



Focus On
**Alcohol
Beverages**

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6



8

CONTENTS



14



20

In This Issue

Hugh Nineham 3

Features

Increased Antitrust Scrutiny of Non-Reportable or Closed Transactions

Jon Dubrow and Carla Hine 4

Minimising Exposure: Understanding the Risk of Bribery in China

Kevin Qian, Lawrence Hu, Martin Tian and William Zhang 6

Are Our Tax Systems Fit for Purpose?

Martyn Gowar 8

Focus On Alcohol Beverages

The Future of Alcohol Beverage Distribution in the United States

Marc Sorini 10

Enforcement of Antitrust Rules to Distribution Agreements in Europe

Veronica Pinotti and Martino Sforza 12

Alcohol Brand Protection Beyond Core Products in Europe

Rohan Massey and Hiroshi Sheraton 14

The Intersection of Trade Mark Rights and Government Labelling Requirements

John Dabney and Richard Kim 16

US Rules on Labelling

Deborah Ringo 18

Fixing the Problem of Counterfeited Alcohol Beverages in China

Carolyn Gleason and Pamela Walther 19

Labelling and Packaging Mixed Alcohol Beverages in the European Union

Frank Schoneveld and David Henry 20

Federal Trade Commission Alcohol Advertising Review Anticipated

Arthur DeCelle 22

In This Issue

Welcome to the second issue of *International News* for 2011. The focus for this issue is various legal matters relating alcohol beverages.

We start with a look at the future of alcohol beverage distribution in the United States and clear up a common misconception that the “three-tier system” of distribution is a legal requirement. We then examine the situation in the European Union, where one of the key issues relating to alcohol distribution is the enforcement of antitrust rules. This is one of the main priorities on the agenda of the European antitrust authorities, making it a priority for alcohol beverage companies reliant on distribution systems.

The focus then shifts to intellectual property (IP). We look at how European trade mark law can help brand owners protect their assets, particularly in relation to activity outside goods and services that would be considered to be core products. In the United States, there are various federal and state labelling requirements that govern the sale of alcoholic beverages, all of which can impact on the protection of a trade mark or brand. A recent decision reinforces the importance of alcohol beverage manufacturers complying with all federal and state labelling requirements in order to protect their brands. Two articles cover the impact of this decision and outline the procedure for labelling as it currently stands in the United States.

Continuing the theme of brand protection, we review the situation in China. As the US Government steps up its examination of how US trade marks and other IP rights can be better safeguarded in China, American businesses, including in the alcohol sector, have new opportunities to work with the Obama administration on enforcement action plans to reduce IP losses in China.

We also explain how manufacturers and distributors of flavoured alcohol beverages (FABs) face new and far-reaching EU labelling rules. A new draft EU law foresees mandatory nutritional information labelling requirements that must be displayed on FABs.

Finally, we note that the US Federal Trade Commission (FTC) has published a notice in the *Federal Register* indicating that a comprehensive review of alcohol beverage industry advertising practices in the United States will begin later this year. The review should be welcomed by the industry as previous FTC reports have generally allayed concern about alcohol advertising by providing a realistic view of industry practices.

In our features section, we note how, in recent years, the FTC and the Department of Justice (DOJ)—the two US agencies responsible for reviewing and challenging transactions that may lessen competition—have increasingly challenged non-reportable and consummated transactions. There are significant implications for parties to transactions, which must remain vigilant in protecting their interests in getting the deal done.

We also look at the problems inherent in international tax systems, and the implications those overlapping systems have for the international wealthy.

Finally, we raise the issue of bribery rules in China. While heavily dependent on China’s fast economic recovery and dynamic economy, multinational corporations are also exposed to unacceptable compliance risks as China is still a developing economy with a legal system plagued by “hidden” rules, particularly in relation to giving and accepting bribes.

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Increased Antitrust Scrutiny of Non-Reportable or Closed Transactions

By Jon Dubrow and Carla Hine

In recent years, the Federal Trade Commission (FTC) and the Department of Justice (DOJ)—the two US agencies responsible for reviewing and challenging transactions that may lessen competition—have increasingly challenged non-reportable and consummated transactions. There have been several such challenges so far in 2011, and at least nine in 2010 (all but one of which resulted in a settlement).

The number of challenges is up significantly over historical trends. Some of these challenges have been to very small acquisitions. For example, the DOJ recently sued to break up a US\$3 million acquisition of a chicken processing facility. These challenges highlight the need for parties to remain sensitive to antitrust risks even where the transaction may not meet the premerger reporting thresholds of the Hart-Scott-Rodino Antitrust Improvements Act (HSR Act).

Generally, under the HSR Act, parties must notify the FTC and DOJ of acquisitions

of voting securities, assets or a controlling interest in a non-corporate entity (such as an LLC or partnership) valued above US\$66 million if the parties also meet certain net sales/total assets thresholds and no exemptions apply. Transactions subject to the HSR Act must be reported prior to closing, and the parties must wait 30 calendar days from the filing of the notification before closing. The agencies may decide to investigate the transaction further, thereby extending the 30-day review period and preventing the parties from closing, pending completion of the review.

The US merger notification statute and regulations enumerate the thresholds for reporting a transaction to the US government. They do not limit the jurisdiction of the FTC and DOJ, and the agencies are free to review transactions that do not meet the reporting thresholds. Section 7 of the Clayton Act gives the FTC and DOJ jurisdiction to challenge any acquisition that may result in a substantial lessening of competition.

Further, there is no statute of limitations, so the FTC and DOJ's authority to review a transaction may continue indefinitely after the transaction has closed.

“Parties to non-reportable transactions should remain sensitive to the potential antitrust risks.”

The antitrust agencies may learn about a non-reportable transaction from any number of sources, such as: customers, competitors, press, industry trade groups, disgruntled bidders for the target company, securities or bankruptcy-related filings, foreign merger notifications or discussions with foreign competition authorities, or subsequent HSR Act filings (unrelated to the current transaction).



Once the FTC or DOJ learns of a non-reportable transaction that causes competitive concerns, the agencies may investigate using various methods. The agencies may ask the parties to provide information voluntarily to help them assess the transaction, or may issue a Civil Investigative Demand or subpoena requiring the parties, or non-parties, to submit documents and testimony. Because non-reportable transactions are not subject to the HSR Act, the parties are not required to observe a waiting period before closing. As such, the agencies may ask the parties to agree not to close during the investigation, or may seek a preliminary injunction in federal district court to stop the parties from consummating the transaction pending the outcome of their investigation, if it has not closed already. If the transaction has closed, the agencies still can sue to force a divestiture, either in federal court or, for the FTC, in an administrative trial.

“The parties need to consider how much antitrust risk they are willing to accept.”

Given the current climate of aggressive antitrust enforcement, parties to non-reportable transactions should remain sensitive to the potential antitrust risks. Understanding the antitrust risks will inform deal negotiations and integration planning and implementation. While an acquisition may raise significant competitive concerns, there may be an easy remedy that the parties would be willing to accept and for which they can plan. Conversely, some transactions may not present any appropriate remedy other than complete abandonment or divestiture of the entire acquisition. The parties need to consider how much antitrust risk they are willing to accept. For example, the buyer may want to negotiate provisions into the contract to provide for some compensation from the seller, such as an adjustment to the purchase price, in the event the FTC or DOJ challenges the transaction post-closing. On the other hand, the seller may not be amenable to accepting any risk. With respect to integration planning and implementation, the buyer should be careful to avoid engaging in any conduct post-closing that may draw antitrust scrutiny or may provide the agencies with direct evidence of a transaction's anticompetitive effects. For example, a post-acquisition price increase may be used as evidence that the transaction was anticompetitive.

