



To: House Committee on Commerce, Labor and Economic Development
From: R.E. "Tuck" Duncan
RE: HB 2206

March 7, 2013

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 states there is some configuration of the 3 tier system, wherein either private licensees or the state act as this middle tier.

If we truly believed as wholesalers it would be more profitable for us under the HB2206 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 HB2206 and in favor of a retail system that has served Kansas consumers well..

Let me first identify that principle embodied in the bill which is meritorious.

If the policy of the State of Kansas will be to allow the retailing of beverage alcohol in a variety of establishment, as opposed to our current configuration, then all retailers must be permitted to sell all categories of products: wine, beer and spirits. All are lawful products. 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 hypocritical 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, as provided for in HB2206, for the sale of all categories is necessary.

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 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 off-premise retailers sell to on-premise retailers (more on that later). 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 has not kept pace with the sales of the other categories and has not kept pace with population growth.

You will hear from law enforcement, religious organization, alcoholic beverage retailers, suppliers and others about their concerns with HB2206 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. No matter which side of this debate you are on, everyone expects there will be a contraction of existing stores and an explosion of new outlets. Based on the current number of CMB licensees, it is reasonable to anticipate at least 3,000 outlets; and based on the broadness of the NAICS (North American Industry Classification System) codes, For example at page 3, line 38 the code 452990 is cited. This code includes (<http://www.naics.com/censusfiles/ND452990.HTM>) “452990 All Other General Merchandise Stores”

“This industry comprises establishments primarily engaged in retailing new goods in general merchandise stores (except department stores, warehouse clubs, superstores, and supercenters). These establishments retail a general line of new merchandise, such as apparel, automotive parts, dry goods, hardware, groceries, housewares or home furnishings, and other lines in limited amounts, with none of the lines predominating.”

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. In reviewing the 2013 edition of the Beverage Marketing Directory Kansas is 34th in spirits consumption and 41st in wine consumption. Kansas, the 34th state, has been generally 34th in consumption for the 30 years I have represented the wholesalers. The proponents’ economic study by Arthur P. Hall, PhD, January, 2011, *An Economic Case for Increased Competition in the Sale of Beer, Wine and Spirits in the State of Kansas* confirms our 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).

Kansas has been constant in its consumption volumes for decades and the only noticeable bump in sales occurred when Kansas recaptured lost border sales by permitting Sunday sales. Thus, in order to recoup these increased costs, it will be necessary to increase prices.

In an attempt to limit that acceleration, we request that if the committee advances this bill it amend it by including a provision that has been included by prior legislative committees in all the prior year’s legislation on this topic, as follows:

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.



As the face of retailing changes, grocery stores, big box stores and c-stores will 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 (the largest store in Kansas carries nearly 20,000). Many stores will dedicate

limited shelf space as this bill envisions alcoholic liquor will be shelved alongside other products offered by the new licensees.

In previous years suppliers have testified their entry into the market is facilitated easier under the Kansas structure. General merchandise stores will have limited room for new products. New product introduction will be weakened and that is unfavorable for consumers and distributors.

As the number of traditional 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 otherwise available in the market place. Proponents suggest that because they generally carry a limited number of products retail stores will continue to survive. However, as they sell the most popular and largest volume skus (like Jack Daniels and Crown Royal), the traditional retailer will not be able to sustain its overhead and offer a diverse inventory. These general merchandise establishments will be “skimming the cream” taking away high value business.

Kansas, as mentioned, like Texas, has a 4 tier structure. Off- premise retailers who secure a wholesalers basic permit from the federal government, sell to the on-premise retailers their wine and spirits (beer may be sold direct). There are historical reasons for this, but the impact of altering the current structure is that as traditional stores phase out and as new retailers with limited selection replaces them, there will be fewer outlets (particularly in less populated areas) who possess the federal wholesalers basic permit to provide this service.

It will then be imperative that we return to the legislature to seek the authority to make these sales direct because restaurants and bars will not be able to purchase in a convenient and timely manner the inventories they need to meet their customer’s demands. This could further impact the traditional retailer by reducing a source of sales that has sustained them over the years. As a result more traditional retailers will close their doors and upwards of an additional 2,333 Class A clubs, Class B clubs, Caterers, Public Venues and drinking establishments could be added to the cost of distribution. These will not be new sales and again there will be upward pressure on prices to recoup these new delivery expenses for which there is no new income.

Kansas’ distributors have worked hard to get their pricing competitive with border states, particularly Missouri, through operational efficiencies, which has been a difficult since Missouri has lower alcohol taxes. The expansion of outlets envisioned in HB2206 will reverse those efforts.

There are also a couple of legal precedents I believe the committee must consider.

In Kentucky a federal judge ruled last year that Kentucky’s existing law is unconstitutional because it blocks groceries from selling wine and liquor, while allowing sales at pharmacies. That ruling is on hold while the case is appealed to the Sixth U.S. Circuit Court of Appeals in Cincinnati. So while the legislation attempts to define the types of retail establishments that could hold licenses to the exclusion of others, based on current litigation in Kentucky federal courts, it appears there are two choices, a liquor only store system like Kansas, or no limitation on the kind of stores that retail alcoholic liquor. The limitations as set forth in HB2206 are constitutionally tenuous. Judge Heyburn rejected Kentucky’s argument that the ban

on wine and spirits sales in grocery stores and other retail outlets, besides drugstores, was crucial to its efforts to control beverage alcohol consumption. Asserting that the state may still exert control over access by limiting the number of licenses granted a certain area, the Judge said the state's argument "does not explain why a grocery-selling drugstore like Walgreens may sell wine and liquor, but a pharmaceutical-selling grocery store like Kroger cannot."

Ironically, as a result, the Kentucky legislature is considering legislation to prohibit sales in grocery stores and pharmacies and return to the alcoholic liquor only model. (<http://www.courier-journal.com/article/B2/20130214/NEWS01/302140052/House-committee-passes-bill-maintain-ban-liquor-sales-grocery-stores-new-pharmacies>)

HB2206, 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 justification to alter this significant public policy that keeps serious criminals out of the alcoholic liquor business. If the committee advances this legislation, you 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). Thus, we would expect that a future challenge to such restrictions for other licensee categories to succeed. Once you let the toothpaste out of that tube there is no putting it back.

It was recently reported in the Des Moines Register on March 1, 2013 that: "Des Moines' elected officials spent much of last year reacting to a 2011 change in state law that essentially allowed gas stations and convenience stores to stock liquor in the same room as candy, soda and other products. Legislators meant for the change to make it easier to access liquor in the state's rural areas, where liquor stores are few and far between. But in larger cities like Des Moines, city officials say, the change enables a liquor store to be on nearly every block." That proves the old maxim, "be careful what you wish for...."

Density is not addressed in HB2206. For decades we have had a self-limiting system in that regard. The marketplace has determined the number of stores based on consumer demand. That demand has been for the last five years: 2009: 742; 2010: 752; 2010: 764; 2011: 761; 2012: 761 (ABC Legislative Briefing, January 18, 2013). The consequences of HB2206 will be an unlimited number of establishments with unlimited access. From our perspective that means skyrocketing expenses.

Again, if we truly believed as wholesalers it would be more profitable for us under the HB2206 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 HB2206 and in favor of a retail system that has served Kansas consumers well.

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