

Washington State Liquor Control Board

**Beer and Wine Three-Tier System Review
Task Force Report**



November 21, 2006

(This page intentionally left blank)

Three-Tier System Review Task Force

Ms. Lorraine Lee, Liquor Control Board Chair
Mr. Roger Hoen, Liquor Control Board Member
Ms. Vera Ing, Liquor Control Board Member
3000 Pacific Ave SE
PO Box 43075
Olympia, WA 98504-3075

November 21, 2006

Re: Three Tier System Review – Task Force Report

Dear Ms. Lee, Mr. Hoen, and Ms. Ing;

It is my pleasure to submit the report from the Three-Tier System Review Task Force related to the sales and distribution of beer and wine in Washington State.

The Task Force dedicated a tremendous amount of time and effort meeting together, reviewing provided materials, considering issues, discussing pros and cons, and adopting recommendations.

The attached report documents the purpose, process and scope of the review, summarizes stakeholder interviews and Task Force discussions, and outlines the Task Force recommendations as adopted by a majority vote. The report appendices include the materials, research and public comments that informed the Task Force members through the process.

The scope of the review was broad and the opinions were varied. The diversity of the Task Force participants created an opportunity for lively debate and airing of multiple sides of important issues. The discussions were productive and informative for the legislative and Liquor Control Board members and staff attending Task Force meetings.

It is our understanding this report will be presented in its entirety to the Legislature by the LCB. We, as a Task Force, believe it provides the Liquor Control Board and the Legislature with an excellent foundation

Three-Tier System Review Task Force

Ms. Lorraine Lee, LCB Chair
Mr. Roger Hoen, LCB Member
Ms. Vera Ing, LCB Member
November 21, 2006
Page 2

for the deliberations and decisions that will occur related to potential changes in Washington's Three-Tier System.

Respectfully,



Nathan S. Ford, Jr.
Three-Tier Review Task Force Chair

c: Pat Kohler – LCB Administrative Director

c: Task Force Members:

Representative Steve Conway; Representative Richard Curtis; Senator Linda Evans Parlette; Senator Jeanne Kohl-Welles; Tom Carr – Seattle City Attorney; Rick Garza – LCB Deputy Administrative Director; Lynn Gust – Fred Meyer; Mike Hale – Hale's Ale; Fred Hellberg – Consumer; Tim Hightower – Washington Wine Institute; Greg Hopkins – Tacoma Police Department; Katie Jacoy – California Wine Institute; Steve Lynn – Water to Wine Shop; John McKay – Costco; Carol Owens – Governor's Council on Substance Abuse; Parry Park – Korean Associated Grocers; Mary Segawa – Thurston Together!; Shelley Sieveking – Anheuser-Busch; Anthony Anton – Washington Restaurant Association; Phil Wayt – Washington Beer and Wine Wholesalers Association

Table of Contents

Executive Summary	Pages 1-5
1. Purpose and Scope of the Beer and Wine Three-Tier System Review	Page 1
2. Three-Tier System Review Approach – Participants and Process	Page 4
3. Washington’s Three-Tier System – Federal Regulations, History and Changes	Page 7
4. Washington’s Three-Tier System Overview	Page 10
5. Washington’s Three-Tier System - Strengths and Weaknesses / Interview Themes	Page 15
6. Policy Context and Criteria	Page 17
7. Relationship Among the Tiers: Current Regulations, Background / Interview Results, and Task Force Discussion Highlights	Page 19
8. Beer and Wine Sales and Distribution: Current Regulations, Background / Interview Results, and Task Force Discussion Highlights	Page 28
9. Control and Enforcement: Current Regulations, Background / Interview Results, and Task Force Discussion Highlights	Page 43
10. Impacts of Changes in 2SSB 6823: Current Regulations, Background / Interview Results, and Task Force Discussion Highlights	Page 49
11. Task Force Recommendation Summary	Page 51
12. Summary of Issues in Costco vs. Hoen, et al.	Page 54
13. Conclusions and Next Steps	Page 56

Appendices

- A. 2nd Substitute Senate Bill 6823
- B. Task Force Charter
- C. Task Force Meeting Agenda Summary
- D. Task Force Meeting Discussion Summaries
- E. Detailed Interview Results – Current System Strengths, Weaknesses and Suggested Changes
- F. Task Force Potential Change Item Prioritization
- G. Task Force Meeting Notes as Approved by the Task Force
- H. Task Force Meeting Presentation Materials
 - 1. May 3 Meeting
 - 2. May 18 Meeting
 - 3. June 15 Meeting
 - 4. August 3 Meeting
 - 5. September 14 Meeting
 - 6. September 28 Meeting
 - 7. October 12 Meeting
 - 8. November 17 Meeting
- I. Task Force Issue Papers
 - 1. Sales and Distribution – Pricing and Post and Hold
 - 2. LCB in Retail Sales
 - 3. Mandatory Use of Distributors
 - 4. Tied House Laws – Ownership, Financial Interests and Money’s Worth (*The full text of Washington’s Tied House Statute – RCW 66.28.010 – is included in Appendix A of this paper.*)
 - 5. Impact Measures Related to 2SSB 6823
 - 6. General Impact Measures
- J. Task Force Data Request Summary
- K. 50-State Survey Results
- L. Comments from Stakeholders During Review Process
- M. U.S. District Court Order on Plaintiff’s Motion for Partial Summary Judgment on Second Claim and Related Portion of Third Claim (Costco v. Hoen, et al.)
- N. U.S. District Court Findings of Fact and Conclusions of Law (Costco v. Hoen, et al)
- O. U.S. District Court Amended Judgment (Costco v. Hoen, et al.)
- P. Order on Defendants’ Motion for Stay (Costco vs. Hoen, et al.)
- Q. Task Force Members

Executive Summary

Second Substitute Senate Bill 6823, Sec. 13 (2006):

The liquor control board shall convene a task force to conduct a comprehensive review of the current regulatory system controlling the sale and distribution of beer and wine in Washington State. The board shall include stakeholders representing the producers, distributors, consumers, retailers, carriers, and legislators in conducting its review. The task force shall review the genesis of the current regulatory system and whether the system in its current configuration should continue. It shall identify key issues, concerns, and desired changes by stakeholders about the current system and shall identify alternatives or modifications to the current system. The task force shall also research and analyze the impacts and implications of this act, and other suggested modifications to the system on distributors, producers, retailers, and consumers. The task force shall make recommendations about any proposed changes to the system by December 15, 2006.

During the 2006 session, the Legislature passed Second Substitute Senate Bill (2SSB) 6823. Section 13 of the bill directed the Washington State Liquor Control Board to establish a task force to conduct a comprehensive review of the state's regulatory system for the distribution and sale of beer and wine. The task force was specifically directed to:

- Review the genesis of the current regulatory system and whether the system in its current configuration should continue.
- Identify key issues, concerns, and any desired changes by stakeholders about the current system.
- Identify alternatives or modifications to the current system.
- Research and analyze the impacts and implications of 2SSB 6823, and other suggested modifications to the system on distributors, producers, retailers and consumers.
- Make recommendations about any proposed changes to the system by December 15, 2006.

To complete this review, the LCB appointed a Task Force consisting of 20 diverse stakeholders, and a non-voting Chair. (A list of Task Force members is provided at the end of this section.) Individual and group interviews were conducted with over 100 individuals to identify current system strengths and weaknesses.

Most Task Force members generally agreed that the current system of regulating the distribution and sale of beer and wine could benefit from some changes. The system was put in place in the 1930s to respond to a specific social and business climate that existed post-prohibition. Since then, Washington has adopted an incremental approach to modifying that system. As a result, the regulatory system in place has not kept pace with the significant changes in industry and society that have occurred in the past 70 years.

Although a majority of the Task Force members agree that change is needed, there is significantly less agreement about what that change should be and when it should be initiated. With a current lawsuit still on appeal [Costco vs. Hoen, et al.], several members of the Task Force would prefer to wait until the case is fully resolved before recommending any significant changes to the current system. Others believe reform is needed regardless of the regulations challenged in the lawsuit.

Some members support maintaining the current system without change. They feel the current system is working well, that implementing changes to the system may result in unintended negative consequences, and the conservative approach to change has served to maintain the health and safety of Washington's citizens.

Eight Task Force meetings were conducted from May 18 through November 17, 2006. The Task Force agreed on recommended changes to state policy goals, which were then used as criteria to assess current regulations and potential changes. The results of the stakeholder interviews were used to help the Task Force focus on key issues and concerns, and to prioritize the Task Force's consideration of alternatives to the current system.

The following items were the focus of discussion for Task Force recommendations at their seventh meeting:

- Price posting and hold,
- Enforcement resources,
- Policy and regulation impact measures,
- General money's worth provisions,
- Ban on quantity discounts,
- Mandatory minimum price mark-up,
- Mandatory (compelled) use of distributors (focusing on common carrier issues),
- Uniform pricing,
- Rules governing LCB retailing of beer and wine,
- Ban on central warehousing,
- Delivered pricing requirement, and
- Ban on credit to retailers.

The results of the review are included in this report, along with eleven recommended changes to better meet industry needs, while safeguarding the health and welfare of the public. Four of the recommended changes shown below were adopted with no opposition (Recommendations 1, 2, 9 and 11); seven recommendations were adopted by majority, but divided, votes.

Recommendation #1: State Alcohol Control Policy

The Task Force believes that an appropriate alcohol regulatory system for beer and wine sales and distribution should be based upon the three policy goals set forth below. In creating and interpreting such a regulatory system, the Legislature and the LCB should consider the economic development of wineries and breweries and related industries, so long as the LCB and the Legislature also consider any adverse impact of any proposals on public health, safety or welfare.

Policy Goal 1: To prevent the misuse of alcohol.

- "Misuse of alcohol" includes underage sales/drinking, driving while under the influence, serving to inebriated consumers, public inebriation, sales outside of the regulated system, or any other use that could promote public harm or create safety or nuisance issues.

- In an attempt to prevent misuse, the state should not affect responsible moderate consumption.
- “Responsible moderate consumption” is the public sale/consumption of alcohol by legal adults, without misuse.

Policy Goal 2: To promote the efficient collection of taxes.

State’s Working Interpretation: readily available and reliable information about all sales in order to effectively collect accurate state taxes.

Policy Goal 3: To promote the public interest in fostering the orderly and responsible distribution of malt beverages and wine towards effective control of consumption.

State’s Working Interpretation: avoidance of pressure on any one industry (producers, distributors, or retailers) from another that would cause collusion or result in unfair advantages or disadvantages that may result in over-consumption or increased access by minors.

Recommendation #2: Tied House Prohibitions against Providing Money or Money’s Worth to Retailers

The Task Force recommends continuing the state’s current approach of adopting specific exceptions to the prohibition against providing money’s worth to retailers, and directs the LCB to work with stakeholders to re-examine current exceptions and develop a comprehensive list of proposed exceptions for legislative consideration. When developing the list of recommended exceptions, the LCB should consider:

- Industry business needs,
- Customer benefits,
- Whether it creates an unwanted inducement for retailers,
- The potential for increased misuse of alcohol, and
- Enforcement resources.

Recommendation #3: Tied House Ownership and Financial Interests

The Task Force encourages the liberalization of the Tied House ownership restrictions, and recommends that the Legislature work with the LCB to arrive at a workable solution.

Recommendation #4: Price Posting

The Task Force recommends that price posting be eliminated.

Recommendation #5: Mandatory Minimum Mark-up

The Task Force recommends elimination of the mandatory minimum mark-up requirement.

Recommendation #6: Volume Discounts

The Task Force recommends that volume discounts be allowed, with the same volume pricing available to all customers. For example, if a distributor offers price breaks at 10, 100 and 500 units, those price breaks are offered to all customers.

Recommendation #7: Use of Common Carriers

The Task Force recommends that manufacturers and distributors be allowed to ship their product to retailers using common carriers and consider establishing a licensing requirement for all common carriers delivering alcoholic beverages regardless of origination.

Recommendation #8: Credit

The Task Force recommends the state allow the option for manufacturers and distributors to offer credit to retailers, with specific terms including a 30-day limit, reporting requirements and penalties for default (temporary license suspension and/or cash penalty).

Recommendation #9: Enforcement Resources

The Task Force recommends that the LCB be supported by adequate enforcement resources and that those resources grow in consideration of population increases and increases in liquor licenses.

Recommendation #10: General Impact Measures

The Legislature is encouraged to provide funding to the LCB to develop research and analysis capability, and work collaboratively with stakeholders and other agencies and organizations to collect independent data, and to use/analyze existing data.

Recommendation #11: Measuring Impacts of 2SSB 6823

The Task Force recommends the LCB identify and select key impact measures that can be monitored and analyzed by the Fall of 2007, to provide the Legislature with data about the impacts related to the implementation of 2SSB 6823.

The LCB is encouraged to work with stakeholders and legislative staff to identify the most pertinent impact measures. Key impact measures should be tied to the state’s policy goals and should address the impact to industry, consumers, the state and society. And, to the extent possible, consideration should be given to selecting measures for which baseline data are already available. Basic data should be collected and reported; suggestions include:

- The number of endorsements granted to out-of-state manufacturers and in-state retailers to use the expanded authority,
- The volume of product sold through out-of-state self-distribution,
- The size and type of retailers using the authority, and
- Tax revenue collections.

The Task Force considered, but did not reach agreement on, recommendations regarding three other areas: central warehousing, uniform pricing, and delivered pricing.

The members of the Three-Tier Task Force respectfully submit this report, along with recommendations for change, to the Liquor Control Board and the Washington State Legislature in fulfillment of its obligations under 2SSB 6823.

Chair: Nathan Ford, Jr.

Members¹:

The Honorable Jeanne Kohl-Welles, Washington State Senate
The Honorable Linda Evans Parlette, Washington State Senate
The Honorable Steve Conway, Washington State House of Representatives
The Honorable Richard Curtis / Cary Condotta, Washington State House of Representatives
Mr. Anthony Anton / Mr. Gene Vosberg (*Washington Restaurant Association*) representing On-Premise Retailers
Mr. Thomas Carr (*Seattle City Attorney*) representing Local Government
Mr. Rick Garza representing the Liquor Control Board
Mr. Lynn Gust (*Fred Meyer*) representing Large Grocers
Mr. Mike Hale (*Hale's Ale*) representing Washington Beer Manufacturers
Mr. Fred Hellberg representing Consumers
Mr. Tim Hightower (*Washington Wine Institute*) representing Washington Wine Manufacturers
Lt. Greg Hopkins (*City of Tacoma Police Department*) representing Local Law Enforcement
Ms. Katie Jacoy (*California Wine Institute*) representing Out-of-State Wine Manufacturers
Mr. Steve Lynn (*Water to Wine Specialty Wine Shop*) representing Specialty Retailers
Mr. John McKay (*Costco*) representing Large Retailers
Ms. Carol Owens (*Governor's Council on Substance Abuse*) representing the Prevention / Treatment Community
Mr. Perry Park (*Korean-American Grocers Association*) representing Small Grocers
Ms. Mary Segawa (*Together!*) representing the Prevention / Treatment Community
Ms. Shelley Sieveking (*Anheuser-Busch*) representing Out-of-State Beer Manufacturers
Mr. Phil Wayt (*Washington Beer and Wine Wholesalers Association*) representing Distributors

¹ Legislative members were non-voting, with the exception of certain procedural items.

Section 1 – Purpose and Scope of the Beer and Wine Three-Tier System Review

Many requests for regulation changes and U.S. District Court rulings prompted a comprehensive study.

