McDermott
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Tied-house Law Update
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October 4, 2018

Roadmap

- Federal trade practice law primer
- Recent legal developments
- Pending federal investigations
- State trade practice law primer
- Recent legal developments

Federal Trade Practice Law

- Source – 27 U.S.C. § 205(a)-(d)
- **Exclusive outlet**
  - Exclusion is the violation
  - Retailers only
- **Tied house**
  - Inducement plus exclusion
  - Retailers only
- **Commercial bribery**
  - Inducement plus exclusion
  - "Trade buyers" not "retailers" (*i.e.*, can apply to supplier-wholesaler relations in addition to supplier/ wholesaler-retailer relations)
- **Consignment sale**
  - No exclusion required
  - Trade buyers

Federal Trade Practice Law

- Theoretical criminal and injunctive remedies
  - But TTB faces the challenge of persuading a busy Assistant Attorney General to take on an FAA Act case
  - Injunctive relief authorized only to "prevent and restrain" future violations
- So, TTB generally must enforce through a "**show cause**" action to suspend or revoke a basic permit
  - 2-strike system – suspension only for a first offense
  - TTB must show any violation was "**willful**"
  - Brewers and retailers do not hold basic permits
- Don't forget the "**penultimate clause**" – a reverse preemption rule for "malt beverages" only

Federal Trade Practice Law

- For the past 25 years, exclusion has bedeviled the enforcement aspirations of TTB and its predecessor (ATF)
- Until the ***Foremost*** (7th Circuit, 1988) and ***Fedway*** (D.C. Circuit, 1992) decisions, ATF asserted that a theoretical purchase of one bottle less of a competing product just one time satisfied the exclusion requirement
- *Foremost* and *Fedway* require the government to show that an activity in question placed or had the potential to <u>place retailer independence at risk</u>
- ATF finalized new regulations in 1995 in response to these decisions

Federal Trade Practice Primer

- Successful federal enforcement action also face a number of other potential hurdles
  - TTB's **subpoena authority is uncertain**, with one Circuit (the Third) holding that Congress did not authorize investigative subpoenas when enacting the FAA Act
  - As the FAA Act requires "**interstate commerce**", and TTB has traditionally adhered to the understanding of that term at the time Congress enacted the Act (1935), an interstate commerce defense might be plausible in a case where activities occurred solely within a single state
  - Rise and continued expansion of **First Amendment protection of "commercial speech"** implicates a number of federal (and state) tied house regulations and concepts (*e.g.*, restrictions on an industry member paying for retailer advertising)

Recent Developments

- TTB has developed strategies, untested by the courts to date, to manage the *Foremost* and *Fedway* requirement that a practice threatens retailer independence
- 1995 rulemaking identified certain practices as *per se* threats to retailer independence, notably including "**slotting fees**"
  - By defining practices as *per se* threats, TTB attempted to avoid the need to make a *factual showing* that a practice threatens or has the potential to threaten retailer independence
  - TTB today accordingly labels virtually any "thing of value" as a "slotting fee"
- Federal regulations (today the **"Subpart D" exceptions**) have long identified some practices as not constituting "inducements"
  - But beginning with the Harrah's investigation in 2010, and as suggested in *Industry Circular* 2012-1, TTB may not view these practices as "safe harbors" if coupled with an (alleged) understanding that the provided items will secure a placement, program acceptance, etc.

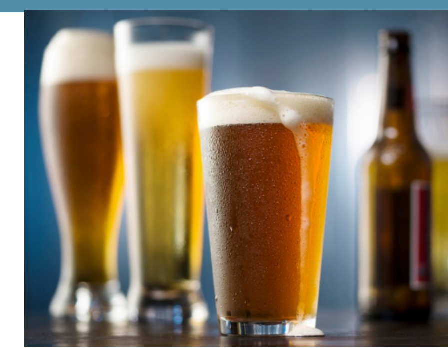
Recent Developments

- *TTB Ruling* 2016-1 on category management
- A nascent ATF investigation of proto-category management practices using software to create sophisticated (for the early 1990s) shelf schematics led to an industry-supported regulation identifying schematics as "Subpart D" exceptions (*i.e.*, not inducements and therefore within the "safe harbor)
- For almost **20** years, the industry viewed the schematics exception as authorizing modern category management practices

Recent Developments

- Then in late 2015, an Kroger/Southern Wine & Spirits program to create a “planogram center of excellence” drew near-universal condemnation and spurred TTB to action
- The resulting ruling, *TTB Ruling* 2016-1, identifies as an “inducement” almost any activity besides giving a schematic to a retailer, including
  - Processing a retailer’s data
  - Providing a retailer with information purchased by the industry member from any source (*e.g.*, Nielsen, IRI)
  - Updating a schematic once it’s provided
- In “clarifying” correspondence with the Wine Institute, TTB took the remarkable position that any sales pitch has the potential to put a retailer’s independence at risk

Recent Developments



- More recently, prompted by a letter from the National Beer Wholesalers Association (NBWA), TTB has breathed life into the application of its commercial bribery regulations to relations between brewers and beer importers and their wholesalers
- But:
  - How many states' laws place any restriction on supplier-tier entities providing a "thing of value" to wholesales?
  - Aside from the very largest suppliers, how can the activity of almost any brewer or importer jeopardize the independence of today's large, multi-million case beer wholesalers?

Recent and Pending Investigations

- **Craft Brewers Guild** (a wholesaler) settlement (announced Nov. 2016) – Wholesaler paid TTB **$750,000** to settle tied-house investigation alleging that wholesaler paid Massachusetts retailers for tap placements; TTB investigation followed a Mass. ABCC investigation
- **Warsteiner Importers** settlement (announced June 2018) – Beer importer paid TTB **$900,000** to settle alleged exclusive outlet, tied house, commercial bribery and consignment sales violations
- **Modus Operandi** winery settlement (announced August 2018) – Winery accepted a **one-day permit suspension** to settle consignment sale allegations; reportedly based on sales to a single New York wholesaler
- **Skokie Valley Beverage** (announced Sept. 2018) – Wholesaler **threatened with criminal prosecution** due to failure to report a prior ownership change

Recent and Pending Investigations

- **Miami-area investigation** with the Florida DABT
  - Focused (but not exclusively) on malt beverages
  - Focused exclusively on industry member activities with on premise retailers
  - Possibly the result of a complaint by a major beer wholesaler
  - No settlement or enforcement action announced yet as a direct result of the investigation
- **Chicago-area investigation** with the Illinois LCC
  - Same focuses as Miami-area investigation
  - Led to the Skokie Valley announcement (*see* prior slide)
  - No actual settlement or enforcement proceeding yet as a direct result of the investigation

Recent and Pending Investigations

- **Napa/Sonoma-area investigation**
  - Seems focused on winery consignment sales to a single New York wholesaler
  - Appears to involve smaller wine companies, not major industry players
  - Resulted in Modus Operandi settlement and agreement to take a one-day suspension (*see* prior slide)
- **Arena and stadium investigation**
  - Both Miami and Chicago investigations have involved at least one large sports/entertainment venue
  - Subpoenas directed at several Nashville, TN-area sports and entertainment venues
  - Subpoenas also directed at several Dallas, TX-area venues
  - No settlement or enforcement action announced yet as a direct result of these investigation(s)

State Trade Practice Law Primer

- Almost all states' have enacted one or more "tied house" statutes generally prohibiting – like federal law – the provision of money, free goods, or other "**things of value**" to retailers, subject to specific exceptions
  - A few exceptional jurisdiction exist, notably including Nevada, where suppliers face no state law "thing of value" prohibitions
- Most states' tied house prohibitions also feature cross-ownership (*e.g.*, "**prohibited interest**") restrictions that are much more restrictive than federal restrictions
  - This talk focuses on the "thing of value" and other trade practice activity prong of the tied house laws

State Trade Practice Law Primer

State law typically includes other substantial departures from federal trade practice law

- **First**, few states' laws require a showing of "exclusion" or other real-world impact – the "thing of value" itself creates the violation
- **Second**, few states have a separate "commercial bribery" restriction, but achieve the same effect by either naming retail officer's, employees, etc. in the tied-house prohibition or through the "directly or indirectly" restriction
- **Third**, a number of states do not have a separate "consignment sale" prohibition
- **Fourth**, a few states, but notably including California, impose restrictions on promotional activities with any persons (*e.g.*, restrictions on gifts and "things of value" to consumers)

State Trade Practice Law Primer

- Dealing with states also can present substantial challenges
  - Many states' laws lack clarity about exceptions to the tied-house laws and similar permutations (*e.g.*, under what conditions can wholesaler take back product under a state's consignment sale provision)
  - In many states, gaps between the "black letter" of the law and the interpretive gloss given to the tied-house laws by decades of interpretive and enforcement discretion
    - The plethora of "bottom drawer" interpretations allows regulators to shift their positions based on changing political winds
  - In many states, gaps between the law, as written or interpreted, and the actual enforcement climate of the state

State Trade Practice Law Primer

- And states face limitations imposed by the **“dormant” Commerce Clause** of the Constitution – restraints not present under federal law
  - **Facially-discriminatory laws** are virtually *per se* unconstitutional (at least as applied to producers and products)
  - Laws that **discriminate in intent or effect**, or that **unreasonably burden interstate commerce**, are also subject to challenge
- State laws that have the **practical effect of regulating conduct outside the state’s borders** are also unconstitutional under federal law
- Federal preemption is rare in the alcohol beverage field

Recent Legal Developments

- **First Amendment** challenges have encountered mixed results
  - ***Retail Digital Network v. Prieto*** (9th Circuit *en banc*, 2017) – California's tied-house prohibitions on suppliers or wholesalers providing retailers with anything of value in exchange for advertising upheld (relying on *Actmedia v. Stroh*, 1986)
  - ***Missouri Broadcasters v. Lacy*** (8th Circuit, 2017) –Missouri statute and regulations prohibiting (1) advertising price discounts; (2) advertising below-cost pricing; and (3) requiring listing of multiple retailers in supplier-paid advertising (equiv. to TTB "retailer advertising services" regulation), potentially unconstitutional under the First Amendment
    - On remand, District Court (in June 2018) enjoined enforcement of the statutes and regulations at issue
  - ***Texas ABC v. Mark Anthony Brewing*** (Tex. Ct. App., 2017) – Texas' ban on private-label malt beverages does not violate First Amendment because underlying conduct – a trademark licensing agreement between a supplier and a retailer – is illegal and thus not protected under the First Amendment

Recent Legal Developments

- **The next wave of Constitutional litigation** may come from cases involving state laws that either explicitly, or by interpretation, applying to conduct occurring outside the state's borders
  - Two Supreme Court cases from the 1980s – *Healy v. Beer Institute* (1989) and *Brown-Forman v. New York State Liquor Authority* – stand for the proposition that a state cannot regulate in ways that have the practical effect of regulating conduct outside the state's borders
  - In New York, shipper Empire Wine has challenged the State Liquor Authority's ability to take enforcement action against the shipper due to shipments allegedly in violation of the laws of other states

Recent Legal Developments

- **August Busch & Co. of Mass.** decision (April 2018) – Wholesaler (wholly-owned by Anheuser-Busch) **did not violate Mass. tied house law** by supporting brewer's activities in installing nearly $1 million worth of coolers at Massachusetts retailers
- **Southern Glazer's Wine & Spirits** settlement (announced Dec. 2017) – Wholesaler paid New York SLA **$3.5 million** and agreed to an aggressive compliance program to settle allegations of widespread trade practice violations, including "credit card" swipes, discriminatory sales, and improper record keeping
- **American Eagle Distributing** fine (May 2017) – Wholesaler (wholly-owned by Anheuser-Busch) fined $5,000 to avoid 14-day suspension of Colorado licenses arising from "unfair trade practices"

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Questions for Marc?

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Doc #155272367

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