February 8, 2011

To: House Committee on Commerce and Economic Development
From: R.E. "Tuck" Duncan , General Counsel
RE: HB 2532

I appear here today to advise the committee as to the rationale of distributor opposition to HB253254. I will not reiterate the testimony regarding the inadequacy of the economic model as justification for the restructuring of the retail industry in Kansas.

What I will primarily address in the limited time allotted are the effects such a change will have on the distribution tier and the consumer price of goods as a result of a major readjustment in the manner of the distribution of goods.

No one is suggesting that there will be an increase in the amount of the gallonage of product - beer, wine and spirits - consumed in Kansas as a result of this realignment of points of sale. The proponents 2011 study states: *"Kansas is among the lowest alcohol consumption states, and deregulation is unlikely to change that fact. Research suggests that cultural factors more than economic factors drive alcohol consumption."*

Over the past decade there has been a modest increase in gallonage of all product categories of 15%, and that at a time when Sunday sales became effective returning sales to Kansas from Misouri.

There will be a regulatory cost, as the fiscal note from the Department of Revenue states: "The Department estimates that HB 2532 would increase expenditures by $1.5 million in FY 2013." And further states that there will be a reduction in State General Fund Revenues of $1.8 million. The Kansas SRS estimated a cost of $4.2 million in its 2011 fiscal memo (on a nearly identical bill) for a total annual cost to implement of at least $7.5 million.

In the words of a former Kansas Secretary of Revenue, the beverage alcohol system is akin to the gossamer thread of the spider web, when you tap it at any point, the movement sends ripples throughout the rest of the web, e.g. system.

The proponents suggest that there will be a considerable expansion of the points of access to grocery, convenience stores, big box stores, drug stores, and perhaps other outlets for which there will be substantial economic benefit. Whether that is true was controverted by a review of the proponents economic study by the Ad Astra Institute.



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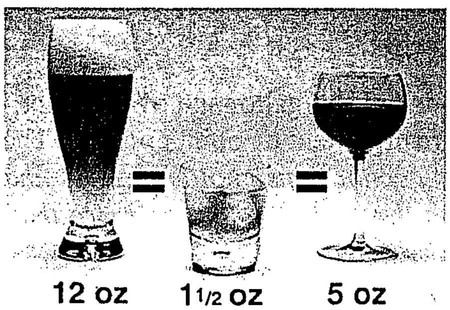
And let me be clear – we do not support HB 2532. We have an orderly system that functions well today that does not need restructuring.

Attached to my testimony are maps of the locations of liquor stories licensed in Kansas and of the cereal malt beverage off-premise licensees. But based on the North American Industry Classification System codes cited in the bill (which I have also attached) many other locations could be licensed like: Macys, Sears, JC Penny, all drug stores, deli's, book stores, Dollar General, Everything's-a-dollar, K-Mart, video stores, and many more.

The point is, 2000 more outlets could be a low number. Current Kansas population is 2,871,238 which means we already have 1 store for each 3800 residents (of which some estimate as many as 40 per cent do not drink*) , so that is 1 store for each 2300 beverage alcohol consumers.

As distributors we urge that there be just one (1) license for the retail sale all the categories of products which we as distributors are allowed to sell: wine, beer and spirits. There has been no rationale explanation as to why this multiple license scheme.




Alcohol is alcohol, the molecule is identical whether the product of brewing, vinification, or distillation. Alcohol is alcohol whether consumed in beer, wine or spirits. "A person's blood alcohol content then, is more dependent on how much and how long the person has been drinking than on what the alcohol content is of the beverage." (*Social and Economic Control of Alcohol*, Jurkiewicz and Painter, 2008, p.226)

Wholesalers have contracts to distribute these multiple products and if you are going to expand the outlets, then there is no reason not to afford distributors the opportunity to meet their contractual obligations by distributing all categories of products to all licensees. Generally the wine and spirits wholesalers have over 15,000 SKUs in their respective warehouses. *Why shouldn't a distributor be afforded the opportunity to sell all our products to a retail establishment?*

Current law provides that the cost of distribution is to be incorporated into the bottle and case price of goods f.o.b. the warehouse. If there is no net increase of goods, but an increase in and a dispersing of delivery points (at a minimum 2020 based on current CMB licenses, (Source: KS ABC map attached), but perhaps twice as many based on the definitions attached, that means smaller payloads and more miles. More miles, more cost. One of the pioneers of this industry schooled me that the consumer always pays for the cost of distribution.

