alcohol industry to be the most robust for consumer choice. According to the Nielsen Company, there are more consumer products available for alcohol than any other product they measure. The system allows consumer demand through retailers working with local distributors who work with various suppliers to "pull" the products they want rather than having closed systems where the suppliers "push" products through limited selection and practices that crowd out consumer choice.

In order to protect this system that works so well for so many, beer distributors must know and comply with the laws. They must work with federal and state regulators as well as their supplier and retail partners to make sure compliance with and enforcement of the laws remains a top priority.

History of Federal Unfair Trade Practice Regulation

The lessons learned from the Prohibition experience in the United States are the foundation of the federal unfair trade practice provisions of the FAA Act. Understanding this history is essential for understanding the statutory elements of the exclusive outlet, tied-house, commercial bribery, and consignment sales prohibitions. Ensuring the integrity of the production, distribution, and sales of distilled spirits, wine and malt beverages/beer is at the core purpose of these provisions so that consumers both receive what they want and are not encouraged towards abusive consumption. Moreover, the framework of these unfair trade practice provisions reflects the concurrent role of the Federal government and state governments in the regulation of alcohol beverages.

Prior to the adoption of the 18th Amendment and Prohibition, the states were unsuccessful in regulating abusive practices in the sale and distribution of alcohol beverages. The debate around Prohibition was often couched in moral terms, political corruption, and dangerous business practices of supplier-owned saloons. The widespread practice of supplier-owned retailers and exclusive dealing arrangements created much societal discord and resulted in highly organized opposition to legal alcohol beverages under the "Anti-Saloon League." This led to National Prohibition.

John Rockefeller, a leading proponent of the 18th Amendment recognized that Prohibition was not working and called for repeal. Further he commissioned a study by Raymond Fosdick and Albert Scott that researched best ways to regulate alcohol properly. On the issue of tied houses, their research noted:

The 'tied house' system had all of the vices of absentee ownership. The manufacturer knew nothing and cared nothing about the community. All he wanted was increased sales. He saw none of the abuses, and as a non-resident he was beyond local social influence. The 'tied house' system also involved a multiplicity of outlets, because each manufacturer had to have a sales agency in a given locality. … large excess of sales outlets. Whether or not this is of concern to the public in the case of gasoline, in relation to the liquor problem it is a matter of crucial importance because of its effects in stimulating competition in the retail sale of alcoholic beverages.

– Fosdick and Scott, *Toward Liquor Control at 43* (Center for Alcohol Policy reprint, 2011)

Likewise, when President Roosevelt announced that the 21st Amendment was ratified, his December 1933 Presidential Proclamation on the Repeal of Prohibition noted, "*I ask especially that no State shall by law or otherwise authorize the return of the saloon in its old form or in some modern guise*."

This concern about the tied house and saloon is important context for understanding the enactment of the FAA Act. Repeal of the 18th Amendment was speedy and, in December 1933, President Roosevelt was confronted with deciding how to regulate the alcohol beverage industry immediately. His answer was the National Industrial Recovery Act with its use of Code of Fair Competition established by industry groups to ensure orderly and stable markets for their goods.

For example, there was a Code of Fair Competition for the Alcoholic Beverage Wholesale Industry and a Code of Fair Competition for the Distilled Spirits Industry, among others. These codes were in addition to the internal revenue laws that taxed and regulated the alcohol industry as well. The codes were in effect until May 1935, when the Supreme Court declared the National Industrial Recovery Act unconstitutional in *Schechter Poultry Corp. v. United States*.

Following the *Schechter Poultry* decision, Congress was extremely concerned that the alcohol beverage industry lacked adequate Federal regulation and quickly enacted the FAA Act in August 1935.

Congress had several key goals and public policies in mind when enacting the FAA Act. These were:

- Prevention of the recurrences of the "social and political evils" giving rise to Prohibition. (S. Rep. No. 1215, 74th Cong., 1st Sess., Federal Alcohol Control Act, pages 6-7.)

- National regulation of interstate commerce where States were unable or limited in regulation: "(W)e must do something to supplement legislation by the States to carry out their own polices. The liquor industry is too big and the constitutional and practical limitations on the States are so considerable that they alone cannot do the whole job." (79 Cong. Rec. 12178.)

