WINE & SPIRITS
WHOLESALERS
OF AMERICA

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August 18, 2021

Ms. Amy Greenberg
Director, Regulations and Rulings Division
Alcohol and Tobacco Tax and Trade Bureau
1310 G Street NW, Box 12, Washington, DC 20005

Re: Federal Register No. 2021-16115, Document ID TTB-2021-0007-0001 Notice No. 204: Request for Information to solicit input regarding the current market structure and conditions of competition in the American markets for beer, wine, and spirits, including an assessment of any threats to competition and barriers to new entrants.

Dear Ms. Greenberg,

Thank you for the opportunity to provide commentary on the U.S. Alcohol and Tobacco Tax and Trade Bureau's (TTB's) request for information (Notice No. 204) dated July 28, 2021.

Wine & Spirits Wholesalers of America (WSWA) is the national trade association representing the wholesale tier of the wine and spirits industry. Founded in 1943, WSWA represents more than 350 companies – large and small – in all 50 states and the District of Columbia that hold federal permits and state licenses to act as wine and/or spirits distributors and/or brokers. WSWA members represent a part of the thousands of wholesalers operating in the U.S. today.

The U.S. enjoys a unique history with alcohol, which has led to a thoughtful legal and regulatory system of oversight. While the details are significant, equally important to consider is the big picture: our unique alcohol system helped create the most dynamic alcohol marketplace in the world. There are more brands from more companies and countries on more retail shelves than in any other country. Even though some brands are much more popular than others, no handful of brands dominate the alcohol market. Instead, the U.S. leads in innovative new alcohol brands, and entrepreneurs are drawn to this industry consistently every year. Moreover, there are few regulatory barriers to becoming an alcohol producer, wholesaler, or retailer. While improvements can be made, it is hard to point to another food or beverage category that enjoys the diversity of companies, products (both new and existing), and brands that we have in alcohol.

I. The Alcohol Marketplace is a Success Story

Why and How the U.S. has the Most Dynamic Alcohol Marketplace Involving a Large Number of Companies, New Entrants, and Tremendous Product Choice

Since the end of Prohibition, most states employ a three-tier system to regulate the distribution and sale of wine, beer, and spirits. Although not all states have adopted identical legal structures, the three-tier system generally separates and regulates the production, wholesale (distribution), and retail levels of the alcohol supply chain. While the 21st Amendment gave states the primary authority to govern alcohol transported or imported within their respective state's borders, the federal government, namely TTB, regulates interstate commerce of alcohol through the Federal Alcohol Administration (FAA) Act, which also acknowledges this supply-chain system of manufacturers, wholesalers, and retailers. The FAA Act essentially only governs the first two tiers of the industry (i.e., producers and wholesalers).

The origins of the three-tier system have an enlightening history. In a prior era, which was relatively free of regulations, alcohol producers owned their own distribution channels and leveraged enormous power over retailers—so much so that retailers were tied to certain producers and blocked from selling other producers' alcohol brands. This relationship became known as a "tied house." The system overwhelmingly benefitted producers with deep pockets that could provide enough incentive to retailers to exclude other companies' (new or existing) brands. This system where retailers were tied to producers led to a host of problems: cheap alcohol, aggressive business practices, and overconsumption, which in turn, caused grave social problems: alcoholism, less productive workers, and domestic violence. Without meaningful regulations or enforcement, society devolved until Americans believed that banning alcohol was the best solution, ushering in Prohibition.

Of course, prohibiting the sale of alcohol did not work. People kept drinking alcohol in secret, and lawlessness flourished. So, with this history in mind, under the 21st Amendment many states separated alcohol producers from retailers by inserting wholesalers into the supply chain to promote a more transparent and competitive market. Not only would there be more businesses involved, which leads to more employment (approximately 1.1 million jobs in the alcohol industry)[1] but also one tier of the system would *not* have outsized leverage over another. An imbalance of power in any industry consistently leads to abuse within the industry, which ultimately harms consumers—and in the case of alcohol, not just financially but also their personal health and safety. The legal and regulatory system we have today is a direct response to the goals of promoting market access, transparency, and competitiveness for all companies involved, as well as limiting risk to public health and safety associated with alcohol abuse, underage consumption, and illicit products. These concerns remain relevant today.