Washington State’s alcohol regulations were promulgated in the early 1930’s to address negative conditions resulting from the lack of appropriate alcohol controls. Over the years conditions have changed. Although regulations have been modified on a piecemeal basis as specific issues are encountered and addressed, systematic changes have not been made. Several studies have been conducted and there have been many requests to the Liquor Control Board (LCB) and the Legislature over the years for specific changes. There is not widespread agreement on what changes, if any, need to be made due to the diversity and perspective of stakeholders and the nature of the product. In the past several years, the Legislature has been approached by a wide variety of interest groups seeking their own individual modifications to the state’s beer and wine regulatory scheme. In the past few years, the LCB and the Legislature have considered ways to take a more comprehensive approach to changes to the existing system.

The desire for a comprehensive review intensified in 2004, when Costco Wholesale Corporation filed a lawsuit against the Washington State Liquor Control Board, challenging a number of Washington State laws and regulations regarding the distribution and sale of beer and wine.² In April 2006, the District Court found in favor of the plaintiff (Costco) on all but one issue.³ In her ruling, District Court Judge Marsha Pechman held: “To the extent that the restraints may have a minimal effect in advancing the state’s core interests under the Twenty-first Amendment, the state’s interests do not outweigh the federal interest in promoting competition under the Sherman Act. Therefore the Court concludes that the challenged restraints are preempted by the Sherman act.”

On December 21, 2005, in a related order, the District Court found that Washington statutes that permit in-state beer and wine producers to distribute their products directly to retailers, while withholding such privileges from out-of-state beer and wine producers, discriminate against out-of-state producers in violation of the Commerce Clause of the United States Constitution. The Court-ordered remedy was to eliminate the self-distribution privilege from the in-state wineries and breweries; however, the Court stayed the entry of judgment until April 14, 2006, to provide a sufficient period of time for the Washington State

- Washington’s alcohol regulations were established in the 1930’s.
- Regulations have changed over time based on individual issues rather than systematic changes.
- A lawsuit filed in 2004 and decided by the U.S. District Court in April 2006, challenged a number of Washington State regulations.
- In December 2005, a District Court ruling directed the Legislature to either withdraw direct sales privileges for in-state manufacturers or extend the privilege to out-of-state manufacturers.

² Costco vs. Hoen, et al. (See Section 12 for a summary of issues.)

³ The court upheld the state’s current regulations prohibiting retailer-to-retailer sales.

Legislature to determine whether to extend the self-distribution privilege to out-of-state beer and wine producers instead. (See Appendix M for the full text of the Order on the Partial Summary Judgment.)

The 2006 Legislature responded by passing a measure that extends the direct sales privilege to out-of-state manufacturers in 2nd Substitute Senate Bill 6823 (2SSB 6823). The bill included a sunset date of June 30, 2008, to bring all interested parties back to the table to review the impacts of the legislation.

Neither the State nor the Washington Beer and Wine Wholesalers Association (WBWWA) are appealing this portion of the Costco decision.

The LCB and the Washington Beer and Wine Wholesalers Association (WBWWA) have filed an appeal to the remaining issues decided in favor of Costco. Costco has filed an appeal related to the issue found in the state's favor (retailer-to-retailer sales). The District Court has granted a stay of the order until May 1, 2007 to give the Legislature the opportunity to act on the court's judgment, however the state has asked the 9th Circuit Court of Appeals to extend the stay through the pendency of the appeal.⁴ They believe it may take at least another year, and perhaps much longer depending on how the case unfolds and whether there are further appeals, before the case is finally resolved.

Legislation directed the formation of a Task Force to conduct a review of Washington's Three-Tier system for beer and wine (spirits were not included).

The provisions in 2SSB 6823 also directed the Washington State Liquor Control Board to convene a task force comprised of industry stakeholders to conduct a comprehensive review of the state's three-tier system for the sale and distribution of beer and wine, and to report conclusions by December 15, 2006. The purpose of the review is to identify key issues and concerns of the current system for the sale and distribution of beer and wine, and to identify alternatives or modifications. The task force is also directed to analyze impacts of changes directed in other parts of the bill, primarily allowing out-of-state beer and wine manufacturers to sell directly to retailers (the same privilege as in-state manufacturers have had for some time).

- 2SSB 6823 grants the out-of-state privilege. The bill's provisions sunset in June 2008.

- The 2006 Legislature directed the Three-Tier review with a report due by December 15, 2006.

⁴The Washington Beer and Wine Wholesalers Association (WBWWA) was granted Intervenor – Defendant status upon petition at the original trial.

The scope of the review includes beer and wine only.

The scope of this review includes only beer and wine, which the state indirectly controls through a licensing and distribution system for sale through independent retail outlets. (The state also is directly involved in the sale of beer and wine to the extent those products are sold in state liquor stores.) Regulations related to spirits (distilled alcohol) are **not** included in this study since the state directly controls the sale and distribution; spirits are sold only in state-owned or contracted liquor stores.

U.S. District Court issues would not drive nor constrain the issues addressed by the Task Force.

Because the state was interested in a broad review of the Three-Tier System, the LCB decided that the regulations at issue in the Costco case should not drive nor constrain the topics of consideration for the Three-Tier Review. The challenged issues would not be off-limits if they were also identified by stakeholders as desired topics of consideration, but they would not necessarily be the primary focus for the Task Force. The LCB believed the District Court findings would not be final for some time due to the appeal and the requested stay. The Board wanted the stakeholders to define the issues that would be considered in the review.

The regulations challenged in the court case surfaced as issues with other stakeholders, but additional concerns about the beer and wine sale and distribution regulations were also identified. (See Sections 7 through 9 and Appendix E for more detail on the issues.) After presentation and discussion of the primary issues identified through interviews, the Task Force prioritized the issues they felt were most important to discuss and consider for change, given the compressed schedule for the review. (See Appendix F.)

This report documents the process, research, discussions and recommendations of the Task Force during the review period.

- The review scope includes the sales and distribution of beer and wine only; spirits are not included.
- The LCB desired a broad system review and therefore decided the issues considered during the review would be determined by stakeholders not by the lawsuit.
- A number of issues were identified by stakeholders.
- Since there was limited time for the review, the Task Force prioritized issues for consideration.

Section 2 – Three-Tier System Review Approach; Participants and Process

Task Force participants

The legislation established in 2SSB 6823 directed the Three-Tier System Review to include stakeholders from relevant industry sectors (specifically producers, distributors, consumers, retailers, carriers) and the Legislature. The LCB convened a Task Force comprised of 20 representatives including legislators,⁵ the LCB, beer and wine manufacturers, distributors, various types of retailers (specialty wine shops, restaurants, large and small groceries, big box and convenience stores), law enforcement, the prevention community, and consumers. (See Appendix Q for a complete list of members.) A former Liquor Control Board Chairman served as the Task Force Chair and was the 21st (non-voting) member.

Some Task Force members expressed concerns about the make-up of the Task Force. The prevention and treatment community as well as the Wholesalers Association believed they were underrepresented. However, the Task Force representation complied with the legislation and a decision was made by the LCB that given the current size and schedule it was not appropriate to add members. The four groups (sports and entertainment facility operators, independent distributors, independent grocers and employee union) requesting representation on the Task Force were provided with an opportunity to present their positions to the Task Force. In addition, interviews were conducted with a broad representation of stakeholders and the LCB indicated they would work with employees on any changes that may affect them.

Over 100 individuals participated in interviews to identify issues, and public comment was received throughout the process.

The LCB contracted with Sterling Associates, LLP, an independent management consulting firm, to interview stakeholders, facilitate the Task Force meetings, prepare materials, conduct research and analysis for Task Force consideration, and prepare the Task Force report for review and acceptance.

Prior to the start of Task Force meetings, 23 individual interviews and 11 group interviews (with approximately 90 total attendees) were conducted with participants from beer and wine manufacturers, distributors, and retailers, the prevention/law enforcement community, and the Liquor Control Board. Task Force materials were posted on the LCB website, and any interested persons were encouraged to submit comments via the LCB website throughout the process. The

- The review was conducted with a Task Force consisting of 20 diverse stakeholders, and a non-voting Chair.

- Individual and group interviews with over 100 individuals were used to identify current system strengths and weaknesses.

⁵ Legislators chose not to vote on Task Force motions and recommendations.

comments were regularly forwarded to the Task Force members. (The full text of stakeholder comments is included in Appendix L.) The interviews and comments were used to identify the perceived strengths and weaknesses of the current three-tier system for beer and wine sales and distribution.

The Task Force met from May 18 through November 17, 2006 and prioritized issues for discussion.

The Task Force began meeting on May 18, 2006, and concluded on November 17, 2006, for a total of eight meetings. (The meeting schedule, general topics and brief meeting summaries are included in Appendices C and D; detailed meeting notes are in Appendix G.) The Task Force began with a general overview of the historical perspective of Washington's liquor control regulations and a brief summary of the current Three-Tier System structure.

After presentations related to the background of the state's liquor control regulations, the Task Force reviewed and made suggested modifications to the state's overarching policy goals for alcohol control. (See Section 6, Recommendation 1.) Those goals were used as criteria in future discussions to assess the merits of current regulations and in considering changes.

The group was then presented with the interview summaries gleaned from over 100 contacts, including a list of the most cited issues for the Task Force to consider. Presentations were received from four other representatives from the sports and entertainment venues, non-association distributors, independent grocers and state employees union. With limited time to complete the review, identify recommendations and complete the report, the Task Force prioritized the issues and attempted to address as many as possible during the course of the meetings. (See Section 5 for interview themes and Appendix E for detailed interview summaries. Sections 7-9 include interview comments within issue discussions.)

For each issue that was discussed, the Task Force considered four basic factors: 1) whether related regulations met the state's overarching policy goals; 2) how the regulations impact the related businesses, society, consumers and state resources; 3) if there were negative impacts, were they significant enough to warrant a change; and 4) alternatives and potential impacts.

- Eight Task Force meetings were conducted from May 18 through November 17, 2006.
- The Task Force agreed on recommended changes to state policy goals, which were used as criteria to assess current regulations and potential changes.
- The Task Force prioritized issues and attempted to address as many as possible.
- The Task Force considered state policy goals and a variety of impacts with each topic discussed.

Data were provided, as available, from a variety of sources.

There is no single repository for alcohol regulations across the nation, or related impact information. Additional data were provided upon request from the Task Force members, when available. A survey of all states was conducted to get information about their regulations, policies and measures. Eighteen states provided at least partial information. Issue papers were developed for the topics scheduled for Task Force sessions, and robust discussions occurred at the meetings.

The Task Force had some difficulty coming to consensus on changes because the Task Force participants represented very different perspectives and interests. In addition impact data showing a definitive cause and effect relationship between specific regulations and outcomes were not available. However, the discussions were informative to the LCB and the participating legislators who grapple with the alcohol control issues on a regular basis. Summaries of the Task Force discussions and final recommendations, adopted by majority vote, are included in Sections 6 through 10.

- Issue papers were developed for each major topic and a 50-state survey was conducted with a limited response.
- The diversity of perspective and interests made it difficult for the Task Force to agree on how changes should be made; however discussions were productive and recommendations were adopted by majority vote.

Section 3 – Washington’s Three-Tier System, Federal Regulations, History and Changes

The 21st Amendment granted states the power to regulate the distribution and sale of alcohol.

With the repeal of national prohibition in 1933, the regulation of beverage alcohol reverted from the federal government to individual states.⁶ The Steele Act was subsequently passed in Washington, creating the LCB and establishing the state’s comprehensive control system for the distribution and sale of alcohol.

Federal regulations and Washington’s alcohol control laws were developed to stem crime and address social issues occurring before and during Prohibition.

The state powers granted by the 21st Amendment did not, however, preclude regulation by the federal government. Federal and Washington State alcohol control laws were developed in the early 1930’s after Prohibition to address significant issues that occurred before and during Prohibition. Prior to Prohibition, lack of controls on alcohol sales and distribution had resulted in: coercion and manipulation of politics, the industry and consumers; monopolies; lack of product diversity; little control over who sold what to whom; and no means to effectively tax and collect revenues from the product. At the time, manufacturers had considerable control and influence over the retailers, which was believed to be one of the principal causes of the problems leading to Prohibition. Adoption of Prohibition brought its own problems, notably organized crime. When Prohibition was repealed, the state wanted to avoid having the pre-Prohibition imbalance between producers and retailers, and its attendant problems, resurface. This imbalance of influence was addressed with the introduction of the Three-Tier System and “Tied House” laws.

Federal Alcohol Regulations are less restrictive than the state’s.

The Federal Alcohol Administration Act (FAA) of 1935 provides the basis for federal regulation of alcohol. Federal powers focus primarily on three items: 1) who can produce or introduce alcohol into commerce; 2) how alcohol must be packaged and labeled; and 3) how alcohol is marketed or sold. (These last two items must involve an element of interstate commerce to fall within the federal government’s purview.)

- The Steele Act created the state’s comprehensive system of control over the distribution and sale of alcohol.
- When Federal and Washington State alcohol laws were developed, previous lack of controls resulted in wide-spread crime, coercion, monopolies, minimal product diversity and no means to collect tax revenues.
- Federal regulations focus on who can produce/introduce alcohol into commerce, how it is packaged/labeled, and how it is marketed and sold. Interstate commerce must be involved.

⁶ The 21st Amendment gave States the authority to either permit or prohibit importation or sale of alcoholic beverages within their borders; to determine the specific structure of alcohol distribution within their borders; and to regulate various aspects of alcohol sales and possession.

The FAA and associated rules include provisions to preclude unfair trade practices, similar to Washington’s Tied House statute.⁷ These provisions regulate practices such as exclusive outlets (an exclusive outlet is a practice by which a supplier *requires* a retailer to purchase its alcohol beverages) and tied house arrangements (a practice whereby a supplier *induces* a retailer to purchase its alcohol beverages).

Unlike Washington’s regulations, the FAA Tied House regulations allow total ownership of a retailer, and allow partial ownership of a retailer provided there is no significant impact on competition. The FAA prohibits a number of activities that are also prohibited under Washington law (providing things of value to a retailer, paying for retailer advertising, for example) but **ONLY IF** the activity results in exclusion. Exclusion means that a practice:

- must **place a retailer’s independence at risk** by means of a tie or link between the supplier and the retailer; AND,
- that such practice results in the **retailer purchasing less than it would have of a competitor’s product.**

A key distinction between the FAA and Washington’s Tied House statutes is that proving a violation of the FAA is difficult because violations under the FAA require proving the practice resulted in exclusion. Proving this can be very difficult (particularly proving the practice resulted in an impact on the retailer’s purchasing.)

A second key distinction between the federal and state regulation is the lack of retailer control at the federal level. The federal regulations (law and rules) are enforced exclusively at the manufacturer and distributor tiers. The state regulations, however, are directed at all three tiers – manufacturer, distributor and retailer.

The state’s environment has changed since the regulations were first developed.

Over the years, the state’s environment has changed. There are rules and regulations for enforceable licensing, to effectively collect taxes and prevent illegal activities, and to monitor and control consumption, especially for minors. Consumers are more educated and sophisticated, and they expect and demand diversity and quality in beer and wine, especially in Washington State.

- Tied House laws refer to regulations that separate financial interests of manufacturers from retailers.
- Federal regulations apply only when a prohibited activity results in exclusion.
- “Exclusion” places a retailer’s independence at risk, AND results in the retailer purchasing less of a competitor’s product than it otherwise would have.
- Federal regulations are difficult to enforce since exclusion must be proved.
- Federal laws do not apply to the retailer tier.
- The state’s environment has changed. There are enforceable regulations and licenses, and effective tax collection, monitoring, and control of flow.