- Exclusive outlet, tied-house, commercial bribery, and consignment sale prohibitions: "The practices here involved are analogous to those prohibited by the [Federal] anti-trust laws." (H. Rep. No. 1542, 74th Cong., 1st Sess., Federal Alcohol Control Bill, page 12.)

- Flexibility by the administering agency on regulations on the tied-house exceptions authorized in section 205(b)(3).

Both the FAA Act and the prior Codes of Fair Competition were drafted in the context of the developing three-tier system that was established under State laws. The unfair trade practice provisions respected this market structure and were intended to level the playing field in the distribution and sale of alcohol beverages to prevent the promotional practices that would lead to abusive consumption that had several decades earlier inspired the Temperance Movement and led to the adoption of Prohibition. The public policy goal was an alcohol beverage retail marketplace reflecting the products that the consumer wanted and not a marketplace controlled by the alcohol industry attempting through unfettered trade practices to dictate to the consumer what he or she should want and causing abusive consumption via overstimulation of sales. Congress meant to use its full Constitutional powers here when it declared: "*In order effectively to regulate interstate and foreign commerce in distilled spirits, wine, and malt beverages, to enforce the twenty-first amendment, and to protect the revenue and enforce the postal laws with respect to distilled spirits, wine, and malt beverages*" (27 USC 203)

Unfair Trade Practices Under the FAA Act

The unfair trade practices of the FAA Act are found at Title 27, United States Code, Section 205 and are comprised of 1) Exclusive Outlet 2) Tied House 3) Commercial Bribery and 4) Consignment Sales.

Who Is Covered?

Before turning to these specific unfair trade practices, let's look at who is covered. It is unlawful for an industry member to enter into these practices with a retailer (assuming the other statutory elements of a violation are established.) Industry member means a distiller, wine producer, brewer (even though it is not required to hold a basic permit), importer, and wholesaler, among others. For commercial bribery and consignment sales, the prohibition also applies to dealings between a supplier and a distributor because these provisions apply to dealings with "trade buyers" and not only retailers. The consignment sales provision is even broader in its application. Not only does it prohibit an industry member from offering to sell, selling on, or contracting to make a consignment sale, it also prohibits the retailer from offering to purchase or purchasing on a consignment sales arrangement from an industry member. It also prohibits a wholesaler from offering to purchase, contracting to purchase, or purchasing from an industry member on a consignment sales arrangement.

Congress intended section 205 have broad application to conduct by industry members. It covers unfair trade practices engaged in by the industry member "directly, indirect, or through an affiliate." Affiliate is defined in section 211(a)(4) as covering two situations:

- "any one of two or more persons if one of such persons has actual or legal control, directly or indirectly, whether by stock ownership or otherwise, of the other or others of such persons, and

- "any one of two or more persons subject to common control, actual or legal, directly or indirectly, whether by stock ownership or otherwise."

Non-Licensed Third Parties

Industry members are liable for an unfair trade practice indirectly through the services or conduct of a third party. These are business arrangements where the industry member enters into a transaction with a third party but the benefits flow to a retailer or the third party controls the purchasing decisions of the retailer.

For example, under exclusive outlets - Third party arrangements, the regulations states at 27 CFR 8.23:

> "Industry member requirements, by agreement or otherwise, with non-retailers which result in a retailer being required to purchase the industry member's products are within the exclusive outlet provisions. These industry member requirements are covered whether the agreement or other arrangement originates with the industry member or the third

> party. For example, a supplier enters into a contractual agreement or other arrangement with a third party. This agreement or arrangement contains an industry member requirement as described above. The third party, a ball club, or municipal or a private corporation, not acting as a retailer, leases the concession rights and is able to control the purchasing decisions of the retailer. The third party, as a result of the requirement, by agreement or otherwise, with the industry member, requires the retailer to purchase the industry member's products to the exclusion, in whole or in part, of products sold or offered for sale by other persons in interstate or foreign commerce. The business arrangements entered into by the industry member and the third party may consist of such things as sponsoring radio or television broadcasting, paying for advertising, or providing other services or things of value."

