



Summary of Initiative 1105

Prepared for members of the Washington House of Representatives by the House Office of Program Research.

This information has been prepared in response to various requests for a summary of Initiative 1105. It is provided for analytical and legislative policy purposes only. It is not provided as an expression of support for or opposition to any ballot measure. These materials are intended to provide general information and are not intended to be an exhaustive analysis of all issues presented by the measure.

BRIEF SUMMARY

- Closes state liquor stores by April 1, 2012.
- Creates spirits licenses for qualified retailers and distributors. Encourages the Liquor Control Board (Board) to grant spirits retailer licenses to contract liquor stores.
- Requires spirits retailers to generally purchase spirits from a licensed distributor.
- Allows suppliers and distributors of spirits to offer quantity discounts.
- Repeals the spirits markup and spirits liter and sales taxes.
- Requires spirits retailers and distributors to pay to the state percentage amounts of gross sales for five years.
- Requires the Board to recommend a distributor liter tax rate to the Legislature that, along with other spirits revenue, will generate the same revenue as under the current system and at least an additional \$100 million over a five-year period.
- Makes other changes in liquor laws.

BACKGROUND

Initiative 1105

Initiative 1105 was certified for the ballot on July 23, 2010. The ballot title and summary prepared by the Attorney General, and amended by court order on June 9, 2010, are as follows:

Ballot Title

Statement of Subject: Initiative Measure No. 1105 concerns liquor (beer, wine and spirits).

Concise Description: This measure would close all state liquor stores and license private parties to sell or distribute spirits. It would revise laws concerning regulation, taxation and government revenues from distribution and sale of spirits.

Should this measure be enacted into law? Yes [] No []

Ballot Measure Summary

This measure would direct the liquor control board to close all state liquor stores and to license qualified private parties as spirits (hard liquor) retailers or distributors. It would require licensees to pay the state a percentage of their first five years of gross spirits sales; repeal certain taxes on retail spirits sales; direct the board to recommend to the legislature a tax to be paid by spirits distributors; and would revise other laws concerning spirits.

Distribution and Sale of Spirits

Washington is one of 18 liquor "control" states, in which the state has a monopoly over some aspect of the distribution and sale of liquor, which includes beer, wine, and spirits. In Washington, spirits in the original package (including spirits sold by restaurants and other licensees) may only be purchased from state liquor stores operated by the Liquor Control Board (Board) or private liquor stores under contract with the Board. (An exception allows a craft distillery to sell a limited quantity of spirits in the original package that it produced.) The Board also enters into agreements for tribal and military stores. "Spirits" is any beverage containing alcohol obtained by distillation, except flavored malt beverages, but including wines exceeding 24 percent of alcohol by volume.

There are approximately 160 state liquor stores and 155 contract liquor stores in the state. The Board also operates a distribution center in Seattle. Distribution of spirits to state and contract stores is performed by trucking companies under contract with the Board. (State and contract liquor stores also may sell beer and wine.)

The selling price charged for spirits by state and contract liquor stores is made up of the distillery price plus a markup. Certain licensees that sell spirits, including restaurants, receive a 15 percent discount on the selling price. Purchasers of spirits also pay federal and state taxes.

Distribution and Sale of Beer and Wine

The distribution and sale of beer and wine to licensees takes place under what is known as the "three tier" system, in which manufacturers generally sell their products to distributors who then

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sell to retailers. In contrast to spirits, beer and wine are distributed by private distributors licensed by the Board. A number of exceptions to the three-tier system have been enacted. For example, a domestic winery may distribute and sell at retail wine it produces. With a direct shipping endorsement, a winery certificate of approval holder (out-of-state winery) may distribute wine it produces.

Beer suppliers meeting a production threshold and their distributors are regulated under the Wholesale Distributor/Supplier Equity Agreement Act (Act), in addition to state liquor laws. Under the Act, suppliers and distributors are entitled to certain protections which must be incorporated into distributorship agreements. For example, notice is required to terminate an agreement unless the termination is for specified reasons. If an agreement is terminated because a supplier acquires the right to distribute a particular brand and elects to have that brand handled by a different distributor, the successor distributor must compensate the terminated distributor. The Act also lists certain prohibited acts by suppliers, such as requiring a distributor to accept product that was not ordered. Attorneys' fees and costs are available in certain actions under the Act.

