Wholesale Beer Association Executives
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Peter J. Mucchetti
Chief, Litigation I, Antitrust Division
United States Department of Justice
450 Fifth Street, N.W.
Suite 4100
Washington, DC 20530

Re: Comments of the Wholesale Beer Association Executives on the Proposed Final Judgment Between the United States Department of Justice and Anheuser-Busch InBev

Dear Mr. Mucchetti:

Beer distributors in the United States are represented by trade associations on both a national and a state level. The Executive Directors of the various State Beer Wholesaler Associations have formed their own organization known as the Wholesale Beer Association Executives (WBAE) for the purpose of conferring with one another in furtherance of their individual state beer association interests. The Executive Directors of 43 State Beer Wholesaler Associations are members of WBAE.

Recently, WBAE met to discuss the Proposed Final Judgment (PFJ) in the above-referenced matter and offers these comments on the PFJ. With the caveats expressed below, WBAE is supportive of the PFJ and expresses its gratitude to the Department of Justice for addressing certain anti-competitive aspects of the proposed transaction and conduct in the mature marketplace after the closing of the transaction.

Specifically, WBAE desires to provide the Court and the Department of Justice with (1) its perspective on alcohol regulation generally and the beer market specifically; (2) its perspective on the relationship and relative bargaining power between beer suppliers and independent beer distributors as it relates to alcohol regulation, orderly and competitive markets, and the goals sought to be achieved by the PFJ; and (3) its specific concerns about certain aspects of the PFJ.

ALCOHOL REGULATION

Distinguished from the regulation of other products, the goal of state liquor regulation is to protect the welfare, health, peace, morals and safety of the public by "promoting temperance, ensuring orderly market conditions, and raising revenue". *North Dakota vs. United States,* 495 U.S. 423, 432 (1986). Ultimately, liquor regulation strives to balance robust competition, on the one hand, with appropriate control, on the other. The decision of where to place the fulcrum between these two competing ends is left to the states and local units of government. Community norms and standards across the country differ widely regarding intoxicating liquor. This fact underscores the soundness of the Constitutional decision to rest regulatory authority primarily at the state and local level. In recognition of States' authority under the Twenty-first Amendment, Congress has ceded primary jurisdiction to the States. *See* 27 U.S.C. §205 (Penultimate Clause).

The keystones of alcohol regulation in this country are three-tier and tied-house laws. Pursuant to the states' plenary authority to regulate the sale and distribution of alcohol under the Twenty-first Amendment, each state regulates the sale and distribution of alcohol within its borders through some form of a "three-tier system" of licensed and structurally separate producers, distributors, and retailers. *Granholm v. Heald,* 544 U.S. 460, 466 (2005); *North Dakota v. U.S.,* 495 U.S. 423, 432 (1990). The purpose of the three-tier system is, in part, to avoid the harmful effects of vertical integration in the industry by restricting producers, distributors, and retailers to their respective service functions. The United States Supreme Court has expressly recognized that the three-tier system is "unquestionably legitimate." *North Dakota v. U.S.,* 495 U.S. 423, 432 (1990), *see Granholm v. Heald,* 544 U.S. 460, 466 (2005). The vital states' interests served by the three-tier system were cogently explained in *Manuel v. State of Louisiana,* 982 So.2d 316, 330 (La. Ct. App. 2008).

> Under the three-tier system, the industry is divided into three tiers, each with its own service focus. No one tier controls another. Further, individual firms do not grow so powerful in practice that they can out-muscle regulators. In addition, because of the very nature of their operations, firms in the wholesaling tier and the retailer tier have a local presence, which makes them more amenable to regulation and naturally keeps them accountable. Further, by separating the tiers, competition, a diversity of products, and availability of products are enhanced as the economic incentives are removed that encourage wholesalers and retailers to favor the products of a particular supplier (to which wholesaler or retailer might be tied) to the exclusion of products from other suppliers.

In further support of three-tier and tied-house laws, most states have adopted fair competition laws, commonly referred to as beer franchise laws, which safeguard distributor independence, enabling the distribution tier to serve its regulatory function as a buffer between suppliers and retailers. Most beer franchise laws also include a provision which prohibits suppliers from limiting a distributor's right to carry competing brands.

If a supplier is allowed to monopolize the beer market, effectively eliminate distributor independence, and control and dominate retailers, it will not only deny competitors access to market and otherwise restrain trade, it will also cripple or at least significantly undermine effective liquor regulation. As a result of our regulatory system, American consumers enjoy unprecedented choice and variety with regard to beer. Our regulatory system nurtures small, independent family-owned businesses at every tier. In fact, the beer industry remains one of the last bastions of family-owned businesses in this country at least at the distribution and retail tier. There is a regulatory, as well as an economic, benefit to local ownership and control because alcohol vendors who are rooted in their community are more likely to be sensitive to local norms and standards, more likely to abide the law, and more readily subject to effective enforcement. Preventing monopolization of the industry, and insulating retailers from undue pressure, not only ensure that small suppliers have access to market, it also safeguards an orderly, open, transparent, and accountable alcohol market. In turn, this guarantees one of the highest tax collection rates on a product that is one of the most heavily taxed commodities in our economy.

THE RELATIONSHIP BETWEEN BEER SUPPLIERS AND BEER DISTRIBUTORS

Typically, beer suppliers draft very one-sided distribution agreements. At least as to large suppliers, there is no opportunity for distributors to negotiate the terms of these agreements. It is a take it or leave it situation and the viability of the beer distributorship and the very livelihood of beer distributor employees depends on the relationship with these large suppliers. The relative bargaining between large suppliers and beer distributors is significantly disproportionate. As an example, the Anheuser-Busch InBev (ABI) Equity Agreement defines the duties of distributors, defines the circumstances under which the relationship can be terminated, reserves the right to unilaterally amend the agreement at its sole discretion in certain circumstances, reserves the right to approve the individual managing the distributor's business or to mandate replacement of that individual, requires that the manager that they approve must actually own 25% of the equity in the business (a provision that does not exist in any other beer distribution agreement), reserves the right to approve a proposed buyer of the distributor's business, purports to retain a right of first approval to buy the distributor's business, and requires that the distributor devote "primary" efforts in the promotion of its brand over other brands.

In recent years, ABI has exercised its purported rights under the Equity Agreement in a manner designed to either force "non-aligned" distributors to sell or to diminish the resources devoted to the promotion of competing brands. As an example, there have been numerous instances where a proposed purchaser of a distributor, who has a diversified product portfolio, including competing brands, has been disapproved notwithstanding the fact that the proposed purchaser is already an approved ABI distributor. Similarly, as discussed below, where a proposed purchaser of a distributor has a diversified product portfolio, including competing brands, ABI will often purport to exercise its right of first refusal (even in jurisdiction that do not permit a brewer to own a distributor) and immediately thereafter assign it's purported right to purchase to an "aligned" distributor. There have also been numerous examples where a proposed manager or successor manager of a distributorship, which has a diversified product portfolio, including competing brands, has been disapproved notwithstanding the fact that the proposed manager was clearly qualified for the position. In instances where ABI has approved a proposed sale or management change, it has frequently conditioned approval on the divestiture of competing brands or the commitment to devote greater resources to the promotion of ABI products to the detriment of resources devoted to competing products.

As the supplier tier has consolidated, the supplier's ability to further erode the independence of beer distributors (as outlined above) and impose onerous and anti-competitive terms has grown significantly. In 2008, SABMiller and Molson formed the Joint Venture MillerCoors. In the same year, InBev SA acquired Anheuser Busch Companies to form the market leader ABI. These two foreign-owned companies then controlled over 70% of the U.S. beer market. In 2010, Heineken N.V. acquired the beer division of Mexican brewer FEMSA. Since 2013, ABI acquired Mexico-based Grupo Modelo, 10 Barrel, Breckenridge, Golden Road, Elysian, Devil's Backbone, Virtue Cider, Four Peaks, and Blue Point. In addition, ABI has negotiated an option to purchase in the next three years the remaining interest in Craft Beer Alliance that it does not own. Other large suppliers are also acquiring smaller craft beer companies. In the last year, Miller Coors acquired Saint Archer, Terrapin, Revolver, and Hop Valley. Finally, Heineken acquired a 50% ownership interest in Lagunitas and Constellation acquired Ballast Point.