The lack of any premerger notification obligations does not obviate the need for careful document creation. Where the FTC and DOJ learn of an acquisition that may raise potential competitive concerns, they may seek both transaction-related documents as well as documents created in the ordinary course of the parties' businesses. Careless document drafting can create a Sisyphean task of trying to convince an already sceptical agency of the competitively benign nature of a transaction. Conversely, careful wording can make a hard deal easier to defend. Whether or not the parties anticipate significant antitrust issues, careful document creation is a best business practice that can mitigate against undue costs and delays in the course of an antitrust review.

“There is no statute of limitations.”

Documents prepared by the parties and their advisors that evaluate the deal are the most important information in the regulators' initial review, and can make or break the antitrust review of a deal. When creating transaction-related documents, parties should be careful to avoid antitrust “buzz words”, such as market leader, dominant position, high entry barriers, rationalise pricing or competition, achieve pricing power, avoid a price war, foreclose competition or increase costs for rivals. This obviously applies to all press releases, talking points, frequently asked questions and US Securities and Exchange Commission filings, which may be the source from which the agencies find out about the transaction in the first instance. However, this guidance also applies to all internal presentations, documents and communications, including “private” e-mail correspondence.

“The lack of any premerger notification obligations does not obviate the need for careful document creation.”

Whether a transaction meets the reporting thresholds of the HSR Act is not the determining factor when assessing the potential antitrust risks. Parties must remain vigilant in protecting their interests

in getting the deal done. This means understanding the potential antitrust risks, anticipating the outcomes that the parties would be willing to accept, careful creation of documents and avoiding antitrust scrutiny by not engaging in anticompetitive behaviour post-closing. Early involvement of antitrust counsel in the transaction planning process can help parties understand these risks and how to navigate them so as to avoid unnecessary scrutiny, delay and expense.



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Minimising Exposure: Understanding the Risk of Bribery in China

By Kevin Qian, Lawrence Hu, Martin Tian and William Zhang

While heavily dependent on China's fast economic recovery and dynamic economy, multinational corporations (MNCs) are also exposed to unacceptable compliance risks as China is still a developing economy with a legal system plagued by "hidden" rules, particularly in relation to giving and accepting bribes. Some MNCs may simply follow the rules and regulations of their home country to mitigate these compliance risks, but it is also vital that they comply with Chinese laws and regulations and are aware of what may constitute a bribe.

The Definition of Bribery

Under the Chinese legal system, as in most countries, bribery is covered by both the regulatory and criminal legal systems. The Administration for Industry and Commerce is responsible for investigating cases of commercial bribery and, according to the circumstances, can fine offenders between RMB 10,000 and RMB 200,000 and confiscate illicit gains. If the violation is serious enough in terms of the financial value of the bribe to constitute a criminal offence, the Public Security Bureau or the Procuratorate will conduct an investigation. If the perpetrator works for

the Government, the matter falls under the jurisdiction of the Procuratorate.

In determining whether a particular act constitutes an offence of commercial bribery, the act is judged against a number of criteria.

The Subjective Element

Under both the Chinese regulatory and criminal legal systems, to be found to be an act of bribery, there must be the subjective intent on behalf of the perpetrator of giving benefits in order to derive business opportunities and exclude competition. Criminal law goes further in also distinguishing between the subjective intent of bribe perpetrators and bribe recipients. The law requires the bribe perpetrator to "seek improper benefits" to constitute a crime, while the bribe recipient needs only to "seek benefits" for the act to constitute a crime.

"Seek benefit" is relatively easy to determine, but what constitutes the seeking of *improper* benefits under criminal law? The latest judicial interpretation refers to the actions of "a party who, through bribery violates laws, regulations, rules or policy interests, or asks the other party to violate laws, regulations, rules, policies, and industry norms in order to derive benefits", suggesting that "violation"

denotes impropriety. The interpretation's definition includes acts "in the bidding process, during government procurement and other commercial activities that are contrary to the principle of equity, such as property given to relevant personnel to obtain a competitive advantage".

The Objective Element

Under both systems, the objective element for a definition of commercial bribery is the exchange of certain "properties" for commercial opportunities. The definition of property has been expanded to include things such as free travel, home decorations, gift certificates, *etc.* It also includes various types of hidden transactions that mask an improper transfer of property interests, such as the briber giving the recipient a disproportional amount of dividends through co-investment vehicles, or deliberate gambling losses that benefit the recipient.

Perpetrators

Under Chinese laws, generally only commercial operators can be found guilty of offering bribes. However, there are no restrictions on who can be found guilty of being a bribe recipient. Under Chinese criminal law, different crimes are applicable depending on whether the recipient of the bribe works for the government or not.



Under criminal law, if a unit, as opposed to an individual, is convicted of bribery, a double punishment would be enforced. The unit would be fined and those involved given a criminal punishment such as imprisonment. “Those involved” includes not just the people who committed the actual crime but also those who made relevant decisions about approved, condoned, authorised or ordered the bribe, such as management.

If an act meets the criteria above, it constitutes commercial bribery under the regulatory system. If the circumstances are serious, *i.e.*, if the bribe crosses a certain financial threshold, the act falls under the jurisdiction of criminal law.

Grey Areas

Business Gifts

Chinese laws do not prohibit legitimate gifts between friends and family, and gift-giving is an accepted part of Chinese commercial life. However, some people use the excuse of gift giving as a cover for their illegal activities. Distinguishing bribery from a legitimate exchange of gifts involves the balance of factors such as background information, the value of the exchanged property, the reason, timing and manner of the property transaction, *etc.*

Emotional Investment

Between gifts and bribes lies a grey area termed “emotional investment”. Emotional investment involves the accepting of property in exchange for no specific immediate benefit and is therefore generally not considered bribery. However, if and when (at a later time) the recipient acts for the benefit of the provider, and the accumulated amount of the previous “emotional investment” reaches a certain threshold, which could be different subject to local practices in different areas of China, both the provider and the recipient could be found to have committed a crime.

Intermediaries

To decrease potential legal liability, intermediaries employed by MNCs to undertake commercial negotiations are often asked to sign guarantees that they will not perform acts that may be construed as bribery, and other disclaimers. However, the principal can still bear criminal liability for the acts of its agent(s) if it knew or should have known the criminal intent of the agent. Although determining whether the principal “knew” or “should have known”

requires a comprehensive investigation, once such knowledge has been established, the agent’s act is considered a joint crime with the principal.

Avoiding the Pitfalls

There are some weaknesses in anti-bribery corporate governance that are common to most MNCs active in China. These include having good risk management policies in the home jurisdiction, but failing to apply the same rigour in China, such as not having a specific compliance officer; a lack of understanding regarding the specific issues associated with the Chinese cultural environment; a lack of control over third-party intermediaries; a lack of action and failure to take effective measures after a discovery of misconduct; and a lack of awareness regarding bribery risks during the acquisition of Chinese companies.

Some of these common mistakes can be avoided by undertaking the following actions:

- Determine the legal issues and areas of risk under Chinese law, such as industry-specific issues, the employment of intermediaries, improper accounting and complex commercial transactions, then implement written guidelines, policies and procedures to manage those risks.
- These should be disseminated clearly through training programmes and should include: industry-specific risk assessments; thorough due diligence assessments and investigation of new/existing business partners, particularly in relation to allegations of bribery; comprehensive control on high-risk expense payments; and specific wording for contract clauses that confirm anti-bribery compliance.
- Invite an external expert to conduct independent audits regularly to ensure both management and staff are following procedures and also to benchmark the company against industry best practice.
- Implement other effective anti-commercial bribery measures, such as periodic internal audits to ensure the effectiveness of the corporation’s internal control system, and provide regular legal training for key staff on changes to anti-bribery legislation.

Michael Xu and Jia Yau also contributed to this article.



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Are Our Tax Systems Fit for Purpose?

