State of Washington

Office of Program Research | **House of Representatives** | **August 19, 2011**

Summary of Initiative 1183

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 1183. 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, allows sale of spirits by private retailers beginning June 1, 2012, and repeals the Liquor Control Board's authority to set prices for spirits, including spirits markup.
- Creates spirits retailer and spirits distributor licenses.
  - Requires spirits retailer premises to comprise at least 10,000 square feet, with some exceptions, and establishes training and other requirements.
  - Requires spirits retailers to pay a license issuance fee to the state of 17 percent of spirits sales revenue.
  - Requires spirits distributors to pay a license issuance fee to the state of 10 percent of spirits sales revenue, decreasing to 5 percent beginning in third year of licensure, subject to a $150 million collective payment requirement as of March 31, 2013.
- Allows distillers to sell directly to retailers.
- Creates an endorsement to a grocery store license, allowing certain resales of wine to retailers who sell wine for on-premises consumption.
- Allows certain discounts by wine and spirits suppliers and distributors.
- Permits central warehousing by wine and spirits retailers.
- Repeals 2011 law providing for a competitive process for the long-term lease of the state's spirits warehousing and distribution assets and contract for the exclusive right to distribute spirits.
- Requires that local governments receive from spirits license fees no less than the amounts received from the Liquor Revolving Fund prior to the Initiative plus an additional $10 million per year.

BACKGROUND

Initiative 1183 was certified for the ballot on July 27, 2011. The ballot title and summary prepared by the Attorney General, and amended by court order on June 17, 2011, are as follows:

> **Ballot Title**
> Statement of Subject: Initiative Measure No. 1183 concerns liquor: beer, wine, and spirits (hard liquor).
>
> Concise Description: This measure would close state liquor stores and sell their assets; license private parties to sell and distribute spirits; set license fees based on sales; regulate licensees; and change regulation of wine distribution.
>
> Should this measure be enacted into law? Yes [ ] No [ ]
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> **Ballot Measure Summary**
> This measure would close state liquor stores and sell their assets including the liquor distribution center. The state would license private parties to distribute spirits and to sell spirits in retail stores meeting certain criteria, subject to specified training and compliance requirements. The measure establishes licensing fees for sale and distribution of spirits based on the licensee's sales revenues. It would change some wine distribution laws and allow non-uniform wholesale pricing for wine and spirits.

Overview

Washington is one of 18 liquor "control" states, in which the state has a monopoly over some aspects of the distribution and sale of alcoholic beverages. In Washington, spirits in the original package (including spirits purchased by restaurants and other licensees) may in general be purchased only from state liquor stores operated by the Liquor Control Board (Board) or private liquor stores operated by managers under contract with the Board. Beer and wine may be sold by businesses licensed by the Board.

"Spirits" is any beverage containing alcohol obtained by distillation, except flavored malt beverages, but including wines exceeding 24 percent of alcohol by volume. "Liquor" includes spirits, beer, and wine.

The Board handles the purchase, distribution, and sale of liquor sold in state and contract liquor stores in its business enterprise division. Advertising by the Board is prohibited. In its licensing and regulation division, the Board handles the regulation and enforcement of liquor laws. The Board has rule-making authority over the purchase of liquor by the state, the conditions for obtaining licenses to sell beer and wine, ingredient standards, and other matters.

Distribution and Sale of Spirits

There are approximately 166 state liquor stores and 163 contract liquor stores in the state. The Board operates a distribution center in Seattle, and distribution of spirits to state and contract liquor stores is performed by trucking companies under contract with the Board. State and contract liquor stores also may sell beer and wine. The Board has agreements with tribes and the military for spirits sales.

A law enacted in the 2011 special session (Engrossed Substitute Senate Bill 5942) allows the Board to enter into a long-term contract for the lease of the state's assets related to the warehousing and distribution of spirits and the exclusive right to distribute spirits. As a condition of entering into a contract, the Office of Financial Management must first find that a proposal is in the best interest of the state.