Similarly for tied-house, the use of third party retailer promotion entities has been the subject of recent TTB activity. In this regard, 27 CFR 6.42, Indirect inducements through third party arrangements, of the regulations, states:

> "(a) *General.* The furnishing, giving, renting, lending, or selling of equipment, fixtures, signs, supplies, money, services, or other thing of value by an industry member to a third party, where the benefits resulting from such things of value flow to individual retailers, is the indirect furnishing of a thing of value within the meaning of the Act. Indirect furnishing of a thing of value includes, but is not limited to, making payments for advertising to a retailer association or a display company where the resulting benefits flow to individual retailers.
> "(b) *Exceptions.* An indirect inducement will not arise where the thing of value was furnished to a retailer by the third party without the knowledge or intent of the industry member, or the industry member did not reasonably foresee that the thing of value would have been furnished to a retailer. Things which may lawfully be furnished, given, rented, lent, or sold by industry members to retailers under subpart D may also be furnished directly by a third party to a retailer."

In the tied-house regulation, you see that subsection (b) allows an industry member to utilize a third party to furnish, give, rent, loan, or sell anything of value allowed under the tied-house regulatory exceptions to a retailer that the industry member could have done so directly. However, this subsection does not apply to a situation where the industry member's conduct is a subterfuge for an arrangement that otherwise violates the unfair trade practice provisions. In 2011, TTB took administrative action against several industry members for a promotional arrangement whereby industry members funded a third party promotional company that a retailer could obtain things of value allowed under the regulatory exception. TTB found the arrangement a violation because it was conditioned on the retailer giving preferred shelf space to the industry members that was an unlawful slotting fee. Industry Circular 2012-01 (January 11, 2012), Guidance Regarding Industry Members Participation in Retailer Programs, contains a detailed explanation on how industry members may utilize these third party arrangement without violating the unfair trade practice provisions.

Similar State Law

(Section 205(f) and Sections 6.4(b), 8.4(b), 10.4(b), and 11.4(b))

It is imperative that you are aware of and understand the trade practice laws of the state(s) where you do business. Forty-eight states have broadly defined laws prohibiting suppliers and distributors from providing things of value to retailers. Not only do the states have significant jurisdiction over the regulation of alcohol beverages for which they have trade practice regulations, the similar state law requirement under the FAA Act that applies only to malt beverages/beer is a threshold of federal trade practice enforcement here. The lack of a similar state law is often dispositive in resolving whether there is a FAA Act violation.

In the case of malt beverages, the four federal unfair trade practices apply to transactions between a retailer (or trade buyer in commercial bribery) and a brewer, importer, or wholesaler inside or outside such state only to the extent that the laws of such state impose requirement similar to the requirements of section 205(a) through (d). This provision is the result of a debate and compromise between the House of Representatives and the Senate in 1935, on whether the brewing industry (given its then very localized presence rather than a nationwide presence) should be covered by the FAA Act. The same debate and compromise is the reason why brewers are not required to obtain basic permits.

TTB has not compiled a list of similar state laws. Similar means similar; it does not mean the same or identical law. While many states have adopted the provisions of the federal unfair trade practice provisions under the FAA Act, a state law is still similar even if it uses different wording. TTB broadly interprets the standard of similar. The state law does not have to be an alcohol-based law; it may be a consumer protection or state unfair competition law. Also, some states explicitly permit items under state law which may conflict with the federal prohibition, in that case the state law for beer prevails. As you consider whether a practice violates the FAAA, ask yourself, is there any state law under which the state could take action based on this set of facts?

Exclusive Outlet (Section 205(a))

This provision makes it unlawful for an industry member to require, by agreement or otherwise, that a retailer purchase its products to the exclusion, in whole or in part, of those offered by another industry member in interstate or foreign commerce. (Exclusion is discussed in more detail later.) The key focus is on a requirement existing between the industry member and retailer. Express and implied requirements are covered. The requirement need not be in writing and can be a verbal understanding between the two parties. Sometimes it is referred to as a “wink and a nod” and other times as a handshake agreement. Alternatively, it may be the result, directly or indirectly, of a threat or act of physical or economic harm by the selling industry member. (27 CFR 8.52(a))

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 is an exclusive outlet arrangement. (27 CFR 8.22) Examples include:

- An advertising contract between an industry member and a retailer with the express or implied requirement of the purchase of the advertiser's products.

