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WINE & SPIRITS
WHOLESALERS ASSOCIATION

To: House Committee on Commerce, Labor and Economic Development
From: R.E. "Tuck" Duncan
RE: HB 2282 February 14, 2017

I appear today on behalf of Kansas' wine and spirits wholesalers. Recently I distributed to members of the Kansas Legislature an explanation regarding Kansas' Three-tier System of distribution which explains the many benefits of Kansas' current system of sale of beverage alcohol. 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 and in the *Primer on the Three Tier System* formatted for the Legislative Briefing Book which we provided you last month.

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 HB 2282 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 HB 2282.

You will hear from law enforcement, religious organizations, alcoholic beverage retailers, suppliers and others about their concerns with this bill 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.

It is ironic that the proponents propose this legislation because of their claim there customers want "convenience" and yet the bill createa a most inconvenient system by requiring consumers to make two stops to make their beverage alcohol purchases.

HB 2282 will deconstruct the efficient, safe, orderly market of selling package liquor to the general public. The current system ensures social responsibility by limiting access to persons under the legal age. The current system has consistently provided a stable source of revenue to the state general fund. As demonstrated below that is likewise jeopardized.

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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.
• Community input on approval of licensees and locations during hearing process forces higher standards of compliance.

Currently there are 1317 on-premise and 1641 off-premise CMB licenses. Source: Kansas ABC (as of January 20, 2017). The "beer and wine" licenses will deconstruct package retailing and will cause significant dislocation. Based on a study of the CMB market in Colorado[1] (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."***

Similar findings were contained in a report from the Distilled Spirits Council of the United States. The Council concluded: ♦ Since 70% of spirits buyers are also beer buyers there

[1] *Economic Impact of Replacing 3.2 Beer Sales With Full Strength Beer Sales*. Prepared for: Pueblo Licensed everage 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

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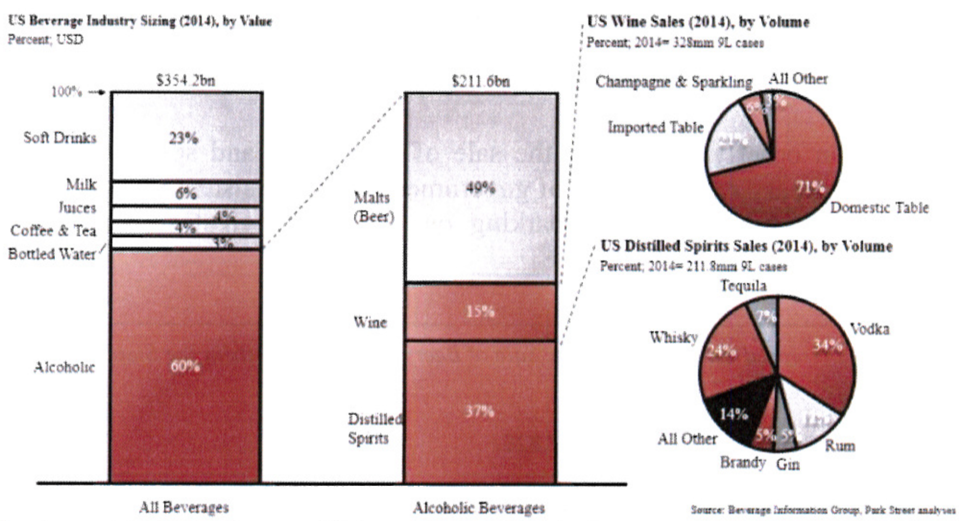
is a danger that many shoppers will forgo or curtail spirits purchases as they begin shopping for beer in stores that do not carry spirits. ♦ Beer sales make up an estimated 50% of total package store revenues – they are a core part of package store business. The reduction in beer sales, along with lost spirits sales will, initially, reduce average package store revenues by 45%. ♦ As a result of lost revenues, hundreds of package stores are projected to go out of business.

In Kansas the first obvious effect is the increased alcohol content in the malt beverages being sold in the grocery, big-box and c-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.[2]

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 1641 beer 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. These new licensees will require more trucks, more routes, more 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."***

The practical effect of the new licenses will be to eliminate CMB, and 6 counties with no liquor-by-the-drink will not have malt beverages for their taverns or pizza establishments.[3]

Beverage alcohol sales in the United States are beer 49%, wine 15% and spirits 37%.



We do not believe there will be an appreciable increase in consumption for the general public. The economic study by Arthur P. Hall, PhD,[4] confirms that belief: "Kansas is among the

[2] http://media.khi.org/news/documents/2014/06/20/KHILiquorHIA_FINAL_062014.pdf

[3]Gray, Haskell, Jewell, Meade, Stafford, Stanton (Source: KS A.B.C. as of January, 2017)

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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.