⁷ The term “Tied House” generally refer to regulations that require the financial separation (or independence) of manufacturers from retailers. Manufacturers could no longer be “tied” to the retailer (“house” or tavern) through ownership or other financial interests or create incentives that could also exert undue influence on retailers and ultimately, on consumers.

The current regulatory structure originated to address previous problems and evolved to support high level state policy goals to: 1) foster temperance and promote moderation in consumption of alcohol, 2) assure controlled and orderly marketing of alcohol, and 3) promote the efficient collection of taxes. (Also see Section 6, Recommendation #1.)

In today's environment, there is a highly diverse and competitive wine and beer industry contributing to the state's tourism and economy; new businesses have emerged that old rules did not envision. While in the past, manufacturers were limited and large, and retailers small, now there is a large array of manufacturers, most of them small. Although there are still many small retailers, there are also large grocery and "big box" stores that carry beer and wine. The diversity and competition has minimized the undue influence of any one manufacturer. In addition, retailers have grown in ability to exert much more influence, and consumer demand and expectations drive the market.

However, alcohol is still a highly regulated product that can cause harm to people and society. There continues to be concern about negative impacts and the desire to control abuse and misuse, especially as it affects youth.

Current regulations have evolved.

The state's alcohol regulations have been modified incrementally as specific situations and interests have been accommodated. For example, manufacturers may now sell their own product on their premises (i.e. wineries and brew-pubs), and breweries and wineries may sell their product directly to retailers (under the same basic regulations as distributors, and with some constraints). Tied House laws, including a ban on suppliers' direct or indirect ownership of retail establishments and the conveyance of "money or money's worth" – any service or product from a supplier that directly or indirectly provides value to the retailers – are mostly intact. Many industry participants believe they are too restrictive for today's social environment and business structures. Other stakeholders believe they are still appropriate for avoiding corruption and minimizing misuse of alcohol.

The next section presents a brief overview of Washington's current regulatory structure. Section 5 highlights the strengths and weaknesses of the current system as indicated through stakeholder interviews. Sections 6 – 10 contain discussions of the issues and Task Force perspectives and Section 11 summarizes the Task Force recommendations. Section 12 outlines the regulations at issue in the U.S. District Court Findings of Fact and Conclusion of Law.

- The current structure evolved to support overarching state policy goals:
 - 1) Temperance and moderate consumption,
 - 2) Orderly market, and
 - 3) Efficient tax collection.
- Today there is a highly diverse, competitive beer and wine and retail industry, and more sophisticated, demanding consumers.
- Alcohol is a highly regulated product because it can cause harm if misused.
- Current regulations have evolved with many individual changes, especially the ability for manufacturers to sell their own product.
- Tied House laws, prohibiting financial interests between manufacturers and retailers, are largely intact.

Section 4 – Washington’s Three-Tier System Overview

All states opted for some type of three-tier system in the early 1930’s to separate the manufacturers from the retailers with regulations on product distribution and prohibition of financial interests.

There are three distinct industry roles: manufacturer, distributor and retailer.

The manufacturer tier represents the producers of beer and wine. Washington’s beer and wine manufacturers have grown substantially over the years, resulting in a thriving business economy for the state. There are currently approximately 100 Washington breweries (many are small micro-breweries) and more than 450 Washington wineries (also many small businesses). There are over 700 out-of-state manufacturers licensed to do business in Washington.⁸

Generally, manufacturers may sell their own product at their own physical locations where the product is manufactured, but may not own or have an ownership interest in other retail outlets. (An exception has been granted to in-state wineries; they may own up to two retail outlets that are not on the winery premises.)

Manufacturers may sell directly to retailers if they deliver the product to the specific physical site of an individual retail outlet with their own transportation, or the retailer makes arrangements to pick up product via a common carrier and have it delivered directly to the individual location. Otherwise, they must use a licensed distributor to deliver their product. Manufacturers that directly sell or distribute their own product are responsible to pay appropriate taxes.

The distributor tier consists of business entities that purchase product from the manufacturers and resell and distribute to retailers. They also pay excise taxes to the state on product they purchase. Distributorships may be owned by manufacturers. Some distributors belong to the Washington Beer and Wine Wholesalers Association (WBWWA) but there are distributors that are not members of the WBWWA and may have different views on some of the issues considered by the Task Force.

- All states utilize a three-tier system; there are three distinct industry roles – manufacturer, distributor and retailer.
- Manufacturers include the producers of beer and wine.
- There are approximately 100 breweries and 450 wineries based in-state and over 700 out-of-state breweries and wineries licensed to do business in Washington.
- Manufacturers may sell their own product directly to retailers, acting as distributors (abiding by the same regulations).
- Distributors purchase product from manufacturers and resell/deliver to retailers.

⁸ Manufacturer licensee numbers supplied by the Liquor Control Board.

The distributor tier was inserted into the system after the Prohibition to provide a buffer between the manufacturers and retailers to eliminate or reduce undue influence and to provide a mechanism for efficient tax collection. Originally, their use was mandatory. Exceptions have been made over the years to allow in-state and out-of-state manufacturers to self-distribute under certain conditions.

The retailer tier sells beer and wine to consumers and includes restaurants, beer and wine shops, grocery stores, convenience stores, large “box” stores, and sports and entertainment venues. Retailers purchase most of their product through distributors, but may get product directly from the manufacturer. Retailers may make arrangements with a common carrier to pick up and deliver beer and wine to their premises; they may have the manufacturer deliver the product; or the retailer can pick up the product from the supplier. Retailers are responsible for remitting sales tax collected on the sale of beer and wine. There are over 12,000 retailers licensed in Washington to sell beer and/or wine.⁹

Prior to the 1930’s, manufacturers also acted as distributors and often as retailers. Even if the three tiers were not separate entities, Washington (and other states) recognized the need to regulate the roles separately. Over time, Washington regulations have evolved with less distinction between the manufacturers and distributor as separate and distinct entities – for instance, manufacturers can also own distributorships – but there are still regulations related to both roles. The separation of manufacturers from retailer entities, in terms of ownership interests and uncompensated value added (money’s worth) has been more stringently maintained in Washington law.

All tiers are licensed for their specific activities and for their physical location.

Participants in each tier must be licensed to either manufacture, distribute, or sell beer and wine, with a variety of regulations applying to each type of license, and variants on each type of license. Many regulations apply to the role as well as the license; for example a manufacturer distributing their own product to a retailer is then acting in the *role* of a distributor and must abide by the same regulations, including tax collection and payment. Similarly, a manufacturer selling their own product in its establishment is acting in the role of a retailer and must comply with similar regulations.

- The distributor tier was originally inserted to separate the retailers from undue influence by manufacturers.
- Retailers sell beer and wine in restaurants, stores (grocery, convenience, box, and specialty), and sports and entertainment venues.
- There are over 12,000 retailers licensed to sell beer and/or wine.
- Washington laws have evolved with less distinction between manufacturers and distributors as entities, but have maintained the financial separation of manufacturers from retailers.
- All tier participants must be licensed by the LCB, and act in accordance with the regulations established for each tier’s role.

⁹ Source: LCB 2005 Annual Report.

All licenses are specific to a physical location. Retail licenses correspond to a location where the beer or wine is being sold or served. For example a chain of restaurants must be individually licensed by location, not as a larger business entity. Current regulations allow delivery of beer and wine only to the licensed location, and beer or wine may not be stored in a central warehouse for distribution to multiple locations or moved between licensed establishments.

Washington is one of 18 control states – states that directly control some part of the alcohol sales and distribution. Some of the 18 control states allow sales of beer and wine only through state stores. Others, like Washington, allow sales of beer and wine through licensed retailers, but directly control the sale of spirits through state owned or contracted stores. Washington State owns and directly operates 161 liquor stores, and contracts with 154 stores.¹⁰ The Washington State Liquor Control Board provides licenses to over 12,000 retail outlets and enforces the laws and regulations related to sale and distribution of alcohol.¹¹

The state uses three strategies to control alcohol.

The state uses three major strategies, supported by laws and regulations, to control alcohol and promote the state’s alcohol related goals:

- 1) Separate the tiers through physical distribution requirements and prohibitions on ownership and financial interests,
- 2) Ensure a level playing field through pricing regulations, and
- 3) Monitor and control the flow of alcohol through licensing.

These strategies also fall into three categories defined by the Task Force for use in grouping issues:

- 1) Relationship among the tiers,
- 2) Sales and distribution, and
- 3) Control and enforcement.

Separation of the Tiers Strategy / Relationship Among the Tiers

The strategy to **separate the tiers** (relationship among tiers category) refers to compelling the use of distributors as a way to separate manufacturers and retailers in the sale and delivery of products, and to provide an efficient means to collect the excise (based on barrels or gallonage) taxes. Originally, licensed manufacturers were *required* to sell to a distributor who paid the excise tax to the state on the amount purchased, and the distributor in turn sold and delivered product to the

- Retail licenses correspond to physical locations, and product cannot be stored elsewhere or moved among licensed establishments.
- Washington is one of 18 control states – directly controlling the sale of alcohol (spirits only). Other states indirectly control the sale of alcohol through licensing, as Washington does for beer and wine.
- The state uses three strategies to promote the state’s policy goals:
 - 1) Separate the tiers,
 - 2) Level the playing field, and
 - 3) Monitor and control the flow of alcohol.
- The strategy of **separating the tiers** includes compelling the use of distributors, prohibiting ownership interests between manufacturers and retailers, and prohibiting

¹⁰ Source: LCB 2005 Annual Report.

¹¹ Source: LCB 2005 Annual Report.

licensed retailer. (Retailers are responsible to pay retail sales taxes.) Early exceptions allowed in-state wineries to sell directly to retailers, and later exceptions allowed in-state breweries the same privilege. The 2SSB 6823 allows out-of-state manufacturers to self-distribute as well. Participants indicate that most manufacturers and retailers will continue to use distributors, if available, for business reasons and because of the impact of some regulatory constraints. Many participants indicate that some small breweries and small and medium-sized wineries are not able to find effective distribution to handle all or some of their products.

Two other sets of controls regulate the alcohol industry through the separation of the tiers: 1) the prohibition of ownership interests of suppliers in retail establishments (except when it is connected to their own production facility such as a retail shop within a winery or a brew-pub), and 2) a prohibition on suppliers providing money or “money’s worth” to retailers – added value that is not directly compensated. (These regulations are discussed in more depth in the Issue Paper “Tied House Laws: Money’s Worth and Ownership” found in Appendix I.)

Level Playing Field Strategy / Sales and Distribution

The sales and distribution category coincides with the level playing field strategy the state has utilized to promote state policy goals. It includes primarily pricing and product delivery regulations.

It is the state’s intention that the pricing regulations in this category are meant to ensure beer and wine is not priced so low as to encourage misuse (over-consumption or purchase by minors) and to promote an orderly market, constraining price competition to ensure small manufacturers and retailers can participate on equal footing with larger competitors. The main pricing regulations include:

- Price posting and hold – a requirement for the manufacturer and distributor tiers to post the prices for their product to the LCB, and hold the price for a specified period. This facilitates the LCB’s ability to monitor and enforce other pricing policies.
- Uniform pricing – requires each manufacturer to offer the same price for a particular product to all of its distributors and requires each distributor to offer the same price for a particular product to all of its retailer customers.
- Ban on quantity discounts – requires each manufacturer and distributor to charge one price for each product sold, regardless of the quantity purchased.
- Delivered pricing – a requirement that distributors include the price of delivery within the uniform price of the product, regardless of the services provided or actual delivery costs.

“money’s worth” between manufacturers and retailers – adding value without direct compensation.

- The **level playing field** strategy includes pricing and product delivery regulations designed to promote the state’s policy goals.
- Primary pricing regulations include price posting and hold, uniform pricing, ban on quantity discounts, delivered pricing, mandatory minimum price mark-ups, and a requirement for retailers to pay cash on delivery (no credit).

- Mandatory 10% minimum mark-up – a requirement that manufacturers mark-up their prices to distributors at least 10% above their cost of production, and that distributors (or manufacturers in the role of a distributor) mark-up their product at least 10% above the acquisition cost. Retailers do not have a mandatory mark-up requirement; retailers are, however, prohibited from selling beer or wine for less than what they paid for it.
- Ban on credit to retailers – a requirement that retailers pay cash on delivery for product.

Regulations related to delivery are also meant to ensure a level playing field and to help monitor the flow of alcohol, including a requirement to deliver directly to each physical licensed location where the product will be sold or served. This requirement effectively prohibits central warehousing (storage of beer and/or wine in a central warehouse for distribution by the retailer to individual locations). The state believes central warehousing could constrain the LCB's ability to monitor where the product is at any given time, and could result in diversion – moving the product through illegal channels.

Another tool to control the flow of alcohol includes a prohibition on manufacturers' or distributors' use of a common carrier for product delivery to retailers. Recent legislation allows retailers to arrange and pay for pick-up of beer and/or wine from a manufacturer through a common carrier, but suppliers cannot contract with a common carrier to deliver to a retailer; they must deliver the product in their own vehicle. The state believes this regulation is consistent with the manufacturer acting in the role of a distributor who must deliver product with their company vehicles at a delivered price.

Control the Flow through Licensing Strategy / Control and Enforcement

The third major strategy the state uses to promote its policy goals is **controlling and monitoring the flow of beer and wine through enforcement and licensing**. The regulations contained in this category of control and enforcement were not a focus of the review, although there were some issues identified related to regulation impact measures, and enforcement resources and priorities.

- Delivery regulations include a prohibition on retailer central warehousing.
- A prohibition on manufacturers or distributors from using a common carrier to deliver product also constrains the ability to distribute.
- The third strategy relates to **control of alcohol and enforcement** of regulations.

Section 5 – Washington’s Three-Tier System; Strengths and Weaknesses / Interview Themes

The initial phase of the 2006 LCB Three-Tier Review consisted of interviews with over 100 stakeholders ranging from beer and wine manufacturers, distributors (independent and WBWWA members), retailers (large and small, on-premise and off), law enforcement and prevention and treatment advocates. The full list of interview participants is included in Appendix E.

Multiple and diverse perspectives on system strengths and weaknesses.

The interviews identified multiple and diverse perspectives on the state’s regulatory system and a range of answers to the fundamental question of “is there a problem with the state’s current three-tier regulatory system?” from “No,” to “Yes, the whole system needs to be overhauled.” The Task Force members themselves expressed views on each end of this spectrum and multiple points in between, with many suggestions for changes and some suggesting no change at all.

Interview participants **generally agreed** that:

- The state should regulate and enforce laws directly related to the misuse of alcohol and effective tax collection.
- All agree there should be strong enforcement of prohibitions on serving/selling to minors and over-serving/selling to inebriated individuals.
- There were no suggestions that the state should not control distribution through licensing.
- The state lacks sufficient resources to adequately enforce prohibitions on serving/selling to minors and over-serving/selling to inebriated individuals (and, some Task Force members added, for trade practices too).
- Distributors offer a valuable, efficient service to producers, retailers and the state, and they would continue to be heavily utilized for distribution without mandatory use or other rules/practices that force their use.
- Current regulations are overly complex, hard to understand and prone to inconsistent interpretation. (The WBWWA perspective was an exception to this theme.)