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*LSU Public Administration series *Social and Economic Control of Alcohol* (2008). That text notes that 4 in 10 Americans do not drink and "nondrinkers have a stake in this debate which regulators and legislators must consider as they try to balance public health, industry, consumer and other issues" (p.15)

We estimate that based on HB 2532 as drafted the annual costs for capital investment and additional operating expense will be within the range of $7.5 to $10 million including an increase in fuel by $1 million per year, increase in the delivery fleets by 20 plus trucks, and one time expenses for more advanced ERP systems estimated at $5 million.

We anticipate that there will be an increase in the shelf price of goods. We suggest that if the committee advances this bill that to off-set this effect it amend the legislation to permit distributors to establish order minimums for quantity and/or dollar amounts, to apply uniformly. The Senate committee agreed to last year by providing:

***New Sec. 5. Notwithstanding the provisions of K.S.A. 41-1101, and amendments thereto, a distributor may establish minimum order quantities or minimum order prices, or both, for alcoholic liquor distributed by the distributor to a retailer.***

This is a standard practice in other sectors of the food industry.

It is worth noting that the distribution tier has spent the last two decades ringing out cost inefficiencies. Through a combination of improved technology, cooperative delivery, and smart inventory control there is minimal fat in the delivery system. Therefore, to ramp up to serve this new profile we need 18 months, not the six months contemplated by HB 2532 and ask that if the bill moves forward the effective dates be modified accordingly to an effective date no sooner than January 1, 2014.

We also have a concern about unintended consequences. Currently Kansas is one of two states with a four tier sales structure. On-premise restaurants purchase their wine and spirits not from distributors but from retailers that concurrently possess a federal permit to make these sales. As there is contraction of the retail stores (by one half) it is uncertain that these new retailers will want to sell to and carry the broad inventories needed to service on-premise accounts or to do so at today's margins of just 2-3 percent over bottle cost. These new outlets (the Hy-Vees, Dillons, Walgreens, CVS, Wal-Marts, Caseys) are primarily consumer sales oriented – not b-to-b oriented. As the restructuring settles in we anticipate a need to restructure the wholesale sale to on-premise accounts. How that effects price and regulatory costs is at this time unknown.

Our current model works well for Kansas. One example: The recent caffeine-alcohol product recall demonstrated how effective and orderly a system we have in this state. Literally within days, even hours, of the directive to remove these products that job was accomplished by distributors and retailers. The FDA determined that these products contained "unsafe food additives" and per directive of the ABC, Kansas' current orderly market respond quickly, efficiently and effectively. What we used to call *temperance* and now call *regulation* is about protecting the public. It is about having effective mechanisms in place to deter underage sales, to reduce impaired driving, to reducing the need for prevention and intervention. In so doing the system should not consume precious resources needed elsewhere or place disproportionate demands on state and local governments.

It also seems contradictory to pass the DUI law last year and then expand the number of outlets this year. How do you reconcile this bill with that act of restraint? *We can't.*

The distribution tier foresees increased costs in servicing the system proposed in HB 2532 that will be assumed by the consumer. We are concerned about unforeseen consequences by the loss of free standing retail stores that may foreshadow future restructuring as the ripples shake the web and sales are further dispersed. We do not see the need for three licenses when one will do.

We support appropriate regulations that promote social policies that deter abuse and underage consumption. We oppose policies that weaken the qualifications for licensure. The total package retail beverage alcohol sales in Kansas, based on enforcement taxes, are $685 million annually which are less than one-half of one percent of the sales of the proponents of HB 2532.