And the system works well, balancing social responsibility with business growth. This supply-chain system of producers, wholesalers, and retailers, generally independent of one another—and all ultimately serving consumers—has created the most accessible and responsible alcohol marketplace in the world. The U.S. sports an unparalleled array of alcohol companies and products. No other country comes close to having the dynamic alcohol marketplace that exists in the U.S. We have more types of products and more brands from more companies—and at more price points—than in any other country, even considering the U.S.'s relative size. There are no retail alcohol stores in other countries that have the selection that is regularly seen in alcohol retailers across the U.S.

[1] John Dunham & Associates, Economic Impact of the Wine and Spirits Industry: 2020, prepared for the Wine & Spirits Wholesalers of America. https://www.wswa.org/data-and-impact/economic-database

Even within the U.S., compared with any other beverage categories such as soda or fruit juice, wine and spirits contain hundreds more companies entering the market each year. According to TTB, active distilled spirits permits continually increased between 14%–33% each year from 2013-2019.[2] Another source that tracks craft distillers (a subset of all distillers) reported an increase of almost 850% from 2010-2019 (i.e., 195 craft distilleries in 2010 to 1,836 in 2019).[3] Wineries also increased in the U.S. from 6,900 in 2011 to 11,053 in 2021.[4]

Our alcohol supply-chain system, including the federal and state laws and regulations it is subject to, fosters new companies and brands as evidenced by the wine and craft spirits explosion of the past decades. In the past 12 months alone, TTB approved 176,782 new labels (an increase of +0.6%) representing a large range of new products.[5] Spirits product registrations surged +112% over last year and wine product registrations grew +23%.[6] Also, the number of brands selling under 50,000 cases, generally considered small wineries and craft distillers, increased 6% from 2019 to date.[7] While improvements can and should be made, we should not lose sight that the U.S. alcohol supply-chain system provides consumers in all 50 states and the District of Columbia with an unmatched variety of products and brands from both new, up-and-coming innovative companies, as well as more established businesses at all price points. The foundational structure of the alcohol supply-chain system has and continues to create an alcohol marketplace that simply does not exist anywhere else.

How Wholesalers Help Foster Competition in the Alcohol Marketplace

There are thousands of wine and spirits wholesalers across the country, and each is an integral part of the independent alcohol distribution system. Wholesalers provide logistical services that enable wine and spirits producers of all sizes to distribute their products efficiently and more cost-effectively beyond their local area. Wholesalers also employ highly trained sales teams that help producers build their brands by connecting with, educating, and selling to the hundreds of thousands of locally licensed wine and spirits retailers. By helping local retailers efficiently get

[2] Alcohol and Tobacco Tax and Trade Bureau, Statistical Report - Distilled Spirits Permit Counts and Average Removals by Year (Sept. 8, 2020). https://www.ttb.gov/images/pdfs/foia_xls/beverage_spirits_producers_bottlers_average_taxable_removals_proof_gallons.pdf
[3] Statista, Number of operating craft distilleries in the United States from 2005 to 2019 (Sept. 24, 2020). https://www.statista.com/statistics/463435/us-number-of-operating-craft-distilleries/
[4] Wine Vines Analytics: U.S. Wineries - By State January 2021. https://winesvinesanalytics.com/statistics/winery/ (last accessed Aug. 17, 2021); ShipCompliant and Wines Vines Analytics, Direct to Consumer Wine Shipping Report (June 28, 2011).
[5] bw166, Product Approvals Report (July 2021). "The Product Approvals Report is a monthly publication providing a complete view of TTB product approvals over the preceding 24 months. The report allows readers to view overall trends . . . to identify potential areas of increasing product launches."
[6] SOVOS ShipCompliant, Spirit New Product Registrations Surge 112% Over Last Year (Aug. 11, 2021). https://www.sovos.com/shipcompliant/blog/spirit-new-product-registrations-surge-112-over-last-year/
[7] SipSource: Wine and Spirits Distributor Depletion Data (database accessed Aug. 12, 2021).

access to thousands of producers and their brands, wholesalers enable retailers to maximize their time and sales.

