TTB STEPS UP:

NEW AGENCY RULING MAKES CLEAR THAT TIED-HOUSE EXCEPTION FOR SHELF PLANS AND SCHEMATICS DOES ***NOT*** ENCOMPASS BROADER SERVICES BY DISTRIBUTORS

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For months, the alcohol beverage trade press and industry observers have been abuzz about plans by major retail supermarket chain Kroger Company to contract with giant alcohol distributor Southern/Glazers to oversee how the supermarket distributes shelf space to alcohol beverage brands. The plan, designed as the development of a "Planogram Center of Excellence," calls for Southern/Glazers to oversee how much display alcohol beverage brands get in the grocery aisles of the more than 2,600 Kroger stores in 29 states. The new plan also calls for Southern/Glazers to cover the cost of the service it will provide with "voluntary" contributions from alcohol beverage suppliers based, in part, on the volume of their products that show up on Kroger shelves.

Kroger announced the plan in 2015, arguing that contracting with its largest distributor to handle shelf and space allocation, brand choice and placement, *etc*., made good business sense to improve the grocer's responsiveness to customer demands. Currently, alcohol beverage shelving plans typically are updated only once or twice each year, based on input from the brands' suppliers, who act as "category captains" to provide shelving advice and shelf space allocation suggestions. With Southern/Glazers alone organizing the purchase and placement arrangements, Kroger argued new craft beers, seasonal wines and innovative products will make it to the grocery shelves faster.

Alcohol suppliers and numerous industry trade associations, however, objected to the plan from its unveiling. Many questioned the notion that Southern/Glazers could provide "unbiased" direction based on customer data. Suppliers who do not use Southern/Glazers to distribute their products cried foul over the risk of unfair discrimination in the selection and placement process.

Similarly, small brands expressed their fears that Kroger's new approach to product and shelf management could require them to find money to pay Southern/Glazers for placement in stores – an interesting challenge in and of itself, as payments by alcohol suppliers or distributors to retailers for shelf space (commonly known as "slotting fees") are prohibited under federal and state alcohol laws.

Opposition was so vigorous that a coalition of trade associations petitioned the US Alcohol and Tobacco Tax and Trade Bureau (TTB) to investigate the Kroger plan. Industry groups including the Distilled Spirits Council of the United States (DISCUS,) the Wine Institute, the Beer Institute and the Brewers Alliance all asked the TTB to examine whether Kroger's plan complies with federal rules on alcohol distribution.

After months of silence, the TTB delivered its answer in the form of Ruling 2016-1. The verdict: a resounding thumbs down to Kroger.

Specifically, the TTB's decision analyzed applicable regulations, focusing on §6.99 of the Subpart D exceptions to the tied house evil regulations codified pursuant to the Federal Alcohol Administration Act ("FAA Act") as 27 CFR §§6.41[1] and 6.42.[2] Section 6.99 deals with a tied-house exception relating stocking shelf plans and schematics that was adopted by TTB's predecessor, the US Bureau of Alcohol, Tobacco and Firearms ("ATF") in 1995 at the request of industry. The exception provides:

> **6.99 Stocking, rotation, and pricing service**.
>
> (a) **General**. Industry members may, at a retail establishment, stock, rotate and affix the price to distilled spirits, wine, or malt beverages which they sell, provided products of other industry members are not altered or disturbed. The rearranging or resetting of all or part of a store or liquor department is not hereby authorized.
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> (b) **Shelf plan and shelf schematics**. The act by an industry member of providing a recommended shelf plan or shelf schematic for distilled spirits, wine, or malt beverages does not constitute a means to induce within the meaning of section 105(b)(3) of the Act.

After carefully reviewing the history of the regulation's promulgation and the policy behind their enforcement, TTB ultimately concluded that the language of the exception was plain on its face, and meant what it said. Unfortunately for Kroger and Southern/Glazers, that suggests the Planogram Center of Excellence may extend far beyond what the federal regulators say is allowed by Section 6.99.

Without identifying either Kroger or Southern/Glazers by name, TTB nevertheless made its point clear:

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[1] §6.41 of TTB's Tied–house regulations (27 CFR 6.41) provides that, subject to the subpart D exceptions, the act by an industry member of furnishing, giving, renting, lending, or selling any equipment, fixtures, signs, supplies, money, services, or other things of value to a retailer constitutes a means to induce within the meaning of the FAA Act.

