



To: House Committee on Commerce, Labor and Economic Development
From: R.E. "Tuck" Duncan
RE: HB 2556

February 19, 2014

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 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 every states there is a 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.kswa.org

In considering whether wholesalers could better meet their contractual commitments to suppliers to promote their brands in the marketplace and if consumers will be better served we have determined HB2556 is as the Chinese say: "death by a thousand cuts"¹ and 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 dislocated during the decade long transition.

A major deficit of this bill is that it does not allow the sale of all categories of products wherever package alcoholic beverages are sold. If the policy of the State of Kansas will be to allow the retailing of beverage alcohol in a variety of establishments then all retailers must be permitted to sell all categories of products: wine, beer and spirits. All are lawful products. Alcohol is alcohol whether it be brewed, distilled or fermented. As wholesalers we have contractual agreements to sell all categories. To be limited to delivering only one or two categories is economically restrictive. It would be incongruous to select one category of product over another for sale in these new locations. If the policy of the State is to alter the system then one license for the sale of all categories is the only balanced and nondiscriminatory policy which should be enacted.

¹ **Slow slicing** (simplified Chinese: 凌迟; traditional Chinese: 凌遲; pinyin: *língchí*; Wade-Giles: ling-ch'ih, alternately transliterated *ling chi* or *leng t'che*), also translated as the **slow process**, the **lingering death**, or **death by a thousand cuts** (simplified Chinese: 杀千刀; traditional Chinese: 殺千刀) or "千刀万剐", was a form of torture and execution used in China from roughly AD 900 until it was banned in 1905. In this form of execution, a knife was used to methodically remove portions of the body over an extended period of time, eventually leading to their death.

It is in the state's interest not to limit categories, for as the retailing environment changes, restricting the sale of certain categories to one retail account and other categories to other retail accounts, even for a limited number of years, will impact the collection of spirits gallonage and excise taxes. Texas has taught us this lesson. Texas is similar to Kansas because it is the only other state with a four tier model where package liquor retailers sell to bars and restaurants. In Texas, where beer and wine are sold in the grocery, convenience and big box stores, spirits are sold only in retail liquor stores. As a result the sales of spirits have not kept pace with the sales of the other categories and have not kept pace with population growth. This at a time when spirits are a growing category in demand by millennials.²

You will hear from law enforcement, religious organizations, alcoholic beverage retailers, suppliers and others about their concerns with HB2556 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.

The first obvious effect is the increased costs of distribution. Based on the current number of CMB licensees, it is reasonable to anticipate at least 1,650 beer (Class "A") outlets. Over time that same number of outlets will sell beer and wine (Class "B").³ The "transition effect" will be to front load distribution costs with the lowest margin items, and not allow the sale of our more profitable category to the expanded number of distribution points for a decade.

That means 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.*"

We do not believe there will be an appreciable increase in consumption. The economic study by Arthur P. Hall, PhD,⁴ confirms same: "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 these increased costs, it may be necessary to increase prices.

Under the HB2556 model it is reasonable to expect that for the first ten (10) years there will still be approximately 750 retail licensees (Class "C") selling wine, beer and spirits. However, as the face of retailing changes, grocery stores, big box, super-stores and c-stores will stock fewer numbers of items, what we call "SKUs" (stock keeping units).

² **Millennials**, or the **Millennial Generation**, also known as **Generation Y**, are the demographic cohort following Generation X. There are no precise dates when the generation starts and ends. Commentators use beginning birth years from the early 1980s through the nineties. *Americans Turning Away From Beer, Embracing Liquor As Drink Of Choice: Gallup*, August 8, 2013.

³ Currently there are 1,333 on-premise and 1,647 off-premise CMB licenses. Source: Kansas ABC.

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

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” 750 Class “C” licenses during the next decade will dedicate limited shelf space as this bill envisions alcoholic liquor shelved alongside other products offered by acquiring licensees. General merchandise stores will have limited room for new products and c-stores minimal floor display space. New product introduction will deteriorate and that is extremely unfavorable for consumers, suppliers and distributors.

As the number of “full service” outlets close,⁵ 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 contractual obligations, and is a disservice to consumers who will find it less convenient to purchase the variety of products now available in the marketplace. These general merchandise establishments will be “skimming the cream” taking away high value business.⁶

Kansas’ distributors have worked hard to get pricing competitive with border states, particularly Missouri, through operational efficiencies. This is a difficult task since Missouri has lower spirits and beer taxes. The expansion of first beer, then beer and wine, outlets envisioned in HB2556 will reverse those efforts.

The marketplace has determined the number of stores Kansans want based on consumer demand. That demand has been for the last six years: 2009: 742; 2010: 752; 2010: 764; 2011: 761; 2012: 761; 2013: 751.⁷ The consequences of HB2556 will be an unlimited number of beer and then beer and wine establishments with unlimited access.⁸

From our perspective the HB2556 model means skyrocketing expenses at the front end and unforeseen returns at the end of the decade when the landscape of “full service” stores has weathered away.

⁵ As the new Class “A” and “B” 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 during the decade - for at the end of the decade these “frozen” licenses have no equity value.

⁶ 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 HB2556).

⁷ ABC Legislative Briefing to Kansas Legislature, January 21, 2014.

⁸ The North American Industry Classification System codes (NAICS) in the bill are broad and not limited to what one commonly thinks of as a convenience store or grocery store. The bill provides definitions “including but not limited to” the cited examples. They include, but are not limited to, gasoline stations, pharmacies and drug store, department stores, warehouse clubs, supercenters, “all other general merchandise stores,” and liquor stores.

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 — the effort to prohibit within its borders the manufacture and sale of alcoholic beverages, are not repeated.⁹

The increased cost to Kansas taxpayers, and to municipalities that provide law enforcement efforts will be considerable. In prior years similar legislation has resulted in fiscal notes of \$1.5 - \$1.9 million just for funding of the Kansas Alcoholic Beverage Control. We believe that to be a conservative estimate as the true number of outlets selling beer, wine, or beer, wine and spirits is a moving target. 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 two 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.”¹⁰

Police will have to expand patrols to monitor the expanded number of outlets. When sales in Iowa were expanded in convenience stores the result was “[A] proliferation of outlets where liquor is sold.” According to Councilman Skip Moore.¹¹ “We’ve got liquor stores popping up everywhere and it is causing some concern with me, and I think that if we can tighten it down a little bit ourselves, we should,” he said. “I don’t think, on the Class E, they ever anticipated what is happening with Class E liquor licenses. Those are showing up everywhere.”

For the reasons of:

- ◆ discrimination among product categories,
 - ◆ negative impact on spirits tax collection,
 - ◆ increased costs of distribution,
 - ◆ reduction of product variety (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.

⁹ See: <http://www.pbs.org/kenburns/prohibition/> Read also: Last Call: The Rise and Fall of Prohibition, by Daniel Okrent , Simon & Schuster, 2010.

¹⁰ *Surge in liquor thefts in state must be quelled*, <http://union-bulletin.com/news/2013/jul/31/surge-liquor-thefts-state-must-be-quelled/>

¹¹ *Des Moines Proposes Revised Liquor License Approval Process. The proposal would add a "good moral character" qualifier to the city code that assesses liquor license applications.* Association for Convenience & Fuel Retailing, <http://www.nacsonline.com/News/Daily/Pages/ND0214126.aspx>