However, when you separate spirits sales from wine and beer sales, the prospect of the loss of 1/3rd of the retail outlets will result in a corresponding loss of gallonage taxes of approximately $3.5 million[5] and enforcement (retail) taxes of $8.2 million[6]. There is the very real potential that the 20 counties that have only 1 liquor store could lose that store when 64% of their product sales shift to the grocers and gas stations. There is a very real potential that the 20 counties that have only 2 liquor stores could lose one or both of those stores when 64% of their product sales shift to the grocers and gas stations. Allowing liquor stores to sell a small percentage of other goods cannot compensate the sales losses.

With respect to the addition of this new category of licenses 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. New product introduction will deteriorate and that is extremely unfavorable for consumers, suppliers and distributors.

As the number of "full service" outlets close 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] From our perspective the HB2282 model results in a landscape where "full service" stores will have weathered away.

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]

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

[5] FY2016: $10,629,777 x .33 (outlets closed)= $3,507,826.

[6] FY2016: $67,754,222 x (spirits share) .37 x .33 (outlets closed) = $8,272,790.

[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 HB2200). 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.

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

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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]

HB2282, makes it possible for a felon to own up to 15% of the license. The generally accepted limitation for non-qualifying ownership in Kansas for liquor stores is 0%, and for on-premise establishments 5%. We are not aware of any justification to alter this significant public policy that keeps serious criminals out of the alcoholic liquor business. If the committee advances this legislation, it should seriously consider modifying this provision.

The bill also eliminates these sections of the law in Section 16:

Repeals: 41-103. Declaration of public policy; separate retail sale of 3.2 beer and alcoholic liquors; retail sales in cities only, exceptions. The legislature hereby declares the public policy of this state to be that: (a) Cereal malt beverage shall be sold at retail separately from sales of alcoholic liquor at retail; (b) cereal malt beverage shall be sold and dispensed at retail in rooms or premises separate and distinct from rooms or premises where alcoholic liquor is sold; and (c) no retailer's license for the sale of alcoholic liquor shall be granted to any applicant making application therefor if the premises sought to be licensed are located outside the corporate limits of any city within this state, except as provided in K.S.A. 41-303 and amendments thereto.

Repeals: 41-711. Sale at retail forbidden on certain premises. No alcoholic liquor shall be sold at retail upon any premises which have an inside entrance or opening which connects with any other place of business

We suggest that if the committee advances this bill that to off-set increased distribution costs it amend the legislation to permit distributors to establish order minimums for quantity and/or dollar amounts, to apply uniformly. This is a standard practice in other sectors of the food industry.

> New Sec. ___. 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.[10]

If the bill is to be advanced it should include provisions for density and/or proximity for the location of liquor stores. There should be provisions that prohibit dormancy of licenses such that otherwise a license could be purchased and never used. Dormant licenses after a year should escheat to the state and be auctioned in the county of their origin. There should be provisions to create equity for existing retailers.

The definitions as set forth in the NAICS codes are overly broad. Definitions describing the entities the legislature desires possess retail licenses should be written with specificity. For example Code 445120 Convenience Stores is defined as:

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[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] This provision has been included in most of the prior versions of the Uncork legislation.

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> 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.

Is not a Dollar General a convenience store under this definition? Is the ABC Director to approve Casey's which also sells pizza and other deli foods, but not a Dollar General?

> 445110 Supermarkets and Other Grocery (except Convenience) Stores: 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.

Is a delicatessen a grocery store? Appears so under this definition. The point is, let Kansas define what it means and not use vague codes leading to litigation.

And the bill hides the fact that big-box stores are also included. The grocery store definition includes the NAICS code:

> 452910 Warehouse Clubs and Supercenters
> 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.

We know the intent is Sam's and Costco. Target, too? So what does "primarily" mean? 51% food and 49% other stuff? 25-75% OK? Menards sells lots of food, is that enough, does it qualify. If not, why not? What are the standards?

While we oppose the bill, if there is any desire to move it forward, an extended transition period such as was included in Colorado legislation should be included and a specific provision should be included to provide that the rules and regulations implementing this bill be adopted within a year of its publication in the statute book. This will ensure that the transition will be uniform.

If we truly believed as wholesalers it would be more profitable for us under the HB2282 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 might 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 HB2282 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 ♦ loss of tax revenues and sales of a profitable category (spirits) ♦ and lack of safeguards to preserve and maintain an orderly market - we respectfully request that the committee not advance the bill to the House and report the bill adversely.

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

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