

Approved 2-11-87
Date

MINUTES OF THE SENATE COMMITTEE ON FEDERAL AND STATE AFFAIRS

The meeting was called to order by Senator Edward F. Reilly, Jr. at
Chairperson

11:00 a.m./~~p.m.~~ on February 9, 1987 in room 254-E of the Capitol.

All members were present, ~~except~~

Committee staff present:

Mary Galligan, Legislative Research
Emalene Correll, Legislative Research
Mary Torrence, Assistant Revisor of Statutes
June Windscheffel, Secretary to the Committee

Conferees appearing before the committee:

The Chairman asked the Committee to give its attention to Mr. John Lamb, for an explanation of an Attorney General's opinion which had just been received, concerning the minimum price markup. (Attachment #1) Mr. Lamb gave a summary of the opinion and answered questions from the Committee. See Mr. Lamb's Memorandum dated today. (Attachment #2)

Mr. Lamb was thanked for his appearance.

The Chairman stated that the Committee would then proceed on through SB141, concerning liquor by the drink. Staff walked the Committee through the bill.

Senator Anderson moved, on page 19, that the language "having a population of more than 200,000 be stricken. The motion was seconded by Senator Martin. The motion carried.

Senator Morris made the conceptual motion that the Regents not allow liquor to be served or sold in student union activities or at student activities. The motion was seconded by Senator Bond. The motion failed.

The Chairman distributed copies of an article from The Kansas City Star which points to a problem they have in Kansas City concerning the issue of licensing premises. The Chairman said it is not the intent of the Legislature or this Committee to prohibit a person from bringing his or her own alcohol. (Attachment #3)

The subject of fees was approached by the Committee. Staff was directed to balloon this out for the Committee.

Tomorrow the Committee will continue on with the bill and will take up the matter of the balloon concerning fees for consideration.

The meeting was adjourned.



2/9/87
Attachment #1

STATE OF KANSAS

OFFICE OF THE ATTORNEY GENERAL

2ND FLOOR, KANSAS JUDICIAL CENTER, TOPEKA 66612

ROBERT T. STEPHAN
ATTORNEY GENERAL

February 9, 1987

MAIN PHONE (913) 296-2215
CONSUMER PROTECTION: 296-3751

ATTORNEY GENERAL OPINION NO. 87- 26

John Lamb, Director
Division of Alcoholic Beverage Control
Kansas Department of Revenue
700 Jackson, 2nd Floor
Topeka, Kansas 66612

Re: Intoxicating Liquors and Beverages--Miscellaneous
Provisions--Minimum Markups

Synopsis: In 324 Liquor Corp. v. Duffy, the Supreme Court of the United States held that the State of New York's statutory scheme for maintenance and control of retail liquor prices was in violation of Section 1 of the Sherman Act. The Court also held that New York's pricing system would not be saved under the "state-action exemption" from the antitrust laws (due to the fact that the state did not actively supervise the pricing system) or the Twenty-first Amendment to the United States Constitution (because the asserted state interests were not substantiated and did not suffice to afford such immunity).

In Kansas, distributors are to file current bottle and case prices with the Director of the Division of Alcoholic Beverage Control. The Alcoholic Beverage Control Board is required to establish a minimum markup to be added on to the bottle price on file at the time of retail sale. The Board does not regulate the prices posted by distributors and has not adjusted the markup percentage for distilled spirits for approximately ten years.

Attachment #1
FSA 2/9/87

The pricing system for alcoholic liquor sales in Kansas is so closely aligned with that of New York that it too is in violation of antitrust laws. As a practical matter, prices are set by private industry and the State does not "actively" supervise the pricing system. Additionally, the United States Supreme Court held that unsubstantiated claims that the system promotes temperance and protects small liquor retailers are not sufficient to afford immunity under the Twenty-first Amendment. Cited herein: K.S.A. 41-1101; 41-1111; 41-1114; 41-1115; 41-1116; 41-1117; 41-1118; K.A.R. 13-4-2; 15 U.S.C. §1.

* * *

Dear Mr. Lamb:

As Director of the Division of Alcoholic Beverage Control (ABC) for the State of Kansas, you request our opinion concerning §1 of the Sherman Act, 15 U.S.C. §1. Specifically, you are concerned with the "minimum markup" pricing system for alcoholic beverages and the enforcement of current Kansas law.