Wine and spirits wholesalers—primarily all family-owned businesses—employ more than 88,000 Americans in jobs[8] ranging from mixologists to importers, truck drivers, warehouse workers, sales and logistics experts, office workers, and administrative personnel—all working towards getting quality products into the retail market, from wine shop shelves to hotel bars and restaurants. Unlike other industries, many of these jobs are union jobs. It is common to see generations of families working at a wine and spirits wholesaler company.

It is easy to blame the proverbial "middleman" as an unnecessary bottleneck in the alcohol supply-chain system, but that belief does not accurately reflect business today. Independent wholesalers are an important link in getting products in front of retailers and ultimately consumers.

The alcohol system was designed to have the middleman, specifically so no tier (producers, wholesalers, nor retailers) could compel anticompetitive market leverage or outsized marketplace dominance. Without a strong independent wholesaler tier, choice and market access is restricted by large, well-capitalized producers seeking to restrict competitors' routes to market.

The alcohol distribution channel provides transparency, valuable marketing, sales, local inventory, and transportation and fulfillment services that enable producers of all sizes to meet consumer demand and grow. In addition, wholesalers are the primary link between alcohol sales and the collection of state excise taxes across the country. In 2020, wholesalers collected approximately $3 billion in state and local excise taxes.[9]

Some other advantages of an independent distribution tier include:

1. Core Competency. A producer's core competency is making products – not executing a sophisticated sales system. Using wholesalers enables a manufacturer to reduce its efforts on sales and focus its resources on manufacturing. Indeed, specialization of labor and the division of labor results in greater efficiency.

2. Market Expansion. The process of finding and selling to retailers (and ultimately to consumers) is expensive and time-consuming. Wholesalers offer producers a network of retailers in the markets they represent. A wholesaler effectively becomes an added sales and distribution arm of a producer, helping to expand market reach.

3. Administrative Savings. By using distribution, producers can sell their products more quickly because wholesalers purchase alcohol from producers and take on that inventory in their (wholesalers') warehouses. This, in turn, reduces carrying and transportation costs for producers and retailers alike. Wholesalers also handle customer service issues

[8] John Dunham & Associates, *supra* note 1.
[9] *Ibid*.

(the customers being retailers in this case), these services especially help smaller companies that simply lack the staff or capital to handle those tasks.

Wholesalers help producers of all sizes expand their businesses beyond local markets. Each distributor is locally focused (even if operating in multiple markets) and has developed business relationships with a large number of retailers (both on- and off-premise) through frequent sales visits and the weekly delivery of inventory. Producers, especially small ones, simply do not have the time to develop those relationships as the number of alcohol retailers in any given city is considerable—with many needing only a small number of bottes from a wide-variety of brands at any given time. Wholesalers leverage already established retailer relationships to help producers expand their business reach. Without independent wholesalers, large producers could use their own distribution networks to muscle out new entrants as seen in other beverage categories such as soft drinks where only two dominant players control the products accessible to consumers and new entrants are virtually non-existent.

Annually, the services wholesalers provide reduce costs to America's wine and spirits producers and retailers by $11.4 billion. Wholesalers provide goods, services, and labor that would otherwise need to be managed and performed by each producer and retailer in-house—but at a great savings due to wholesalers' economies of scale.[10]

In the alcohol industry, small producers struggling to grow sometimes cite distributor consolidation as an impediment and call for producer direct-to-consumer (DTC) access via e-commerce. As an initial matter, it is important to note that there are no federal regulations regarding producer DTC sales, rather, these sales are regulated on a state-by-state basis as empowered by the 21st Amendment.