- Stakeholder interviews were conducted to identify the current system strengths and weaknesses.
- Diverse perspectives and interests ranged from – there is no problem – to, change the whole system.
- There was general agreement that the state should regulate to minimize misuse of alcohol and effectively collect taxes.
- Many participants believe the state lacks sufficient enforcement resources.
- Distributors offer a valuable efficient service and would continue to be used under less compelling regulations.
- The regulations are overly complex.

Interview participants expressed major **themes with some contrary opinions**:

- The state should control misuse of alcohol and tax collection, but should not regulate business practices that are not directly tied to those two objectives. (Exceptions: wholesalers association, some treatment/prevention, minority of small producers/retailers.)
- The social, political and economic environment has changed substantially since the alcohol control laws were established. The regulations should reflect positive changes in education, attitudes and behaviors towards beer and wine, and should reflect the attitude of the Legislature in supporting the Washington beer and wine industry. (Exceptions: treatment/prevention urges care in assuming permanent changes in attitudes and habits. Alcohol is still a highly regulated product capable of creating harm to individuals and society.)

There were fundamental themes **in contention** among interview participants:

- The system generally works. Use the current change mechanisms when needed. It is dangerous to change regulations without knowing how the interrelationships among the rules will be affected or how the changes might affect outcomes. (Some Task Force members believe that effective control of misuse of alcohol and effective tax collection can be best accomplished if there is state regulation of the transactions between producers or distributors and retailers because that is where the large volume of beer and wine transactions take place.) (WBWWA, minority of small retailers/producers, prevention / treatment were in this category.)
- The system needs to be dramatically changed. Most business advantages in the current system (perceived as “leveling the playing field”) are outweighed by the business constraints. These stakeholders want to change the system, letting the market control the business aspects that don’t contribute to misuse. (Most large and small producers, most large and small retailers were in this category.)

- Moderate agreement that the state should control the misuse of alcohol and tax collection, but not unrelated business practices.
- Moderate agreement that the environment has changed positively since the laws were originally established, and the regulations should better reflect these changes.
- Some participants believe the system generally works and should not be fundamentally changed.
- Others believe the system needs dramatic changes, letting the market control aspects that don’t contribute to misuse of alcohol.

Section 6 – Policy Context and Criteria

Background

According to LCB officials, state policy regarding the distribution and sale of beer and wine has generally been guided by three underlying principles or policy goals – preventing the misuse of alcohol, efficient collection of taxes and ensuring an orderly market. Although these principles have been used by the state, and some portions adopted in RCW language, they have not been formally stated and adopted as policy goals. Before considering any potential changes to the existing system, the Task Force agreed it was necessary to formally articulate the state policy goals that would guide their recommendations for potential changes to the Three-Tier System.

Task Force Perspectives

Task Force members generally agreed that the policy goals used by the LCB to guide its regulatory decisions are still valid and appropriate. Many felt, however, that further definition of these goals would provide clearer guidance to the LCB and to the Legislature when they are considering changes to the current regulations. The Task Force adopted clarifying language to accompany each of the three policy goals. Potential regulatory changes should further, or at least be consistent with, these goals.

Task Force members also felt that potential changes should be evaluated in terms of their economic impact on the beer and wine industry. Although the Task Force did not conclude that economic development should be a policy goal for alcohol regulation, economic impacts (including the economic impacts related to public health, safety and welfare) should be considered when evaluating potential changes. The Task Force adopted a preamble to the recommended policy goals that focuses on the need to consider economic development impacts on the industry and clarifies that such consideration is intended to supplement, not supersede, the recommended policy goals.

Recommendation #1 – State Alcohol Control Policy

The Task Force believes that an appropriate alcohol regulatory system for beer and wine sales and distribution should be based upon the three policy goals set forth below. In creating and interpreting such a regulatory system, the Legislature and the LCB should consider the economic development of wineries and

- Current state policy goals had not been vetted or formally adopted.

- Generally, policies that were in use are valid and appropriate, but specific wording was adopted as a formal recommendation from the Task Force.

- The recommended policies guided the Task Force recommendations for potential changes to the Three-Tier System.

- A policy preamble was adopted to ensure economic impacts are also considered when making policy decisions.

- Recommendation #1 is related to State Alcohol Control Policies and considerations.

breweries and related industries, so long as the LCB and the Legislature also consider any adverse impact of any proposals on public health, safety or welfare.

Policy Goal 1: To prevent the misuse of alcohol.

- *“Misuse of alcohol” includes underage sales/drinking, driving while under the influence, serving to inebriated consumers, public inebriation, sales outside of the regulated system, or any other use that could promote public harm or create safety or nuisance issues.*
- *In an attempt to prevent misuse the state should not affect responsible moderate consumption.*
- *“Responsible moderate consumption” is the public sale/consumption of alcohol by legal adults, without misuse.*

Policy Goal 2: To promote the efficient collection of taxes.

State’s Working Interpretation: readily available and reliable information about all sales in order to effectively collect accurate state taxes.

Policy Goal 3: To promote the public interest in fostering the orderly and responsible distribution of malt beverages and wine towards effective control of consumption.

State’s Working Interpretation: avoidance of pressure on any one industry (producers, distributors, or retailers) from another that would cause collusion or result in unfair advantages or disadvantages that may result in over-consumption or increased access by minors.

Section 7 – Relationship Among the Tiers: Current Regulations, Background/Interview Results, and Task Force Discussion Highlights

Issues were identified in stakeholder interviews and prioritized by the Task Force.

This section and the next two, focus on the specific issues that were identified as problematic and potential candidates for change by at least several individuals or groups of participants during the interviews. There is not necessarily agreement among the participants or Task Force members that any or all of these are issues, since it largely depends on one's perspective, interest or position within the system.

NOTE: The issues and summaries reflect the statements and perceptions of the interview participants and may or may not have factual basis or quantifiable evidence for support. The priorities were determined by a vote of the Task Force members and generally reflect how often or how many interview participants stated them as issues. (A table including the actual priorities as scored at the Task Force meeting is included in Appendix F.)

Detailed interview comments and information on which groups supported the statements are included in Appendix E. The detailed comment summary in the appendix includes many suggested changes. Although the Task Force was not able to consider all of these individual suggestions, the summary may be a good resource for the state in considering future changes.

The issues were sorted into three categories identified by the Task Force that correspond to the three primary strategies used by the LCB for management and enforcement of alcohol control responsibilities. The categories are: 1) Relationship Among the Tiers, 2) Sales and Distribution, and 3) Control and Enforcement.

The LCB and Legislative Task Force members did not vote on recommendations.

NOTE: The LCB and Legislative Task Force members abstained from voting on proposed recommendations considered by the Task Force since the report will go to the LCB and the Legislature for action.

A longer summary of discussions is included in Appendix D. The detailed meeting notes are located in Appendix G. Related issue papers and a summary of data collected at the request of the Task Force is included in Appendices I, J and K.

- The issues identified reflect statements and perceptions of interview participants and may or may not have factual basis or quantifiable evidence for support.
- Issues were prioritized for potential change through a vote of the Task Force members.

Use of distributors (medium priority)

Current Regulations

Originally, use of distributors was mandatory – manufacturers had to sell their products to distributors who then sold the product to retailers. A number of exceptions to the original mandated use of distributors have been codified in regulations over the years.

In-state beer and wine manufacturers have been able to distribute directly to retailers for some time, but cannot use common carriers. They must use their own vehicles or retailers must make arrangements to send a common carrier to pick up an order.

The Legislature extended the privilege of self-distribution to out-of-state manufacturers, under the same constraints as in-state manufacturers. Other regulations such as a prohibition on central warehousing and constraints on the use of common carriers make self-distribution more difficult. (These issues will be discussed in Section 8 – Sales and Distribution. The issue paper, “Compelled Use of Distributors” is included in Appendix I.)

Background / Interview Results

Almost all industry participants interviewed believe the distributors offer a valuable service that is more effective and efficient than self-distribution in most cases. Even without provisions for mandatory use, manufacturers with distributor relationships indicated they would continue to use distributors. The participants who object to the compelled use, do so mainly because they want the flexibility to choose delivery methods, and they believe the distributors should compete for their business, using a market-driven approach.

Most manufacturers, independent distributors and retailers want the ability to self-distribute more easily (using common carriers) when it is best for their business. Most of these participants stated this use is for exceptions more than the norm, and want the flexibility of various distribution mechanisms. Some small manufactures, especially small wineries, depend on the ability to self-distribute to a limited clientele.

Some interview participants believe the distributors’ business has been unfairly protected by the constraints on self-distribution. They state the distributor tier has many protected business advantages such as being able to purchase their inventory on credit, but requiring cash on delivery from retailers, influencing what products are delivered, and adding an addition layer of costs that may not in some instances add value.

- A number of exceptions to the original mandate to use distributors have been codified over the years.
- Other issues related to the use of distributors are discussed in Section 8.
- Regulations compelling the use of distributors create unnecessary constraints for manufacturers and retailers.
- Most industry participants with distributor relationships believe distributors offer a valuable service that they would continue to use, even under a more competitive, market-driven model.
- Most manufacturers, independent distributors and retailers want the ability to self-distribute using common carriers as an option.
- Some participants believe the distributor regulations unfairly protect distributors’ business advantage and increase costs.

The WBWWA distributors believe compelling the use of distributors is critical to many of the goals of the control system, by providing a structure to monitor product deliveries and pricing, efficient collection of taxes, and by assisting retailers in understanding and abiding by many of the alcohol advertising regulations.

Task Force Perspective

The Task Force discussions related to the use of distributors focused on the constraints around the use of common carriers, delivered pricing and the prohibition on retailers using a central warehouse. Each of these discussions is summarized in Section 8.

- The WBWWA believes compelling the use of distributors is critical to many of the goals of the current control system.

Money's worth (medium priority)

Current Regulations

“Money’s worth” is a term used to denote value that is added apart from obvious or direct compensation. It pertains to any “value” provided to a retailer from a manufacturer that is not specifically paid for by the retailer. Manufacturers, distributors, importers and authorized representatives are prohibited from providing items of value (money or money’s worth) to retailers. Narrow exceptions have been granted through the legislative process to address specific situations.

Prohibited practice examples include giving retailers t-shirts or hats, wine manufacturers pouring wine at a wine tasting in a retail shop, and many advertising restrictions.

The prohibition on “money’s worth” was introduced to eliminate undue influence of a manufacturer on a retailer and thereby influencing product placement, sales, or lack of competitors’ products.

Background / Interview Results

The state’s purpose for these rules is to ensure that suppliers cannot control, through economic inducement, the actions of the retailer. The patchwork of exceptions have made it difficult for suppliers and retailers to understand where the line is drawn between allowed and prohibited activities, and as important, why the line is drawn where it is.

From a retailer perspective it is difficult to understand the rationale behind the rules at times, and with the various exceptions that have been granted they can be difficult to apply. From an enforcement standpoint, small exceptions represent a slippery slope. For example, giving a retailer one box of coasters may not represent an inducement, but one hundred thousand may. With the exceptions that have been granted, the once bright line between accepted and prohibited practices has become somewhat blurred.

- Money’s worth refers to added value apart from obvious and direct compensation.
- The prohibition on money’s worth was introduced to eliminate undue influence of manufacturers on retailers.

- Many participants believe the regulations and interpretations are too strict and do not reasonably relate to undue influence or misuse issues.
- A multitude of exceptions over time have blurred the line between accepted and prohibited practices.

Many interview participants believe Washington’s interpretation of the prohibition of “any” money’s worth is too strict and often does not seem linked to the original purpose or to contributing to the state’s alcohol control goals. In addition, Washington’s implementation of “money’s worth” provisions is more restrictive than the federal law. Most interview participants believe some restrictions are appropriate, but that they should be reasonable and enforceable, and tied more closely to prohibiting coercion or practices that would not support the LCB’s primary goal of preventing alcohol misuse. If the regulations are not enforced, it gives an unfair advantage to those establishments that choose to ignore the regulations, compared to those that abide by the regulations, regardless of how marginal the value of the item provided.

Task Force Perspectives:

The Task Force members were in general agreement that these regulations should be relaxed, but had difficulty developing a general exception that would meet current needs. Task Force members were reluctant to recommend that a “*de minimus*” exception be adopted (one that would allow the LCB to grant a small amount of leeway to the supplier). Some members were uncomfortable with such an approach because it would give too much discretion to the LCB in deciding what practices would and would not be allowed.

The Task Force adopted an approach that gives the LCB the responsibility of working with stakeholders to develop a list of currently prohibited practices that could be allowed. This would address many items the industry considers frivolous and that would not contribute to alcohol misuse. Consideration of new exceptions should also take into account its impact on the LCB’s enforcement resources. The Task Force wants to ensure that enforcement resources are focused on critical outcomes, such as underage drinking. Some Task Force members believe that this requires significant enforcement with respect to sales to retailers as well as sales by retailers. The transactions between distributors and retailers or between suppliers and retailers involve large quantities of beer and wine.

It was noted that since the industry is evolving so rapidly, it may be difficult to develop one list that will address all needs. Such a list, however, would remove the pressure on the Legislature to consider individual requests from multiple interest groups.

The Task Force also agreed to recommend that the LCB should re-examine the existing exceptions to ensure they are still relevant and consistent with the state’s policy goals. The historical practice of using the legislative process to propose and grant individual exceptions to the prohibition against providing money’s worth has made it difficult to have a thorough policy discussion about the impact of exceptions, with

- Some restrictions are appropriate, as long as they are closely tied to prohibiting coercion and clearly support avoiding misuse.
- Regulations should be enforceable and enforced.

- There is general agreement that some money’s worth regulations could be relaxed.
- The Task Force agreed on an approach for the LCB to work with stakeholders to develop a list of specific exceptions.

- LCB enforcement resources should be considered when developing exceptions.

- Although a list of exceptions will not be static, it may remove the pressure to consider exceptions one at a time.

- The Task Force agreed that the LCB should re-assess existing exceptions to ensure they are still relevant and consistent with state policy goals.

a full airing of all perspectives. This was not supported by some members who are concerned that such a reexamination would be too big a task, and any recommendation for change should focus on future proposed exceptions.

There was a concern that the recommendation ignores a significant and large exception – the inclusion of distributor services (such as stocking services) in the posted price of the product. Currently a distributor's price to a retailer includes three components: the cost of the product itself, the cost of delivery, and the cost of the distributor's services. Because the services are built into the price of the product, all retailers must pay for those services regardless of whether they actually use them, and the practice itself constitutes "money's worth." They believe the adopted recommendation does not adequately address this issue.

(An issue paper, Relationship Among the Tiers: Tied House Laws: Money's Worth and Ownership is included in Appendix I.)

The Task Force adopted the following recommendation by a vote of 15 for, and none (0) opposed.

Recommendation #2 – Money's Worth

The Task Force recommends continuing the state's current approach of providing specific exceptions to the prohibition against providing money's worth to retailers, and directs the LCB to work with stakeholders to re-examine current exceptions and develop a comprehensive list of proposed exceptions for legislative consideration. When developing the list of recommended exceptions, the LCB should consider:

- 1. Industry business needs,***
- 2. Customer benefits,***
- 3. Whether it creates an unwanted inducement for retailers,***
- 4. The potential for increased misuse of alcohol, and***
- 5. Enforcement resources.***

- Concern by some members that the recommendation adopted does not address the money's worth issue inherent in "delivered pricing" which includes the price of the product, delivery and services that may or may not be used.
- Recommendation #2 is related to creating specific exceptions to money's worth prohibitions.