By Martyn Gowar

We take the pace of change in our modern world so much for granted that we have forgotten what life was like before the changes. Can we imagine what it would be like to try and work without e-mail or a computer? The risk is that we have so little time to stop and reflect that when it comes to making the changes necessary to keep up, we just try to throw together a quick solution. The international tax system seems to have done just that, without going back to first principles and determining what is needed from a tax system in the globalised world of the 21st century. Nowhere does the current international tax system show its inadequacy in the modern world more than in its handling of the international wealthy.

How We Got Here

Income tax was only permanently introduced in Britain in 1842. It was modeled on the Income Tax Act 1799, which was an annual tax that was cancelled after the end of the Napoleonic war. Its history reminds us that a tax system is there simply to raise money for the purposes that a government considers necessary (and the Napoleonic war was very expensive). What governments consider necessary varies enormously of course. If you look at some of the offshore financial centres, such as Bermuda, the Cayman Islands, Guernsey and Jersey, you find an average population of less than a moderate-size town in England. These countries do not need to provide for nuclear submarines or major armed forces, an extensive overseas aid programme or a massive bureaucracy. Alternatively, take as an example a Middle East, oil-producing nation where the royalties

from its resources mean there is no need to raise money from its citizens by a direct charge on their personal earnings or wealth.

“A tax system is there simply to raise money for the purposes that a government considers necessary.”

So, in 1842, when the United Kingdom could not raise the money it needed from duties levied on trade, income tax was re-introduced and its rules reflected the pragmatic reality of the society that existed at that time. No extended jurisprudential debate was required or undertaken. The system had to accommodate those who went abroad to run the British Empire or to fight

in its armies, or to run the rubber plantations in Malaysia or the tea plantations in India and Ceylon.

“Income tax was re-introduced and its rules reflected the reality of the society that existed at that time.”

When those people came back after 10 or 15 years, if they were lucky, they returned to a tax system that looked to a person’s “domicile”. This system captured them perfectly in that they slipped back into it very easily. Later, the concept of domicile helped enormously when, in the 20th century, Greek ship-owners moved their bases to the shipping capital of the world in London and ran their businesses from there.

Across the English Channel, for continental European countries such as Germany and Austria, neither international trade nor an international empire were really relevant in the 19th century, certainly not in the same way as with Britain. Not many people travelled far from their home base. As a result, permanent residence was the practical base of their income tax systems. Looking further afield, across the Atlantic to the United States, the practical pressures were entirely different. The United States, in its infancy, dealt with an influx of enormous proportions of people from abroad. In return for citizenship, immigrants became taxable, not only for the income and assets they built up in the United States, but also on what they had brought in from their country of origin or any points in between. For those coming to the United States, there was no country of domicile as the British understand the term and no track record even of residence, so a new system had to be created; taxation by reference to citizenship was the answer.

One or another of these three basic systems of tax has been applied more or less across all countries of the world, and the reality is that they are incompatible with each other. It is like trying to run a car on diesel, petrol and electricity. The reality is that you can’t switch power sources (at least, not yet!). So, as a result of these mismatched foundations, we need the patchwork of double tax treaties

between various countries, all of which were created with the intention of relieving what would otherwise have inevitably been double taxation. During their creation, no mention was ever made of trying to stop tax avoidance. After all, the rule according to *Government of India v Taylor* is that no country will enforce the taxation laws of another.

Where We Are

Let us look at the world of 2011 and take stock. Of course, for well over 95 per cent of the populations of all countries, the tax systems work reasonably well because most people still stay at home. However, it is said that the top 5 per cent of tax payers in the United Kingdom pay 43 per cent of the tax revenues. These wealthy people and their families are all now part of one very shrunken globe, and a much more globalised society.

It would be unfair to expect nations to stay ahead of our shrinking world, especially given the pace at which it has shrunk over the last 50 years. But it seems even more unfair that the existing plethora of tax systems allows nations to be both avaricious in their desire to attract overseas tax payers and self-righteous in their pursuit of taxes they believe should be paid to them when another country tempts away their citizens.

“The problem requires an international review of what is the right tax system for an international world in the 21st century.”

The truth remains that, with three incompatible bases of tax systems, all of which operate in different ways from country to country, there will always be opportunities, even necessities, for tax arbitrage to avoid double taxation. And if you avoid double taxation, you are (by definition) avoiding tax from one of the countries between which the treaty is in place.

Where We Should Go

When approaching the question of how you deal with tax avoidance, the first thing that has to be established is that avoidance is not evasion. Blurring the edges of the distinction between tax evasion, which is cheating, and tax avoidance by reference to

the law of the land, which is not, is unworthy. It is particularly unworthy when, by doing so, nations are not facing up to a real problem that is only going to increase: globalisation and internationalism are not going away.

“It is like trying to run a car on diesel, petrol and electricity.”

The problem requires an international review of what is the right tax system for an international world in the 21st century. The same applies to corporate taxes, as can be seen from the difficulties inherent in transfer pricing, which stems from the same problem. The debate must be sensitive to each countries’ rights to be responsible for their own fund raising, but must recognise that trying to shoehorn the international wealthy into unrealistic systems will not work.



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The Future of Alcohol Beverage Distribution in the United States

By Marc Sorini

People often ask for predictions about the future of “the three-tier system” of alcohol beverage distribution in the United States. A better question to ask is where alcohol beverage distribution systems, three-tier or otherwise, are heading.

The three-tier system refers to the flow of alcohol beverage products in the US marketplace from the supplier, *i.e.*, producer/importer (first tier), to wholesale distributors (second/middle tier), to retailers (third tier) and, finally, to consumers. As a practical reality, most alcohol beverages sold in the United States pass through this three-tier distribution chain.

Legally, however, the picture is much more complex. The United States is a federal system, with alcohol distribution substantially regulated at the state (and occasionally even local) level. Yet, despite the commonplace assumption that a three-tier system exists as a requirement, federal

law neither establishes nor mandates such a system. Indeed, the only restriction federal law imposes on the integration of the three tiers relates to suppliers’ and wholesalers’ *partial* (but not complete) ownership of a retailer as a *potential* “tied house” issue, depending on whether that partial ownership leads to the exclusion of competing products.

Suppliers and Retailers

Legal underpinnings for a three-tier system arise from state law and, quite naturally, vary from jurisdiction to jurisdiction. This diversity partially reflects different political realities in each state, as well as the evolution of the distribution system since the repeal of National Prohibition in 1934. At that time, there was a near-universal consensus that the supplier and wholesaler control of retailers that existed prior to Prohibition—the “tied house evil”—had promoted excessive and irresponsible consumption. Thus, most

post-Prohibition legal regimes prohibited or severely restricted upper-tier ownership of retail outlets. Far fewer restrictions existed between the upper two tiers. Indeed, in the 1930s most breweries distributed directly to retailers, a situation that would not change until the rise of dominant national brands after the Second World War.

Many tied house separations enacted immediately after Prohibition still remain, with some exceptions. Most notably, as small producers, particularly wineries and breweries, proliferated during the past three decades, states often granted these producers retail privileges. As a result, most states permit winery tasting rooms, brewpubs and on-premise restaurants to exist within the three-tier system. And despite frequent resistance to such exceptions at the time of their enactment, the three-tier distribution model has continued to thrive alongside such operations.



Suppliers and Wholesalers

Separations between the supplier and wholesaler tiers evolved more gradually and exhibit even less uniformity, even within one state. Thus, while most states prohibit distillery ownership of wholesale operations, a substantial number of states, including critical markets like California and New York, permit cross-ownership between breweries and their wholesalers. Of course, virtually all beer sold in those states passes through three-tier distribution channels, but not as a requirement of law.

