



UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Office of Policy Planning
Bureau of Economics
Bureau of Competition

May 16, 2011

The Honorable Alice H. Peisch
Representative, 14th Norfolk District
The Commonwealth of Massachusetts
House of Representatives
State House, Room 473G
Boston, MA 02133-1054

Dear Representative Peisch:

The staffs of the Federal Trade Commission's Office of Policy Planning, Bureau of Economics, and Bureau of Competition¹ are pleased to respond to your invitation for comments on Massachusetts House Bill 1871 ("H.B. 1871" or "the Bill").² The Bill will add new administrative requirements when the ownership of a malt beverage supplier changes and the new malt beverage supplier wants to terminate a wholesale distribution agreement that existed with the prior supplier. In addition, the Bill will require wholesalers brought in by a successor supplier to pay terminated wholesalers for the value of the distribution rights, including the value of any goodwill associated with the distribution of the discontinued brand. If adopted, the Bill would further impede competition in the distribution of malt beverages, and thereby harm competition and consumers. The Bill appears to provide no countervailing consumer benefits that might justify such competitive restrictions. Thus, FTC staff urge that the Massachusetts legislature not pass H.B. 1871.

FTC staff also note you have introduced alternative legislation, H.B. 1897. This Bill would maintain much of the current regulatory structure imposed under Massachusetts law, which already places significant constraints on the ability of suppliers to deal in a competitive manner with wholesalers. However, because H.B. 1897 avoids the additional restrictions on successor suppliers and would provide some relief for

¹ This letter expresses the views of the Federal Trade Commission's Office of Policy Planning, Bureau of Economics, and Bureau of Competition. The letter does not necessarily represent the views of the Federal Trade Commission or of any individual Commissioner. The Commission has, however, voted to authorize staff to submit these comments.

² Letter from Hon. Alice Peisch, Massachusetts House of Representatives, to Susan DeSanti, Director, Office of Policy Planning, Federal Trade Commission (Apr. 4, 2011) [hereinafter Peisch Letter]. A copy of H.B. 1871 may be accessed at <http://www.malegislature.gov/Bills/187/House/H01871>.

“small brewer relationships,”³ it likely would be an improvement over the current regulatory environment.

Interest and Experience of the Federal Trade Commission

The FTC is charged with enforcing the FTC Act, which prohibits unfair methods of competition and unfair or deceptive acts or practices in or affecting commerce.⁴ Effective competition is at the core of America’s economy;⁵ vigorous competition among sellers in an open marketplace gives consumers the benefits of lower prices, higher quality products and services, more choices, and greater innovation.⁶

Under this statutory mandate, the Commission seeks to identify business practices that impede competition or increase costs without offering countervailing benefits to consumers. The FTC has considerable experience in analyzing the competitive impact of regulations affecting the alcoholic beverage industry, including in circumstances similar to this one involving restrictions on the relationships between alcoholic beverage suppliers and wholesalers.⁷ In addition, FTC staff conducted an empirical study of a wine market in a state that banned interstate direct shipping, and the results of that study were included in a FTC staff report addressing anticompetitive barriers to electronic commerce in the wine industry.⁸

³ H.B. 1897 would amend Mass. Gen. Law, Ch. 138 § 25E, and is available at <http://www.malegislature.gov/Bills/187/House/H01897>.

⁴ Fed. Tr. Comm’n Act, 15 U.S.C. § 45.

⁵ See *National Society of Professional Engineers v. United States*, 435 U.S. 679, 695 (1978) (“The heart of our national economy long has been faith in the value of competition.”).

⁶ See *Goldfarb v. Virginia State Bar*, 421 U.S. 773, 787 (1975).

⁷ See, e.g., Letter from FTC Chicago Regional Office Staff to Ill. State Sen. Dan Cronin (Mar. 31, 1999) (where the Illinois legislature proposed a bill that would impose regulatory restraints similar to those contained in H.B. 1871, FTC staff strongly discouraged adoption of the bill), available at <http://www.ftc.gov/be/v990005.htm>; Letter from FTC Staff to Florida State Sen. Paula Dockery (April 10, 2006) (supporting a proposed bill that would allow direct shipment of wine from manufacturers to consumers), available at <http://www.ftc.gov/os/2006/04/V060013FTCStafCommentReFloridaSenateBill282.pdf>; see also Letter from FTC Staff to Ohio State Rep. Bill Seitz (Dec. 12, 2005), at <http://www.ftc.gov/os/2005/12/051212cmntohiolegiswinefranchis.pdf>; Letter from FTC Staff to Cal. State Sen. Wesley Chesbro (Aug. 24, 2005), at <http://www.ftc.gov/os/2005/08/050826beerfranchiseact.pdf>; Letter from Atlanta Regional Office Staff to North Carolina State Sen. Hamilton C. Horton, Jr. (Mar. 22, 1999), at <http://www.ftc.gov/be/v990003.htm>; Statement of Phoebe Morse, Dir., Boston Regional Office to the Mass. Alcoholic Beverages Control Comm’n (June 26, 1996), at <http://www.ftc.gov/be/v960012.htm>.

