



To: House Committee on Commerce, Labor and Economic Development
From: R.E. "Tuck" Duncan
RE: HB 2200

February 12, 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.kswa.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 HB2200 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 HB2200.

You will hear from law enforcement, religious organizations, alcoholic beverage retailers, suppliers and others about their concerns with HB2200 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.

HB2200 will deconstruct¹ 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:

¹ 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.

- 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.
- Crime syndicates do not have access to liquor sales; money laundering curtailed.
- 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.

HB2200 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 Colorado² (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.”

² *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

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 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 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.³

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 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” 749 licenses in three years will dedicate limited shelf space as this bill envisions alcoholic liquor will be shelved alongside other products offered by the acquiring licensees. 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

³ Clark, Clay, Gray, Haskell, Jewell, Meade, Sheridan, Stafford, Stanton, Wallace (Source: KS A.B.C. as of 12.15.14)

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

⁵ 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.

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.⁶ The consequences of HB2200 will be a nearly unlimited number of beer licenses with unlimited access to minors.⁷ From our perspective the HB2200 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 — the effort to prohibit within its borders the manufacture and sale of alcoholic beverages, 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

HB2200 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. The Liquor Control Act is an expression of the state’s police powers.¹⁰ These are powers possessed by government to preserve the “health, safety and welfare” of governed. HB2200, in the face of almost all state laws with which I am familiar, makes it possible for a felon to own up to 25% of the licensee. The generally accepted limitation for non-qualifying ownership in Kansas, and elsewhere, is 5%. We are not aware of any

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 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.

⁷ 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. More on this *infra*. The bill provides definitions found at: <http://www.census.gov/cgi-bin/sssd/naics/naicsrch>

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 and which the states delegate to their political subdivisions 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. Under the system of government in the United States, 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.

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. Under 14th Amendment equal protection considerations there is probably no rational basis to allow felons to own one type of liquor enterprise (a retail liquor store) but not another (like a drinking establishment, or public venue).

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.

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.

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

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.

So is Ice & Olives¹¹ a delicatessen here in Topeka, 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.

¹¹ "Ice & Olives is truly the city's finest delicatessen, with "daily deli fare" and an array of grocery items featuring upscale foods, gifts, gourmet coffee, imported cheeses bulk olives, Italian sauces, Boar's Head Brand meats and more. If you enjoy fine foods and culinary delights, you won't find a more interesting shopping experience in Topeka. Daily foodservice offerings include soup, salads, panini and deli sandwiches, made-to-order or packed to-go. We offer "bistro breakfasts" every day from 7 AM - 10 AM, and from 8 AM to 1 PM on weekends." <http://www.iceandolives.com/>

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? The store does 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?

447110 Gasoline Stations with Convenience Stores: 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.

Can I be an auto repair shop, or parts shop, with a gas pump and sell beer? Again, how little of the food items is enough - is a coffee pot and a candy counter satisfactory?

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 HB2200 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 HB2200 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.