It appears this bill will cause more disorder than order and thus we suggest that first the legislature do no harm to a system that has served Kansans well by rejecting HB 2532.

*Thank you for your attention to and consideration of these matters.*

**<u>North American Industry Classification System - NAICS</u>**

<u>445310 Beer, Wine, and Liquor Stores</u>
This industry comprises establishments primarily engaged in retailing packaged alcoholic beverages, such as ale, beer, wine, and liquor.

<u>44512 Convenience Stores</u>
See industry description for 445120.
<u>445120 Convenience Stores</u>
This industry comprises establishments known as convenience stores or food marts (except those with fuel pumps) primarily engaged in retailing a limited line of goods that generally includes milk, bread, soda, and snacks

<u>447110 Gasoline Stations with Convenience Stores</u>
This industry comprises establishments engaged in retailing automotive fuels (e.g., diesel fuel, gasohol, gasoline) in combination with convenience store or food mart items. These establishments can either be in a convenience store (i.e., food mart) setting or a gasoline station setting. These establishments may also provide automotive repair services.

<u>445110 Supermarkets and Other Grocery (except Convenience) Stores</u>
This industry comprises establishments generally known as supermarkets and grocery stores primarily engaged in retailing a general line of food, such as canned and frozen foods; fresh fruits and vegetables; and fresh and prepared meats, fish, and poultry. Included in this industry are delicatessen-type establishments primarily engaged in retailing a general line of food.

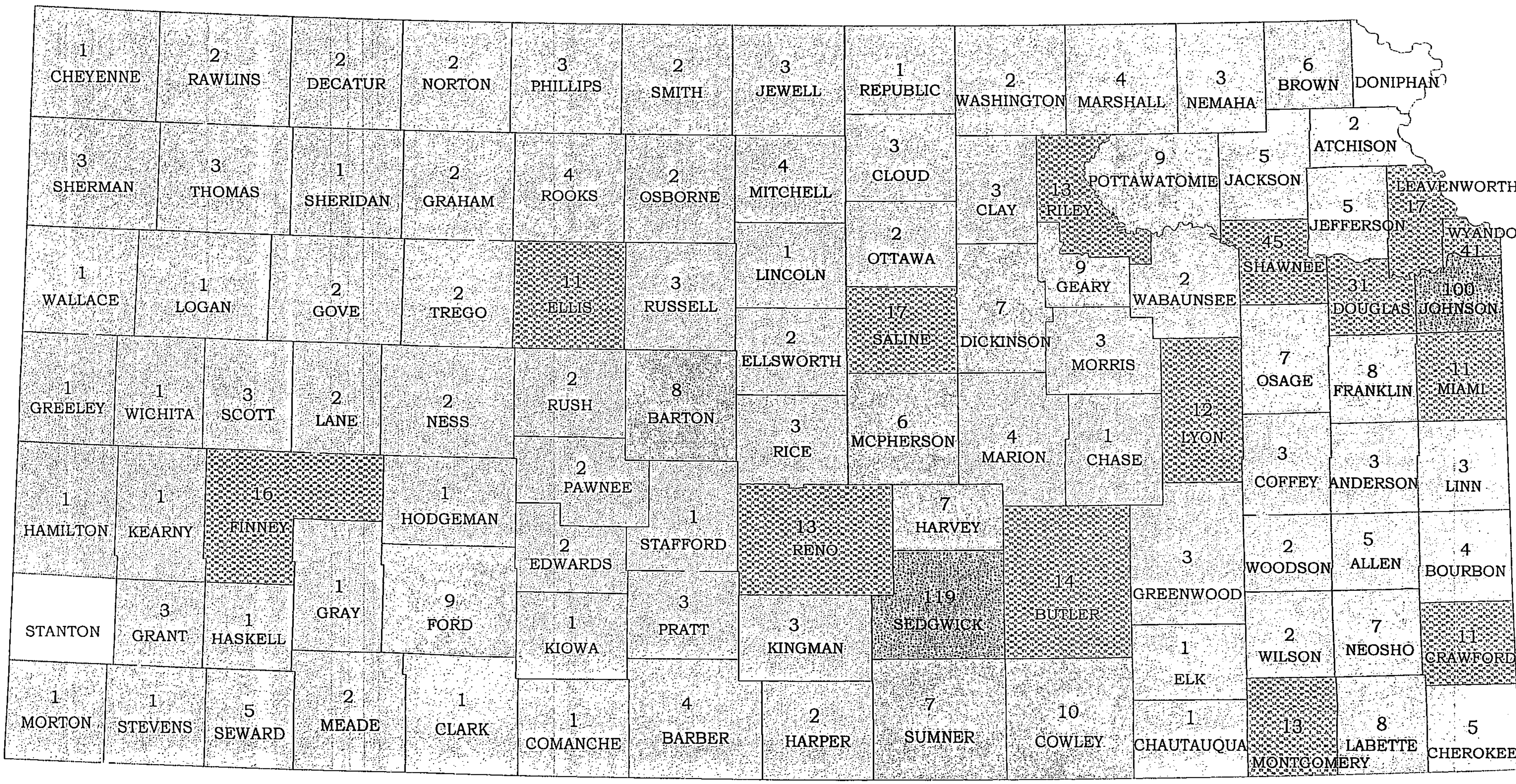
<u>452910 Warehouse Clubs and Supercenters</u>
This industry comprises establishments known as warehouse clubs, superstores or supercenters primarily engaged in retailing a general line of groceries in combination with general lines of new merchandise, such as apparel, furniture, and appliances.