The existence and proliferation of exceptions made for small or local producers further belies the perceived uniformity of the three-tier system. Today, wineries in most states enjoy direct-to-retail sales privileges, and breweries are not far behind. Although those privileges are shifting from local producers (raising federal Commerce Clause concerns) to facially-neutral small producer privileges, it seems highly likely that the thousands of small wineries and breweries in operation today will continue to enjoy self-distribution privileges in the future.

Inertial Forces Supporting the Three-Tier System

As explained above, no monolithic, legally mandated three-tier system exists in the United States. Instead, the three-tier system exists *as a business reality*, not necessarily a legal requirement for most alcohol beverages, most of the time. Nevertheless, powerful inertial forces created by the totality of existing laws and business relationships channel commerce into the three tiers and pose obstacles to any quick or dramatic changes to existing business arrangements.

Suppose, for example, that a major winery currently sells its wine in the United States through a network of independent wholesalers. The laws of several major wine-consuming states (*e.g.*, California, Oregon and Washington) permit the winery to either ship direct to retail or own its own wholesalers. Theoretically, the winery could bypass the three-tier system in an attempt to capture additional margin and/or reduce prices, but it would face a myriad of business and legal obstacles.

First, the winery would need to terminate its agreements with existing wholesalers, an often difficult task made more complex in

many states by the existence of “franchise laws” restricting the termination rights of suppliers. Second, in many states the wine would remain subject to “at rest” requirements and prohibitions on retailer store-to-store deliveries. These requirements would force the winery to create in-state infrastructure (warehouses, trucks, drivers, *etc.*) that would duplicate the infrastructure already provided by traditional wholesalers. Moreover, the winery would need to spread the costs of this infrastructure over a lower sales volume than its previous wholesalers did, while risking the trust, focus and attention of its wholesalers in other jurisdictions where it can not establish its own direct-to-retail channel. When evaluated in light of these and other considerations, the supposedly attractive direct-to-retail option looks risky.

Evolution

Although strong inertial forces will likely mean that three-tier distribution does not disappear anytime soon, alcohol distribution in the United States will continue to evolve, just as it has for the more than 70 years. The rise of direct-to-consumer wine sales presents the most dramatic recent example of this evolution. The massive proliferation of small wineries (the United States currently has more than 6,000 wineries) and the equally massive consolidation of wholesalers (today just five companies distribute almost 50 per cent of the wine sold in the United States) created substantial pressure for a new distribution outlet for small wineries’ products. This led to legislative and litigation efforts that today give wineries (or at least small wineries) the right to ship wine directly to consumers in 39 states, including the major consuming states of California, Florida, Illinois, New York and Texas. Nevertheless, wholesalers continue to thrive and grow alongside this mostly new sales channel.

Evolution is occurring elsewhere. As intellectual property takes an increasingly central role in commerce, trade mark licensing arrangements have blurred the separation of retailers created in the 1930s by the tied house laws. Thus, suppliers have licensed to retailers their brands and trade dress to enable retailers to establish branded bars around the country (and seemingly at every major airport). Conversely, the alcohol beverage market has not been immune to the growth of

retailer private-label brands, with retailers licensing their trade marks to suppliers in order to produce brands that, in reality, sell only within a particular retailer’s stores.

Other innovative distribution models are evolving today:

- Brand-owning wholesalers that avoid cross-ownership restrictions by contracting actual production to independent third parties
- Importers and wholesalers that provide stripped-down services (*e.g.*, little or no sales and promotional support) in exchange for lower margins or fixed mark ups
- Integrated supplier/wholesaler sales forces that operate in a collaborative manner for growth that benefits both supplier and wholesaler
- Online “e-tailers” that harness a network of wholesalers and retailers to provide consumers with a direct-purchase experience while complying with legal requirements

In short, the three-tier system does not have one future, as it lacks a single past or present. Innovations will develop as technologies (*e.g.*, online ordering, better business to business capabilities) and business considerations (*e.g.*, small supplier proliferation) create incentives and pressures to change. These developments are unlikely to end the business reality of three-tier distribution; but distribution models will continue to evolve.



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Enforcement of Antitrust Rules to Distribution Agreements in Europe

By Veronica Pinotti and Martino Sforza

Some recent developments in the European antitrust legal arena demonstrate that the enforcement of antitrust rules in the distribution sector is clearly one of the main priorities on the agenda of the European antitrust authorities. As such, compliance with antitrust legislation is also a priority for alcohol beverage companies reliant on distribution systems.

New Rules

Article 101, paragraph one, of the Treaty on the Functioning of the European Union (TFEU) prohibits agreements that have as their object or effect the prevention, restriction or distortion of competition. Under Article 101, paragraph three, of the TFEU, potentially restrictive agreements may, however, be exempt if they benefit customers.

The European Commission has adopted a number of block exemption regulations for agreements that meet a set of specific requirements. The main one applies to vertical distribution agreements (the Vertical Block Exemption, or VBE). A new VBE, along with a new version of the relevant vertical guidelines entered into force on 1 June 2010. Companies involved in the supply and distribution of their products in Europe were given until 31 May 2011 to review their existing vertical agreements and adjust them to comply with the new VBE and guidelines. If a business is not sure if it is currently compliant, it should seek legal advice immediately.

Recent Antitrust Cases Related to Distribution in Europe

Meanwhile, a number of antitrust proceedings and sector specific investigations have been started by the Commission and national competition authorities, in order to better understand potential competition concerns related to distribution of goods and services.

In November 2010, the Italian competition authority launched an investigation into the role of large-scale distribution in Italy, which included, *inter alia*, the main alcohol beverage groups that are active in Italy. The investigation aims at assessing potential antitrust issues, focusing on the agreements and strategic negotiations between suppliers and large-scale distributors, the role of centralised purchasing, the use of private-label brands and their likely effects on the final prices. The investigation is still ongoing and may be the prelude to specific investigations against individual companies.

“Foreign companies cannot merely import their existing standard distribution agreements into Europe.”

In February 2011, the German competition authority also launched a sector inquiry into the market for the purchase of food, drinks and tobacco for retailers, focusing on the purchasing power at retail level and the relationship between retailers and their suppliers.

Very recently, in April 2011, the Austrian competition authority launched a national antitrust enquiry over allegedly unlawful pricing practices for beer in barrels as compared to beer in bottles, and other alleged anticompetitive restrictions at wholesale level.

Multinational companies distributing their products in European Economic Area (EEA) countries (the European Union, plus Iceland, Liechtenstein and Norway), or wishing to enter such markets, are well advised to review their current distribution agreements in order to ensure overall compliance with EU competition law.

Minimising Exposure to Antitrust Risks

EU competition rules differ substantially from those applicable outside Europe, particularly in the United States. Therefore, foreign companies cannot merely import their existing standard distribution agreements into Europe, but must adapt their strategies to comply with EU and national rules.

Even the most basic restrictions contained in vertical distribution agreements, such as restrictions on the buyer's ability to determine the sale price or the territory where (or the customers to whom) it may sell the goods, or when the buyer is required to purchase all or most of its stock from a supplier, may potentially give rise to competition issues.

Price Restrictions

In the EEA, fixed or minimum resale price maintenance (RPM) is very likely to be considered illegal. Recommended resale prices are generally allowed, however they are also likely to be considered illegal if they operate as RPM in practice. For example, rewarding distributors that follow the prices recommended by the suppliers could be seen as establishing an illegal agreement to adhere to minimum resale prices.

Under the new VBE, fixed or minimum RPM continues to fall outside the scope of the block exemption. However, the Commission has inserted into the vertical guidelines a description of certain cases where RPM may increase efficiency and might, therefore, be exempt from the prohibition contained in Article 101 TFEU. In particular, RPM may have beneficial effects in the introduction of a new brand or entry into a new market; in relation to organising a coordinated short-term, low-price campaign (in a franchise system or similar distribution systems); in preventing large distributors from using a particular brand as a loss leader and the avoidance of sales below cost leading to the delisting of the product by other retailers, to the detriment of consumers.

