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WINE & SPIRITS
WHOLESALE ASSOCIATION

To: Senate Committee on Federal and State Affairs
From: R.E. "Tuck" Duncan
RE: SB 298

March 31, 2015

I appear today on behalf of Kansas' wine and spirits wholesalers. Many of you have heard my presentation regarding Kansas' Three-tier System of distribution and are keenly aware that wholesalers are uniquely positioned in that we have contractual relationships with suppliers from across the country and globe; we function as a partner with the state in the collection of gallonage taxes on beer, wine and spirits; and wholesalers provide inventory, education and expertise to Kansas' retail liquor dealers. In all the states there is some configuration of the "Three-tier System", wherein either private licensees or the state functions as this middle tier.



Additional information on the "The Origin of America's State-Based Alcohol Regulatory System," on the Three-Tier System and on the economic impact of the wine and spirits industry in Kansas is available at www.kwswa.org. Recently we distributed to all members of the Legislature a *Primer on the Three Tier System* formatted for the Legislative Briefing Book.

In considering whether wholesalers could better meet their contractual commitments to suppliers to promote their brands in the market place, and if consumers will be better served, we have determined that SB298 as currently drafted will not create an orderly marketplace for the sale of beverage alcohol. In fact, the present retail system that has served Kansas consumers well will be severely deconstructed by SB298.

You will hear from law enforcement, religious organizations, alcoholic beverage retailers, suppliers and others about their concerns with SB298 relating to a myriad of operational, social and societal concerns. I will concentrate on the consequences of making this change as it affects the middle tier and as it affects consumers of our products, as well as the complications created by a "county option" approach.

COUNTY OPTION

While it is true that both Sunday Sales and Liquor-by-the-drink were implemented by local option¹, we believe that is a bad idea for implementation of the Uncork plan as set forth in SB298. It may interest you to know that a local option approach was discussed by the proponents and opponents during a meeting hosted by Commerce Chairman Mark Hutton before his committee worked the House bill (which has since been referred back to committee). At that

¹ The Liquor-by-the-drink amendment provided 3 options for voters: dry, sales with 30% food and sales with no food requirement. It was necessitated because the voters had to approve a change to the Kansas Constitution. Sunday sales were initially permitted as a result of a court decision upholding a Wyandotte County Charter Ordinance. Since Charter Ordinances provide for a ballot initiative, when Sunday Sales were added to the Liquor Control Act the ballot initiative was preserved.

time, all parties agreed that local option was not a good idea so it was not included in the amended bill model adopted by that committee. *Here are just a few of the complications:*

1) **Consumer Confusion:** In the case of Sunday Sales and Liquor-by-the-drink, the effect of the local elections did not cause the kind of consumer confusion that will follow if one county or city approves an SB298 election and the next county does not. Stores either are or are not open on Sunday. Restaurants and bars either are or are not open to the public. However under local option for the Uncork plan, consumers shopping in a convenience or grocery store on one side of the county boundary will find only 3.2% beer and in a similar store on the other side of the line they will find strong beer. The product labels look very similar so consumer confusion will be the result.

2) **Distributor Logistics:** For distributors the logistics will be nightmarish. Delivery of the correct product to the appropriately licensed store in the correct county will be a daily challenge. The current system for licensing and distribution is efficient and cost effective.

3) **Increased Cost of Regulation:** Under current laws, all retailers of strong beer, wine and spirits are licensed and regulated by the ABC, while CMB retailers are licensed and regulated by the cities and counties. Under SB298 some convenience stores and grocery stores would be regulated by the ABC, and would collect liquor enforcement tax. Similar stores in other locations would be regulated by the cities and counties and would collect state and local sales taxes. The certain result would be increased cost with less consistent enforcement and government regulation.

SUBSTANTIVE ISSUES

SB298 will deconstruct² the efficient, safe, orderly market of selling package liquor to the general public. It is a system that ensures social responsibility by limiting access to persons under the legal age. It is a system that has consistently provided a stable source of revenue to the state general fund.

The current system works because:

- Independent liquor stores are evenly spaced across the state and urban neighborhoods because licenses are issued based on expressed needs of communities
- Liquor stores are independent family-owned businesses offering access and opportunity for all comers with drive and ambition.
- Profits stay in a community with local families.
- Businesses support traffic in smaller neighborhood shopping areas.
- Safety controls prevent access, theft, or consumption by minors.
- Regulatory control is highly successful – few violations and closures.
- Product selection is responsive to local desires.
- Fair and balanced competition among many entities of similar size.