⁸ FTC STAFF REPORT, POSSIBLE ANTICOMPETITIVE BARRIERS TO E-COMMERCE: WINE (2003); available at <http://www.ftc.gov/os/2003/07/winereport2.pdf>.

I. Background

A. The Current Law

Presently, Chapter 138, Section 25E of the Massachusetts general laws governing alcoholic beverages prohibits an alcohol beverage supplier from discontinuing sales to a wholesaler unless it demonstrates “good cause” for doing so.⁹ Under the law, “good cause” is limited to cases where the wholesaler: (1) disparages the product so as to impair the reputation of the brand owner or the name of any product; (2) shows unfair preference in sales efforts for brand items of a competitor; (3) fails to exercise best efforts in promoting the sale of any brand item; (4) engages in improper or proscribed trade practices; or (5) fails to comply with the terms of sale agreed upon by the supplier and wholesaler.¹⁰ Before discontinuing sales, the supplier must provide 120 days’ notice to the wholesaler, file such notice with the Alcohol Beverages Control Commission (ABCC), and state specifically the grounds supporting the “good cause” for its decision.¹¹ Either party may appeal to the ABCC, which then must order the supplier to continue selling to the affected wholesaler pending the outcome of the ABCC’s proceedings.

B. H.B. 1871

H.B. 1871 does not change any of the existing requirements or obligations of Section 25E. It broadens the scope of Section 25E, however, by adding new obligations when one malt beverage supplier acquires another supplier and seeks to install its own wholesalers and terminate any of the prior supplier’s wholesalers. H.B. 1871 would require the ABCC to conduct a hearing each time a successor supplier decides to terminate existing wholesalers subsequent to a transaction. First, the ABCC must determine whether the wholesale distribution obligations of the previous supplier are imputed to the new supplier. If so, then that successor supplier becomes bound by the provisions of Section 25E.¹² Thus, if the previous supplier’s wholesale agreement is imputed to the successor supplier, the ABCC must find good cause as defined under Chapter 138, Section 25E to terminate the agreement.

If the existing wholesale agreement does not impute existing distribution obligations to the successor supplier, the successor supplier may terminate the agreement, but the Bill would require a successor wholesaler (*i.e.*, the new wholesaler that will

⁹ See Mass. Gen. Law, Ch. 138 § 25E.

¹⁰ *Id.* Although the current law is silent on what, if anything, a supplier can do to terminate a wholesaler if the ABCC does not find “good cause,” we understand that in practice a supplier, its new wholesaler, or both would offer an incumbent wholesaler compensation for the distribution rights.

¹¹ *Id.*

¹² The proposed legislation is silent as to how the ABCC will determine that the existing obligations can be “imputed” to the new supplier. The uncertainty of the method of imputation in this new legislation is likely to add an additional layer of costs to transactions in this industry.

receive the distribution rights) to pay the affected wholesaler the fair market value of the distribution rights, including the loss of goodwill.¹³ The process of determining the value of the old wholesaler's rights begins when the new supplier gives notice of refusal to sell to the old wholesaler. If, after thirty days, the affected and successor wholesalers cannot agree on the fair market value of the distribution rights, they are required to undergo and share the costs of binding arbitration.

C. H.B. 1897

H.B. 1897 would exempt from the provisions of Section 25E "small brewer relationships," which are defined as the relationship between a supplier and a wholesaler "if: (i) the annual global sales of such supplier does not exceed six million barrels of malt beverages; and (ii) the sales of products to the wholesaler by the supplier do not exceed 20% of the wholesaler's total sales in the prior calendar year preceding any refusal to sell."¹⁴ H.B. 1897 would allow suppliers and wholesalers in a small brewer relationship to set by contract the terms under which the supplier could terminate the wholesaler. Moreover, H.B. 1897 would allow a supplier in a small brewer relationship to terminate a wholesaler regardless of the contractual terms as long as the supplier's successor wholesaler compensates the terminated wholesaler in an amount equal to the fair market value of the distribution rights. Fair market value would be determined by the parties, or if they cannot reach agreement, by binding arbitration.¹⁵

II. Likely Effects on Competition and Consumers

A. H.B. 1871

H.B. 1871 would require a successor supplier's new wholesaler to buy the distribution rights from the former supplier's wholesaler unless the successor supplier can prove to the ABCC that it has good cause for terminating the existing wholesale agreement. This requirement adds a new distribution cost that must be accounted for by the new supplier. Thus, the Bill would raise distribution costs for malt beverage