Territorial/Customer Restrictions

EU competition does not allow the use of airtight, exclusive arrangements to completely seal off markets.

“EU competition does not allow the use of airtight, exclusive arrangements.”

In principle, a supplier may prohibit a distributor from “actively” seeking sales in territories reserved exclusively for other distributors, but it may not prevent a distributor from filling unsolicited (passive) orders from customers outside its territory. Similarly, a supplier is permitted to reserve a customer group for itself (or for another distributor), but it cannot prohibit a distributor from filling unsolicited orders sought by customers in that group.

Channel Restrictions: Online Sales

In principle, the internet must be available to all retailers. Suppliers may, however, impose reasonable conditions on how retailers can use the internet (e.g., brand image guidelines) or require a minimum brick and mortar presence.

“These rules have serious implications for companies engaged in distribution agreements.”

Acts currently prohibited under EU law include restricting access to websites for customers outside the territory, re-routing based on the IP address of the customer, refusing payment if made from outside the territory and placing limitations on the proportion of sales made through the internet.

Conversely, the use of “banner” advertising outside the territory or national extensions of other reserved territories (e.g. .de, .fr) is considered restrictive of active selling and, therefore, is allowed in certain circumstances.

Non-Compete Clauses

Non-compete clauses (i.e., an obligation on the distributors to buy more than 80 per cent of its total product requirements from a supplier) are not covered by the VBE if their duration exceeds five years. If they do exceed this time limit, they need to be assessed in light of the criteria set out in the vertical guidelines. Post-contract non-compete clauses, which prevent the buyer from distributing competing products when the distribution contract period is completed, are unlikely to give rise to competition issues if their duration does not exceed one year.

These rules have serious implications for companies engaged in distribution agreements. Agreements found to be restrictive are automatically void and unenforceable and the parties may be subject to substantial fines (up to 10 per cent of group worldwide sales), as well as claims for damages.

In order to minimise potential antitrust risks, MNCs active in Europe must review their distribution strategies to ensure they are compliant, if they haven't already done so. Given that the deadline is only recently expired, the effects of any violations would not be major at this stage. Any potential fines would be at a low level, given that they are proportional to the duration of the alleged infringement. However, any further delay would result in increased fines and penalties.

Laure Carapezzi also contributed to this article.



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Alcohol Brand Protection Beyond Core Products in Europe

By Rohan Massey and Hiroshi Sheraton

The alcohol beverage industry has produced some of the world's biggest brands. In common with other consumer brands, sophisticated and extensive marketing techniques are employed by alcohol beverage companies, often in areas of activity outside goods and services that would be considered to be core products. For example, sponsorship of or other involvement by alcohol brands in sports, the arts, music and cultural activities is prevalent. Alcohol beverage websites often carry downloads of graphics, music, video and applications, offer competitions and provide a wide array of information.

From a regulatory standpoint, companies must negotiate carefully a series of laws, regulations and codes of conduct that vary significantly between jurisdictions in their applicability to these “outside” activities. In addition, the association of alcohol with certain activities, such as sporting events, is politically sensitive. Nevertheless, the consistent association of a brand with a particular event or type of activity is often a key ingredient in building brand identity and brand equity. The question therefore arises as to how these assets can be protected. Unfortunately for brand owners, European trade mark law provides a rather complex series of answers.

Defending Against Trade Mark Infringement

The starting point is usually obtaining registered trade mark rights for the brand, to cover goods and services outside of the core product. This protects the brand owner from other businesses using the goodwill inherent in a brand to promote their own product outside the alcohol market.

“European trade mark law provides a rather complex series of answers.”



Even without a trade mark registration that covers the type of goods or services that another businesses is promoting, it may still be possible for brand owners to assert their rights if the brand owner is able to show that the mark is one with a reputation. Under those circumstances, brand protection

is extended to cover goods and services that are dissimilar to the “core product”, provided that the acts complained of dilute, tarnish or take unfair advantage of the reputation of the registered trade mark. In such cases, a brand owner must also show there is a “link” formed in the mind of consumers between the brand and the new product and that there is a change in the economic behavior of consumers as a result. Unfortunately, the state of European law as to how such concepts are to be applied is unsatisfactory, and the evidential burden to prove a case could be substantial.

Having a trade mark registration that includes or is very similar to the goods or services being provided by an alleged infringer will usually substantially improve the prospects of a successful enforcement action. The court will make an assessment of the similarity of the mark and the goods listed in the trade mark specification with those of the alleged infringer. It therefore makes sense for brand owners to register their trade mark for as many goods and services as is practicable and realistic.

“It is also increasingly difficult to identify the dividing line between promotional and commercial activities.”

Trade Marks and “Genuine Use”

However, there is a caveat in relation to registering trade marks outside the core area of alcohol beverages which may stand in the way of enforcing European trade marks outside of a core product area, namely that if the proprietor cannot show genuine use within a period of five years the registration can be revoked. This also permits partial revocation: if the mark has not been used for certain goods or services, these goods can be removed from the specification. European case law gives at least some guidance as to what constitutes “genuine use” for these purposes.

The general principle was established in *Ansul BV v Ajax Brandbeveiliging BV* [2003] C-40/01 ECJ that the use did not have to

be qualitatively significant, but that the commercial exploitation of the mark must be real. The use must be “warranted in the economic sector concerned to maintain or create a share in the market for the goods or services protected by the mark”. However, the requirement for commercial exploitation does not mean that a profit has to be made, which raises questions of whether promotional usage qualifies as genuine use.

“The dividing line between brand extension and promotional activities is not always clear cut.”

Further guidance in relation to promotional giveaways was given by the Court of Justice of the European Union in *Silberquelle GmbH v Maselli-Strickmode GmbH* [2009] C-495/07 All ER (D). In *Silberquelle*, it was held that producing a promotional item that is given away to encourage consumers to buy the core product will not qualify as genuine use. The judgment re-iterated the requirement for maintaining or creating a market share *in the goods protected* and contrasted that with the facts of the case which were concerned with creating or maintaining market share in the core product.

There are many situations involving non-core activities in which it could be argued that the brand is being used to create or maintain market share in those activities. A brand extension into a different product area such as clothing or liqueur chocolates is an obvious example. However, the dividing line between brand extension and promotional activities is not always clear cut. Many alcohol brand owners would argue that their trade marks are well known in certain fields unrelated to alcohol beverages. Indeed, certain events or activities may be more attractive to consumers when compared to alternatives because of the brand’s image or its historical involvement with the event. When it comes to online activities, it is also increasingly difficult to identify the dividing line between promotional and commercial activities when so much content is given away for free. From a brand protection perspective, it is therefore important to understand how the market in the “non-core” product operates and to assess what role the trade mark plays in competing in that market. The burden of proving genuine use rests with the brand owner. It is therefore worth defining suitable contractual arrangements

(on issues such as quality control) and making sure appropriate records are kept, such as advertising expenditure on an event or the promotional product itself, that will assist in proving a “genuine” participation in this market.

Lifestyle branding in the alcohol beverage industry looks set to continue, meaning that the ability to protect brands in fields outside of their core product area will become of increasing significance. While the law in Europe on extended protection for famous marks is in a state of disarray, understanding the trade mark use requirements can provide some relatively simple steps that significantly improve the prospects for maintaining a wider trade mark coverage and successful enforcement later on.



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The Intersection of Trade Mark Rights and Government Labelling and Selling Requirements

By John Dabney and Richard Kim

In the United States, there are various federal and state requirements that govern the sale of alcohol beverages, including rules relating to the labelling and selling of the products.