There is no question that monopolistic market power in consumer goods industries, such as technology, healthcare, and finance, can be found in market share dominance. This market share dominance may limit access to new participants and may raise long-term consumer protection and pricing concerns. As noted above, other industries such as soft drinks, provide a compelling example of the result of significant industry consolidation and why independent distribution is vitally important. At the same time, some amount of consolidation is a natural business evolution and not *de facto* anti-competitive. Consolidation creates economies of scale and efficiencies, which can result in overall cost savings. Also, smaller businesses often seek to capitalize on synergies that come with merging with other companies to remain competitive.[11]

The regulatory structure put in place for the alcohol industry was designed to act as a governor on any one company having market dominance, specifically by advancing independence of the

[10] John Dunham & Associates, The Economic Value of America's Wine and Spirits Wholesalers (updated August 10, 2021). https://www.wswa.org/sites/default/files/2021-08/Economic%20Value%20of%20Wine%20and%20Spirits%20Wholesalers.pdf
[11] Amy Lombard, The Cutthroat World of $10 Ice Cream, *New York Times* (Aug. 13, 2021). In ice cream, "[t]he truth of the matter is that you have two world giants that will spend a fortune to protect what they have," Mr. Glynn said."

retailer, as well as independent distribution. Every tier of the alcohol industry has consolidated to some degree, but the variety of alcohol companies and brands entering into and already operating in the regulated marketplace is evidence of healthy market access for new entities.

Disproportionally providing one group of the marketplace (in this case, alcohol producers) greater marketplace access, for example through producer DTC sales, must be considered carefully. Producer DTC sales are not a panacea and have already created public health and safety, state tax revenue, and other problems across the country.[12] The better solution is enforcement practices that keep businesses independent at every level—suppliers, wholesalers, and retailers—where no one tier has outsized market access.

The reality is that producer DTC privileges, which wineries have enjoyed in many states since the early 2000s, are not a catalyst leading to significant growth of the industry. Wine is losing share to spirits and, even taking into account on-site and DTC sales, wine growth has been flat (+/- 2%) while spirits sales have soared.[13] A serious problem has also arisen as states uncover lost taxes from illegal alcohol shipments into their states due to DTC shipping.[14] While the regulatory barriers to wineries shipping their products to consumers across most states are low, some wineries consistently fail to even apply for basic permitting.[15] Tracking of these products is also difficult to do, leading to extensive losses in tax revenue, lack of oversight in the transportation and sale of alcohol, and an increased risk of underage access.

Additionally, producer DTC sales must be powered by e-commerce, which ultimately strengthens technology companies that already have a monopoly on the tools that help new brands become known through the Internet. Search engine optimization, for example, is expensive especially when 92.5% of all searches go through Google.[16] This system favors well-funded producers (increasingly owned by private-equity companies) that can spend the money needed to capture and hold consumer attention.

Expanding producer DTC makes consolidation in the industry a *fait accompli* as providing outsized market access to one part of the industry (i.e., producers) weakens the tiers (i.e.,

[12] Virginia ABC, Update on Direct Shipment of Beer and Wine - License and Tax Compliance (Jan. 8, 2019). http://sfac.virginia.gov/pdf/Public%20Safety/2019/010819_No1_ABC.pdf; Kansas Department of Revenue, Alcoholic Beverage Control Division: Legislative Briefing (January 19, 2021). www.kslegislature.org/li/b2021_22/committees/ctte_s_fed_st_1/misc_documents/download_testimony/ctte_s_fed_st_1_20210127_01_testimony.html

[13] Sovos ShipCompliant and Wines Vines Analytics, 2021 Wine Shipping Report: 2020 Year in Review (information on winery direct-to-consumer volume and trends). https://www.sovos.com/shipcompliant/content-library/wine-dtc-report/ (last accessed 8/17/2021); SipSource Q1 2021: Wine and Spirits Distributor Depletion Data, Industry Overview of Wine and Spirits – All Channels Combined, 28-29; SipSource Q1 2020: Wine and Spirits Distributor Depletion Data, Industry Overview of Wine and Spirits – All Channels Combined, 28-29; SipSource 2019 Annual + Q1 2020: Wine and Spirits Distributor Depletion Data, Industry Overview: Wine and Spirits Share and 9L Volume Growth Trend, 30.

[14] Virginia ABC, *supra* note 12.

[15] Ibid.