In the last 8 years, ABI has purchased 14 large distributorships located primarily in major metropolitan markets (MA, NJ, KY, OK, CO, OH, WA, OR, and CA). Furthermore, as ABI has acquired craft brewers, it has attempted to avail itself of the three-tier exemptions to sell at retail which were afforded to small craft brewers in an effort to nurture small businesses and create jobs. Specifically, by virtue of its acquisition of craft brewers, ABI now has multiple retail privileges in Arizona, Colorado, Idaho, New York, Oregon, Virginia, and Washington.

Furthermore, suppliers, in particular large suppliers like ABI, now negotiate directly with large chain retailers and typically offer advantageous business terms not available to other retailers. This has the effect of destabilizing the market. It not only has implications on market access for other suppliers, consumer choice, and distributor independence but also impacts effective alcohol regulation. WBAE is concerned that horizontal and vertical integration of the industry not only threatens competition and consumer choice, it also undermines effective alcohol regulation, moderate consumption patterns, and the avoidance of alcohol abuse. WBAE is further concerned that if we travel down the slippery slope of deregulation, we will return to the days of tied-houses with all of the societal problems occasioned by this documented practice.

CONCERNS ABOUT CERTAIN ASPECTS OF THE PFJ

WBAE appreciates the diligent work by the Department of Justice in this matter. We recognize that the PFJ is designed to establish protection against ABI brand exclusivity and other egregious conduct exercised by ABI against independent distributors. However, WBAE has a number of concerns outlined below.

1. Section V (B) of the PFJ prohibits ABI from acquiring a distributor if such acquisition would result in more than 10% of its sales by volume being sold through ABI-Owned Distributors in the United States, its territories, and military bases. The PFJ contemplates that the sales volume will be calculated based upon data provided by ABI's BudNet System. ABI's BudNet system is completely reliant on ABI's self-reporting, is not subject to transparent oversight, and could be subject to manipulation by ABI in calculating whether future acquisitions exceed the 10% threshold established by the PFJ. WBAE recommends that the Monitoring Trustee also rely either in whole or in part on data provided by objective third-party sources.
2. Section V (B) of the PFJ defines "ABI-Owned Distributor" as any distributor in which ABI owns more than 50% of the outstanding equity interests or assets. We understand that this definition was intended to capture those distributorships where ABI controlled the business. WBAE

recommends that "ABI-Owned Distributor" should be either interpreted or redefined to reference a lesser percentage for several reasons. First, as mentioned above, the ABI Equity Agreement purports to provide ABI with the power to select who manages the business of each distributor carrying ABI products. In addition, the ABI Equity Agreement mandates that the manager that ABI approves must own at least 25% of the distributor's stock. Second, ABI purports to reserve a right of first refusal under the ABI Equity Agreement. While presumably ABI can only exercise this right in states that permit brewery ownership of a distributorship, this is a tool that enables ABI to rapidly acquire distributorships in those jurisdictions. Third, WBAE is concerned that ABI, following the entry of the PFJ, will embark upon a program of acquiring less than 50% of a distributor's stock.

Most importantly, however, ABI effectively controls distributorships where it owns less than 50% of its stock by virtue of their veto power over the selection of a manager and the requirement that their approved manager must own 25% of the distributor's stock. A distributor's general manager placed there by ABI will fully understand and appreciate that ABI has the power to mandate his or her replacement under the ABI Equity Agreement. Finally, upon information and belief, ABI has, from time to time, loaned money to its distributors for the purpose of acquiring another distributor. In those circumstances, it is highly likely that ABI has collateralized its loan with a security interest in the stock or assets of the acquiring distributor. It is also highly likely that the loan documents will include typical loan covenants which would require the acquiring distributor to obtain ABI's consent to certain actions, like for instance, borrowing over a set amount or acquiring assets over a set amount. Under these circumstances, WBAE submits that it is reasonable to either redefine "ABI-Owned Distributor" as one in which ABI owns 25% or more of the outstanding equity interests or assets of a distributor or interpret the PFJ in that manner in light of the ABI Equity Agreement requirement that the manager they approve must own 25% of a distributor's stock.