The failure to follow those rules can impact the protection of a trade mark or brand. A recent decision by the US District Court for the Eastern District of California (*The Wine Group LLC v L and R Wine Company*, 2011 U.S. Dist. LEXIS 35405 (E.D. Cal. 2011)) reinforces the importance of alcohol beverage manufacturers complying with all federal and state labelling and selling requirements. Failure to do so may result in a court case or in the Trademark Trial and Appeal Board (TTAB) discounting trade mark use made in connection with the non-compliant product, which could affect trade mark priority or even result in the cancellation of trade mark registrations.

In *The Wine Group LLC*, The Wine Group, which is the maker of FRANZIA wine, applied for and received federal trade mark protection for a wine box design. L and R Wine Company, also a maker of wine sold in a box, received a certificate of label approval (COLA) from the Alcohol & Tobacco Tax & Trade Bureau (TTB) for a wine box that, according to The Wine Group, was confusingly similar to its own federally registered design. L and R denied The Wine Group's infringement claims and alleged priority of trade mark use in commerce of its box design. In response, The Wine Group asserted as an affirmative defence that any prior use of L and R's box design was unlawful because L and R failed to comply with mandatory labelling and selling elements under federal and state law. In particular, The Wine Group contended that L and R's alleged prior use of its box design was unlawful because:

- L and R's label had not been approved by TTB (*i.e.*, L and R had not received COLAs for its labels).
- L and R's label did not contain the government health warning required by law.
- L and R sold the products in stores owned by it in violation of a Pennsylvania statute.
- L and R failed to create and maintain purchase and sale receipts showing the sale of wine in violation of a Pennsylvania statute.
- L and R failed to file and maintain reports with the proper Pennsylvania authorities regarding the sale of the wine.

The court held that The Wine Group's affirmative defence that L and R's prior trade mark use was unlawful was a valid affirmative defence and denied L and R's motion to strike it. The court's holding recognises the rule that use in commerce only creates trade mark rights when that use is *lawful*. As the court explained, "for purposes of trademark priority, lawful use may require compliance with labelling requirements." The use of a mark in connection with a product bearing an unlawful label, or that was sold in violation of state alcohol laws, may not create trade mark rights and may ultimately result in the loss of valuable trade mark priority rights and cancellation of the brand owner's federal trademark registration.

Use in commerce only creates trade mark rights when that use is on a product that is lawful.

Cancellation

The court's decision in *CreAgri Inc. v USANA Health Sciences, Inc.*, 474 F.3d 626 (9th Cir. 2007) illustrates in stark terms the impact of the failure to comply with applicable governmental labelling laws with respect to a regulated product, such as an alcohol beverage. In this case, CreAgri sold dietary supplements that were regulated by the federal Food, Drug and Cosmetics Act (FDCA), most notably, an olive-derived product for which it had a registered trade mark. Over a year after CreAgri brought this product to market, USANA registered a similar olive-derived product. CreAgri attacked USANA's registration on the basis of prior use. However, the label used by CreAgri on its olive-derived product did not comply with the federal regulations promulgated under the FDCA. The court found that each of the products sold by CreAgri under the mark prior to USANA's first use of the allegedly infringing mark were mislabelled.

Based on the undisputed fact that CreAgri's products were not FDCA-compliant and thus were not lawful, the court affirmed the award of summary judgment against CreAgri and ordered the cancellation of CreAgri's trade mark registrations. In so doing, the court explained the rationale behind its ruling:

First, as a logical matter, to hold otherwise would be to put the government in the anomalous position of extending the benefits of trademark protection to a seller based upon the actions the

seller took in violation of that government's own laws. ... Second, as a policy matter, to give trademark priority to a seller who rushes to market without taking care to carefully comply with the relevant regulations would reward the hasty at the expense of the diligent.

The court rejected CreAgri's argument that there was an insufficient "nexus" between the use of the mark and the violation of law. Instead, the court essentially suggested that any time there was a labelling violation on a product meant for human consumption, the nexus "is sufficiently close to justify the withholding trade mark protection for that name *until and unless the misbranding is cured*" (authors' emphasis). The court also rejected CreAgri's contention that the violation of the federal regulation was not material. In so doing, the court reasoned that *all of* CreAgri's products bearing the registered mark that were sold prior to the first use by USANA of its allegedly infringing mark violated the federal regulation. The court distinguished a case where the first batch of the plaintiff's products bearing the mark violated a federal regulation, but then that violation was corrected on all subsequent batches of products *before* the defendant had commenced use of the allegedly infringing mark. Although *CreAgri* relates to dietary supplements, the same principles will apply to alcohol beverages.

In *General Mills Inc. v Healthy Valley Foods*, 24 USPQ 2d. 1270, 1273 (TTAB 1992), the TTAB found that unlawful use justifying the cancellation of a trade mark registration will be found if a court or government agency with competent jurisdiction under the statute involved has previously determined that the party in question has not complied with such statute, or where there has been a *per se* violation of a statute regulating the sale of a party's goods.

Other courts have applied the TTAB policy in evaluating the trade mark implications arising from the fact that the label on the product is unlawful. Examples include *Dessert Beauty Inc. v Mara Fox*, 617 F. Supp. 2d 185 (SDNY 2007), which analysed the unlawful use defence in connection with mislabelled fragrance and beauty products, and *United Phosphorus, Ltd. v Midland Fumigant, Inc.*, 205 F.3d 1219 (10th Cir. 2000), which analysed whether a US Environmental Protection Agency-approved label is required for an aluminium phosphide to be lawfully used in commerce. Again, these examples have direct implications for alcohol beverage manufacturers.

Because of the highly regulated nature of the industry, alcohol beverage manufacturers must be extremely careful in complying

with all federal and state regulations concerning the labelling and selling of their products. The failure to do so can result in loss of the brand and trade mark registrations. If an alcohol beverage manufacturer is made aware of a violation with respect to its label or the sale of its products, it should take prompt steps to correct that violation.

Bess Mallis also contributed to this article.



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US Rules on Labelling

By Deborah Ringo

Every alcohol beverage produced, imported, marketed and sold for US consumption must comply with a myriad of federal and state laws and regulations. The federal Alcohol & Tobacco Tax & Trade Bureau (TTB) promulgates and enforces the federal laws, regulations and policies affecting the formulation and labelling of all distilled spirits, virtually all beer and wine containing more than 7 per cent alcohol by volume.

One of TTB's primary tasks is the review and pre-approval of product formulations and labels. Early collaboration with TTB and pre-planning for brand identity and marketing is crucial to determine how the product will be presented to the consumer and to ensure the label will have the desired effect on brand value.

TTB approvals are not reviewed and issued concurrently. The process is multi-step and encompasses flavour approvals, liquid approvals and label approval. The source of the product (domestic versus imported), classification and production method will dictate what information and samples must be provided for TTB analysis and review.

The first step in the procedure for any product with a flavour is for the flavour manufacturer to submit the flavour's formulation to the TTB laboratory for analysis and approval. The flavour is reviewed for tax status and to ensure that restricted or limited ingredients are not present or exceeded. The flavour name and classification can have an impact on the classification of the finished beverage and other labelling information such as colour declaration.

Once any flavours are approved, the manufacturer of the finished product can

submit for formula approval, if necessary. Many domestic products require a formula approval and many imported products require an analogous pre-import approval. Colours, flavours and food additives are reviewed for label disclosure. Certain products require liquid to be analysed by the TTB laboratory; others require a complete and accurate list of ingredients and method of manufacture to be reviewed without a liquid sample. TTB reserves the right to request additional information or liquid samples to be reviewed by their laboratory.

Some classes of products may proceed directly to label approval without obtaining flavour and formulation approvals first. Bourbon whiskey, Scotch whiskey, cognac and tequila, each a geographically significant class of product, all fall within this category.

Once TTB approves the pre-import approval or domestic formula, a Certificate of Label Approval is submitted for review. TTB reviews labels for compliance with mandatory information requirements such as brand name, class and type, net content, alcohol content and country of origin. The regulations pertaining to alcohol beverage labels can be found in 27 CFR, Part 4 (wine), Part 5 (spirits) and Part 7 (malt beverages).

TTB regulations also address prohibited practices in labelling and advertising. The prohibitions generally include misleading or false information, health or therapeutic claims, and flags or any other implications of government endorsement. Advertising claims also must be consistent with the approved formula and label for the specific product.

Once TTB grants label approval, the state process begins. Some states adopt federal labelling requirements, while others do not. Almost every aspect of the alcohol beverage

business is subject to concurrent federal and state jurisdiction.

Policies and procedures can be ambiguous at times. Innovative products and labelling concepts may provoke controversy and the road from concept to market can be fraught with regulatory minefields. Counsel can provide invaluable assistance in brainstorming the formulation and label approval process to ensure an alcohol beverage product has the brand impact and desired effect in the marketplace.



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Fixing the Problem of Counterfeited Alcohol Beverages in China

By Carolyn Gleason and Pamela Walther

The Obama administration's 2011 annual report on US intellectual property (IP) rights concerns in foreign markets gives primary emphasis to China, the United States' third largest export market, where problems with IP protection are pervasive. The report concludes that because of recurring violations in China across a range of US goods, including alcohol beverages, the US Government has placed China on its "priority watch list" and is redoubling efforts to improve China's enforcement of US IP rights. As the US Government steps up its examination of how US trade marks and other IP rights can be better safeguarded in China, American businesses, including in the alcohol sector, have new opportunities to work with the Obama administration on enforcement action plans to reduce IP losses in China.

A Top Business Concern

A 2011 AMCham-China Business Climate Survey found that US companies regard China's IP rights enforcement as "a top business concern". According to several reports, China's IP rights violations cost US companies billions of dollars in lost revenue and, to a growing extent, are deterring US companies from investing in China. Members of Congress, in letters, hearings and Congressional reports, are voicing similar concerns and are calling on China to make measureable and lasting enforcement improvements.

A Top Concern for US Wines and Distilled Spirits

The US wine and distilled spirits industry is one of the sectors hardest hit by Chinese IP rights violations. The violations reportedly run the full spectrum of piracy methods,

from primitive to sophisticated. Examples include small operations that manually empty bottles of high-end brand spirits and wine and refill them with cheaper, inferior Chinese-produced products; and much larger operations, essentially counterfeiting factories, that produce copycat brands of alcohol beverages for sale in China and abroad. Whatever their form, counterfeited alcohol beverages erode not only the sales and revenues of US companies, but brand equity as well. If the counterfeited product happens to be made with unsafe or adulterated ingredients, US interests risk the cost and reputation burden of food safety claims.

A Top Concern for the Obama Administration

The Obama administration has been raising concerns with China about its IP rights enforcement in virtually every high-level bilateral trade meeting that takes place. China responded in 2010 with a nine-month "special campaign" against counterfeiting, which led to increased raids of counterfeiting operations throughout the country, including reports of intensified raids in the alcohol beverage industry. The Obama administration believes the special campaign made marked progress in protecting US IP rights and has convinced China to implement a long-term IP rights enforcement mechanism, building upon the success of the campaign. The administration is also pushing China to make the manufacture of counterfeit goods a crime, regardless of value, and to confiscate all counterfeiting machinery, not just the illegal goods.

With China now on the United States' priority watch list and committed to extending its special campaign to US industries with significant IP concerns, US alcohol beverage firms have promising new

tools to help safeguard their IP rights in China. The time is right for this sector to be coordinating with the US Government on concrete company and industry action plans to help drive lasting IP monitoring and enforcement improvements in China's fast-growing alcohol beverage market.



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Labelling and Packaging Mixed Alcohol Beverages in the European Union

By Frank Schoneveld and David Henry

Manufacturers and distributors of flavoured alcohol beverages (FABs) face new and far-reaching EU labelling rules. A new draft law foresees mandatory nutritional information labelling requirements that must be displayed on FABs.

Just one effect of this law will be the requirement to show the caloric content of such drinks. Furthermore, all other alcohol beverages, such as wine, spirits and beer, may fall within the ambit of these new EU labelling rules within five years of entry into force of the draft law currently making its way through the latter stages of the EU legislative process. Operators active in the

alcohol industry should keep themselves informed of developments in this sector as failure to comply with EU rules can result in significant penalties.

Why a New Law?

The new draft labelling law will repeal a number of existing laws on nutrition labelling and advertising of foodstuffs and combine them into a single, comprehensive EU law applicable in all 27 EU Member States. This means that the new law will take effect as soon as it is published, with no need for further implementation at national level (the law will be known as the regulation

on the provision of food information to consumers). The rationale behind the revision of the labelling rules is that much of the nutrition information, which under current EU rules should be included on products, is voluntary and outdated. There is, moreover, a perception that self-regulation is not an effective means of ensuring that accurate nutritional information is included on all food and drink packaging. The new draft law seeks to ensure that, amongst other things, FABs provide nutrition information that is accurate, clear and easy to understand for the consumer.



Alcohol Beverages to which Current Rules Continue to Apply and Exemptions from Labelling Requirements

Other alcohol beverages, such as wine and spirits, currently do not fall within the draft law. Wine and spirits are exempt as specific EU consumer protection rules already exist in relation to them.

An exemption from the obligation to list on the label the ingredients and to provide for a nutrition declaration also applies to all types of beer, beverages containing more than 1.2 per cent by volume of alcohol obtained from fermentation of fruits and vegetables (such as wine), and mead (a fermented, honey-based beverage).

Exempted from inclusion on the label of ingredients are, amongst others, some allergens used in making alcohol drinks, as well as whey, cereals and nuts used for making distillates. There are a number of other exemptions to the ingredients labelling and nutrition declaration requirements.

It should be noted that potentially all alcohol beverages may fall within the ambit of the new EU labelling rules within five years of the entry into force of the draft law. A decision to extend the draft law will be made following the publication of a Commission status report on whether further alcohol beverages should also be addressed by the new labelling rules.

Mandatory Labelling Information on Flavoured Alcohol Beverages

Contents

The obligation to list the ingredients and to provide a nutritional declaration will at first apply only to FABs. The draft law requires that the following information be provided on labels of FABs: the name, the list of ingredients, allergens, the quantity of certain ingredients, the net quantity of the drink, the "best before" date, any special storage conditions and/or conditions of use, the name or business name and address of the business operator, the country of origin or place of provenance (under certain conditions), instructions for use where required, the actual alcohol strength by volume if the beverage contains more than 1.2 per cent by volume of alcohol, and a nutrition declaration.

As regards the alcohol strength, the draft law establishes that the alcohol strength by volume of drinks containing more than 1.2 per cent by volume of alcohol must be indicated by a figure to not more than one decimal place. It must be followed by the symbol "% vol" and may be preceded by the word "alcohol" or the abbreviation "alc". The alcohol strength is to be determined at 20°C. Positive and negative allowed tolerances in respect of the indication of the alcohol strength by volume and expressed in absolute values must also be listed.

According to the draft law, the mandatory nutrition declaration must include the energy value in kilojoules (kJ) and kilocalories (kcal) and the amounts of fat, saturates, carbohydrates, sugars, protein and salt in grams (g). This information must be marked in the same field of vision and in the following order: energy, fat, carbohydrates, fibre, protein and salt.

Visual Requirements

This mandatory information must be marked on FABs in a conspicuous place and in such a way as to be easily visible, clearly legible and, where appropriate, indelible. When appearing on the package or on the label attached to it, the mandatory information must be printed on the package or on the label in characters using a specific font size. The information must be presented in a way so as to ensure a significant contrast between the print and the background. There are special rules for re-usable glass bottles and small packages. The net quantity of the drink must be expressed using litres, centilitres or millilitres as appropriate, and the list of ingredients must be headed or preceded by a suitable heading that consists of or includes the word "ingredients".