[2] §6.42 of the Tied-house regulations (27 CFR 6.42) provides that 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, constitutes indirectly furnishing a thing of value within the meaning of the FAA Act. Indirectly furnishing 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.

In enacting the FAA Act, Congress recognized that monopolistic control exercised by suppliers and wholesalers in the alcohol beverage industry was a real threat and viewed the abuses prohibited by the Tied-house provision as the principal means of creating and maintaining such monopolies. Accordingly, the report of the House Ways and Means Committee with respect to the Tied-house provision provided that:

> *The forgoing practices [note, those prohibited by this subsection] have in this industry constituted the principal abuses whereby interstate and foreign commerce have been restrained and monopolistic control has been accomplished or attempted. The most effective means of preventing monopolies and restraints of trade in this industry is by prohibiting such practices, thereby striking at the causes for restraints of trade and monopolistic conditions and dealing with such conditions in their incipiency. (See Hearings on H.R. 8539 before the Committee on Ways and Means, House of Representatives, 74th Cong., 1st Sess. 58 (1935).)*

Although the language of § 6.99(b) is clear, twenty years have passed since the regulation was promulgated. When ATF implemented the § 6.99(b) exception in 1995, it was assured that the provision of a shelf plan or shelf schematic would be used as a stand-alone marketing tool and that the schematics had little or no intrinsic value. As TTB Ruling 2016–1 discussed above, the expectation was that a retailer would receive such plans from multiple sources. **During its review of current practices, TTB discovered that, presumably under the auspices of the § 6.99(b) exception, some industry members are providing schematics as well as additional services that far exceed the exception in § 6.99(b), which unambiguously exempts only the simple act by an industry member of providing to a retailer a recommended shelf plan or shelf schematic from the provisions of section 105(b)(3) of the FAA Act. These additional services constitute "things of value," therefore serving as a means to induce under § 6.21 of the TTB regulations.** A violation of the FAA Act would ensue if such practices result in exclusion of a competitor's product, in whole or in part, with the requisite connection to interstate or foreign commerce. (A similar State law is required only in the case of malt beverages, pursuant to the penultimate paragraph of section 105.) In determining whether exclusion exists, TTB will consider whether the practice places the retailer's independence at risk as defined in 27 CFR § 6.152 and/or § 6.153. Practices involving an industry member in a retailer's day-to-day operations, such as many of those described in this Ruling, are indications that the retailer's independence is at risk. (See 27 CFR 6.153(e).) (**Emphasis added**).

The full text of Ruling 2016-1 is accessible online at: http://www.ttb.gov/rulings/2016-1.pdf

What does this mean for Kroger's plan? It remains to be seen whether the supermarket chain or its primary distributor, Southern/Glazers, will seek reconsideration or clarification of the TTB's latest ruling. However, the concluding language of that ruling could not be clearer: "Additional services, such as those described in this Ruling, furnished by an industry member to a retailer, with respect to alcohol beverages, are not exempted by 27 CFR 6.99(b)."

What constitutes "additional services" outside the scope of shelf plans and shelf schematics? According to TTB, additional services encompass, but are not limited to, the following:

> (1) Assuming, in whole or in part, a retailer's purchasing or pricing decisions, or shelf stocking decisions involving a competitor's products;
> (2) Receiving and analyzing, on behalf of the retailer, confidential and/or proprietary competitor information;
> (3) Furnishing to the retailer items of value, including market data from third party vendors;
> (4) Providing follow-up services to monitor and revise the schematic where such activity involves an agent or representative of the industry member communicating (on behalf of the retailer) with the retailer's stores, vendors, representatives, wholesalers, and suppliers concerning daily operational matters (such as store resets, add and delete item lists, advertisements and promotions);
> (5) Furnishing a retailer with human resources to perform merchandising or other functions, with the exception of stocking, rotation or pricing services of the industry member's own product, as permitted in § 6.99(a) of the TTB regulations.

A disappointing decision in the eyes of Kroger and Southern/Glazer, to be sure.

However, for industry members who might have questioned the authority and continuing relevance of the TTB over the past several months of silence since the Planogram Center of Excellence was first announced, Ruling 2016-1 demonstrates there's an old sheriff that's still in town, and it intends to continue on the job.