² de·con·struct (dē'kən-strūkt') tr.v. de·con·struct·ed, de·con·struct·ing, de·con·structs 1. To break down into components; dismantle , Collins English Dictionary - Complete & Unabridged 2012 Digital Edition.

HB298 affects two (2) systems of beverage sales, not one. The first is to add grocery and big box stores to the types of outlets that can sell package liquor, wine and beer. The second is to expand to convenience stores and gas stations the sale of beer. Currently there are 1,420 on-premise and 1,775 off-premise CMB licenses. Source: Kansas ABC (as of 12.1.14) To deconstruct package retailing will cause significant dislocation, and to do it at the same time as creating a new class of licensees - “strong beer” - will complicate the transition to affording new entities the opportunity to enter the market place.

Based on a study of the CMB market in Colorado³ (a market similar to Kansas in that it too has independent liquor stores and cereal malt beverages are sold in grocery stores) the impacts of creating strong beer licensees are significant.

“Industry Impacts will be that liquor stores will lose 50 percent of full-strength beer sales to supermarkets and convenience stores in the first year alone, liquor stores will 70 percent of beer sales within 3 to 5 years. It is estimated that 40 percent of the Colorado stores will be forced to close within the first 3 years. In Colorado this will result in the loss of 4,830 wage and self-employment jobs resulting in a permanent \$90 million loss in annual wages and proprietor income earnings. These losses will continue through the fifth year. After the fifth year the new market structure will stabilize with 900 fewer stores. There will be 5,500 fewer jobs in the industry, resulting in a loss of \$120 million annually in employee and proprietor earnings. Distribution practices in supermarkets and convenience stores favor volume over premium small-scale products. This will greatly impact Colorado micro breweries, wineries, and spirits distilleries. It will become more difficult for these products to find their way to market shelves.”

In Kansas the first obvious effect is the increased alcohol content in the malt beverages being sold in the Class “A” stores. At a minimum the increase is 20-25%, and for other beers upwards of tenfold that increase. The Kansas Health Institute in its 80 paged study *Potential Health Effects of Expanding Liquor Licenses to Grocery and Convenience Stores*, May 2014, suggests that increased density of higher alcohol products will increase youth consumption, youth STDs, youth alcohol related traffic accidents, theft, and violent crime.

The next obvious effect is the increased costs of distribution. Based on the current number of CMB licensees, it is reasonable to anticipate at least 1,775 beer (Class “A”) outlets will hold the new license. Kansas’ wine and spirits distributors can also possess beer distributor licenses, and have contracts for the sale of “strong” products, some of which have a CMB counter-part contracted to a different beer distributor. Class “A” licensees are all new delivery points for wine and spirits distributors selling beer. That means more trucks, more routes, more

³ *Economic Impact of Replacing 3.2 Beer Sales With Full Strength Beer Sales*. Prepared for: Pueblo Licensed Beverage Association, Colorado Springs Liquor Store Association, Korean Retail Liquor Store Association, Colorado Licensed Beverage Association, Colorado Community Liquor Store Coalition, Prepared by: Summit Economics, LLC. www.Summiteconomics.com

delivery expense. As one of my members who started in the wholesale liquor industry in 1949 oft reminded me – “*The consumer always pays for the cost of distribution.*”

If the practical effect of the new Class “A” licenses is to eliminate CMB, ten (10) counties with no liquor-by-the-drink will not have malt beverages for their taverns or pizza establishments.⁴

We do not believe there will be an appreciable increase in consumption for the general public. The economic study by Arthur P. Hall, PhD,⁵ confirms that belief: “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.” (citing Journal of Studies on Alcohol, Vol. 54, 1993). Thus, in order to recoup increased costs associated with distribution it may be necessary to increase prices. This also means there will be no new tax revenues to the state as well.

With respect to the addition of new categories of eligible entities, (Class “B” licensees) the face of retailing will change for as a general rule grocery stores, big box, and super-stores stock fewer numbers of items, what we call “SKUs” (stock keeping units). For example Costco, as reported by CNBC, typically carries 200 SKUs whereas the typical liquor store carries 2500 and the largest store in Kansas carries nearly 20,000. Many stores that acquire the “frozen” licenses in the three year transition period will dedicate limited shelf space. New product introduction will deteriorate and that is extremely unfavorable for consumers, suppliers and distributors.