Issues for the Alcohol Industry

Operators active in the supply and distribution of FABs (and alcohol beverages in general) should be aware that failure to comply with these new EU labelling rules may result in significant penalties. Each Member State is free to impose different types of sanction, but these may range from fines to a prohibition on placing the products on the market, or withdrawal of products from the market altogether. Furthermore, significant costs could be incurred from the obligation to amend all the labels and packages of FABs that do not comply with these imminent new requirements of EU law.

Those involved in the EU alcohol industry also need to be aware of the very real possibility that within five years of the entry into force of the draft law, and following a Commission report on the matter, the proposed labelling requirements for FABs could very well be extended to cover all alcohol drinks.



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Federal Trade Commission Alcohol Advertising Review Anticipated

By Arthur DeCelle

On 25 February 2011, the United States Federal Trade Commission (FTC) published a notice in the *Federal Register* indicating that a comprehensive review of alcohol beverage industry advertising practices in the US will begin later this year. FTC efforts to monitor alcohol advertising provide a model for maintaining an arms-length government/industry relationship that could be useful to other consumer products industries.

Older FTC inquiries on alcohol advertising focused on specific claims or promotional campaigns. Today, vast amounts of data are available from credible third-party sources providing a comprehensive view of industry sales and advertising practices. The FTC's "key" to industry data banks is the "6b order", named for the section of the FTC Act that authorises broad inquiries into activities of individual businesses or entire industries.

Vast amounts of data are available from credible third-party sources.

FTC reports to Congress were published in 1999, 2003 and 2008 based on 6b orders issued to the largest alcohol beverage companies doing business in the United States. Additional orders were sent to smaller companies in 2009 and 2010.

The FTC reports were based heavily on enhanced media measurement technologies developed to produce a consistent and increasingly detailed view of audience

demographics for millions of advert placements annually. Alcohol beverage industry members adopted voluntary advertising placement guidelines that rely on the standardised report formats.

The 2008 FTC report includes the following information:

- The 12 companies surveyed accounted for 73 per cent of sales by volume in 2005, and pre-tax revenues of US\$30.8 billion.
- The total number of brands and brand extensions was 1,133.
- Expenditures in the 19 categories of advertising surveyed totalled over US\$3.1 billion.
- 93 per cent of advertising placements met the voluntary industry target for audience demographics (70 per cent of an audience should be 21 or older).
- Close to 100 per cent of magazine and newspaper placements met the voluntary standard.
- 98 per cent of motor sports programs on which alcohol advertising appeared in the first half of 2005 had a legal drinking age audience of 70 per cent or higher, and 85 per cent of the attendees at NASCAR events were 21 or older.

These results were achieved without formal federal regulation, and regular audits required by the industry codes have refined placement practices, enabling companies to consistently achieve 95 to 100 per cent compliance.

While responses to 6b orders are expensive, tedious, and time-consuming, they provide

a realistic and verifiable record that can be used to challenge anecdotal and emotional appeals for unwarranted regulation. FTC oversight has generally allayed concern about alcohol advertising by providing a realistic view of industry practices.

Industry critics have responded to FTC reports with complaints that the industry's voluntary standard is inadequate and should be raised so that adverts are placed only when 85 per cent of an audience is expected to be above the legal drinking age. The periodic reports clearly show, however, that alcohol advertising is already targeted toward adults of legal drinking age and that measures are already in place to monitor compliance with the law and voluntary industry standards. Maintaining that effort should enable members of the alcohol beverage industry to continue viable advertising and marketing campaigns in the years ahead.



Arthur DeCelle is counsel based in the Firm's Washington, DC, office. He focuses his practice on alcohol beverage regulation at all levels of government and on legal and public policy challenges facing heavily regulated industries. Prior to joining McDermott, Art was the general counsel of the Beer Institute for 16 years. From 1981 to 1994, Art held senior staff positions in the US House of Representatives and worked on several federal political campaigns. He can be contacted on +1 202 756 8460 or at adecelle@mwe.com.

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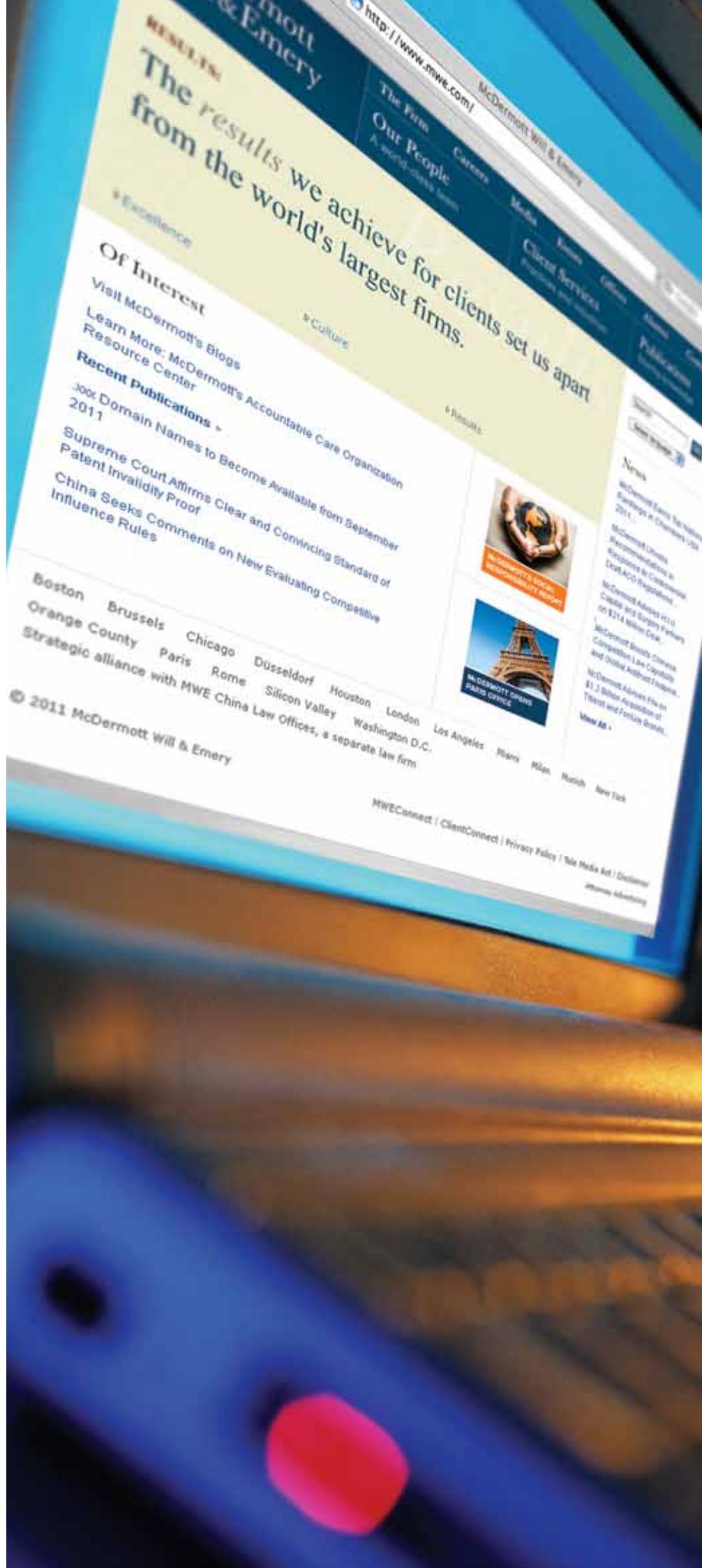
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