On January 13, 1987, the United States Supreme Court issued 324 Liquor Corp. d/b/a Yorkshire Wine & Spirits v. Duffy, et al., No. 84-2022, _____ U.S. _____, 107 S.Ct. 720, 55 U.S.L.W. 4094 (1987). The Court held that §101-bb of the New York Alcoholic Beverage Control Law was inconsistent with §1 of the Sherman Act.

Section 101-b(3) of the New York law provides, in part:

"No brand of liquor or wine shall be sold to or purchased by a retailer unless a schedule, as provided by this section, is filed with the liquor authority, and is then in effect."

Section 101-bb(2) provides, in part:

"No licensee authorized to sell liquor at retail for off-premises consumption shall sell, offer to sell, solicit an order for or advertise any item of liquor at a price which is less than cost. As used in this section, the term:

. . . .

"(b) 'cost' shall mean the price of such item of liquor to the retailer plus twelve percentum of such price, which is declared as a matter of legislative determination to represent the average minimum overhead necessarily incurred in connection with the sale by the retailer of such item of liquor."

"Price," in turn, is defined as the posted bottle price in effect at the time the retailer sells the item. §101-bb(2).

The Court determined that these statutes were invalid because they "mandated resale price maintenance, an activity that has long been regarded as a per se violation of the Sherman Act." Duffy, No. 84-2022 at 6, citing Rice v. Norman Williams Co., 458 U.S. 654, 102 S.Ct. 3294, 73 L.Ed.2d 1042 (1982) (emphasis in original). Therefore, it was held that the retail price maintenance scheme under the New York statutes could not be legal unless the scheme met the requirement for state-action immunity from federal antitrust laws, or was a protected exercise of the state's right to regulate alcoholic beverages under the Twenty-first Amendment to the Constitution of the United States.

The Court found that the New York statutes did not meet the requirements for state-action immunity because the liquor pricing system was not actively supervised by the state. Duffy, supra, at 7. Further, New York's statutes were held not to be protected under the Twenty-first Amendment because New York's asserted, and unsubstantiated, state interests were not sufficient to override the policies of the Sherman Act. Id. at 16.

The Kansas statutes in question provide as follows:

"No retailer licensed under this act shall purchase any alcoholic liquor from any distributor licensed under this act unless the distributor files with the director [of the division of alcoholic beverage control] a written statement sworn to by the distributor, or in case of a corporation by one of its principal officers, agreeing . . . to file price lists showing the current bottle and case

price in the office of the director as often as may be necessary or required by the director but at least once each three months. . . ." K.S.A. 41-1101(b);

and

"No retailer shall sell, directly or indirectly, any alcoholic liquor at less than its current posted bottle cost plus minimum mark-up without first having obtained from the director a permit so to do. . . ." K.S.A. 41-1117(2). [This statute proceeds to outline the situations in which the director may grant a permit to sell other than at posted-price plus mark-up. These exceptions are not relevant to our present inquiry.]

This portion of Kansas' law is virtually identical to that of New York cited above. The distributors post the prices and mandatory markup is based on the posted bottle price. Thus, the Kansas statutory scheme for regulating retail liquor prices, like the New York law, establishes a system of resale price maintenance that would violate the antitrust laws in the absence of state-action immunity or a valid Twenty-first Amendment justification.

In considering whether the New York statutes met the requirement for state-action immunity from federal antitrust laws, the Court stated as follows:

"Our decisions have established a two-part test for determining immunity under Parker v. Brown, [317 U.S. 341 (1943)]. 'First, the challenged restraint must be "one clearly articulated and affirmatively expressed as state policy"; second, the policy must be "actively supervised" by the State itself.' California Retail Liquor Dealers Assn. v. Midcal Aluminum, Inc., *supra*, at 105 [quoting City of Lafayette v. Louisiana Power & Light Co., 435 U.S. 389, 410 (1978) (plurality opinion)]. New York's liquor pricing system meets the first requirement. The state legislature clearly has adopted a policy of resale