Laws also govern pricing and delivery by beer and wine suppliers (manufacturers and other suppliers) and distributors. Suppliers and distributors must maintain specified price lists. Uniform pricing is required, and quantity discounts and sales below cost are prohibited. (Quantity discounts by retailers are permitted.) Distributors must deliver beer and wine to a retailer's licensed premises or a retailer may accept delivery at the distributor's premises. In 2008 the U.S. Court of Appeals for the Ninth Circuit in *Costco v. Hoen*, among other rulings, upheld the uniform pricing, quantity discount, and delivery laws. Suppliers must also file an appointment with the Board identifying distributors who may distribute its products.

Liquor Licenses

The Board issues various liquor licenses, which allow the exercise of specific privileges. Off-premise retail licenses include grocery store and beer and/or wine specialty shop licenses. On-premise retail licenses include restaurant and nightclub licenses. (Some on-premise licenses also allow off-premise sales with an endorsement.) The Board also issues non-retail licenses. These include domestic winery, domestic brewery, distiller, beer distributor, wine distributor, wine importer, beer importer, and liquor importer licenses. Out-of-state wineries and breweries obtain a certificate of approval to ship their products into the state.

Tied House Laws

The tied house laws generally prohibit certain relationships between the tiers of the liquor industry. One aspect of the tied house laws is the financial interest piece, which addresses ownership in multiple tiers. In 2009 the Legislature repealed a general prohibition on financial interests between tiers and permitted financial interests in multiple tiers under certain conditions.

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Another aspect of the tied house laws is the "moneys' worth" piece, which prohibits a manufacturer or distributor from providing money or moneys' worth to a retailer. For example, sales on credit are prohibited. A number of exceptions have been enacted. For example, manufacturers and distributors may give retailers branded promotional items that meet certain requirements. The Board is not a "retailer" for purposes of the tied house laws.

Liquor Revenue

State liquor revenue includes the markup on spirits sales, sales and liter taxes, and license fees.

Markup. The markup is deposited into the Liquor Revolving Fund. Moneys in this fund are used for Board expenses and "excess funds" are distributed to the State General Fund and cities and counties.

State spirits taxes. State sales and liter taxes apply to sales of spirits. Sales taxes are distributed to the State General Fund and cities and counties, and liter taxes are deposited into the State General Fund. The state and local retail sales tax applicable to most sales of personal property do not apply to spirits sales.

License fees. License fees vary depending on the license type. A grocery store annual license fee, for example, is \$150 plus a 10.5 percent surcharge which is in effect until July 1, 2011. License fees are deposited into the Liquor Revolving Fund and distributed for various purposes depending on the license type. Moneys remaining after specific distributions are distributed in the same manner as the markup - for Board expenses, the State General Fund, and cities and counties.

Tribal Agreements

The Board enters into agreements with tribes for tribes to operate tribal liquor stores. Tribes purchase liquor from the Board at a negotiated price and pay the sales and liter taxes on those purchases except that taxes are not paid on a quota based on tribal membership.

The state has entered into agreements with tribes regarding fuel taxes in which the tribes charge their customers a fuel tax equivalent to the state motor vehicle fuel tax. The tribes receive 75 percent of the tax revenue collected and the state receives 25 percent.

SUMMARY

Intent

The intent of the people is stated: (1) privatization of spirits retail and distribution is to result in a system that is more efficient than public sector retail and distribution of spirits and not result in

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revenue losses to state or local governments; and (2) an orderly transition from the state control system to a privatized system is to be provided for.

The people also intend to have greater availability of spirits and a more convenient shopping experience. Further, the people intend to retain a high degree of security and public safety in the handling and sale of all alcoholic beverages.

State Distribution and Sale of Liquor

The state must cease operation of all state liquor stores by April 1, 2012. The Liquor Control Board (Board) must make a good faith effort to sell all inventory and assets of stores and the distribution center by April 1, 2012.

Licenses

Two new licenses are created:

A spirits retailer license allows the sale of spirits for off-premise consumption. The Board must develop criteria for the issuance of licenses to applicants who can demonstrate the same level of security and safety as that which the citizens of the state have come to expect from their state-operated retail stores. Emphasis should be placed on inventory management systems, employee training, employee supervision, and physical security of the product. The Board is encouraged to make spirits retailer licenses available to contract liquor stores.