Prohibition on manufacturer's ownership interest in retail establishment (low priority)

Current Regulation

Statutes generally prohibit suppliers (manufacturers, distributors, importers, authorized representatives) from holding any financial interest in a retail licensee, from owning property on which a retail licensee operates, and from owning a retail license outright. Any form of ownership, however far removed from the manufacturer, by a manufacturer in a retail alcohol establishment is prohibited. (There are specific exceptions addressed in legislation, including exceptions for manufacturers who have their own brew pub, or wineries that have adjacent restaurants and retail shops.) (Also see the previously cited issue paper in Appendix I.)

Background / Interview Results

The purpose of these restrictions has been to prevent the kind of practices that prompted Prohibition (domination of one tier over another and exclusion of competitors' products), and is thought to ultimately lead to misuse of alcohol. In the years since the Tied House statute was adopted in Washington, the business environment has changed dramatically and new forms of ownership and financial networks have emerged that were not contemplated in the 1930s.

Some interview participants, particularly restaurants, state that the regulations are overly strict in disallowing *any* interest, particularly when it is somewhat removed. Industry stakeholders expressed concerns that certain business arrangements are prohibited today even in circumstances where the opportunity for domination or control over the retailer is considered to be remote or controllable through other means. Many stakeholders believe the state goes to unusual lengths to prove and to prohibit a "tie" that may be many steps away from the ability to influence decisions.

Task Force Perspectives

The Task Force engaged in a spirited discussion on this issue. A majority of the Task Force supports the concept of liberalizing the state's current tied house restrictions on overlapping ownership and financial interests among the tiers. Although an alternative was presented that proposed specific percentage limitations (e.g., limiting stock ownership by a supplier to 5% or less), members felt they did not have sufficient data to support such specificity. The Task Force preferred a more general recommendation that the Legislature and the LCB work together to determine the appropriate approach.

- Current regulations prohibit any form of manufacturer ownership in a retail business, however far removed (some exceptions apply).
- The ownership regulations were originally intended to prevent domination of one tier over another.
- Some participants, particularly restaurants, believe the regulations are overly strict in disallowing *any* interest, especially indirect interests.
- A majority of the Task Force support the concept of liberalizing the state's current Tied House restrictions on overlapping ownership and financial interests among the tiers.

Task Force members who support liberalizing the regulations do not believe that allowing manufacturers to have some interest in retail outlets would lead to misuse of alcohol. Nor do they believe that a manufacturer holding an ownership interest in a retailer would necessarily result in the exclusion of product since it is not in any retailer's interest to carry only one or two brands. The restrictions do, however, constrain the development of economic and tourism opportunities. Under the current regulations, the state does not allow any ownership interest, regardless of how remote it is or how unlikely the opportunity would be to result in exclusion of a competitor's product.

If there is a continuing need to prohibit overlapping financial interests, the prohibition should focus on direct links between suppliers and retailers, and it should allow for a certain level of exceptions (for example, allowing a small percentage of ownership if the opportunity for exclusion is remote).

Other members do not support changing the current prohibitions because the current regulations prevent situations where retailers could become beholden to manufacturers or distributors. The current process for granting specific, narrowly drawn exceptions through the legislative process allows the Legislature to deliberate on each issue and make a public policy decision. Some members believe the current Tied House laws also help keep big retailers in check.

Task Force members representing the prevention and treatment community raised concerns that liberalizing ownership restrictions in any way that could increase advertising (particularly in places where youth are likely to be) may lead to increased underage drinking. These members note that research shows that the "social norming" effects of such advertising have a negative impact on youth perceptions of alcohol and ultimately lead to misuse.

The Task Force adopted the following recommendation by a vote of nine (9) for, and three (3) opposed.

Recommendation #3 – Tied House – Ownership and Financial Interests

The Task Force encourages the liberalization of the Tied House ownership restrictions, and recommends that the Legislature work with the LCB to arrive at a workable solution.

- Most members indicated prohibitions should focus on *direct* links between suppliers and retailers, which are more likely to influence decisions, and allow for a certain level of exception.
- Some members do not favor changes due to a concern that retailers could become obligated to manufacturers. They believe the current process of exceptions allows for deliberate policy decisions.
- Prevention and treatment advocates raised concerns about increased advertising that can unduly influence youth.
- Recommendation #3 is related to Tied House Ownership and Financial Interest changes.

Sampling restrictions (low priority)

Current Regulations

Sampling of beer and wine is permitted in specialty wine shops, but is not permitted in grocery, big box or convenience stores. The state believes that there is more control in the limited number of specialty shops compared to the large number of other retail outlets, and that there are fewer opportunities for abuse of this privilege.

Background / Interview Results

This issue surfaced a number of times with wine manufacturers and retail shops. Some grocery retailers and manufacturers would like to have properly controlled grocery store wine and beer samplings that are currently prohibited. Wine sampling is allowed in wine specialty shops, however, wine manufacturers cannot actually pour the wine (related to “money’s worth issue). Prevention stakeholders object to consideration of allowing beer and wine sampling in grocery stores as there are often many children and minors there.

Task Force Perspectives

This issue was not a high priority for Task Force discussion.

- Wine sampling is allowed in specialty wine shops but not grocery stores. Some participants think this is unfair. Others believe it is reasonable given the differences in customers, particularly youth.
- This was not a topic of detailed discussion.

Retail-to-retail sales prohibition (low priority)

Current Regulations

Retail-to-retail sales are currently prohibited. Retailers must purchase beer and wine directly from a manufacturer or from a distributor.

Background / Interview Results

This issue was mentioned in a minority of interviews related to the fact that only a manufacturer or wholesaler may sell wine or beer to a retailer. Some retailers would like to be able to sell to other retailers (i.e., from a grocery store to a restaurant).

Task Force Perspectives

This issue was not a high priority for Task Force discussion.

- A few participants would like to conduct retailer-to-retailer sales.
- This was not a topic of detailed discussion.

Anti-competition regulations (low priority)

Current Regulations

There are a number of regulations that could be classified in this category, primarily related to pricing. The most relevant pricing issues are discussed in Section 8.

Background / Interview Results

Several interview participants believe that many of the state regulations amount to anti-competition regulations, which should fall under the purview of the Federal Trade Commission and not the state. Others believe the federal regulations are too limited to effectively accomplish the state's goals.

Task Force Perspectives

This general issue was not a high priority for Task Force discussion, however specific components are addressed in other areas.

- The anti-competition nature of many regulations was an issue for some participants, but not a high priority for the Task Force in general.
- This was not a topic of detailed discussion; however, some components are addressed in other areas.

Advertising (low priority)

Current Regulations

There are a number of regulations that prohibit joint advertising and compensation for naming rights.

Background / Interview Results

The prohibition on joint advertising as “money’s worth” surfaced with restaurants and wine/beer manufacturers. They believe that some prohibitions are extreme, such as the restriction of putting a winery logo on a restaurant menu.

The sports and entertainment industry interview participants are primarily interested in changing prohibitions on naming rights/sales which could bring extra revenue to the venues. The state believes naming rights may encourage more consumption and result in narrowing the choice of products available.

Task Force Perspectives

The Task Force did not specifically address advertising since it was a low priority for discussion. However, they did address money’s worth issues as noted in a previous section, and adopted a related recommendation. When discussing the issue of naming rights in the context of the Tied House statutes, the prevention community representatives raised a concern that naming rights affects “social norming” which they believe, in turn, encourages underage drinking. (Also see Section 11 – Recommendation Summary.)

- There are many regulations related to advertising connected to “money’s worth” and value-adds that many participants believed were insignificant.
- The sports and entertainment participants would like the ability to create revenue through alcohol manufacturer naming rights.
- This issue was not specifically addressed by the Task Force. Some related issues around money’s worth were addressed.

Section 8 – Sales and Distribution: Current Regulations, Background/Interview Results, and Task Force Discussion Highlights

NOTE: Items with “*” denote that it is one of the regulations that was ruled in violation of the U. S. Commerce Clause by the District Court.

- Items with * are included in the District Court ruling.

Price Posting and Hold (high priority)*

Current Regulations

Post and Hold – the requirement for manufacturers and distributors to **post** their prices for each separate product with the LCB by a prescribed time each month, to be effective at a later date and **hold** them for at least one calendar month after the effective date.

Background / Interview Results

The regulations related to “Price Posting and Hold” were the most frequently cited as problematic to industry representatives in interviews and were rated as a high priority for potential change by the Task Force. Price Posting requirements are considered by many licensees to be burdensome, complicated, and of limited value to the beer and wine industry and the state. Some stakeholders believe the state should not control prices in any form, but should let the market drive prices. Others believe price controls are important to avoid overly low prices that contribute to excessive consumption, and to promote an orderly market. Some stakeholders emphasize the two components of the Post and the Hold, and their different purposes.

The LCB believes price posting is key to controlling the importation and distribution of beer and wine, and is an effective tool to monitor other pricing regulations such as the ban on quantity discounts and uniform pricing requirements.

Other Task Force members believe that any enforcement objective behind price posting could be accomplished by a system that does not, as the current system does, make postings available for viewing by competitors. Further, there is no requirement for retailers to post prices, which seems to some to conflict with the notion that price posting is critical.

- Price posting and hold requires manufacturers and distributors to post their prices with the LCB and hold the price constant for one calendar month.
- Many industry stakeholders believe the process is burdensome, complicated and does not contribute to protecting against misuse.
- The LCB uses this information to monitor and control pricing regulations.

(Also see the issue paper, “State Beer and Wine Pricing: Price Posting and Price Hold” in Appendix I.)

The state believes Price Hold requirements help keep prices stable and avoid prices low enough to encourage misuse. Many industry interview participants indicated that the Hold requirement constrains their ability to be flexible and to get products to the market in a timely way.

Task Force Perspectives

Task Force perspectives vary on the issues of price posting and price holds. Some Task Force members believe the current price post and hold system should not be changed. Price posting requirements and price hold requirements are linked, but serve separate and distinct purposes. Price posting (which is done electronically in Washington) is an enforcement tool for the LCB; a price hold period is necessary for price stability. A price hold is viewed by some Task Force members as essential to meaningful enforcement of the uniform pricing requirement and other aspects of the ‘level playing field’ the state seeks to preserve. Together, these regulations are thought to ultimately help reduce misuse of alcohol by maintaining higher prices.

Others argue that past experience has shown the current post and hold practices in Washington do not bring stability to pricing (and stable prices do not necessarily contribute to prevention of misuse), nor does the post and hold system eliminate cheap products, but the system does unnecessarily burden business. For example, missing a posting deadline can mean that introduction of a new product may be delayed by more than a month and a half. Task Force members’ experiences in states without price posting and hold requirements have not resulted in price wars or other enforcement problems.

Some believe eliminating price posting might make it more difficult for the LCB to monitor other pricing policies (such as the uniform pricing and the 10% minimum mark up requirements). However, with the recommendation to eliminate price posting and the 10% minimum mark up, the LCB’s need for these data may be reduced. In some states, the licensee is required to maintain records for inspection.

Washington’s price posting and hold regulations are at issue in the Costco lawsuit. Some members are concerned that the Task Force should not make recommendations for changes to these regulations until the appeal process has been completed. Others are concerned that the district court has already held the post and hold regulations to be unenforceable and any recommendation from the Task Force that would maintain any portion of the existing system (even if significantly narrowed) would be in violation of the court’s ruling.

- The Price Hold is intended to keep prices stable. However, some stakeholders contend it restricts flexibility and time-to-market.
- Some contend price posting and hold are linked but serve different purposes, and together they help reduce alcohol misuse by maintaining higher prices.
- Other members believe price posting is unnecessary and price holds do not bring stability to pricing (nor prevent misuse).
- The LCB indicates eliminating price posting will make it more difficult to enforce pricing policies.
- One motion to eliminate electronic price posting and hold and require retention of price lists failed to be adopted as a recommendation.

The Task Force discussed one live motion (moved and seconded) prior to adopting the final recommendation. The first motion was to eliminate price posting and holding and require manufacturers and distributors to maintain a current and historical price list (for predetermined length of time) at their establishments, available for LCB audit as requested. This motion failed adoption as a recommendation by a vote of six (6) for, and seven (7) against.

The Task Force adopted the following recommendation by a vote of six (6) for, and five (5) opposed.

Recommendation #4 – Price Posting

The Task Force recommends that price posting be eliminated.

Note: Price Hold was not recommended for change at this time.

- Recommendation #4 is related to Price Posting.

Mandatory Price Mark-up (medium priority)*

Current Regulations

The state requires manufacturers to mark-up the price of their product to a distributor by at least 10% above cost of production, and for distributors to mark-up the price of their product to retailers by at least 10% above cost of acquisition. The state’s reasoning is that cheap beer and wine may encourage more consumption.

Background / Interview Results

During stakeholder interviews manufacturers and distributors stated the mandatory minimum mark-up is meaningless because their mark-ups are well above the 10% required. Some interview participants stated they believe it is an artificial control on the market and the state should allow the market and competition to control prices, while others believe the pricing controls help to control misuse of alcohol. Some Task Force participants believe there is no evidence that the minimum mandatory mark-up discourages over-consumption, as reflected in the state’s decision to abandon retail mark-up provisions after a 1988 federal court decision, without appeal.

- Manufacturers and distributors are each required to mark-up the price of their products by at least 10% over their costs.
- Some participants believe a mandatory mark-up is unnecessary as most mark-up prices significantly higher, and they believe the market should control price.

Task Force Perspectives

Industry participants agreed that since mark-ups are generally more than 10%, the regulation is unnecessary. The Task Force wanted to make clear, however, the recommendation relates only to eliminating the 10% minimum mandatory mark-up, and is not intended to affect other aspects of pricing regulations such as provisions allowing close-outs and prohibitions against selling product below cost. The LCB stated there are rules in place that prohibit selling product below cost (with some exceptions for post-offs, for example) that would not be affected by eliminating the mandatory minimum mark-up requirement.

The Task Force adopted the following recommendation by a vote of seven (7) for, and five (5) opposed.

Recommendation #5 – Mandatory Minimum Price Mark-up

The Task Force recommends elimination of the mandatory minimum markup requirement.

- Industry participants generally agreed that the mandatory mark-up was irrelevant; however, they did not want to abandon the prohibition against selling below cost.
- Recommendation #5 is related to the mandatory minimum price mark-up.

Ban on Volume Discounts (medium priority)*

Current Regulations

Ban on Volume Discounts - volume discounts are not allowed under any circumstances for manufacturer or distributor sales. The price per package must be the same whether they are selling one package or 1,000.¹²

Background / Interview Results

Like uniform pricing, the ban on volume discounts is intended to maintain a level playing field between large and small retailers, and to discourage lower prices.

Some interview participants believe the ban on volume discounts assists small retailers to get the same price as large retailers and therefore levels the playing field. Those stakeholders fear that small retailers could not compete with large retailers who could get better pricing if quantity discounts were allowed. There is also some concern that bulk discounts would result in stocking more of certain items and less diversity of product for consumers. Some participants are concerned that volume discounts to retailers will translate directly into lower prices. Others believe the ban on volume discounts is inequitable to the larger retailer and wouldn't necessarily hurt the specialty retailer. The larger retailer is

- Volume discounts are not currently allowed.
- Some small retailers believe the ban on volume discounts help them compete with larger retailers.
- Others believe the ban is inequitable to the larger retailer and would probably not disadvantage the smaller retailer.

¹² RCW 66.04.010(26) "Package" means any container or receptacle used for holding liquor.

in essence subsidizing the smaller retailer by not allowing quantity discounts. It costs more to deliver two or three bottles to a small retailer.