[16] Statista, Worldwide desktop market share of leading search engines from January 2010 to June 2021. https://www.statista.com/statistics/216573/worldwide-market-share-of-search-engines/

independent distributors and retailers). This solely benefits companies that have the money to compete in a virtual marketplace. Let us not forget, without a strong independent distribution tier, a pay-to-play environment thrives, only benefiting large, well-funded companies.[17]

In the quest to increase market access for new companies, we should carefully consider all potential remedies. What may seem an easy solution may likely, in time, exacerbate the problem we are trying to solve. Many smaller producers, almost all wholesalers (big and small), and a large number of retailers—both established and new entrants—are currently family-owned businesses. Providing outsized market access to one of the tiers will weaken the other two and harm family-owned small businesses across the country. Similarly, creating an environment that in theory helps smaller producers but in actuality is a boon to large producers, who have more capital and more market dominance, will in time reduce market access. Instead, the key to an open, dynamic marketplace is maintaining the balance of the underlying supply-chain structure that has allowed the industry to successfully evolve as it has over the past 85 years.

The fact is that a deregulated market does *not* lead to a long-lasting competitive market with many players. In our industry, less regulation leads to destructive market dominance and aggression, like we witnessed during Prohibition. In other industries, we have watched deregulation lead to the financial crisis just over a decade ago and now, the market dominance of a handful of behemoth technology companies tracking everything we do. These days, consumers experience the negative effects of the lack of regulation and enforcement in technology and health care daily, including problems with market access, data-privacy, transparency, and competition as a small handful of companies control the marketplace.

The efficiencies that independent distribution provides both producers and retailers in any industry are clear. Also clear is that in the alcohol industry, distributors provide a service that is only strengthened when there is constant innovation and new producers entering the marketplace. Wine and spirits wholesalers thrive when they sell a variety of brands from a wide range of companies. It is in their commercial interest to constantly look for quality products from new companies at different price points to bring to their retailer customers. U.S. consumers want and expect the value, choice, and variety that the current industry structure provides.

Furthermore, while it is easy to focus on less than a handful of large wholesalers, there are thousands of small and medium-sized wholesalers that service a wide variety of companies—both established and newer to the market. These wholesalers provide top service to all types of producers looking to expand their distribution footprint—and they are growing. According to historical data collected by WSWA for 18 states in which information was available, in all but

[17] Lombard, *supra* note 11. "The industry shifted from multiple distribution channels to a 'warehouse-driven model' dominated by packaged food corporations, he said. As a result, he added, 'artisanal brands have to go to retailers and pay an enormous amount of slotting' — industry speak for fees to get placement on store shelves, which can run as high as $40,000 per flavor."

two the number of active wholesaler licenses increased between 2016 and 2021.[18] For example, in California, there are currently 4055 active wholesale licenses (926 spirits and 3129 beer and wine).[19] Some independent wholesalers focus on high-end restaurants, while others focus on value brands. Wholesalers of all sizes provide a pathway to success in the marketplace.

Public Health and Safety Must Remain a Priority

Ever top of mind in the alcohol marketplace is public health and safety—after all, alcohol is an intoxicant. When overconsumed and abused, alcohol causes a number of costly social problems—including death. When considering measures to increase competitiveness and new entrants to the alcohol marketplace, we urge the federal agencies to keep social responsibility a priority and examine the potential impacts of any change on the health and safety of citizens, including the probability of increased underage access, overconsumption, illegal sales tactics that are difficult to oversee, and the proliferation of counterfeit products. These concerns are heightened as the recreational use of cannabis, another intoxicant, is becoming increasingly legal. In both industries, a thoughtful legal and regulatory system is needed to avoid known market problems and to keep the public safe. The system of regulating alcohol is a balancing act that the government has not always gotten right but that today has evolved into the safest in the world.

II. <u>The FAA Act Helps Create an Accessible and Competitive Marketplace</u>

An important part of maintaining the structure and balance of our successful alcohol system, WSWA supports the implementation and enforcement of the FAA Act that advances an orderly and balanced marketplace for the production, distribution, and sale of alcohol. For example, WSWA has been an active advocate for TTB to obtain $5 million each fiscal year to assist with trade-practice enforcement. Similarly, WSWA supports strong state-based alcohol laws and regulations that further these same principles.[20]

We write today to urge TTB to maintain the safeguards put in place by the FAA Act and its implementing regulations—specifically, its permitting and trade practice provisions. As we describe below, these regulations are critical to ensure market access and fair competition among regulated industry members and help the U.S. marketplace be the most dynamic and competitive in the world. We also respectfully offer a couple of potential areas of regulatory reform that

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[18] State Alcohol Licensing websites: AK, AZ, CO, CT, DE, FL, IL, LA, MD, MA, NE, NV, NJ, NM, ND, OK, TX, WI (last accessed Aug. 2021).