A spirits distributor license allows the sale of spirits to any person licensed to sell spirits, to other distributors, and for export. All persons who have an appointment by, or who are agents of a spirits manufacturer, supplier, or distiller to distribute products in the state are eligible for a spirits distributor license unless the Board determines issuance of a license is not in the public interest.

Three Tier System

Retail spirits licensees may purchase spirits only from a distributor. (Exceptions allow a retailer to purchase from a government agency that has seized spirits and under certain conditions from a retailer which has discontinued business.) A distiller may not act as a distributor of its products.

Certain provisions of the Wholesale Distributor/Supplier Equity Agreement Act (Act) applicable to suppliers and distributors of beer apply to suppliers and distributors of spirits. Suppliers and distributors are entitled to specified protections and certain acts by suppliers are prohibited. An attorneys' fee provision also applies.

Pricing/Delivery

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The pricing and delivery laws applicable to beer and wine suppliers and distributors generally apply to spirits suppliers and distributors. However, quantity discounts by spirits suppliers and distributors are permitted.

The distributor appointment required to be filed with the Board by suppliers must identify each distributor authorized to distribute its products and all brands that each distributor may distribute. This requirement applies to the distribution of spirits, beer, and wine.

Tied House Laws

A financial interest tied house law for spirits is created. A spirits manufacturer or distiller, whether resident or nonresident, may not possess any direct or indirect interest in a spirits distributor or liquor importer license. A spirits retailer may not possess any direct or indirect interest in a spirits distributor or liquor importer license.

The "moneys' worth" piece of the tied house law applies to spirits.

Liquor Revenue

The state and local retail sales tax applies to spirits sales.

Spirits retailers must agree to pay to the state 6 percent of their gross annual spirits sales and spirits distributors must agree to pay 1 percent of their gross annual spirits sales. These payments apply for a five-year period beginning on the date the licensee first sells spirits and are deposited into the State General Fund. The Board must adopt rules regarding the frequency and timing of the payments and the reporting of sales volume.

The Board must report to the Legislature by January 1, 2011, on a recommended rate of taxation that, along with other spirits-related revenue sources, would project to generate at least the same annual revenue for the state and local governments as under the current system as well as at least an additional \$100 million in net revenue of expenses over a five-year period beginning November 1, 2011. The tax is on a per-liter basis on sales to spirits distributors. In making its recommendation, the Board must consider that there will be other revenue including business and occupation taxes, increased taxable spirits inventory base, and license fees.

The Board must set, by rule, reasonable annual license fees for spirits retailer and spirits distributor licenses and may make reasonable adjustments to the fees.

Tribal Agreements

The Board must adopt a rule regarding the sale of spirits to tribes on terms consistent with and no less favorable to tribes than current rules. At the request of any federally recognized tribe, the

Board must replace any liquor tax compact with an agreement to share amounts equal to liquor taxes collected on sales within the reservation at percentages comparable to fuel tax compacts.

Other

The Board must report to the Legislature, if necessary, on further necessary legislation, which may include provision for the retraining of any state workers displaced by privatization.

Nothing in the initiative shall be construed to affect the rights of tribes or military installations with respect to the sale or purchase of spirits. The Board must prepare a report to the Legislature on a recommended means to carry out this provision.

The Code Reviser must prepare legislation removing all statutory references to "state liquor store", to take effect April 1, 2012.

The Board's powers related to state and contract liquor stores and distribution of liquor are repealed. Sections relating to state and contract liquor stores are repealed.

Timeline Summary

December 2, 2010	<ul style="list-style-type: none">• New spirits retailer and distributor licenses created.
January 1, 2011	<ul style="list-style-type: none">• Board must report to the Legislature on:<ul style="list-style-type: none">○ recommended tax rate; and○ rights of tribes and military regarding purchase and sale of spirits.
July 1, 2011	<ul style="list-style-type: none">• Board must have notified spirits retail and distributor applicants that qualify for licenses.
October 1, 2011	<ul style="list-style-type: none">• Spirits distributors may begin sales.
November 1, 2011	<ul style="list-style-type: none">• Spirits retailers may begin sales.
April 1, 2012	<ul style="list-style-type: none">• State liquor stores closed.• Spirits markup and spirits sales and liter taxes end.

Effective Date:

The initiative takes effect 30 days after the election, except for Sections 201 through 204, 207, and 208, relating to the Liquor Control Board's (Board) authority, certain purchases required from the Board, Board sales, and repeal of the markup and taxes, which take effect April 1, 2012.

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