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 Competition[1] 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

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[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]

"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]

receive the distribution rights) to pay the affected wholesaler the fair market value of the distribution rights, including the loss of goodwill.

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.

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[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 ay h.48 0 0factOC 0 0 1 Tr

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,

Susan S. DeSanti
Director, Office of Policy Planning

Joseph Farrell
Director, Bureau of Economics

Richard A. Feinstein
Director, Bureau of Competition