[19] California Department of Alcohol Beverage Control, State Totals: Wholesale and Off-Sale Licenses. https://www.abc.ca.gov/licensing/licensing-reports/license-summary-counts-for-fy-2020-21/state-totals/ (last accessed 8/17/2021).

[20] Wine & Spirits Wholesalers of America, WSWA-Supported Programs Included in Omnibus Spending Bill (Mar. 23, 2018). https://www.wswa.org/news/wswa-supported-programs-included-omnibus-spending-bill (last accessed Aug. 17, 2021).

could help TTB continue to effectively regulate socially sensitive products in an ever-changing marketplace.

The FAA Act Provides a Free and Fair Entry into the Alcohol Marketplace

Since its enactment following the repeal of Prohibition, the FAA Act has ushered in nearly 90 years of growth and innovation in the U.S. alcohol industry. The Act and its implementing regulations, along with their state-based regulatory system counterparts, create a system that allows market entrants at the supply and distribution levels to not only start a business efficiently but also grow in an environment that is accessible, transparent, and accountable.[21] Below we outline the key provisions that form this business environment.

Permitting of Manufacturers, Importers & Wholesalers

All wine and spirits manufacturers, importers, and wholesalers must hold a federal basic permit (FBP) issued by TTB. This permit is the cornerstone of regulatory compliance as it provides accountability through its potential suspension or revocation. In our industry, obtaining an FBP is simple (through an online application process) and completely free.[22]

As a result of ease of entry into the alcohol industry, growth has been universal in all three manufacturer categories in recent years. According to TTB's FY 2020 Annual Report,[23] the five most recent years ending in FY 2020 saw the following growth in total authorized alcohol producers:

- Breweries: 83% (6833 to 12486)
- Distilleries: 81% (2079 to 3760)
- Wineries: 42% (11270 to 15976)

Additionally, in the wholesale tier, the establishment of new businesses has been the norm. According to WSWA historical data, between 2016 and 2021 in 18 states with available data, active plenary wine and spirits wholesale licenses increased in all but two of the states. In aggregate, the number of licenses in these states grew by nearly 15%.[24] At the state level, it is not uncommon to see hundreds of active wholesaler licenses.[25]

[21] Alcohol and Tobacco Tax and Trade Bureau, Prospective Business Owners. https://www.ttb.gov/main-pages/start-a-business (last accessed Aug. 17, 2021). This webpage lists website the six steps to opening a regulated business.
[22] Alcohol and Tobacco Tax and Trade Bureau, Applying for a Permit and/or Registration. https://www.ttb.gov/applications (last accessed Aug. 17, 2021).
[23] Alcohol and Tobacco Tax and Trade Bureau Annual Report Fiscal Year 2020. https://www.ttb.gov/images/pdfs/ttbar2020.pdf (last accessed Aug. 17, 2021).
[24] See Footnote 18
[25] For example, the State of Washington currently lists 214 active wine distributors: https://lcb.wa.gov/taxreporting/licensee-list (last accessed 8/17/21) while Colorado lists 217 active vinous and spirituous wholesale licensees: https://sbg.colorado.gov/liquor-license-lists (last accessed 8/17/21)

These numbers evidence that the alcohol industry has been growing as new companies enter the industry in the supplier and wholesaler tiers. Moreover, each entrant has an FBP, meaning a clear line of sight for TTB to ensure appropriate tax collection and regulatory compliance. Permitting is an integral tool to ensure regulatory functions are carried out, creating a foundation upon which new companies can compete with existing players.