- A sales contract awarded on a competitive bid basis which has the effect of prohibiting the retailer from purchasing from other industry members by either requiring that for the period of the agreement, the retailer purchase a product or line of products exclusively from the industry member OR requiring that the retailer purchase a specific or minimum quantity during the period of the agreement.

Voluntary industry member-retailer purchase agreements, as shown above, are encompassed by the exclusive outlet prohibition. (T.D. ATF-74, 45 Federal Register 63242, 63250 (September 23, 1980))

The regulations do allow a supply contract for one year or less between the industry member and a retailer under which the industry member agrees to sell products to the retailer on an as needed basis provided that the retailer is not required to purchase any minimum quantity of product. (27 CFR 8.53)

Finally, the exclusive outlet conduct must meet one of three interstate or foreign commerce impacts: (1) the exclusive outlet requirement is made in the course of interstate or foreign commerce; (2) the industry member engages in the practice of using the requirement to such an extent as substantially to restrain transactions in interest or foreign commerce in any such products; or (3) the direct effect of the requirement is to prevent, deter, hinder, or restrict other persons from selling or offering for sale any such products to such retailer in interstate or foreign commerce. The interstate or foreign commerce impact is generally easy to establish. See, *Fedway Associates, Inc. v. ATF*, 976 F.2d 1416, 1424 (DC Cir. 1992).

Tied-house (Section 205(b))

Tied-house practices are probably the most common violations found at both the federal and state levels in trade practices. A tied-house describes the relationship where the supplier or distributor tiers offer something of value or holds an interest that is used to gain control over the retailer. Tied-house laws and regulations keep industry member tiers separate and independent from the retailer tier.

Section 205(b)(1)-(7) on tied-house arrangements enumerates seven types of means to induce a retailer by an industry member that are prohibited (assuming all of the other statutory elements of a violation are proven such as exclusion and interstate or foreign commerce). These statutory means to induce are:

1. Any interest in a license with respect to the premises of a retailer (but complete ownership is not prohibited, section 6.27);
2. Any interest in real or personal property owned, occupied or used by the retailer in the conduct of its business (but complete ownership is not prohibited, section 6.33) ;

3. Furnishing, giving, renting, lending, or selling to the retailer any equipment, fixtures, signs, supplies, money, services, or other things of value SUBJECT to regulatory exceptions issued by TTB (See Subpart D of 27 CFR Part 6);
4. Paying or crediting the retailer for any advertising, display, or distribution service;
5. Guaranteeing any loan or repayment of a financial obligation of the retailer;
6. Extending credit to the retailer for a period in excess of the credit usual and customary in the industry as ascertained in TTB regulations (27 CFR 6.65 (30 days)); or
7. Requiring the retailer to take and dispose of a certain quota of products.

Section 205(b)(3) is a huge pitfall for beer distributors' activities because of its breadth and the narrow manner in which TTB applies the regulatory exceptions. It covers equipment, fixtures, signs, supplies, money, services, or other things of value so there is virtually nothing that a distributor can provide to a retailer either directly or indirectly without consideration of this subsection. For example, free warehousing or providing assistance to a retailer in acquiring a license are services and things of value. (27 CFR 6.44 and 6.45) However, TTB is authorized to provide regulatory exceptions based on considerations of "public health, the quantity and value of articles involved, established trade customs not contrary to the public interest and the purposes of the [tied-house] subsection."

The exceptions are contained in Subpart D of 27 CFR Part 6 and cover product displays, point of sale advertising material and consumer advertising specialties, temporary retailers, equipment and supplies, newspaper cuts, combination packaging, educational seminars, consumer tastings or samplings at retailer establishments, consumer promotions (coupons), advertising service, stocking, rotation and pricing services, participation in retailer associations, merchandise, and outside signs. The specific regulatory exception may contain conditions (such as dollar or per brand limitations) that restrict its application so you should read the regulations carefully. Also, recordkeeping requirements apply to some exceptions and the failure to keep the records removes your eligibility for the exception. (27 CFR 6.81(b)) The Subpart D exceptions only apply to section 205(b)(3) conduct and not to conduct proscribed under sections 205(a), (b)(1), (2), (4)-(7), (c), and (d).

TTB applies the exceptions very literally and according to its "plain language" as was evident in TTB Ruling 2016-2 (February 11, 2016), "The Shelf Plan and Shelf Schematic Exception to the 'Tied House' Prohibition, and Activities Outside Such Exception" and subsequent Frequently Asked Questions about the ruling. One of the regulatory exceptions allows industry members to provide "a recommended shelf plan or shelf schematic for distilled spirits, wine, or malt beverages" to a retailer. (27 CFR 6.99(b)) TTB made it very clear that additional services such as those the industry has called category management or category captains are not within the plain language of the regulatory exception. Industry members must not read more into the text of the exception than is there. For example, the consumer promotion exception (27 CFR 6.96) allows coupons and direct offerings to consumers. The exception covers the "act by an industry member of furnishing to consumer coupons which are redeemable at a retailer establishment" under certain conditions. TTB only applies this exception where the industry member furnishes the coupon to the consumer and not where the industry member furnishes the coupon to the retailer who, in turn, furnishes it to the consumer.

The “pay to play” scenario has been investigated by TTB as a “slotting fee” that is a means to induced under section 205(b)(4) as paying or crediting the retailer for displays. In 2011, TTB collected a total of $1.9 million in offers in compromise for the allegations of tied-house violations stem from the companies’ participation in the 2008-2009 Harrah’s Nationwide Beverage Program. The TTB investigation, which focused on activities in the Las Vegas area, alleged that the companies collectively furnished nearly $2 million in inducements through a third party to Harrah’s Entertainment’s hotel and casino subsidiary corporations during the two year period of the program. TTB alleged that the purpose of these inducements was to obtain preferential product display and shelf space (also known as slotting fees) at Harrah’s Hotels and Casinos. In its press release, TTB explained that the payment of slotting fees by an alcohol beverage supplier to an alcohol beverage retailer is an unlawful marketing inducement which creates an artificial barrier to open and fair competition especially for small to medium-sized companies that cannot pay such fees.

Finally, the means to induce in the tied-house practice must meet one of three interstate or foreign commerce impacts: (1) the inducement is made in the course of interstate or foreign commerce; (2) the industry member engages in the practice of using such means, or any of them, to such an extent as substantially to restrain transactions in interest or foreign commerce in any such products; or (3) the direct effect of such inducement is to prevent, deter, hinder, or restrict other persons from selling or offering for sale any such products to such retailer in interstate or foreign commerce. The interstate or foreign commerce impact is generally easy to establish. See, *Fedway Associates, Inc. v. ATF*, 976 F.2d 1416, 1424 (DC Cir. 1992).

Commercial Bribery (Section 205(c))

This provision makes it unlawful for an industry member to induce a “trade buyer” to purchase its products through one of two types of commercial bribery (assuming all of the other statutory elements of a violation are proven such as exclusion and interstate or foreign commerce). A trade buyer is a wholesaler or retailer. (27 USC 211(a)(3)) The two means to induce are (1) commercial bribery and (2) offering or giving any bonus, premium, or compensation to any officer, or employee or representative of the trade buyer. Commercial bribery as the means to induce means a secret payment to employee(s) of the trade buyer without the knowledge or consent of the trade buyer-employer in return for the employee(s) agreeing to order products from the industry member. (27 CFR 10.51)

The second means to induce is the more general scenario of the industry member providing a bonus, premium or other compensation to an employee, officer, or representative of the trade buyer. “Officers” mean all corporate executives including presidents, vice presidents, treasurers, and chief executive officers. (27 CFR 10.11) Commonly this type of trade practice arises in sales promotion contests sponsored by an industry member which offer prizes directly or indirectly to officers, employees, or representatives of the trade buyer. (27 CFR 10.24) While these are not *per se* violations because exclusion needs to be shown, these types of contests may attract TTB scrutiny. Importantly, the commercial bribery provision applies only to conduct involving individuals associated with the trade buyer and not the trade buyer as a business entity itself. For that reason, an industry member may offer or give money or other things of value to the wholesaler entity provided certain conditions are met to ensure the entity is not a mere conduit to pass the money or things of value along to the employees. (This does not apply to trade buyers who are retailers because the tied-house provisions apply to these transactions.) (27 CFR 10.23)

Finally, the means to induce in the commercial practice must meet one of three interstate or foreign commerce impacts: (1) the inducement is made in the course of interstate or foreign commerce; (2) the industry member engages in the practice of using such means, or any of them, to such an extent as substantially to restrain transactions in interest or foreign commerce in any such products; or (3) the direct effect of such inducement is to prevent, deter, hinder, or restrict other persons from selling or offering for sale any such products to such trade buyer in interstate or foreign commerce. The interstate or foreign commerce impact is generally easy to establish. See, *Fedway Associates, Inc. v. ATF*, 976 F.2d 1416, 1424 (DC Cir. 1992).

Consignment Sales (Section 205(d))

Consignment sales activity has recently been investigated by TTB in the malt beverage/beer industry. Two large offers in compromise were accepted from major brewers in 2015-16, for these alleged violations. TTB could have pursed administrative sanctions against the wholesalers but one brewer included the wholesalers within the scope of the offers in compromise. However, TTB could have declined to allow this and may pursue wholesalers in the future.

Among the unfair trade practices, consignment sales are easier matters for TTB to pursue because the statutory element of exclusion is not required. Additionally, the first interstate commerce jurisdictional clause is frequently met because the offer, sale or contract was made in the course of interstate commerce through use of telephones, emails, fax machines, U.S. postal service, and other forms of interstate communications. Use of "electronic communications, to include emails and transmissions of promotional documents" were cited by TTB in one of the offers in compromise noted above.

It is unlawful for an industry member to sell, offer for sale, or contract to sell OR for a trade buyer (that is, a wholesaler or retailer) to purchase, offer to purchase, or contract to purchase on:

- Consignment (27 CFR 11.22)
- Conditional sale
- With the privilege of return
- Other than a bona fide sale
- Where any part of the transaction involves, directly or indirectly, the acquisition by such person from the trade buyer or agreement to acquire from the trade buyer other products

Any one of these five types of agreements at the time of the offer or sale or contracting can trigger the application of the consignment sales provision. However, the FAA Act authorizes TTB to issue regulations providing exceptions for returns (for cash or credit against outstanding indebtedness) or exchanges for "ordinary and usual commercial reasons. TTB regulations identify reasons that are ordinary and usual and several reasons that are not ordinary and usual commercial reasons.

Ordinary and Usual Commercial Reasons (27 CFR 11.32 – 11.39)

- Defective Products (Exchange or return for cash or credit against outstanding indebtedness) TTB Ruling 2012-4 (November 19, 2012) Freshness Dating and Allowable Returns of Malt Beverages under the FAA Act applies this regulation to the conditions when product is considered defective due to the freshness date
- Error in Product Delivered (Exchange or return for cash or credit against outstanding indebtedness)
- Products Which May No Longer Be Lawfully Sold (Return for cash or credit against outstanding indebtedness)
- Termination of Business But Not a Temporary Seasonal Shutdown (Return for cash or credit against outstanding indebtedness)
- Termination of Franchise (Return for cash or credit against outstanding indebtedness)
- Change in Product (Exchange for equal quantity of new version of the product)
- Discontinued Products (Return for cash or credit against outstanding indebtedness)
- Seasonal Retail Dealers (Products likely to spoil during off season may be returned for cash or credit against outstanding indebtedness)

Reasons NOT Considered Ordinary and Usual

- Overstocked and Slow Moving Products
- Seasonal Products (such as holiday decanters and certain distinctive bottles)

Apart from the allowed exchanges above, while the exchange of one product for another is prohibited as a sale transaction conditioned on the acquisition of another product, the exchange of a product for equal quantities (case for case) of the same type and brand of product, in containers of another size is not considered an acquisition of "other" products and is not prohibited if there was no direct or implied privilege of return extended when the product was originally sold. Industry members may make price adjustments on product eligible for exchange in this situation. (27 CFR 11.23)

Because wholesalers are in the middle between suppliers and retailers, they potentially have great exposure to consignment sales violations because of their purchases from suppliers and their offers, sales, and contracts with retailers. If a supplier pressures a distributor to purchase on a consignment sales basis from the brewer and re-sell on a consignment sale basis to a retailer, the distributor could face TTB alleging two charges of a consignment sales violation.

