

Good Morning,

My name is David Farrell and I am the president of Farrell Distributing, a beer, wine, and non-alcohol beverage distribution company. We have been doing business in Vermont since 1933 and employ approximately 330 people statewide in our two operations in South Burlington and Rutland, Vermont.

As you heard today from Clare Buckley, changes to Vermont's franchise law pose some significant challenges to what should be considered a highly functional and effective method of alcohol distribution in VT. Highly functional and effective because it brings unprecedented access and choice to consumers in retail outlets in every city and town in Vermont. Highly functional and effective by promoting an independent distribution system whereby distributors can't be unduly pressured by suppliers not to carry competitive products, thereby expanding the market for all brewers. Finally, highly functional and effective because it maintains public safeguards due to strict regulatory transparency as to where alcohol products are sold, by whom, and how responsibly. This access and selection is available to consumers because franchise lowers distributor risk and promotes investment in bringing new brewers and brands to the market.

I'm here today to present my concerns relative to proposed changes to Vermont's franchise law for beer. My areas of concern fall in several key areas.

They are,

- 1) Fair market compensation for no-cause termination,
- 2) The level of impact of no-cause termination
- 3) Current investments and financing based on existing law
- 4) Contractual burden on distributors to negotiate and rewrite dozens of contracts
- 5) Unintended consequences of allowing predatory practices by suppliers and distributors

To be clear I see very little wrong with existing law and think it has served all interested parties in the beer industry very well. So well in fact that Vermont leads the nation in market share for craft beer and breweries per capita. As first proposed the bill did the untenable in my estimation because it didn't give due consideration to the investment distributors make towards brand building, or the risks that have been taken based on existing law. I do believe distributors have been open minded in appraising the proposed legislation and we have been willing to compromise towards some remedies to perceived problems with the law. I'd like to thank your colleagues in the House for making very important amendments to the initial

proposal. They did that by addressing three pressing concerns. One by instituting fair market compensation for no-cause termination, two by minimizing potential impact by not exempting brands that make up over 3% of a distributors portfolio, and three, by providing for a 3.5 year transition period to renegotiate existing contracts.

On the second point I still believe the level of real and potential impact at the 3% threshold to be too high, and a more reasonable number would be 1% of portfolio. The brewers point to NY law which has a 3% threshold, but Vermont has much lower overall volume and our impacts are exacerbated by our lack of scale. Additionally, no-cause termination remains a significant threat and an imminent burden to distributors and to the retailer community at large. In our case the impact of having a no-cause termination of a 1% brewer would lead to service cutbacks or staff reductions of 2-3 employees. At the 3% level that impact jumps to the point where staff reductions would be upwards of 15-20 people. That could be the impact of just one brewer exercising no-cause termination who represents 3% of our portfolio.

Relative to the transition period this bill puts little onus on brewers, but it puts a significant demand on distributors to renegotiate dozens of contracts at a heavy price. Brewers having to deal with only one negotiation, but in the case of our company we will face dozens even at the 1% of portfolio level. I noted earlier our willingness to listen and we believe we are not asking for too much in minimizing the impacts to us and the industry. At the 1 % level over 70% of the brewer community would be able to terminate without cause. Today that number is 0. That is great compromise at no cost or risk to the brewer community, but not so for the distributors who will face heavy expenses and greater risk.

This proposed bill also introduces no-cause termination, a dangerous path for the Vermont beer category, its brewers, retailers, and distributors. No cause termination tears at the fundamentals of our successful distribution infrastructure and creates the potential for distributor investments to be usurped and unreturned. It opens the door for predatory practices by powerful regional and national businesses which would threaten our local jobs.

I am not suggesting that franchise law does not afford rights and privileges to distributors. The fact is that it does, but it does so with key responsibilities and requirements. These are not small investments so I'd like to present a few. There are investments in large facilities with increased demand on controlled warehouse environments due to rigorous brewer temperature standards. These capital expenses are intense and many are financed and take years to repay. These products are perishable and distributors bear the cost of destroying outdated product to the tune of hundreds of thousands of dollars annually. Distributors have the responsibility of serving all retail customers in Vermont. That means profitable accounts and accounts that are not. Our company makes approximately 30% of our deliveries at break even or a loss each year. This is a business practice that does not happen in non-franchise industries. Providers in non-franchise industries that deliver food, fuel, textiles, repair services etc. simply won't service non-profitable customers or charge as much a \$100 just to make a call. Additionally, brewer brand access to larger format outlets also requires investment in

sophisticated and expensive technology. It requires dedicated and qualified distributor personnel to call on buyers. It requires distributors to manage resets, building displays, merchandising, sign-making and point of sale production. It requires robust delivery infrastructure that provides enormous savings to suppliers versus traditional shipping firms. On the marketing side we deploy marketing to support building our partner brands in social media, print and television. We invest marketing spends against each of our suppliers that are front loaded in the early years of brand development. In bars and restaurants we clean draft lines no less than once a month, another significant expense. The level of expense and investments made in this industry are rare in almost any other sector and the only reason distributors can maintain this proactively on behalf of brewers, retailers and consumers, is through the reasonable predictability franchise provides towards achieving return on investment. The brewer/distributor partnership is one that involves each party investing into brand equity.

I do not bemoan the intense amount of capital and operational investment necessary to offer and provide our distribution platform to the partners that willingly choose it. Many would say that's the cost of doing business and with that I would agree. However, that's the voluntary cost of doing business the way it is today. It is unrealistic to assume that distributors can and would continue to make these investments in people and organizational capability in the face of increased uncertainty and risk.

This legislation seeks to solve a philosophical "unfairness" portrayed by many of our important supplier partners. It is founded on the notion that brewers have no remedy to extract themselves from a franchise relationship. That is simply not the case. First, they can demonstrate good cause in current franchise law. Second, a distributor can execute a sale or trade of a brand on behalf of a brewer to a chosen alternative. Finally, in some cases brands are simply just released. Our company has executed dozens of such remedies on behalf of our partners. To suggest that they are all trapped into perpetuity is inaccurate and doesn't represent the majority of alignments or realignments in industry practice today. As it relates to fairness, we operate in the same system the brewers do, but brewers can operate a brewery, run a distributor, run a bar or restaurant, and run a retail outlet selling beer out the door, all at the same time. We on the other hand cannot have an interest in any other business selling alcohol in any manner. These are strong privileges and should be considered when evaluating the unique benefits existing legislation provides to each party today.

To close I'd like to reiterate a few key points from my earlier comments.

- 1) It is imperative that fair market compensation remain in this proposal.
- 2) A 1% of portfolio threshold is extremely reasonable as it allows over 70% of brewers to terminate without cause, poses no risk or burden to brewers, and minimizes impacts to Vermont jobs.
- 3) A 3.5 year transition period is critical and necessary to allow for contract negotiations and to spread the cost of these negotiations

Finally, I appreciate the time afforded to me today to present my concerns. We are a committed Vermont employer and builder of the Vermont brand. We proudly represent nearly 40 Vermont manufacturers. We have seen many go from fledgling operations in garages and basements, to some that now have strong statewide and regional reach due to our joint efforts. We respect our partners and believe we are being fair in looking for compromise on this important issue.

Vermont is a beacon to world class brewing and brewers because of the strength and effectiveness of the system we all participate in. Please consider carefully anything that might threaten that.

Thank you for your time and consideration.