¹³ See H.B. 1871. Nothing in existing law appears to require any payment when one supplier purchases a brand from another supplier and the wholesale agreement is not part of the purchase agreement. Thus, it appears, absent settlements resolving legal disputes, no payment would be made to the affected wholesaler. Under H.B. 1871 a successor wholesaler is only exempt from making a payment to the affected wholesaler when the ABCC finds that the successor supplier demonstrated "good cause" as described in Mass. Gen. Law, Ch. 138 §§25E (a)-(e), which is limited to conduct where the wholesaler: (a) disparaged the brand, (b) showed unfair preference for a competitor, (c) failed to exercise best efforts to promote sales, (d) engaged in improper or proscribed trade practices, or (e) failed to comply with the terms of sale, such as timely pay for product pursuant to the supply agreement.

¹⁴ H.B. 1897, available at <http://www.malegislature.gov/Bills/187/House/H01897>. According to the Brewers Association, the following definitions are used to describe the different-sized brewers: a Microbrewery is one that produces less than 15,000 barrels per year; a Regional Brewery is one that produces between 15,000 and 6,000,000 barrels of beer per year; and a Large Brewery is one that produces over 6,000,000 barrels a year. Brewers Association, Market Segments, available at <http://www.brewersassociation.org/pages/business-tools/craft-brewing-statistics/market-segments>.

¹⁵ H.B. 1897.

suppliers, discourage efficient business decisions, and potentially hinder competition among wholesalers and suppliers.

Consumers benefit when suppliers are free to choose distribution channels that offer the best combination of price and service quality. H.B. 1871 makes it more difficult for malt beverage suppliers to switch wholesalers, which could result in higher prices and lower quality services. Moreover, to the extent that suppliers are unable to select their preferred wholesalers, such restraints could increase barriers to entry for new wholesalers who may be willing to offer a more attractive combination of price and services.

In particular, H.B. 1871 imposes new costs on a successor supplier who wants to create a different, and perhaps, more efficient wholesale distribution channel. These costs include a hearing before the ABCC, the payment to the terminated wholesaler for distribution rights and, if the parties cannot agree on the fair market value of the distribution rights, the cost of binding arbitration.¹⁶ Moreover, these additional costs may have a greater impact on smaller suppliers because they likely are less able to absorb the costs related to terminating wholesalers. Thus, these requirements may make it especially difficult for smaller suppliers to seek more efficient wholesale distribution arrangements.

Moreover, because H.B. 1871 would increase a successor supplier's costs to switch malt beverage wholesalers, incumbent wholesalers could have reduced incentives to lower costs or provide better services because they know there is a low risk they will lose a supplier's business. If suppliers are reluctant to change wholesalers, incumbent wholesalers will be shielded from competition, and may provide a lower level of quality in their services.

Finally, by reducing competition among wholesalers, H.B. 1871 also may hinder competition among suppliers. In addition to their own efforts, suppliers rely on wholesalers to take actions that increase demand for their products. Wholesalers and suppliers typically have different incentives to take these actions, however, and the threat of termination may help motivate wholesalers to provide more services in support of a particular supplier's brands.¹⁷ Because H.B. 1871 makes it more difficult for a supplier to terminate a wholesaler, wholesalers' incentives to take actions to help their suppliers compete more effectively with rival brands likely are reduced.

¹⁶ The Bill offers no guidance as to how the "fair market value" of the distribution rights should be determined, thus increasing the uncertainty, and potentially the costs, of reaching this determination. In addition, although the Bill specifies that the new wholesaler must compensate the terminated wholesaler, presumably the associated costs would be reflected in the financial arrangement between the supplier and the new wholesaler and both likely would share in these costs.

¹⁷ See Ralph A. Winter, *Vertical Control and Price Versus Non-Price Competition*, 108 Q.J. ECON. 61 (1993).

B. H.B. 1897

H.B. 1897 is likely to reduce some of the inefficiencies that exist in Massachusetts' alcohol distribution markets as a result of the current regulatory system. Although H.B. 1897 retains some provisions governing the relationship between suppliers and wholesalers that we believe are unnecessary and hinder a competitive market, we believe H.B. 1897 is an improvement over the current regulatory regime. In particular, H.B. 1897 would allow "small brewer relationships" more flexibility to respond to market conditions and likely would inject some additional competition into the market.

Conclusion

For the reasons discussed above, FTC staff urge that the Massachusetts Legislature not pass H.B. 1871. H.B. 1871 likely will reduce competition and harm consumer welfare, without any countervailing benefits to consumers. FTC staff also suggest that the Massachusetts Legislature adopt H.B. 1897, which would provide some regulatory relief to smaller brewers and help them be more competitive in the marketplace.

We appreciate your consideration of these issues.

Respectfully submitted,

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