Some stakeholders state that volume discounts already exist, but they are masked. Workarounds have developed that have the same end result. Since they often already exist, many would prefer to make it allowable.

Task Force Perspectives

Several task force members supported providing a volume discount if the discount is offered to all retailers uniformly. Some Task Force members are concerned that even if offered on a uniform basis, volume discounts would put small retailers at a disadvantage. Smaller retailers cannot order product in the quantity larger retailers can, and therefore would be unable to take advantage of the discounts. But others noted they feel convenience stores do not compete on price; their value is convenience.

Some members from the prevention community are concerned that the lower prices resulting from volume discounts would increase misuse. However, others noted they believe the current system can make it worse from a public safety perspective because they believe convenience stores, which are often the target of underage or impulse buying, are being subsidized by the uniform pricing requirement. Allowing volume discounts eliminates that subsidy to small retailers, effectively raising prices at those outlets that can be the most problematic from a misuse perspective.

One Task Force member suggested that when considering whether to allow volume discounts, beer and wine should be addressed separately. Distributors have a contractual obligation to take back beer that is expired. If volume discounts are offered, a retailer could be enticed into buying too much product because of the better price. The distributor would be expected to take back any product that does not sell. Since beer is perishable, that may mean the product could not be resold but would have to be destroyed. Others noted the recommendation adopted by the Task Force would allow (not require) the distributor to offer a volume discount. It would be up to the distributor to work with its clients on buying at appropriate levels.

- Some believe volume discounts already exist, but they are masked through “workarounds.”
- Some members supported volume discounts if uniformly offered.
- Others believe allowing volume discounts would put small retailers at a disadvantage.
- Some members are concerned about any changes that will make product less expensive and result in misuse.
- Allowing volume discounts may increase prices at smaller outlets, which may discourage misuse.
- There was a suggestion that beer and wine should be handled differently since beer is perishable.

The Task Force adopted the following recommendation by a vote of seven (7) for, and four (4) opposed.

Recommendation #6 – Volume Discounts

The Task Force recommends that volume discounts be allowed, with the same volume pricing available to all customers. For example, if a distributor offers price breaks at 10, 100 and 500 units, those price breaks are offered to all customers.

- Recommendation #6 is related to volume discounts.

Use of Common Carriers for Retail Deliveries

NOTE: This item was not originally prioritized as a separate discussion item by the Task Force – it was embedded in issues around central warehousing and was integral to that discussion.

Current Regulations

Common carriers may be used by manufacturers to deliver to distributors, and they may be used by a retailer who arranges and pays for them to make a pick-up from a manufacturer. Common carriers cannot be used by a manufacturer to deliver to a retailer nor by distributors to a retailer.

Background / Interview Results

The rationale used to explain this requirement is that when a common carrier is used, the state’s ability to monitor or control its movement is limited, thus increasing the risk of illegal sales. In 2006, when the Legislature expanded the self-distribution authority to out-of-state manufacturers, it also granted retailers the authority to contract with common carriers to have product shipped to them. This authority was not extended to manufacturers. Since distributors must use their own vehicles to deliver product it seemed equitable to require manufacturers acting as distributors to use their own vehicles.

Some manufacturers, however, see this as key obstacle to their business and the effectiveness of provisions to self-distribute. They see it as another way to compel the use of distributors (particularly in combination with the ban on retail central warehousing). Distributing product directly to retailers requires that either the manufacturer ask the retailer to make the shipping arrangements, the retailer must pick up the product at the manufacturer, or the manufacturer must deliver it using a company vehicle.

- Common carriers can be used by manufacturers to deliver to distributors and by retailer to pick up orders, but not by manufacturers to retailers (or distributors to retailers).
- The state needs to monitor the flow of alcohol and therefore limits the points of contact.
- Distributors are required to use their own trucks; therefore manufacturers acting in the role of distributor must do the same.
- Some manufacturers and retailers see the restriction as a key obstacle to self-delivery.

Task Force Perspectives

Some members are firmly opposed to allowing the use of common carriers for the distribution of alcohol because such practices could increase the potential for diversion of product, and for delivering to unlicensed entities. Using licensed distributors allows the state to maintain control over the product. Some believe allowing manufacturers to use common carriers to deliver their product would be inconsistent with the Task Force's recommended state policy goal of providing an orderly market. Others were strongly opposed to this argument, contending that there is no definition of orderly market and therefore it is not possible to show that allowing manufacturers to arrange common carriage to retailers would hurt that market.

Other Task Force members noted that common carriers are already being used to deliver product from manufacturers to distributors and when contracted by the retailer directly from the manufacturer, so the current regulatory scheme is inconsistent. A recommendation to allow manufacturers to contract with common carriers would not be changing *whether* common carriers can be used to deliver alcohol, simply *who is authorized to contract* for it.

These deliveries would be between licensed entities – manufacturer and retailer. Since the manufacturer will require payment and the retailer needs product, they both have incentive to be vigilant about making sure product does not go missing. Requiring common carriers that transport alcohol to obtain a license or other form of authorization would help the state monitor and control these transactions.

The WBWWA representative indicated their strong opposition to expanding the authority to use common carriers. If it is expanded, they recommend strong licensing requirements be implemented to ensure the state has a mechanism for control over the carriers. Others believe that stringent licensing requirements would dissuade carriers from participating, and that a less onerous approval process is sufficient to ensure the state knows which carriers are transporting alcohol. Some members believe that special licensing is not necessary and will simply create another layer of costly bureaucracy and a further barrier to competition with distributors.

Task Force members agreed that any licensing or approval requirements for common carriers should be consistent, whether they are delivering product from a retailer to a consumer or from a manufacturer to a retailer.

- Some members are firmly opposed to allowing further use of common carriers.
- Others noted that common carriers are already used.
- Manufacturers require payment and retailers want the product so there is a vested interest in ensuring it gets to the right place.
- Some members favored a licensing or approval process for common carriers if their use is expanded; others believe it may discourage common carriers from participating.
- Any form of licensing or approval for common carriers should be consistent.

The Task Force adopted the following recommendation by a vote of 13 for, and two (2) opposed.

Recommendation #7 – Use of Common Carriers

The Task Force recommends that manufacturers and distributors be allowed to ship their product to retailers using common carriers and consider establishing a licensing requirement for all common carriers delivering alcoholic beverages regardless of origination.

- Recommendation #7 relates to the use of common carriers.

Ban on Central Warehousing (medium priority)*

Current Regulation

Beer and wine must be delivered directly to the retail licensee’s premises. Central warehousing – storing beer and/or wine at a central location for distribution to individual retail outlets – is therefore, prohibited.

Background / Interview Results

This regulation helps the state monitor the flow of alcohol to ensure it is not diverted through illegal channels.

In 2006, the Legislature expanded to out-of-state manufacturers the authority to also act as distributor of its own product. Some industry representatives are concerned that the legislative change did not go far enough, leaving in place regulatory barriers that make it difficult for both in-state and out-of-state manufacturers to self-distribute.

One of these barriers is the requirement to deliver to each physical licensed location, effectively prohibiting central warehousing. Industry stakeholders believe the retailers’ lack of ability to centrally warehouse beer and wine products makes self-distribution economically infeasible.

The fee structure of interstate commerce using a common carrier makes small deliveries cost prohibitive. If a carrier has to deliver to every store in a chain, for example, it is too expensive and the retailer has to use a distributor. If manufacturers and distributors could ship to a central warehouse, retailers could then use their own trucks to deliver out to individual stores.

During stakeholder interviews, industry members stated that central warehousing would be more efficient for distributors, and better serves some of their clients. They felt that removing this restriction would allow the market to determine the most efficient means of getting the product to the customer.

- Retailers cannot keep beer or wine in a central warehouse for distribution to individual stores.
- Some participants believe this protects distributors’ business and constrains the option of direct distribution from manufacturers.
- The LCB believes it would be more difficult to monitor the flow of alcohol if central warehousing is allowed.
- Using common carriers to deliver to individual retail locations is costly due to multiple drop-points. Central warehousing would be more cost effective for distributors and retailers.

Task Force Perspectives

Concerns were raised that once the product is delivered to the central warehouse the state would lose control over the movement of the product, increasing the opportunity for illegal sales. Some participants expressed concern that central warehousing would make it harder to enforce restrictions such as the Alcohol Impact Areas. Currently distributors know which retail premises are legally entitled to receive which products; with central warehousing distributors would not know where the products they were delivering would ultimately be sold, and thus would not be able to prevent improper deliveries as they can now.

Other Task Force members believe there is no support for the concern that the state would lose control and there would be an increase in illegal sales. There are already provisions for licensing distribution warehouses, and provisions for licensing point-of-sale outlets. There is no evidence that central warehousing would result in loss of control any more than those examples. Further, Washington lawmakers did not believe loss of control was a reason to prevent out-of-state wineries from shipping wine directly to Washington citizens by common carrier; there is far less control risk present by retailer warehouses distributing beer and wine to licensed retail locations.

A motion for a recommendation was made and discussed, but failed five (5) to eight (8). The motion was: *“Allow central warehousing as long as each central warehouse is owned by the retailer, stores and distributes only the retailer’s purchased product to its own licensed retail outlet (i.e. no retailer-to-retailer delivery or sales), the warehouse is appropriately licensed, and documentation is required showing the product was purchased legally and distributed legally (to licensed establishments) – to allow for appropriate tracking, an audit trail and minimized diversion.”*

When considering the motion for a recommendation, Task Force members were concerned about whether central warehousing should be allowed only for single-owner entities with multiple outlets (like chain grocery stores, for example) or whether cooperative groups or franchises (like Associated Grocers and 7-Eleven, for example) should also be able to operate a central warehouse for its members.

Questions were also raised about whether the state could limit central warehousing to in-state warehouses. If the state were required to extend to out-of-state warehouses as well, it could impact enforcement and the state’s ability to track product for tax purposes. However, some members stated they do business outside of Washington and routinely report to other states for tax purposes.

- There is concern that the ability to centrally warehouse may interfere with the state’s ability to monitor alcohol flow.
- A motion was made to allow central warehousing but failed adoption as a recommendation.

- Questions were raised about whether Washington could require a central warehouse to be located in-state.

Quality of product could become an issue if central warehousing is allowed, particularly for beer because it is perishable. Others believe any quality issues are the domain of the manufacturers and retailers and handled through private contract and business practices – the state shouldn't be regulating these practices.

Impacts of central warehousing on beer and wine producers and on distributors need to be considered in more detail. Several Task Force members did not feel they had sufficient information about the potential impacts of easing or eliminating this restriction to make a recommendation for change.

The Task Force did not adopt a recommendation related to central warehousing.

- There were some concerns about the quality of beer products since they are perishable.
- The impacts and details of central warehousing need more deliberation.
- No recommendation was adopted.

Need for Product Placement Restrictions (low priority)

Current Regulations

There is no current regulation related to alcohol product placement in relation to non-alcoholic beverages.

Background / Interview Results

Some of the prevention community interview participants believe there should be restrictions so grocery/food/convenience stores cannot place alcoholic beverages in the same proximity as non-alcoholic drinks, mainly to discourage the temptation of under-age consumers.

Task Force Perspectives

This was a low priority as decided by the Task Force and was not discussed.

- There is no current regulation about the placement of alcohol in grocery stores in relation to non-alcoholic beverages.
- Some prevention participants would like regulations controlling the placement of beer and wine in grocery stores.
- The Task Force did not discuss this issue further.

Distributors' Delivered Pricing (low priority)*

Current Regulations

The price of delivery must be included in the price of the product, including all related services such as stocking and rotation, and it must be the same for all customers.

Background / Interview Results

Although this issue was originally voted as a lower priority for discussion by the Task Force, it is one of the issues challenged in the U.S. District Court and decided to be prohibited for enforcement on May 1, 2007, unless a stay is granted by the 9th Circuit Court of Appeals. Due to the Court's decision, Task Force feedback was requested.

- Distributors must charge the same price for delivery and placement of product, regardless of whether the retailer uses the product services.

Some retailers and independent distributors would like the ability to charge different delivery prices depending on the services the retailer wants. Retailers who do not need or want the full services believe they are subsidizing other retailers who do, and that the regulation unfairly benefits the distributors with the ability to charge the highest delivery prices to everyone. (See discussion on Money's Worth.)

The WBWWA distributors indicated that the same delivered pricing is necessary to ensure smaller retailers can afford the services and get deliveries in more remote areas.

Task Force Perspectives:

Washington is on the most restrictive end in this area. The WBWWA representative contends that fuel surcharges would not be difficult, but varying service levels in the pricing would be challenging. They also noted that there is a significant difference between beer and wine related to this issue, since beer is perishable. Some Task Force members also believe eliminating delivered pricing would create a significant advantage for some retailers.

The delivered price is a blended price reflecting three distinct items – the cost of the commodity, the cost of a variety of distributor services, and the cost of delivery. Retailers are not opposed to paying a uniform price for the actual cost of the commodity, nor are they opposed to paying for the cost of delivery. Only some retailers, however, can take advantage of the distributor services. By using distributor detailing services the retailer's own labor is freed up for other activities. Since the cost of these services is built into the price, other retailers are subsidizing these activities because they pay for the service even though they cannot use them. Some members indicate that any recommendation coming from the Task Force should reflect a uniform price for the product, absent additional services. Other members believe that any attempt to separate the price of the product from the price of the delivery would make it impossible to maintain uniform pricing because the product price could be manipulated by negotiating differences in the price for delivery services.

The state believes this regulation links higher prices to lower consumption, and increased regulation with higher prices. Some members noted the consumption data provided to the Task Force do not seem to support these correlations. License states do not necessarily have higher consumption than control states, and Washington appears to be somewhere in the middle. In fact, Washington wine consumption is on the higher end, even with current regulations and higher prices. There are many factors contributing to consumption rates. It is difficult or impossible to know which are related to regulations and which result from other factors.

- Some retailers and independent distributors would like to negotiate the delivery charges, based on the services provided.
- The WBWWA indicates delivered pricing is necessary to ensure smaller retailers can afford the services and deliveries are made in remote areas.
- Some members believe it would be difficult to vary service levels and prices, and beer and wine should be treated differently.
- Delivered pricing is a blend of the cost of the product, the delivery, and product services such as stocking shelves. Some retailers do not or cannot use all of these services and believe they are subsidizing retailers who do.
- The state and the prevention participants believe higher prices are linked to lower consumption, but others questioned the link.

Some members suggest the state can achieve its objectives through means other than pricing mechanisms and compelling the use of distributors. If higher prices are the intended outcome of the regulations around delivered pricing, using tax rates to maintain prices would give the state more control; it is more direct and efficient and the state could use the additional tax revenues for prevention and enforcement. Other members believe it is unwise to rely on taxes because they are politically difficult to impose and raise, and that raising taxes alone would not support, and might hinder, other regulations such as uniform pricing.

The Task Force considered one live motion (moved and seconded) to: *“Maintain delivered pricing requirement, but with different levels of service and allow for surcharges for fuel or excessive distances.”* The Task Force did not adopt the recommendation by a vote of two (2) for, and 10 opposed.

A second live motion was also discussed, *“Eliminate delivered pricing requirement and allow for negotiated delivery prices.”* This motion was not adopted as a recommendation due to a tie vote of seven (7) for, and seven (7) opposed.

The Task Force did not adopt a recommendation related to this issue.

- Some advocate using taxes to increase prices.
- The Task Force considered two recommendations, but one was opposed by a majority and the other was tied.
- No recommendations were adopted related to this issue.

