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

March 22, 1999

The Honorable Hamilton C. Horton, Jr.
1406 Legislative Building
Raleigh, North Carolina 27601-2808

The Honorable George W. Miller, Jr.
611 Legislative Building
Raleigh, North Carolina 27601-1096

Dear Senator Horton and Representative Miller:

The Atlanta Regional Office of the Federal Trade Commission(1) is pleased to respond to your February 4, 1999, and February 17, 1999, requests for comment on "An Act to Amend the Wine Franchise Law to Provide For Exclusive Territories" (the Bill) currently being considered by the North Carolina Legislature. The Bill would make "airtight" exclusive territorial arrangements between wineries and wholesalers in the wine industry and thus create an exemption to the antitrust laws. In addition, Representative Miller requested our views on the competitive effects of the current statute governing wine distribution agreements.(2) We believe that the Bill and the current statute may provide an unnecessary exemption to the antitrust laws that might cause adverse consequences to competition and consumers in North Carolina.

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.(3)

The Bill being considered would prohibit wine wholesalers from distributing any brand of wine to a retailer whose premises are outside of the wholesaler's exclusive retail territory. Under the Bill, the wholesaler and the winery would establish the wholesaler's exclusive retail sales territory. These exclusive territories may be modified once the term of an agreement between a winery and wholesaler terminates. The Bill is an amendment to the current statute governing wine distribution agreements that prohibits wineries from entering into more than one agreement with any one wholesaler for each brand of wine or beverage it offers in any territory. Possible competitive effects of the underlying statute will be discussed after the effects of the Bill are analyzed.

Exclusive Territorial Restraints between Buyers and Sellers May Have Anticompetitive Effects in Some Circumstances

Our concern with the Bill is that it could legalize some restraints that might have anticompetitive effects. Under current law, which applies to the wine industry, vertical non-price restraints, such as agreements providing for exclusive territories, are illegal if they are anticompetitive. We believe it is unwise to broadly legalize all such agreements even though many vertical restraints raise no competitive concerns. Special antitrust exemptions should be granted only where competition has proven unworkable.

The analysis used to determine whether an agreement is anticompetitive is called the "rule of reason." Under a rule of reason analysis, "the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on trade." *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433

U.S. 36, 49 (1977). For example, exclusive territorial agreements might facilitate collusive activity and could raise competitors' costs by foreclosing or disadvantaging competing firms from obtaining the inputs -- here, wine distribution agreements -- they need to compete. Such effects could follow if there was little interbrand competition (competition among dealers for different labels and brands), and the exclusive territorial arrangements eliminated substantial intraband competition (competition among dealers of the same label or brand) that previously existed.(4)

On the other hand, exclusive territories are often pro-competitive. The anticompetitive effects noted above could be offset by the factors the Supreme Court cited in Continental T.V. For example, exclusive territories could allow manufacturers (wineries) to achieve certain efficiencies in the distribution of its products by inducing competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer.(5) *Continental T.V*., 433 U.S. at 55.(6)

Under the rule of reason, the outcome of the analysis of any one agreement may differ under differing circumstances. The results of the analysis also may change over time in a single geographic area as changes occur in the industry (including the number of wineries, wholesalers and retailers operating in the market), in technology, and in distribution and marketing techniques. Thus, it appears unwise to immunize all such exclusive agreements from the antitrust laws, given that at least some of those agreements may have anticompetitive effects that harm consumers.

Antitrust Exemptions Traditionally Have Been Disfavored

The Supreme Court has called the antitrust laws the "Magna Carta of free enterprise."(7) The antitrust laws reflect the Nation's fundamental policy in favor of free enterprise and competition. And, as a general matter, immunity from the antitrust laws is exceptional and disfavored -- there are few industries or competitive situations in which the antitrust laws do not apply.(8)

The Bill currently being considered by the North Carolina Legislature would create an exemption to the antitrust laws by legalizing exclusive sales territories between wine wholesalers and retailers in all situations. The Bill would exempt a single industry from certain of the usual antitrust laws that apply to almost every other industry and company in the United States. As a proposed exemption, the Bill should be scrutinized under rigorous standards requiring clear evidence that potentially anticompetitive conduct should be permitted in order to achieve some fundamental social objective or to correct some otherwise-uncorrectable market failure.

We are unaware of any evidence establishing the need for this exemption from the antitrust laws. We have seen no evidence suggesting that wine wholesalers are different from wholesalers in other industries. Wine 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 industry or that state policy governing alcohol distribution would require such an exemption from the antitrust laws.

We believe that the same analytical framework described above is applicable to the existing statute governing wine distribution agreements. The existing statute prohibits wineries from entering into more than one agreement with any one wholesaler for each brand of wine or beverage it offers in any territory.(9) As discussed above, our concern is that the current statute may have legalized some restraints that might have anticompetitive effects.

In summary, the reduced competition that could result from exclusive territories in the wine wholesaling industry that are proposed in the Bill could result in higher prices for consumers without any offsetting consumer benefit. Likewise, the existing statute also may be having similar adverse effects on consumers by restricting wineries from entering into more than one agreement with wholesalers for each brand of wine they offer in any territory.

Sincerely,

Andrea Foster, Acting Director
Harold E. Kirtz, Senior Litigator

Atlanta Regional Office
Federal Trade Commission

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

2. N.C. Gen. Stat. Sec. 18B-1200 et seq. (1998).

3. 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 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).

4. *E.g., Skyview Distributing, Inc. v. Miller Brewing Company*, 620 F. 2d 750, 752 (10th Cir. 1980)(the court held that the lower court's dismissal of a complaint was in error because the complaint contained allegations about the anticompetitive effects of an agreement that was designed to harm the defendant's competitors).

5. *E.g., New York v. Anheuser-Busch, Inc.*, 811 F. Supp. 848, 876-8 (E.D.N.Y. 1993) (noting the procompetitive benefits of an agreement which induced the wholesaler to make investments in controlled environment warehouses, personnel, uniforms, product promotions, and transportation vehicles in an effort to compete more effectively).

6. *In Continental T.V.*, the Court recognized that it is important to weigh how exclusive territorial arrangements have the potential for a simultaneous reduction of intrabrand competition and stimulation of interbrand competition. Id. at 52.

7. United States v. Topco Assoc., 405 U.S. 596, 610 (1972).

8. *See generally* ABA Section of Antitrust Law, Antitrust Law Developments 1135 (4th ed. 1997) ("With few exceptions, the antitrust laws apply to all industries.").

9. N.C. Gen. Stat. Sec. 18B-1203 (1998).