As the number of “full service” outlets close,⁶ the opportunity to sell new products, line extensions, and the upward of 25,000 items wholesalers carry will shrink. This is a disservice to our suppliers, impairs our ability to fulfill our contractual obligations, and is a disservice to consumers who will find it less convenient to purchase the variety of products now available in the market place. The grocery and big-box stores will be “skimming the cream” taking away high value business.⁷ The consequences of SB298 will be a nearly unlimited number of beer licenses with unlimited access to minors. From our perspective the SB298 model results in a landscape where “full service” stores will have weathered away.

⁴ Clark, Clay, Gray, Haskell, Jewell, Meade, Sheridan, Stafford, Stanton, Wallace (Source: KS A.B.C. as of 12.15.14)

⁵ *An Economic Case for Increased Competition in the Sale of Beer, Wine and Spirits in the State of Kansas, January, 2011*

⁶ As the new Class “A” licensees erode the sales of current Kansas retailers in the initial term of the transition, the current economic model will fail and current retailers will seek to sell their licenses to entities that will not carry the extensive inventory of existing package stores.

⁷ Cream-skimming means selection by retailers of a limited number of products (SKUs) expected to be profitable. Avoidance of cream-skimming requires adequate risk adjustment and pro-competitive regulation (neither of which are provided for in SB298). Pro-competitive regulations would include density or proximity rules, or rules requiring product segregation in the grocery and big-box locations, which encourage greater selection.

Kansas has an orderly market for the sale of wine, beer and spirits. Maintaining an orderly market is a primary responsibility of government. It is consistent with ensuring that the ills which led to the United States embarking on one of its greatest social experiments: Prohibition, are not repeated.⁸ Already overextended police departments will have to contend with the prospect of greater theft as they have in the State of Washington which expanded sales to grocery and big box stores several years ago. “[T]he increase in thefts is far higher than many anticipated across the state. Local police estimate a 175 percent increase in shoplifting liquor. News reports out of Seattle describe the theft rate as ‘practically an epidemic.’ ”⁹

SB298 is deficient in that it is not a comprehensive piece of legislation that will afford the Kansas Alcoholic Beverage Control the tools needed to implement the transition and maintain an orderly market. For example, there are no provisions for new licenses as populations increase in various counties. The Liquor Control Act is an expression of the state’s police powers.¹⁰

If the bill is to be advanced it should include provisions for density and/or proximity for the location of liquor stores, something more than a provision that picks one winner and two losers close to a grocer. The current provisions do not provide for segregation of all beverage alcohol products within the store by maintaining beer in a location different from wines and spirits.

If we truly believed as wholesalers it would be more profitable for us under the SB298 system and that we could better meet our contractual commitments to suppliers to promote their brands in the market place, and that consumers will be better served - - then we would support changing the retail system. However, our unique perspective “in the middle” of the distribution system has provided us with a dispassionate ability to recognize pros and cons. In weighing those pros against the cons, the scale weighs against SB298 and in favor of a retail system that has served Kansas consumers well.

For the reasons of ♦ discrimination among product categories ♦ increased costs of distribution ♦ reduction of SKUs ♦ potential increased price of goods ♦ barriers to entry of new products ♦ reduction of “full service” stores ♦ increased costs of regulation and policing ♦ and lack of safeguards to preserve and maintain an orderly market - we respectfully request that the committee not advance the bill to the House. *Thank you for your attention to and consideration of these matters.*

⁸ See: <http://www.pbs.org/kenburns/prohibition/> Read also: Last Call: The Rise and Fall of Prohibition, by Daniel Okrent , Simon & Schuster, 2010.

⁹ *Surge in liquor thefts in state must be quelled*, <http://union-bulletin.com/news/2013/jul/31/surge-liquor-thefts-state-must-be-quelled/>

¹⁰ Police Power: The authority conferred upon the states by the Tenth Amendment to the U.S. Constitution to enact measures to preserve and protect the safety, health, welfare, and morals of the community. Police power describes the basic right of governments to make laws and regulations for the benefit of their communities. Only states have the right to make laws based on their police power. The lawmaking power of the federal government is limited to the specific grants of power found in the Constitution. The 21st Amendment to the U.S. Constitution provides, in part: Section 2. The transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited.