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WINE & SPIRITS
WHOLESALERS ASSOCIATION

February 16, 2011

To: Senate Committee on Federal and State Affairs
From: R.E. "Tuck" Duncan , General Counsel
RE: SB 54

I appear here today to advise the committee as to the rationale of distributor opposition to SB54. I will not reiterate the testimony regarding the inadequacy of the economic model as justification for the restructuring of the retail industry in Kansas, nor will I repeat the concerns of retailers that the moratorium is merely "smoke and mirrors." *

What I will address in the limited time allotted are (1) 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 and (2) the underlying public policy issues that you as legislators may want to consider in addressing this issue.

EFFECTS OF SB 54 ON THE WINE AND SPIRITS DISTRIBUTION TIER

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 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.

There will be a regulatory cost, as the fiscal note from the Dept of Revenue states:
"SB 54 would increase [state government] expenditures by $1,654,564 in FY 2012."

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.

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*__Smoke and mirrors__ is a metaphor for an insubstantial explanation or description. The source of the name is based on magicians' illusions, where magicians make objects appear or disappear by extending or retracting mirrors amid a confusing burst of smoke. The expression may have a connotation of virtuosity or cleverness in carrying out such a deception.

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 is controverted.

And let me be clear – we do not support SB54. We have an orderly system that functions well today that does not need restructuring.

Nonetheless, if the committee answers the policy questions I pose below affirmatively, then from our perspective having more than one type of license is unnecessary. It is not the license type that SB54 presents as a policy issues. The changes this bill proposes are more basic:

Can a corporation have a license?
Can there be multiple retail license ownership?
Should qualifications for license be diluted ?
Should persons under 21 years of age sell the product?
Can you sell package alcohol anywhere?
Will there be transferability of licenses and therefore equity/blue sky value?

As distributors we suggest 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.

We have contracts to distribute these multiple products and if you are going to expand the outlets, then there is no reason not to afford us the opportunity to meet our 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 we be afforded the opportunity to sell all our products to a retail establishment?*

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, *discussed infra*.)

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 2321 based on current CMB licenses, (Source: KS ABC map attached) that means smaller payloads and more miles. More miles, more delivery vehicles, more personnel, more cost. One of the pioneers of this industry schooled me that the consumer always pays for the cost of distribution.

We estimate that based on SB 54 as drafted the costs for capital investment and additional operating expense will be an annual cost within the range of $7.5 to $10 million based on the addition of sales reps system wide by 30, increase in merchandisers by at least 25, increase in drivers by approximately 36, increase in operations personnel by 20, increase in fuel by $1 million per year, increase in the delivery fleets by 30 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. 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 SB 54 and ask that if the bill moves forward the effective dates be modified accordingly.

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.

PUBLIC POLICY ISSUES

Let me now address the public policy concerns that should be considered when enacting intoxicating liquor legislation: it has been a precept of the Liquor Control Act for over 60 years that the state will preserve an orderly market. We obviously can have a healthy conversation about what is or is not an orderly market, but undoubtedly in the final analysis any new system must be one that <u>can</u> be regulated and one which the state will have the resources to regulate.

I am not an apologist for being in a regulated industry. As an industry we support the use of beverage alcohol in moderation. Abuse of our products is bad for society and for business. Most recently, for example, the 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.

This public policy foundation began with the landmark treatise by Fosdick and Scott, *Toward Liquor Control* (1933) funded by the Rockefellers in anticipation of the adoption of the 21st Amendment and has been reanalyzed recently in the LSU Public Administration series *Social and Economic Control of Alcohol* (2008), *supra*.

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). "Fosdick and Scott conclude that any system of alcohol control must have the approval of the community. . The new text concludes: "Americans want control over alcohol…" (p.220).

So today we are experiencing what some call a New Temperance Movement (not prohibition but restraint). This includes:

+ DUI Commission recommendations such as SB 7,
+ Interlocks
+ Defense of Community Act restraints on sale
+ Bottle Bills

…*all matters now pending before this legislature.*

How do you reconcile SB 54 with these other acts of restraint? *We can't.*

Also, none of the other states with which I am familiar have such a scheme for package sales as set out in SB 54. That is to say, it has not been since national repeal over 75 years ago ever tested and thus predictions as to effectiveness are just guesses. Other states have permanent caps on licenses and restrictions on qualifications.

CONCLUSION

The distribution tier foresees increased costs in servicing the system proposed in SB 54 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 SB 54. It seems 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 SB 54.

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