FAA Act Trade Practice Regulations Help Create a Level-playing Field, Requiring All Industry Members Play by the Same Rules

While initial access to the alcohol supply and distribution business is imminently feasible through the existing free federal permit application process, a new question arises once such a business has formed: is the marketplace in which it is entering "fair"? The trade practice guidelines are in place to make it fair, and regulations and enforcement play a critical role.

"Trade practice" as outlined by TTB, encompasses four separate regulatory provisions (i.e., exclusive outlet, tied house, commercial bribery, and consignment sales) that work together to, in TTB's own words "prevent industry members from engaging in [activities] that threaten the independence of retailers and/or give the industry members an unfair advantage over their competitors."[26]

Few industries have a similar regulatory framework intended to foster a "level-playing field" for *all* industry members, and the impact is obvious. In no other food or beverage category do consumers expect not just dozens or hundreds of SKUs of a product category, but thousands? A quick walk down the aisle of a wine and spirits retailer is fundamentally different than the aisles of a grocery store.

Hundreds, if not thousands of SKUs, representing suppliers big and small are available for purchase in many alcohol retailers because alcohol suppliers working with wholesalers are able, within the boundaries of federal and state trade practice laws, to *compete* for consumers' business.

Below we examine certain aspects of each of the four federal trade practice provisions to explore why each is a fundamental part of our accessible, equitable, and competitive industry. Each provision serves as an important *limiter of financial influence* among the tiers that helps small and independent businesses compete terms on a level-playing field with larger, incumbent businesses.

- **Exclusive Outlet**: 27 CFR Part 8 governs industry member transactions with retailers to ensure a transaction is not structured to *require* the retailer to purchase a product from that industry member "to the exclusion in whole or in part" of the products sold by another industry member. Preserving retailer independence is a core goal of the regulation. We note this because an independent retailer is a critical component of a fair

[26] Alcohol and Tobacco Tax and Trade Bureau, Trade Practices. https://www.ttb.gov/trade-practices (last accessed Aug. 17, 2021).

system that enables *all* suppliers to compete. By ensuring that an industry member cannot induce a retailer to purchase only their products, the access point to the retail market remains open to all suppliers to compete for shelf space on the merits of their products. Diminishing or failing to enforce these trade-practice provisions harms small, independent industry members who otherwise might be pushed aside by the sales and marketing force of larger competitors.

- **Tied-House:** 27 CFR Part 6 establishes "tied-house" regulations that specify actions that industry members are prohibited from engaging in with retailers. In particular, Section 6.21(c) addresses the prohibition on providing a "thing of value" other than those listed as exceptions to the rule in Subpart D, while Section 6.21(d) prohibits the paying or crediting of a retailer for any advertising, display or distribution service. The underlying goal here is to ensure that no industry member uses their financial resources to advantage themselves over another, less capitalized competitor. While these provisions are a rarity in today's broader economy, they are the cornerstone of fair competition among the alcohol industry. When pay-to-play activities are restrained, new and smaller companies have greater market access.[27] Also, we note that the Subpart D exceptions create practical and enforceable *permitted* activities between industry members and retailers, such as the provision of product displays within a specified dollar amount, that enable permittees to market products within specified boundaries.

- **Commercial Bribery**: 27 CFR Part 10 establishes a prohibition on industry members inducing a trade buyer (i.e., wholesaler or retailer) to purchase their products "to the complete or partial exclusion of products sold or offered for sale by other persons in interstate or foreign commerce, by offering or giving a bonus, premium, compensation, or other thing of value to any officer, employee, or representative of the trade buyer." This requirement is exactly the type of provision that aids small and independent businesses entering the alcohol marketplace. It restricts bigger, more financially secure businesses from using their strength to squash competition. It also restricts such activity *between* the upper tiers - meaning that suppliers cannot impermissibly influence wholesalers (not solely retailers) to purchase their products to the exclusion of others. Again, preserving independent tiers of the industry is important to prevent any tier (or type of business within a tier) from market dominance and reduced market access.

- **Consignment Sales**: Like the sections above, 27 CFR Part 11 establishes another "field leveler" in the alcohol industry, this time preventing industry members from selling products on consignment or conditional sale. This requirement, that all sales be "bona fide," helps ensure that no industry member uses their financial resources or incumbent market position to "flood" the market with product that can be later repurchased. If such transactions were allowed to occur, large entities would certainly have an advantage over small businesses who could not afford to carry out such sales tactics. Notably, Section

[27] Lombard, *supra* note 11.

11.21 extends the prohibition on consignment to *retailers* as well. This is the only time the FAA Act applies to retailers and helps prevent retailers from pressuring industry members to break the law. Like commercial bribery, the consignment provisions also apply to supplier-wholesaler transactions, thereby further leveling supplier behavior regardless of company size.

III. <u>Suggested Improvements to Enhance Marketplace Access and Fairness</u>

While the trade practices currently outlined in the FAA Act are essential to a well-functioning alcohol marketplace, improvements can be made. The alcohol marketplace has certainly evolved in various ways, and so we suggest areas where the FAA Act could be strengthened to reflect this evolution.

Addressing the Evolution of Retailers

The FAA Act and regulations have retailer independence as a primary goal. Certainly, an independent retail marketplace has been an essential element to creating an alcohol system as strong and vibrant as it is today. These independent retailers can look to a large number of wholesalers carrying thousands of SKUs from hundreds of suppliers both domestic and foreign from which to stock their shelves.

This retailer independence, one primary outcome of the trade practice regulatory structure, results in new brands having *a greater diversity of outlets* in which to sell their products, ranging from grocery stores to specialty wine and spirits retailers to restaurants. Put simply, independent retail means more opportunities for new and existing brands to get in front of consumers. WSWA strongly supports a robust independent retailer tier.

In the 1930s after Prohibition was repealed, alcohol retailers were small and could easily be swept up in the activities of the large alcohol suppliers of the day—to the detriment of competing brands. This explains why the emphasis of the FAA Act is on regulating suppliers and wholesalers. Congress did not envision our current marketplace that features sophisticated retailers, some with hundreds of locations around the U.S., giving retailers of all sizes leverage over suppliers and wholesalers.

The FAA Act does not regulate retailers (except in the narrow instance of consignment sales). Today, free of any federal permit restrictions, retailers can use their market dominance to push industry members to commit trade practice violations with no fear of federal consequences. Thus, we respectfully suggest that Congress consider the inclusion of retailers within 27 USC 205(a), (b) and (c) so they are also accountable to trade practice violations.

Better Delineating Roles in the Alcohol System

Building on the suggestion above, we also note there has been a certain blurring of the tiers in the marketplace as both producers and retailers increasingly take on activities traditionally performed by the other. In these instances, how should trade practice enforcement be perceived? For example, when a manufacturer operates an on-site tasting room as allowed by the state where they reside, how should they be characterized – as a supplier, a retailer, or both?

Another evolution in the marketplace not anticipated in current regulation is the sale of private labels, an evolution seen in many consumer package goods. With these types of products, retailers take on the role of a manufacturer directly or indirectly through agreements with producers to develop private-label products they then sell on their own shelves, often under trademarks they control. Retailers use market knowledge they obtain through selling third-party products to determine what private-label offerings they will develop. The unique knowledge position of the retailer selling their own products and at the same time third-party goods through their outlet, provides an ability for the retailer to give preferential placement, marketing, and pricing to their own private labels, potentially to the disadvantage of third-party products. As we are witnessing with companies like Amazon, these products can help large retailers achieve that dominance due to them favoring those products in stores and online. As private-label products increase in the alcohol marketplace, there can be confusion as to what trade practices are allowed when a retailer produces its own products to sell. Clarity on what businesses or business roles are subject to trade practice restrictions would help the industry better understand what is acceptable conduct. We respectfully suggest that TTB consider rulemaking to better delineate these types of permissible activities.

For all the reasons noted above, we respectfully urge TTB to view the existing, highly successful federal regulatory structure as a delicate balance of government oversight that allowed the U.S. alcohol industry to flourish into the envy of the world. Further, we ask that you consider the enhancements to the regulatory structure that we outlined above to help this system continue to function as it was intended in the evolving 21st-century marketplace.

We, along with the undersigned state associations, thank you for your consideration of our perspectives on this important matter.

Very respectfully,

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