3. In states that do not allow a brewer to own a distributorship, ABI has nonetheless purported to exercise its right of first refusal by often assigning that right to a preferred distributor who often conforms to the policies regarding competing brand portfolios that are prohibited by the PFJ. The PFJ does not address this match and redirect practice which will likely have the effect of reducing market access for competing suppliers. WBAE asserts that if state law prohibits a brewery from owning a distributorship then ABI's right of first refusal is void ab initio, is unenforceable, and is therefore unassignable. WBAE recommends that the PFJ should either expressly incorporate this conclusion or be interpreted by the Monitoring Trustee in a manner consistent with this conclusion. While ABI has a legitimate interest in verifying that the proposed purchaser is qualified to distribute its product, it should not have the right or ability to dictate to a distributor that it must sell to only one purchaser selected by ABI or to unreasonably withhold consent to a proposed purchaser who otherwise qualified. Finally, if ABI purports to exercise the right of first refusal, the sales volume of the distributorship subject to the exercise should be included in the 10% sales calculation referenced in Section V (B) of the PFJ and, if it exceeds 10% should be disallowed.

4. Section V (D), (E), (F), (G), and (H) of the PFJ embody numerous prohibitions relating to ABI's conduct regarding distributors. For instance, the Section prohibits ABI, pursuant to the terms of any contract or agreement, from providing "any reward or penalty to, or in any other way condition its relationship with, an Independent Distributor or any employees or agents of that Independent Distributor based upon the amount of sales the Independent Distributor makes of a Third-Party Brewer's Beer or the marketing, advertising, promotion, or retail placement of

such Beer". In addition, it prohibits ABI from "[p]reventing an Independent Distributor from using best efforts to sell, market, advertise, or promote any Third-Party Brewer's Beer which may be defined as efforts designed to achieve and maintain the highest practical sales volume and retail placement of the Third-Party Brewer's Beer in a geographic area." Section V (D) embodies other prohibitions relating to ABI's conduct vis-à-vis it's distributors and Section V (I) requires ABI to notify its distributors of these actions.

The current ABI Equity Agreement and the ABI policies promulgated thereunder, in fact, require ABI distributors to do the things that are now specifically prohibited by Section V. Accordingly, WBAE recommends that notice to distributors include the following language:

> "The Consent Decree negotiated between the United States Department of Justice and Anheuser Busch InBev, and entered by the United States District Court for the District of Columbia, embodied certain terms and conditions that relate to the duties and obligations existing between Anheuser Busch InBev and its distributors. To such an extent, the ABI Equity Agreement is hereby amended to conform to the Consent Decree and, in the event that any provision of the ABI Equity Agreement conflicts with a provision of the Consent Decree, the provision of the Consent Decree shall govern."

5. The presumed acquirer of the divested assets required by the PFJ is Molson Coors. As noted in DOJ's Complaint, as well as documented by economists,[1] and highlighted by the leading independent antitrust policy voice,[2] major brewers tend to follow one another with respect to pricing and promotions. Moreover, Molson Coors has already begun to implement numerous tactics of concern similar to those of ABI, such as aggressive acquisition of craft brewers with three announced since the filing of the PFJ. By increasing its U.S. market share exponentially through its acquisition of divested assets, Molson Coors will be incented to mimic control over independent distribution akin to ABI, potentially leading to much of the same problematic

[1] Nathan H. Miller & Matthew C. Weinberg, *Mergers Facilitate Tacit Collusion: Empirical Evidence from the U.S. Brewing Industry* (Mar. 25, 2015)
[2] Letter from the American Antitrust Institute to Renata Hesse, Department of Justice (April 25, 2016)

conduct that this PFJ is designed to curb. Accordingly, WBAE recommends that the prohibitions on ABI imposed by Article V (D), (E), (F), (G), and (H) of the PFJ also be imposed on Molson Coors or the Acquirer.

CONCLUSION

WBAE supports the entry of the Final Judgment and Consent Decree but urges DOJ and the Court to address the concerns outlined above in the manner suggested.

WHOLESALE BEER ASSOCIATION EXECUTIVES