<u>452111 Department Stores (except Discount Department Stores)</u>
This U.S. industry comprises establishments known as department stores that have separate departments for various merchandise lines, such as apparel, jewelry, home furnishings, and linens, each with separate cash registers and sales associates. Department stores in this industry generally do not have central customer checkout and cash register facilities.

<u>452112 Discount Department Stores</u>
This U.S. industry comprises establishments known as department stores that have central customer checkout areas, generally in the front of the store, and that may have additional cash registers located in one or more individual departments. Department stores in this industry sell a wide range of general merchandise (except fresh, perishable foods).

<u>446110 Pharmacies and Drug Stores</u>
This industry comprises establishments known as pharmacies and drug stores engaged in retailing prescription or nonprescription drugs and medicines.
Source: http://www.census.gov/cgi-bin/sssd/naics/naicsrch

# 2012 Active Kansas Off-Premise Retailers




The data used for this map
was derived from the
Kansas Department of Revenue,
Alcoholic Beverage Control Division,
Liquor Licensing Database,
for January 2012 This map was prepared
by Kansas Department of Revenue,
Property Valuation Division, GIS Section.

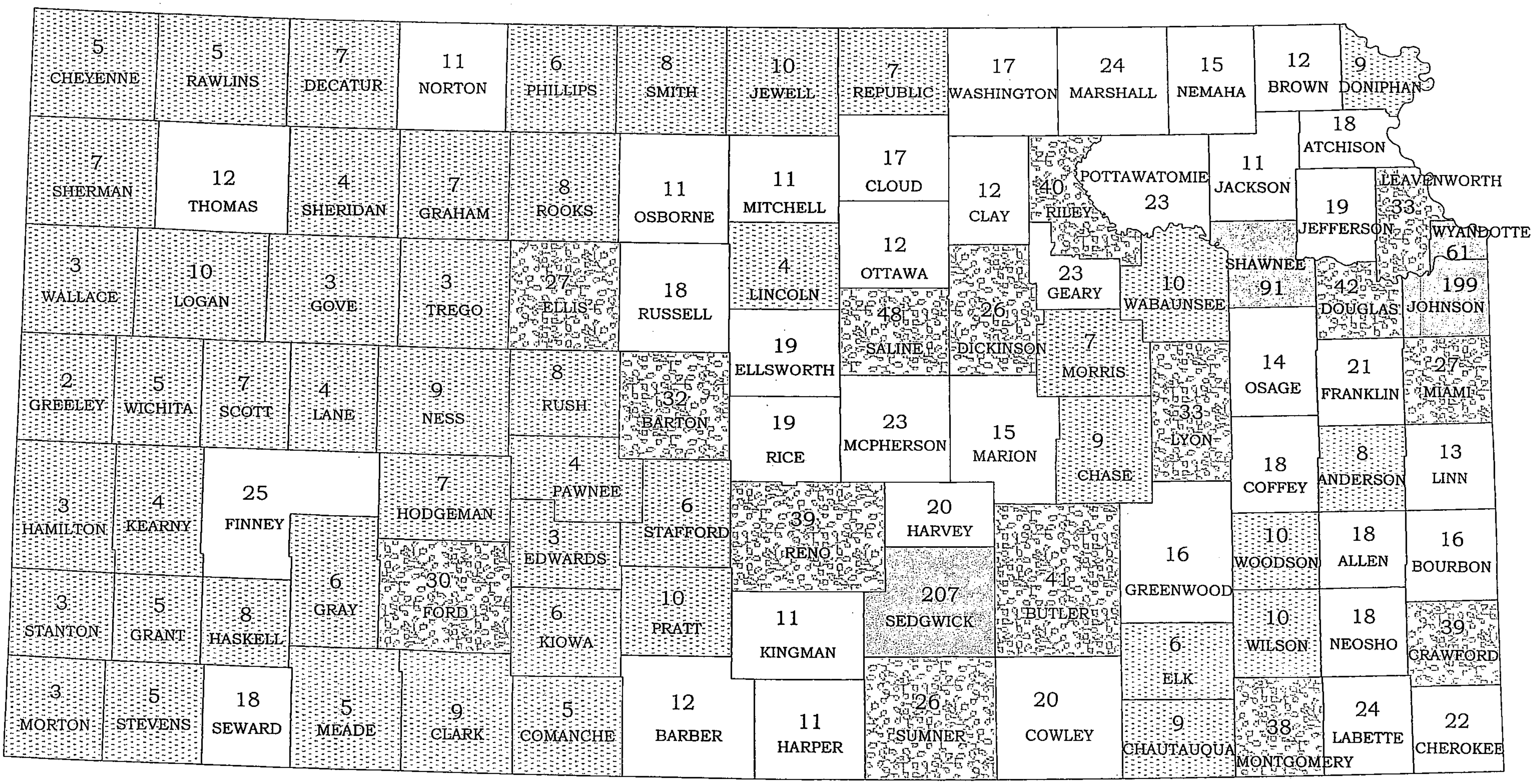
| # of Counties | # of Licenses Per County |
|---|---|
| ( 2 ) | 0 |
| ( 73 ) | 1 - 5 |
| ( 14 ) | 6 - 10 |
| ( 14 ) | 11 - 99 |
| ( 2 ) | 100 - 119 |

Total: 761 Active Retailer Licenses

Kansas
Department of Revenue
Alcoholic Beverage Control

January 6, 2012
Map #AC12-002

# 2012 Kansas Cereal Malt Beverage Licenses
# Off-Premise Retailers




The data used for this map was derived from the 2012 Cereal Malt Beverage applications received from the cities and counties by the Alcoholic Beverage Control through January 6, 2012. This map was prepared by Kansas Department of Revenue, Property Valuation Division, GIS Section.

| # of Counties | # of Retailers Per County |
|---|---|
| ( 48 ) | 1 - 10 |
| ( 38 ) | 11 - 25 |
| ( 15 ) | 26 - 50 |
| ( 2 ) | 51 - 100 |
| ( 2 ) | 101 - 207 |

Total: 2,020 CMB Off-Premise Retailers

Kansas
Department of Revenue
Alcoholic Beverage Control

January 6, 2012
Map #AC12-008

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