Foreign Import Regulations (low priority)

Current Regulations

Foreign (outside of the country) imports must follow most of the same rules as other manufacturers/distributors, but cannot self-distribute.

Background / Interview Results

A limited number of independent wholesalers indicated that it is sometimes difficult to get foreign products because the regulations, including price posting, are so burdensome. They are concerned that some manufacturers will not make their product available in Washington when other states are “easier to deal with.”

Task Force Perspectives

The Task Force did not discuss this item since it was a lower priority issue.

- Some participants believed burdensome foreign import regulations may restrict product diversity.
- This issue was not discussed further.

COD Requirement / Ban on Credit (low priority)*

Current Regulations

Distributors may receive credit terms from product purchased from manufacturers, but retailers must pay cash (or cash equivalent) on delivery for products purchased from a distributor. (Current regulations allow credit to retailers on food products with 30-day terms.)

- Distributors may purchase product on credit, but retailers must pay cash to distributors.

Background / Interview Results

Although this issue was originally voted as a lower priority for discussion by the Task Force, it is one of the issues challenged in the U.S. District Court and decided to be prohibited for enforcement on May 1, 2007, unless a stay is granted by the 9th Circuit Court of Appeals. Due to the Court's decision, Task Force feedback was requested.

Association distributors believe this regulation is necessary to avoid retailers from overextending themselves on credit, and perhaps going out of business without paying for the product. They also believe it is necessary to preserve the separation between the tiers. They believe there is a difference between a retailer being in debt to a credit card company and a retailer being in debt to a distributor or supplier. The supplier or distributor might try to use that debt to gain undue influence over the retailer. The retailer might attempt to extract favorable credit terms from the supplier or distributor.

The industry participants work in a business environment where some credit terms are the norm. In fact, manufacturers can provide credit terms to distributors under the current laws. Many of them believe credit should be allowed to retailers as well.

Although manufacturers and independent distributors realize it is more burdensome to them to carry the financing for a time and to do the paperwork, they believe the *ability* to offer credit (not the mandate to do it) would allow them to provide better customer service. Retailers would like the ability to buy with credit terms.

Association distributors and some independent distributors would prefer not to have a credit option as many retailers will expect it, and it will create more administration and cash flow issues for them. They also express concerns that retailers may get overextended and go out of business.

Task Force Perspectives

Some Task Force members believe that offering credit terms to retailers is a money's worth issue because it is providing value to a retailer. They are also concerned that if a distributor offers credit to one retailer but not another, it could be construed as a violation of other pricing regulations such as uniform pricing. These Task Force members believe the ban on credit sales is important to preserving separation of the tiers, is essential to preservation of uniform pricing, and eliminates what would otherwise be a potential for special deals favoring one retailer over another.

- WBWWA believes COD is necessary to avoid retailers overextending or failing to pay taxes.
- Retailers and some independent distributors believe short credit terms should be available.
- Some members are concerned about violating money's worth regulations.

There is also some concern about retailers overextending themselves, and that extending credit to retailers provides opportunities to abuse the system by creating an obligation that could unduly influence retailers.

Other members believe that allowing credit to retailers is part of modern business. Retailers can currently use credit cards to purchase product from a distributor. Allowing them access to credit from the distributor should not present any greater risk of becoming overextended. The Task Force should recommend *allowing*, not *requiring*, distributors to offer credit to retailers; the distributor has the option to decline if the retailer does not present a good credit risk.

The Task Force adopted the following recommendation by a vote of nine (9) for, and three (3) opposed.

Recommendation #8 – Retail Credit Terms

Allow the option for manufacturers and distributors to offer credit to retailers, with specific terms – 30 days, and reporting requirements and penalties for default (temporary license suspension and/or cash penalty), such as the Texas model.

- There is some concern that retailers may overextend themselves and become obligated to manufacturers or distributors.
- Other members do not see credit for this product any differently than credit for other products.
- Recommendation #8 is related to retail credit terms.

Uniform Pricing Requirements (low priority)*

Current Regulation

Uniform Pricing – Each manufacturer and distributor must offer products to all buyers at the same price.

Background / Interview Results

Although this issue was originally voted as a lower priority for discussion by the Task Force, it is one of the issues challenged in the U.S. District Court and decided to be prohibited for enforcement on May 1, 2007, unless a stay is granted by the 9th Circuit Court of Appeals. Due to the Court’s decision, Task Force feedback was requested.

The rationale underlying uniform pricing is that it provides a level playing field for small and distant retailers, since big box stores receive no price advantage, and the retailer in Omak pays no more than the retailer in Seattle. The intent of this regulation is to encourage the level playing field so small retailers can compete and are not tempted to go outside of the licensed system for products. Uniform pricing therefore is thought to contribute to the orderly distribution of beer and wine.

Some stakeholders including manufacturers, independent distributors and some retailers would prefer the pricing to be more market-driven. Examples include wine manufacturers who would like to be able to give discounts to restaurants who pour their wine by the glass. Other

- Individual products must be sold at the same price to all customers.
- The state believes uniform pricing provides a level playing field.
- Many participants believe pricing should be more market-driven.

stakeholders, primarily small retailers, appreciate the uniform pricing regulations which help them compete against larger retailers.

Prevention and law enforcement stakeholders believe that uniform pricing helps control the misuse of alcohol by providing incentives to stay within the system and to not sell alcohol outside the system to make a profit.

Task Force Perspectives

One Task Force member noted that at the heart of the three pricing issues is a common concern. Currently, the price offered by a distributor to a retailer is a blended price reflecting three items – the price of the commodity, the cost of delivery, and the cost of a variety of services (such as stocking). Some retailers cannot use the services distributors offer. Therefore, other retailers are getting a significant benefit from this approach to pricing. Most retailers support paying a uniform price for the product itself, but they do not want to pay for services they do not use.

The market allows for many methods of competition beyond just price. Some use level of service, selection diversity, and product education as their value proposition. Others add value through price. Some members of the Task Force believe the retailer should be able to negotiate price and offer any savings to customers, which is not necessarily inconsistent with state policy goals.

Prevention community members do not support market-driven pricing since they believe lower prices in general do contribute to alcohol misuse.

A live motion (made and seconded) was discussed, “*Require uniform pricing on product but allow negotiated delivery and service costs.*” However, the Task Force was not able to come to agreement about a preferred recommendation regarding uniform pricing. The recommendation failed to be adopted by a vote of six (6) for, and seven (7) opposed.

- Others believe that uniform pricing helps prevent misuse.
- It was noted that uniform pricing includes delivery and product services which are not always used; some favor an approach to uniform price for the product only.
- Retailers use different methods to compete; only one is price. It is unfair to restrict the business model of offering lower prices.
- While some members support market-driven pricing, the prevention participants do not.
- The Task Force did not adopt a recommendation on this issue.

Return of Damaged Goods (low priority)

Current Regulations

Damaged goods may be returned to the distributor (or manufacturer acting as a distributor). However, if the damage was caused by the retailer customer, no return is allowed.

Background / Interview Results

A few retailers expressed the need to have more flexibility to return damaged goods.

Task Force Perspective

This was determined to be a low priority for the Task Force and was not discussed.

- Damaged goods may be returned unless damaged by retailer.
- Some interview participants wanted more flexibility to return products.
- The Task Force did not discuss this issue.

Section 9 – Control and Enforcement: Current Regulations, Background/Interview Results, and Task Force Discussion Highlights

Lack of LCB enforcement resources (high priority)

Current Environment

The LCB currently employs approximately 85 liquor enforcement officers to enforce all alcohol and tobacco related regulations.¹³ (Of the 85, 17 officers are assigned to tobacco tax enforcement.) Five enforcement officers are devoted specifically to enforcement of wine and beer tax collection and business practices among three tiers.

Background / Interview Results

During stakeholder interviews several industry members noted the lack of sufficient resources in the LCB to enforce the regulations related to business practices. As a result, current regulations are not vigorously enforced and some members of the industry do not play by the rules. This creates an unlevelled playing field for those in the industry who are trying to abide by the current regulations. Others felt that enforcement resources should be focused in areas where they are most needed such as enforcing underage drinking laws and preventing misuse of alcohol.

Task Force Perspective

More liquor enforcement resources are needed. Other entities (cities, prevention, etc.) are required to devote their own resources to enforcement because the state does not have sufficient resources. The LCB's enforcement resources have not kept pace with population increases, and the increased number of licensees.

The Task Force adopted the following recommendation by a vote of 15 for, and none (0) opposed.

Recommendation #9 – Enforcement Resources

The Task Force recommends that the LCB be supported by adequate enforcement resources and that those resources grow in consideration of population increases and increases in liquor licenses.

- The LCB has limited resources for enforcement purposes.
- Many participants believe there are not sufficient resources for the LCB to enforce all regulations, so they should focus on preventing misuse.
- The Task Force agreed that more enforcement resources are needed.
- Recommendation #9 relates to enforcement resources.

¹³ Source: LCB 2005 Annual Report.

Lack of impact measures related to regulations and changes in regulations (medium priority).

Current Environment

The LCB lacks sufficient means or tools to identify and measure impacts of regulations and changes.

Background / Interview Results

Many participants in the interview process noted that the state did not seem to have data to assess the impacts of regulations and therefore could not credibly explain if certain regulations were effective in their intended purpose.

The LCB also acknowledges a lack of resources to conduct research and to collect impact data. Previous attempts to get resources for this effort have failed. (Also see the issue paper, “General Impact Measures” in Appendix I.)

Task Force Perspectives

The Task Force generally agreed there is an on-going need for more and better data about the effectiveness of the alcohol distribution and sale regulations in meeting the state’s policy goals. Throughout the discussions of the Task Force, one of the main problems has been the lack of data.

The prevention representatives indicate there are social and health indicator data available. The LCB should be encouraged to work collaboratively with other state agencies (such as the Department of Social and Health Services Division of Alcohol and Substance Abuse) using both original independent research and relevant existing analysis.

Some members are concerned the timing may not be good to establish research capacity within the LCB, questioning whether it makes sense to gather data to support a system that may need to change due to the Costco litigation. Without resolution of the Costco lawsuit, it is unclear what the system will look like in the future. Other members noted the intent is to collect information because of the on-going need for better and more information so the Legislature and the LCB can make data-driven decisions, regardless of the lawsuit. It is important to set the systems in place to develop this capacity now so comparative data are available when changes occur.

This is particularly important because Washington is on the cutting edge of these policy discussions. Even the National Conference of State Legislators (NCSL) is not collecting any of these data. Policymakers across the country will be watching the developments in Washington, therefore sound data-driven policy will be particularly important. The

- There is a general lack of impact measures to show the effects of regulations or changes to support the intended goal.
- Interview participants noted the lack of data to link regulations to outcomes.
- There was general agreement that the LCB lacks data to assess the impacts of policies or regulation changes.
- The prevention participants indicate there is social and health data available through other agencies and organizations.
- There is a need for better data to inform the LCB and the Legislature during policy discussions and decisions.

state needs factual, depoliticized data to attempt to determine the extent of a causal link between specific regulations and alcohol misuse. Today, it is not clear to all that there *is* a link.

There was some concern that if the recommendation did not specifically reference the need for FTEs and funding, it could create an unfunded mandate, however many were reluctant to specify the type of resources recommended.

The Task Force adopted the following recommendation by a vote of 10 for, and two (2) opposed. One member, Gilbert Canizales attending for Shelley Sieveking, requested that it be noted he was abstaining from this particular vote.

Recommendation #10 – General Impact Measures

The Legislature is encouraged to provide funding to the LCB to develop research and analysis capability, and work collaboratively with stakeholders and other agencies and organizations to collect independent data, and to use/analyze existing data.

- Some are concerned that the LCB will be given an unfunded mandate.
- Recommendation #10 is related to general impact measures.

The LCB in the business of beer and wine sales (high priority)

Current Regulations

Although the LCB licenses private retailers to sell beer and wine, the state also owns and contracts for state liquor stores that sell spirits (not available through private retailers) and beer and wine.

Background / Interview Results

This issue came up with a related issue that the LCB has some unfair advantages in the state sale of beer and wine.

Some retailers believe there is inequity with the regulations that govern sales of beer and wine at state stores versus private retailers, and therefore question if the state should be in the beer and wine sales business. They believe their business suffers to some extent when the state is in the retail sales business. They also note that product is often sold for less in state stores than private retail stores, which is inconsistent with the state's "price matters" policies.

Some small wine manufacturers use the state retail stores as their primary or exclusive sales outlet and believe their business would be hurt if the state did not retail wine.

Task Force Perspective

This issue was discussed to some extent with the issue of the regulations related to state stores, but other studies have thoroughly reviewed this issue. The Task Force did not opt to address it further.

- Many retailers believe the state has an unfair advantage with different rules for the sale of beer and wine in state stores versus private retailers. They also believe they often sell at lower prices which is inconsistent with their "price matters" policies.
- Small wine manufacturers use the state stores as their exclusive or primary outlet.
- The Task Force did not make a recommendation on this issue.

Standard criteria for developing and interpreting regulations (medium priority)

Current Environment

The LCB develops administrative rules and policies as allowed and provides interpretation of laws and regulations.

Background / Interview Results

Some interview participants believe the philosophy or policy goals of the Legislature and the LCB are not always clear, and that there seem to be inconsistencies between the two. An example cited is that the Legislature seems to generally support the wine industry as a business asset for Washington State, yet the LCB develops and/or interprets regulations in a way that unduly constricts and hampers that same business.

Task Force Perspective

This issue was not discussed further by the Task Force.

- Some participants believed the LCB should develop criteria for interpreting regulations to be internally consistent, more equitable, and congruent with Legislative support.
- This issue was not discussed further by the Task Force

Different rules for LCB retailing (medium priority)

Current Regulations

The LCB does not have to follow the same rules as all other retailers, including price posting, mandatory mark-up, and quantity discounts, and sometimes sells wine products for less than other retailers. However, there are other regulations that apply to the LCB that do not apply to private retailers.

Background / Interview Results

This discrepancy is perceived as inconsistent with the LCB philosophy that higher prices reduce consumption, and it seems inequitable to some because the LCB does not have the same business constraints or costs as other retailers who must comply with the regulations.

(See the issue paper on this subject in Appendix I.)

Task Force Perspectives

It was noted that beer sales in state stores are a very small percentage of the total Washington sales, however, smaller breweries like to do business with the state because they can deliver to one place, the state distribution center. The winery representatives concur.

From the small specialty shops perspective, there is not a strong policy driver for the state to be in the beer and wine retail business.

- The LCB has different retailing rules than private retailers.
- Some participants believe the same general rules related to sales of beer and wine should apply to the LCB as to private retailers.
- It is easier for small manufacturers to deliver to one location – the state distribution center.
- From a small specialty shop perspective, there is not a strong policy driver for state-owned stores.

From a consumer perspective, the Legislature has supported the Washington wine industry, and sales through state stores also support that strategy. Furthermore, the LCB stores supply revenue to the state. If there is a serious consideration to discontinue beer and/or wine sales in state stores, there would also need to be revenue replacement proposal.

Retailers iterate that the state does not have the same business constraints as private retailers because they do not have to abide by all the same rules. The general rules should be the same for both so there is not a competitive advantage to the state. Others pointed out, however, that the state is subject to other business constraints, such as a ban on advertising that private retailers do not have.

A motion that new rules would apply to the state and private retailers failed.

There was no agreed upon recommendation related to this issue.

- The Legislature has supported the industry via state liquor stores and the state receives revenues from sales.
- The Task Force did not adopt a recommendation for this issue.