price maintenance. Just as clearly, however, New York's liquor pricing system is not actively supervised by the State. As in Midcal, the State 'simply authorizes price setting and enforces the prices established by private parties.' 445 U.S., at 105. New York 'neither establishes prices nor reviews the reasonableness of the price schedules.' Ibid. New York 'does not monitor market conditions or engage in any "pointed reexamination" of the program.' Id., at 106 [quoting Bates v. State Bar of Arizona, 433 U.S. 350, 362 (1977)]. Each wholesaler sets its own 'posted' prices; the State does not control month-to-month variations in posted prices. Nor does the State supervise the wholesaler's decision to 'post off,' the amount of the 'post off,' the corresponding decrease, if any, in the bottle price, or the frequency with which a wholesaler posts off. The State has displaced competition among liquor retailers without substituting an adequate system of regulation. 'The national policy in favor of competition cannot be thwarted by casting such a gauzy cloak of state involvement over what is essentially a private price-fixing arrangement.' 445 U.S., at 106." Duffy, No. 84-2022, at 7, 8, 9.

Of importance to our present inquiry, and in comparing the law struck down in Duffy to Kansas law, is footnote six of the opinion:

"A simple 'minimum markup' statute requiring retailers to charge 112 percent of their actual wholesale cost may satisfy the 'active supervision' requirement, and so be exempt from the antitrust laws under Parker v. Brown, 317 U.S. 341 (1943). See Morgan v. Division of Liquor Control, 664 F. 2d 353 (CA2 1981) (upholding a simple markup statute). Section 101-bb, however, is not a simple minimum markup statute because it imposes

a markup on the 'posted bottle price,' a price that may greatly exceed what the retailer actually paid for the liquor. As we have explained, supra, at 3-4, Bulletin 471 permits wholesalers to reduce the case price--the price actually paid by most retailers--without reducing the bottle price. The New York Court of appeals expressly held that Bulletin 471 'is consistent with Alcoholic Beverage Control Law §101-b(3) which does not mandate any price ratio between scheduled case and bottle prices.' J.A.J. Liquor Store v. New York State Liquor Auth., supra, at 523, 479 N.E.2d, at 790. We may not 'construe a state statute contrary to the construction given it by the highest court of a State.' O'Brien v. Skinner, 414 U.S. 524, 531 (1974). Appellees nevertheless argue that invalidation of Bulletin 471 does not require invalidation of §101-bb. Appellees contend that §101-bb does not prevent the SLA from establishing a relationship between case price and bottle price; indeed, Rule 16.4(e) establishes such a relationship. Brief for Appellees 24-25 n. 37. Invalidation of Bulletin 471 alone, however, would not prevent wholesalers from selling large quantities at low prices in one month, and then requiring retailers to charge abnormally high markups by raising bottle prices in subsequent months. See supra, at 3. We cannot accept appellees' suggestion that such unsupervised price fixing should be tolerated as a reasonable accounting method or as a hedge against inflation. See App. to Juris. Statement 101A (advertising a guaranteed 31.3 percent markup on liquor purchase in August, 1984 and sold in September, 1984). We thus have no occasion to consider whether a simple minimum statute would be entitled to antitrust immunity under Parker v. Brown.

"Some States completely control the distribution of liquor within their

boundaries. E.g., Va. Code §§4-15, 4-28 (1983). Such comprehensive regulation is immune under Parker v. Brown because the State substitutes its own power for 'unfettered business freedom.' See New Motor Vehicle Bd. of Cal. v. Orrin W. Fox Co., 439 U.S. 96, 109 (1978). Duffy, supra at 7, 8.

As with the New York law, K.S.A. 41-1111(b) clearly articulates Kansas' policy "that minimum markups on alcoholic liquor sold by retailers licensed in this state should be determined and regulated by law," thereby satisfying the first part of the Parker v. Brown test by affirmatively expressing the State's policy of restraining price competition. The second part of the test, whether Kansas law would meet the requirements of state-action immunity, hinges upon whether the State's policy is "actively supervised" by the State itself.

Kansas statutes, and rules and regulations promulgated under the authority of those statutes, provide a mechanism by which the State can establish the minimum markup rate and adjust that rate over time. K.S.A. 41-1114; 41-1115; 41-1116; 41-1117; 41-1118; K.A.R. 13-4-2. The alcoholic beverage control board meets quarterly to review the minimum percentage markup. K.S.A. 41-1117(1). You have informed us, however, that only one adjustment has been made to the minimum markup percentage for specialties and wines since February 28, 1983, and that the markup percentage for distilled spirits has remained unchanged for approximately ten years. In footnote 7 of the Duffy opinion, the Court stated that "neither the 'monitoring' by the SLA, nor the periodic reexaminations by the State Legislature, exerts any significant control over retail liquor prices or markups." Duffy, supra at 9 (footnote 7). We must conclude, therefore, that though a mechanism does exist by which the State could control the minimum markup percentages, as a practical matter the State has not actively done so.

Further, adjustment of the minimum markup percentages does not guarantee control over ultimate prices. Under Kansas law, as under the stricken New York law, wholesale distributors are required to file their current bottle and case prices with the regulatory agency (in Kansas, the ABC) and to sell their products at such prices to all retailers in the State without discrimination. K.S.A. 41-1101(b). The established minimum

markup is then applied to the "posted" bottle price. Distributors are free to change case and bottle prices "as often as may be necessary . . . but at least once each three months" by filing new price lists with the director. It is our understanding that case prices can be changed without a corresponding change in the bottle price. As a result, both the retail price and the margins received by retailers who buy in case lots can be changed by the distributors by simply filing new bottle price lists. Similarly, distributors may control retail price and the margins received by retailers by selling to retailers at one bottle price in one month, and then raising the "posted" bottle price in the following month when the retail sale takes place. This is because retailers must sell at the bottle price posted at the time of retail sale (plus markup) rather than at actual price plus markup. These are exactly the two problems discussed by the Duffy Court in footnote 6 (quoted above). Even with the ability to adjust markup percentages the State would be hard put to keep up with fluctuation in posted prices. Since, as a practical matter, it is private industry which sets the prices rather than the State itself, the statutory scheme for maintenance and control of retail liquor prices in Kansas does not meet the second prong of the state-action immunity test.

According to the Supreme Court decision rendered in Duffy, Kansas law is not made valid under the Twenty-first Amendment to the Constitution of the United States either.

"Section 2 of the Twenty-first Amendment reserves to the States the power to regulate, or prohibit entirely, the transportation or importation of intoxicating liquor within their borders. Section 2 'grants the State virtually complete control over whether to permit importation or sale of liquor and how to structure the liquor distribution system.' Midcal, 445 U.S., at 110. The States' Twenty-first Amendment powers, though broad, are circumscribed by other provisions of the Constitution. See Larkin v. Grendel's Den, Inc., 459 U.S. 116, 122, n. 5 (1982) (Establishment Clause); Craig v. Boren, 429 U.S. 190, 204-209 (1976) (Equal Protection Clause); Wisconsin v. Constantineau, 400 U.S. 433, 436 (1971) (procedural due process); Department of Revenue v. James Beam Co.,

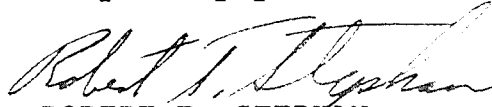
377 U.S. 341, 345-346 (1964) (Export-Import Clause). Although §2 directly qualifies the federal commerce power, the Court has rejected the view 'that the Twenty-first amendment has somehow operated to "repeal" the Commerce Clause wherever regulation of intoxicating liquors is concerned.' Hostetter v. Idlewild Liquor Corp., 377 U.S. 324, 331-332 (1964). Instead, the Court has engaged in a 'pragmatic effort to harmonize state and federal powers.' Midcal, supra, at 109. The question in each case is 'whether the interests implicated by a state regulation are so closely related to the powers reserved by the Twenty-first Amendment that the regulation may prevail, notwithstanding that its requirements directly conflict with express federal policies.' Capital Cities Cable, Inc. v. Crisp, 467 U.S. 691, 714 (1984)." Duffy, supra at 9, 10, 11.

The Court held that New York's asserted interests in protecting the economic position of small liquor retailers and promoting temperance, particularly when unsubstantiated, did not suffice to afford immunity from the Sherman Act under the Twenty-first Amendment. [It is interesting to note that studies cited by the New York court concluded that higher prices do not decrease consumption of liquor. J.A.J. Liquor Store v. New York State Liquor Auth., 479 N.E.2d 779, 788, n. 2 (N.Y. 1985), citing Moreland Commission Report No. 1, at 3, 17.] K.S.A. 41-1111 sets forth the State's interest as promoting the orderly sale and distribution of alcoholic liquor, fostering temperance and promoting the public welfare. Again, without proof that these interests are furthered by the price maintenance system now in place in Kansas, they are not sufficient justification to immunize the State from federal antitrust laws.

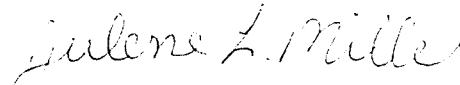
In conclusion, the pricing system for alcoholic liquor sales in Kansas is so closely aligned with that of New York which

was struck down in 324 Liquor Corp. v. Duffy that it too is in violation of antitrust laws.

Very truly yours,



ROBERT T. STEPHAN
Attorney General of Kansas



Julene L. Miller
Deputy Attorney General

RTS:JLM:jm

2/9/87

Attachment #2

MEMORANDUM

TO: Senate Federal & State Affairs Committee
FROM: Alcoholic Beverage Control Division
DATE: February 9, 1987
SUBJECT: Senate Bill 141, minimum markups

If the minimum price markup system is eliminated, the Alcoholic Beverage Control would ask that the Legislature to adopt a provision prohibiting liquor retailers from selling below acquisition cost.

Attachment #2
FSA 2/9/87

Vista rule on liquor hurts city

87
KC

Dennis Prenevost from Mora, Minn., was staying at the Vista International Hotel here recently, representing his company at the boat show.

Entering the hotel before noon with a packaged bottle of Scotch whisky, he met with a small adventure.

According to Prenevost, a hotel employee with a walkie-talkie brusquely confronted him and told him he couldn't take liquor into the hotel.

"You gotta be kidding," said Prenevost. He left the bottle outside the hotel and asked someone at the desk what the deal was. He was told that the registration form plainly advises guests what the deal is.

The fine print at the bottom of the form reads: *Food and beverage not provided by the hotel is prohibited.*

"Mora is a small town," Prenevost said the other day. "But I've been all over the United States and I've never run into this. I've never been so embarrassed in my life."

Why was Prenevost prohibited from bringing libation into the hotel? According to Martin J. Lawrence, executive assistant manager of the Vista, *because it's against the law.*

It seems that the entire 21-story hotel at 200 W. 12th St. has been uniquely licensed for by-the-drink liquor sales.

In other words, the Vista could be viewed as one immense bar.

Each room has its own minibar stocked with the miniature liquor bottles you find on airplanes. Guests who wish to use the service receive a key and are billed for what they consume.

According to the Vista's interpretation of the law, each room is consequently a "licensed premises." The only way to legally have a drink in your room is to buy it from the minibar. Using your own hooch is a crime.

"There were four little bottles of Scotch," said Prenevost. If he invited some Scotch drinkers to the room, those four little bottles wouldn't go very far. "What would we do? Drink Grand Marnier and Creme de Menthe? And who wants to spend \$3.50 a drink?"

2/9/87
Attachment #3

Lawrence says that the minibars are provided first for the convenience of guests, second for revenue.

"The hotel doesn't want to be a policeman," he said. "If someone brings a bottle in his suitcase it's his business. But the law is black and white, and if someone comes in with an obvious bottle of liquor, we're obliged to obey the law."

Those who disapprove of the consumption of alcohol will perhaps have no sympathy for any of the characters in this homely tale. But the vulgar truth is that many of those who toil on the road carry their own bottles, for their own reasons of convenience and economy.

They have their own sacrosanct cocktail hour rituals, and you have to wonder whether it's wise for the Vista to risk tampering with them. The pursuit of convenience and extra revenue seems to have backfired here.

The hotel has had its share of problems trying to attract business and make ends meet. And, as Lawrence said, it's had more than its share of bad publicity.

"That's because it's Kansas City's baby," he said, referring to the local civic and business involvement in the hotel's financing. "Unfortunately, it ends up hurting Kansas City."

Certainly, enforcement of this bizarre ordinance can't help Kansas City or the Vista. Confrontations occasioned by it may drive away business. Enforcement may come into conflict with rights protecting citizens from unreasonable search and seizure.

"No wonder ... we are experiencing a second position as a convention site," wrote Jack E. Ferguson, a business associate of Prenevost's, from Richmond, Mo. "Needless to say, our company will not participate any further in the future with the hotels and convention facilities in Kansas City."

Attachment #3
FSA 2/9/87