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

March 31, 1999

The Honorable Dan Cronin
State Senator, 39th District
127 Capitol Building
Springfield, Illinois 62706

Dear Senator Cronin:

The Chicago Regional Office of the Federal Trade Commission(1) is pleased to respond to your request for comment on S.B. 15, the "Illinois Wine and Spirits Industry Fair Dealing Act of 1999" (the Bill) currently being considered by the Illinois Legislature. If enacted, S.B. 15 would modify general state commercial law as the law governing distribution agreements between suppliers and distributors in the wine and spirits industry. It would make permanent existing agreements between suppliers and distributors by prohibiting a supplier from canceling, failing to renew, or terminating any such agreement without good cause (e.g., fault, insolvency, or other serious misconduct).

S.B. 15 would shield the business of liquor distribution from market forces. Distributors know that if they attempt to charge more than the competitive price, suppliers can move their business to new distributors that are willing to charge lower wholesale prices. S.B. 15 would eliminate this competitive pressure by requiring suppliers to retain their current distributors. The likely result of such a static distribution system will be increased consumer prices.

The Commission is an independent administrative agency responsible for maintaining competition and safeguarding the interests of consumers. In the course of research, investigation, and litigation of antitrust matters, the staff applies established principles and recent developments in economic theory and empirical analysis to competition issues. Upon request, the staff of the Commission also analyzes regulatory or legislative proposals that may affect competition or the efficiency of the economy.(2)

Section 15(a) of the Bill prohibits a supplier or a distributor from canceling, failing to renew, or otherwise terminating a distribution agreement unless it has "good cause" for the action.(3) "Good cause" will not exist unless the terminated party: (1) fails to comply with a provision of the agreement that is lawful, reasonable, or nondiscriminatory; (2) is in serious financial difficulty; (3) has been convicted of certain types of crimes; or (4) has failed to act in good faith in performing under the agreement.(4) Section 15(b) prohibits a supplier, unless it has good cause, from failing to renew an agreement on terms then equally available to all of its distributors. In addition, Sections 15(c) and (d) prohibit both suppliers and distributors from waiving compliance with any of the Bill's requirements. In essence, the Bill makes permanent existing agreements between suppliers and distributors for the distribution of wine and spirits in Illinois.

We are unaware of any evidence establishing the need for this type of legislation. We have seen no evidence suggesting that wine and liquor wholesalers are different from wholesalers in other industries, thus requiring special treatment under state commercial law. These wholesalers provide storage and distribution services that are typical for wholesalers, especially in the food and beverage industries. Nor have we seen anything to indicate that competition is unworkable in the wine and liquor industries or that state policy governing alcohol distribution would require such legislation.(5)

The Bill Is Likely to Make it Difficult for Suppliers to Distribute their Products Efficiently

Although the Bill applies equally to suppliers and distributors, the Bill's restrictions are likely to make it difficult for suppliers to distribute their products efficiently. By providing that distributors cannot be terminated except for fault, insolvency or other serious misconduct, the Bill is likely to prevent suppliers from reacting quickly and efficiently to changes in supply and demand conditions. Thus, suppliers might be unable to restructure distribution networks that have become obsolete. The higher prices associated with such inefficiencies would presumably be passed on to consumers.

The constraining effects of the Bill might be severe in areas where suppliers have established exclusive sales territories for their distributors. Because Section 15 of the Bill prohibits the supplier from terminating or refusing to renew an agreement except under limited circumstances, a supplier that has assigned an exclusive sales territory may not be able to create new distributorships in that territory without triggering a claim from the existing distributor alleging that its exclusive territory is being terminated or reduced.

As a result of the proposed Bill, suppliers also might find it difficult to improve their distribution networks by consolidating territories to achieve scale efficiencies. Even though a supplier may have legitimate and procompetitive business reasons for wanting to modify, reduce, or eliminate a distributor's territory, it could not act in the absence of the distributor's fault or insolvency. Furthermore, even in some cases of distributor misconduct, a supplier might be reluctant to undergo a court battle and the costs of proving the existence of "good cause."

The Bill Might Deter Entry of New Distributors and New Products

The Bill also might have the highly undesirable effect of making entry into the market more difficult. Under current law, distributors have an incentive to provide retailers with liquor at competitive prices. If distributors attempt to charge more than the competitive price, suppliers can move their business to new distributors that are willing to charge lower wholesale prices. By limiting possible entry into the territory, however, the Bill may eliminate this competitive pressure and may therefore increase the prices paid by consumers. In addition, by increasing suppliers' costs of altering their distribution systems, the bill will reduce the incentives of existing suppliers to introduce new brands into Illinois and of new suppliers to enter the market.

Conclusion

S.B. 15 is likely to interfere with market forces by increasing the supplier's costs of adding or eliminating distributors or switching from one distributor to another. In the absence of the Bill's proposed restrictions, competition is likely to encourage suppliers to maintain efficient distributional arrangements, which will keep prices competitive for consumers. Suppliers also will retain necessary flexibility to respond effectively to shifting demand preferences and changes in supplier/distribution practices (e.g., technological change).

Sincerely,

C. Steven Baker, Director
Chicago Regional Office
Federal Trade Commission

1. This comment represents the views of the Chicago Regional Office of the Federal Trade Commission, and not necessarily the views of the Commission itself.

2. The staff of the Commission has commented in the past on the effects of vertical restrictions on competition in the wine industry, including comments to the North Carolina Legislature, An Act to Amend the Wine Franchise Law to Provide for Exclusive Territories (Mar. 22, 1999); Nevada Legislature, A.B 569 (June 12, 1987) (franchise agreements between liquor suppliers and wholesalers); Economic Matters Committee, Maryland House of Delegates, Wine Cooler Fair Dealing Act (Mar. 11, 1987); Council of the District of Columbia, Council Bill 6-442, The Wine, Beer and Spirits Franchise Act of 1986 (Aug. 29, 1986); Rhode Island Legislature, Distilled Spirits and Vinous Beverages

Fair Dealing Law (May 3, 1985); Virginia Senate Committee on Rehabilitation and Social Services, H.B. No. 1301, Wine Franchise Act (Feb. 8, 1985); California Department of Alcoholic Beverage Control, Proposed Changes in Regulations (May 5, 1984); Michigan State Legislature, Michigan Liquor Control Act (Apr. 4, 1984); and the Oregon Legislature, H.B. 2961 (May 20, 1983).

3. Section 20 also provides that the moving party also must provide prior notification of its intent to cancel, fail to renew, or otherwise terminate an agreement.

4. S.B. 15, §5. Even when the moving party can establish the requisite good cause, the party to be canceled, not renewed, or terminated has 90 days to cure the claimed default. Id., § 15.

5. S.B. 15 also creates an exemption to the antitrust laws by legalizing all agreements between suppliers and wholesalers. The staff of the Commission's Atlanta Regional Office recently commented to the North Carolina Legislature on the competitive effects of such an exemption. This comment can be accessed through the Commission's website <http://www.ftc.gov/be/advofile.htm > (V990003).