Priority of enforcement resources (medium priority)

Background / Interview Results

Some interview participants believe the LCB should focus its limited resources on preventing alcohol misuse, including access for minors, rather than on perceived less offensive or insignificant issues such as who may pour wine at a wine retail shop wine tasting. (Manufacturers cannot actually pour wine at a wine tasting as it is interpreted to be “money’s worth” – adding value to the retailer.)

Task Force Perspective

The Task Force did not address this issue specifically, but some Task Force members noted in several discussions that enforcement priorities should focus on stemming misuse of alcohol, such as ensuring minors are not allowed to purchase alcohol, reducing the over-serving of customers at on-premise outlets, and enforcing regulations governing transactions between suppliers or distributors and retailers.

- Some participants believe the LCB should focus its limited enforcement resources on misuse rather than insignificant issues.
- Many participants believe the regulations are unnecessarily complex and burdensome and could be simplified.
- The Task Force did not address this issue specifically, but noted on several occasions that enforcement should focus on issues directly related to misuse.

Complexity of regulations (low priority)

Background / Interview Results

Many interview participants stated the alcohol regulations are complex and hard to understand. Many exceptions and changes have been applied since their inception, creating some conflicting objectives and making it difficult to understand, explain and defend the principles upon which they were based.

- Many interview participants indicated the alcohol regulations were overly complex.

Task Force Perspective

This was determined to be a low priority issue for the Task Force and was not specifically discussed.

Abundance of paperwork (low priority)

Background / Interview Results

Some interview participants stated there is too much paperwork involved in licensing and reporting to the LCB.

Task Force Perspective

This was determined to be a low priority issue for the Task Force and was not specifically discussed.

- The Task Force did not address this issue.
- Some interview participants indicated there is too much paper processing.
- The Task Force did not address this issue.

Section 10 – Impacts of Changes in 2SSB 6823: Current Regulations, Background/Interview Results, and Task Force Discussion Highlights

Current Regulations

Second Senate Substitute Bill (2SSB) 6823, enacted in the 2006 Legislative Session, essentially provided the same self-distribution privileges to out-of-state manufacturers as had been allowed for in-state manufacturers for some time. (See the issue paper, “Assessing the Impacts of 2SSB 6823” in Appendix I for a detailed discussion of the changes.)

Background

2SSB 6823 requires the Task Force to examine the impacts of implementing the expansion of the self-distribution authority to out-of-state manufacturers. To date, approximately 50 out-of-state direct shipping endorsements have been granted, and just over 50 retailer endorsements have been granted (to receive those shipments).

Task Force Perspectives

The Task Force members agreed that the actual impacts of the 2SSB 6823 changes cannot yet be determined since the new rules have only been effective since July 1, 2006. Instead, the Task Force focused discussion on the type of information that would be important to track and consider when there is more experience, prior to the expiration of the changes in 2008.

The focus here is specifically on the impacts related to changes associated with 2SSB 6823. If the goal is to evaluate the impacts of the bill, then the measures and data need to have a causal link to the provisions of the bill. For example, draw data only from those manufacturers and retailers that are in fact using self-distribution, not just those that have been granted an endorsement.

It will be very difficult to assess any societal impacts since it would be impossible to track which products contributed to any negative consequences – how would the state know if societal impacts occurred as the specific result of out-of-state products that were directly shipped? Measures such as citations or driving under the influence arrests are totally dependent on the law enforcement resources and not on how many actually occur, so they are not good measures (besides the fact of not knowing if the offense occurred due to product distributed directly from out-of-state manufacturers). Prevention representatives indicate there are rich social indicator data, and general impact measures need to be linked to these data.

- 2SSB 6823 allows self-distribution for out-of-state manufacturers.
- 2SSB 6823 requires the Task Force to examine the impacts of changes.
- Since the new regulations have only been effective since July 1, 2006, impacts cannot be assessed.
- The Task Force focused on data that could be used to assess impacts once there is more experience with the changes.
- It is difficult to assess societal impacts related to out-of-state self-distribution since it is difficult to isolate that particular product. It was also noted it will be a very small percentage of the total product.

The Washington Wine Institute believes self-distribution is very important to the health of the in-state wine industry. (In-state micro brewers also stated in interviews that this ability is vital to their industry, specifically to small emerging breweries.) Whatever type of evaluation is recommended must address the impact of NOT having the out-of-state authority in place, since the alternative to this bill is that all authority to self-distribute would be eliminated. If self-distribution is prohibited, many small manufacturers would likely go out of business.

The Task Force believes enforcement costs should be considered with any impact assessments.

The Task Force considered evaluating the impact of 2SSB 6823 on beer and wine prices and determined the value of price information would be associated with general impacts not necessarily with the impacts of 2SSB 6823.

The Task Force adopted the following recommendation by a vote of 11 for, and none (0) opposed.

Recommendation #11 – Measuring Impacts of 2SSB 6823

The Task Force recommends the LCB identify and select key impact measures that can be monitored and analyzed by the Fall of 2007, to provide the Legislature with data about the impacts related to the implementation of 2SSB 6823.

The LCB is encouraged to work with stakeholders and legislative staff to identify the most pertinent impact measures. Key impact measures should be tied to the state's policy goals and should address the impact to industry, consumers, the state and society. To the extent possible, consideration should be given to selecting measures for which baseline data are already available. Basic data should be collected and reported. Suggestions include:

- ***The number of endorsements granted to of out-of-state manufacturers and in-state retailers to use the expanded authority,***
- ***The volume of product sold through out-of-state self-distribution,***
- ***The size and type of retailers using the authority, and***
- ***Tax revenue collections.***

- Manufacturers strongly believe the ability for in-state self-distribution should not be prohibited.
- LCB enforcement costs should be considered when assessing impacts.
- Recommendation #11 is related to measuring the impacts of 2SSB 6823.

Section 11 – Task Force Recommendations Summary

The following recommendations were adopted by the Task Force by majority vote. Please refer to Sections 6 – 10 for discussions and votes related to the recommendations.

NOTE: The LCB and Legislative Task Force members did not vote on recommendations since they are being submitted to the LCB and the Legislature from the Task Force.

Recommendation #1: State Alcohol Control Policy

(Preamble adopted 17 yes to 0 no)

The Task Force believes that an appropriate alcohol regulatory system for beer and wine sales and distribution should be based upon the three policy goals set forth below. In creating and interpreting such a regulatory system, the Legislature and the LCB should consider the economic development of wineries and breweries and related industries, so long as the LCB and the Legislature also consider any adverse impact of any proposals on public health safety or welfare.

Policy Goal 1: To prevent the misuse of alcohol. *(adopted 10 yes to 5 no)*

- “Misuse of alcohol” includes underage sales/drinking, driving while under the influence, serving to inebriated consumers, public inebriation, sales outside of the regulated system, or any other use that could promote public harm or create safety or nuisance issues.
- In an attempt to prevent misuse the state should not affect responsible moderate consumption.
- “Responsible moderate consumption” is the public sale/consumption of alcohol by legal adults, without misuse.

Policy Goal 2: To promote the efficient collection of taxes. *(adopted unanimously by voice vote)*

State’s Working Interpretation: readily available and reliable information about all sales in order to effectively collect accurate state taxes.

Policy Goal 3: To promote the public interest in fostering the orderly and responsible distribution of malt beverages and wine towards effective control of consumption.

(adopted 9 yes to 8 no)

State’s Working Interpretation: avoidance of pressure on any one industry (producers, distributors, or retailers) from another that would cause collusion or result in unfair advantages or disadvantages that may result in over-consumption or increased access by minors.

Recommendation #2: Tied House Prohibitions against Providing Money or Money’s Worth to Retailers *(adopted 15 yes to 0 no)*

The Task Force recommends continuing the state’s current approach of providing specific exceptions to the prohibition against providing money’s worth to retailers, and directs the LCB to work with stakeholders to re-examine current exceptions and develop a comprehensive list of proposed exceptions for legislative consideration. When developing the list of recommended exceptions, the LCB should consider:

- Industry business needs,
- Customer benefits,
- Whether it creates an unwanted inducement for retailers,
- The potential for increased misuse of alcohol, and
- Enforcement resources.

Recommendation #3: Tied House Ownership and Financial Interests

(adopted 9 yes to 3 no)

The Task Force encourages the liberalization of the Tied House ownership restrictions, and recommends that the Legislature work with the LCB to arrive at a workable solution.

Recommendation #4: Price Posting

(adopted 6 yes to 5 no)

The Task Force recommends that price posting be eliminated.

Recommendation #5: Mandatory Minimum Mark-up

(adopted 7 yes to 5 no)

The Task Force recommends elimination of the mandatory minimum mark-up requirement.

Recommendation #6: Volume Discounts

(adopted 7 yes to 4 no)

The Task Force recommends that volume discounts be allowed, with the same volume pricing available to all customers. For example, if a distributor offers price breaks at 10, 100 and 500 units, those price breaks are offered to all customers.

Recommendation #7: Use of Common Carriers

(adopted 13 yes to 2 no)

The Task Force recommends that manufacturers and distributors be allowed to ship their product to retailers using common carriers and consider establishing a licensing requirement for all common carriers delivering alcoholic beverages regardless of origination.

Recommendation #8: Credit

(adopted 9 yes to 3 no)

The Task Force recommends the state allow the option for manufacturers and distributors to offer credit to retailers, with specific terms including a 30-day limit, reporting requirements and penalties for default (temporary license suspension and/or cash penalty).

Recommendation #9: Enforcement Resources

(adopted 15 yes to 0 no)

The Task Force recommends that the LCB be supported by adequate enforcement resources and that those resources grow in consideration of population increases and increases in liquor licenses.

Recommendation #10: General Impact Measures

(adopted 10 yes to 2 no, 1 abstain)

The Legislature is encouraged to provide funding to the LCB to develop research and analysis capability, and work collaboratively with stakeholders and other agencies and organizations to collect independent data, and to use/analyze existing data.

Recommendation #11: Measuring Impacts of 2SSB 6823

(adopted 11 yes to 0 no)

The Task Force recommends the LCB identify and select key impact measures that can be monitored and analyzed by the Fall of 2007, to provide the Legislature with data about the impacts related to the implementation of 2SSB 6823.

The LCB is encouraged to work with stakeholders and legislative staff to identify the most pertinent impact measures. Key impact measures should be tied to the state's policy goals and should address the impact to industry, consumers, the state and society. And, to the extent possible, consideration should be given to selecting measures for which baseline data are already available. Basic data should be collected and reported; suggestions include:

- The number of endorsements granted to of out-of-state manufacturers and in-state retailers to use the expanded authority,
- The volume of product sold through out-of-state self-distribution,
- The size and type of retailers using the authority, and
- Tax revenue collections.

Section 12 – Issues in *Costco v. Hoen, et al.*

The U.S. District Court case is part of the context of the Task Force review.

The District Court case has not been the primary driver for the Task Force review, but with the partial stay order, received on September 14, 2006, it is more likely the Legislature will have to make decisions earlier rather than later.

The following is a short synopsis of the District Court ruling as background information. The full text of the U.S. District Findings of Fact and Conclusion of Law is included in Appendix M.

In 2004, Costco Wholesale Corporation filed a lawsuit against the Washington State Liquor Control Board, challenging a number of Washington State laws and regulations regarding the distribution and sale of beer and wine.¹⁴ In 2005, the U. S. District Court Judge in *Costco vs. Hoen, et al.*, had decided in a summary judgment that seven of the challenged regulations in Washington were “...irreconcilably in conflict with federal antitrust law, as embodied in the Sherman Act of 1890.”

On December 21, 2005, in a related order, the District Court found that Washington statutes that permit in-state beer and wine producers to distribute their products directly to retailers, while withholding such privileges from out-of-state beer and wine producers, discriminate against out-of-state producers in violation of the Commerce Clause of the United States Constitution. The Court-ordered remedy was to eliminate the self-distribution privilege from the in-state wineries and breweries; however, the Court stayed the entry of judgment until April 14, 2006, to provide a sufficient period of time for the Washington State Legislature to determine whether to extend the self-distribution privilege to out-of-state beer and wine producers instead. The Washington Legislature and Governor chose this option by enacting 2SSB 6823. Neither the State nor the WBWWA are appealing this portion of the Costco decision.

The final issue decided in the April 21, 2006, ruling was whether the challenged restraints may be upheld as a valid exercise of the state power under the Twenty-first Amendment to the U. S. Constitution, despite their anticompetitive nature. The District Court found that the challenged policies do not, for the most part, advance the state’s core interests under the Twenty-first Amendment and the state’s interests do not trump the federal interests in promoting competition. The Court concluded that the following “...state restraints are preempted by the

- Full text of U.S. District Court Findings of Fact and Conclusions of Law, along with Judge Pechman’s Order, is included in Appendix M.
- The U.S. District Court found that seven of the eight challenged Washington policies were in violation of the Sherman Act, were not shielded by the 21st Amendment, and the LCB should be enjoined from enforcing:
 - Price posting and hold
 - Uniform pricing
 - Ban on retailer credit
 - Ban on volume discounts
 - Delivered pricing
 - Ban on central warehousing
 - 10% minimum mandatory mark-up

¹⁴ The WBWWA was granted Intervenor-Defendant status upon petition at the original trial.

federal Sherman Act and are not shielded by the Twenty-first Amendment:” and “...the LCB should be enjoined from enforcing the following policies:”

- to “post” their prices with the state and to “hold” those prices for a Policies that require beer and wine distributors and manufacturers full month;
- Policies that require beer and wine distributors to charge uniform prices to all retailers;
- Prohibition on selling beer and wine to retailers on credit;
- Prohibitions on volume discounts for beer and wine sales;
- Policies that require beer and wine distributors to charge the same “delivered” price to all retailers, regardless of the actual delivery costs;
- Prohibitions on central warehousing of beer and wine by retailers; and
- Policies that require a 10% minimum mark-up on sales of beer and wine from producers to wholesalers, as well as a 10% minimum mark-up on sales of beer and wine from distributors to retailers.

The District Court upheld the state’s current regulations prohibiting retailer-to-retailer sales.

The Findings of Fact states, “The Court’s ruling will require changes in Washington’s regulatory system for beer and wine. It is the job of the Washington Legislature and not this Court to determine how to best revise Washington’s system in a manner that is consistent with the United States Constitution and federal law. The Court urges the Legislature to do so with dispatch. The Court will stay the judgment in this case during the 30-day time period allotted to Defendants to file a notice of appeal.”

The LCB and the WBWWA have filed an appeal related to the seven items noted above. Costco has filed an appeal related to the issue found in the state’s favor (retailer-to-retailer sales.) The state filed a stay request pending the appeal decision, hoping to extend the time for deliberations on changes for the several years expected prior to the conclusion of the appeal. On September 14, 2006, the District Court filed its order on the stay motion, granting only a partial stay until May 1, 2007, giving the Legislature time to act. The state filed a motion with the 9th Circuit Court of Appeals to extend the stay through the appeal process, but the disposition has not been received at this time.

- The U.S. District Court upheld the state’s current prohibition of retailer-to-retailer sales.
- Changes must be made by May 1, 2007, unless the state receives an extension from the 9th Circuit Court of Appeals.

Section 13 – Conclusion and Next Steps

The recommendations provided in this report are advisory in nature and are intended to assist the LCB and the Legislature as they undertake the significant challenge of modernizing Washington's regulatory system for the distribution and sale of alcohol.

The members of the Three-Tier Task Force respectfully submit this report, along with recommendations for change, to the Liquor Control Board and the Washington State Legislature in fulfillment of its obligations under 2SSB 6823.