Finally, the consignment sales transaction must meet one of three interstate or foreign commerce impacts: (1) the sale, purchase, offer, or contract is made in the course of interstate or foreign commerce; (2) the industry member or trade buyer engages in such practice to such an extent as substantially to restrain transactions in interest or foreign commerce in any such products; or (3) the direct effect of such sale, purchase, offer, or contract is to prevent, deter, hinder, or restrict other persons from selling or offering for sale any such products to such trade buyer in interstate or foreign commerce. As noted above, TTB considers the use of certain electronic communications to come within the scope of the first jurisdictional clause.

Exclusion

A unique feature of the federal unfair trade practices of exclusive outlet, tied-house, and commercial bribery is the statutory element of exclusion under which TTB must establish that the practice result in the retailer or trade buyer "purchas(ing) any such products from [the industry member] to the exclusion, in whole or in part, of distilled spirits, wine, or malt beverages sold or offered for sale by others in interstate or foreign commerce." For example, exclusion "in part" in an exclusive outlet arrangement occurs where a retailer is required to buy all of its draft beer from one industry member and still purchases bottled beer from other industry members.

Exclusion is a two-step analysis under the TTB regulations (27 CFR 6.151, 8.51 and 10.51):

- When a practice by an industry member, whether direct, indirect, or through an affiliate, places (or has the potential to place) retailer ["trade buyer" in the case of commercial bribery] independence at risk by means of a tie or link between the industry member and retailer [trade buyer] or by any other means of industry control over the retailer [trade buyer]; AND
- Such practice results in the retailer [trade buyer] purchasing less than it would have of a competitor's product

In an effort to make the exclusion element manageable, TTB has regulations that identify practices that put retailer independence at risk. For tied-house, these are: resettling stock on a retailer's premises (other than your own products); slotting allowance; using less than a 100 percent ownership interest in a retailer to influence the retailer's purchases; or requiring a retailer to purchase one product in order to purchase another at the same time ("tie-in sale") (27 CFR 6.152). For commercial bribery, this is a payment to a trade buyer employee without the knowledge or consent of the trade buyer-employer in return for the employee agreeing to purchase that industry member's products. (27 CFR 10.52) In both of these cases, TTB also has to prove the second step that the retailer or trade buyer purchased less of a competitor's product. Note that for exclusive outlets, however, the regulations provide that certain practices result in exclusion. (27 CFR 8.52) These two practices are: (1) purchases of products by a retailer as a result, directly or indirectly, of a threat of an act of physical or economic harm or (2) a contract expressly restricting the retailer from purchasing, in whole or in part, such products from another industry member. Thus, for exclusive outlet, either of these situations meets both exclusion parts.

Similarly, the regulations identify practices that do not place retailer (or trade buyer in commercial bribery) independence at risk or result in exclusion. For tied house, these are the Subpart D exceptions. None are included in the commercial bribery regulations. (27 CFR 10.53) For exclusive outlets, a supply contract (for one year or less) as "as needed" basis by a retailer that does not require any minimum quantity of purchase is identified. (27 CFR 8.53)

For all other practices, TTB has identified six criteria it will apply to determine whether retailer (or trade buyer in commercial bribery) independence is put at risk. Not all need be present for TTB to conclude that a practice places such retailer or trade buyer independence at risk. These factors are (27 CFR 6.154, 8.154 and 10.54):

- The practice restricts or hampers the free economic choice of a retailer [trade buyer] to decide which products to purchase or the quantity in which to purchase them for sale to consumers.
- The industry member obligates the retailer [trade buyer] to participate in the promotion to obtain the industry member's product.
- The retailer [trade buyer] has a continuing obligation to purchase or otherwise promote the industry member's product.
- The retailer [trade buyer] has a commitment not to terminate its relationship with the industry member with respect to purchase of the industry member's products.
- The practice involves the industry member in the day-to-day operations of the retailer [trade buyer]. For example, the industry member controls the retailer's [trade buyer's] decisions on which brand of products to purchase, the pricing of products, or the manner in which the products will be displayed on the retailer's [trade buyer's] premises.
- The practice is discriminatory in that it is not offered to all retailers [trade buyers] in the local market on the same terms without business reasons present to justify the difference in treatment.

Unfortunately, due to the uncertainty about exclusion resulting from a specific trade practice, TTB is frequently not able to give advice to an industry member on whether a prospective promotional practice will result in a violation. For this reason, distributors should carefully adhere to the strict interpretation of the Subpart D regulations and other published guidance from TTB.

Pricing Arrangements

Pricing arrangements are generally outside the scope of regulation under the FAA Act. (Industry Circular 81-2, January 20, 1981.) Guidance on pricing arrangements is not contained in the TTB regulations but in administrative rulings and industry circulars. Rev. Rul. 54-161 provides, in pertinent part, as follows:

> "Price reductions, rebates, refunds, and discounts given by a wholesale liquor dealer to a retail liquor dealer pursuant to an agreement made at the time of the sale of the merchandise involved are considered a part of the sales transaction, constituting reductions in price pursuant to the terms of the sale. Such transactions do not fall within the purview of section 5(b) of the Federal Alcohol Administration Act, provided they do not involve the imposition of any requirement upon the retailer to take and dispose of a certain quota of the wholesale dealer's products, or do not involve any of the other practices set forth in section 5(a) to 5(d), inclusive, of the Act. This view would hold irrespective of whether the quantity discount was prorated and allowed on each delivery, given in a lump sum after the entire quantity of merchandise purchased had been delivered, or based on dollar volume or on the quantity of merchandise purchased."

When the discount is given in goods, such as one free case for every 10 cases purchased, the "free goods" may be dissimilar alcohol beverages. (ATF Ruling 83-3)

Cumulative discounts are a pricing arrangement under certain conditions. (Industry Circular 82-12, November 11, 1982, Question 17) However, a depletion allowance to a retailer is not a pricing arrangement but a thing of value under the tied-house provisions. (Industry Circular 87-2, April 13, 1987)

Conclusion

Compliance starts and ends with you. You are to be commended for making a great start by reading this guide and educating yourself on the federal requirements. Unlike many of the more clear-cut state unfair trade practice restrictions that your state associations can help you understand, the federal laws and regulations are more complicated. It is easier to make a mistake and inadvertently commit a federal violation. The information in this guide will help you to avoid participating in promotional practices that are unfair trade practices and, thereby, face penalties or suspension or revocation of your basic permit, the payment of offers in compromise to TTB, or even civil injunctions or criminal prosecutions. Make sure your industry partners are taking their responsibilities seriously and ask for them to provide assurances of compliance with trade practice laws in your partnerships. Finally, know your state laws and regulations. For malt beverages/beer, the similar state law requirement under the FAA Act makes state law and regulations the threshold of determining whether the conduct prohibited under the federal unfair trade practices is an actionable violation for TTB enforcement. But remember, TTB takes a broad view of what is similar state law. By following the unfair trade practice rules, you are contributing to a level playing field among industry members and are doing your part to build a solid reputation as a socially responsible member of your community in the sale, distribution, and fair promotion of alcohol beverages.

Resources

Legislative History of the Federal Alcohol Administration Act published in 1935
https://archive.org/details/legislativehisto00unit

Questions and Answers on Unlawful Trade Practices under the Federal Alcohol Administration Act, ATF Industry Circular 82-12
https://www.ttb.gov/industry_circulars/archives/1982/82-12.html

Freshness Dating and Allowable Returns: TTB Ruling 2012-4
https://www.ttb.gov/rulings/2012-4.pdf

The Shelf Plan and Shelf Schematic Exception to the “Tied House” Prohibition, and Activities outside Such Exception. TTB Ruling 2016-1
https://www.ttb.gov/rulings/2016-1.pdf

TTB Information on Trade Practices
https://ttb.gov/trade_practices/index.shtml

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