The selling price for spirits in the original package is comprised of the distillery price plus a markup set by the Board. 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 generally takes place under what is known as the "three-tier" system, in which suppliers generally sell their products to distributors who then sell to retailers. In contrast to spirits, beer and wine are distributed by private distributors licensed by the Board. Sales between retail licensees (e.g., by a grocery store to a restaurant) are not allowed. A number of exceptions to the three-tier system have been enacted. For example, a winery may distribute and sell at retail wine it produces. A licensee (including a retailer) may transfer up to 20 cases of wine per calendar year to another licensee under common ownership. Licensees generally must follow the laws of the tier in which they are acting.

Laws also govern pricing and delivery by beer and wine suppliers and distributors. Suppliers and distributors must maintain specified price lists. Uniform pricing is required, and quantity discounts and sales below cost (except for sales of close-out items by distributors) are prohibited. Central warehousing is generally not allowed; distributors must deliver beer and wine to a retailer's licensed premises or a retailer may accept delivery at the distributor's premises.

Beer suppliers meeting a production threshold and their distributors are regulated under the state 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, 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. Remedies are available under the Act.

Liquor Licenses, Approvals, and Permits

The Board issues various licenses which allow the exercise of specific privileges. Non-retail licenses include domestic (in-state) winery, domestic (in-state) 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. Off-premise retail licenses include grocery store licenses. On-premise retail licenses include restaurant and nightclub licenses. The Board also issues special permits, such as permits for licensees to serve liquor at various events.

Before the Board issues or renews a license, the Board must notify and provide local governments, schools, churches, and public institutions an opportunity to object.

Licensees are subject to penalty for violations. For example, for first-time public safety violations (e.g., sale to a minor), the penalty is a five-day license suspension or, if mitigating circumstances are shown, a $500 fine.

Grocery store and beer and/or wine specialty shop licensees may allow employees between 18 and 21 years of age to handle beer or wine if an adult 21 years or older is on duty.

Liquor Revenue

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

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 to cities, towns, and counties.

Both a sales tax and liter tax are paid by purchasers. Sales taxes are distributed to the State General Fund and to cities and counties, and liter taxes are deposited into the State General Fund.

License fees vary depending on the license type. A grocery store annual license fee, for example, is $150. License fees are distributed for various purposes depending on the license type.

SUMMARY

Findings and Intent

Findings are made that the state government monopoly on liquor distribution and liquor stores, and regulations that arbitrarily restrict the wholesale distribution and pricing of wine, are outdated, inefficient, and costly. Intent is stated to privatize and modernize wholesale distribution and retail sales of liquor and remove outdated restrictions on the wholesale distribution of wine.

Privatization of Distribution and Sale of Spirits

The Liquor Control Board (Board) must complete an orderly transition from a state-controlled system to a private licensee system for spirits distribution and retail sales by June 1, 2012. All state liquor stores must be closed by June 1, 2012. The Board must have a goal of depleting all liquor inventory by May 31, 2012, and closing all other asset sales by June 1, 2013. In selling assets, the maximum reasonable value must be obtained. The Board may sell liquor inventory to spirits licensees. The Department of Revenue must dispose of any assets remaining after June 1, 2013.

Sales proceeds less transition costs are deposited into the Liquor Revolving Fund. The transition to a private licensee system must include a provision for applying revenues to just and reasonable measures to avert harm to tribes, military buyers, and contract liquor store operators.

The Board must auction the right to operate a retail liquor store at the location of each state liquor store. Acquisition of the operating right does not confer eligibility for a license.

The 2011 law providing for a competitive process for the long-term lease of the state's spirits warehousing and distribution assets and contract for the exclusive right to distribute spirits is repealed.

Spirits Licenses/Approval

Three new spirits liquor licenses/approvals are created.

<u>Spirits Retail License</u>.
Privileges of the License. The spirits retail license allows the:
- sale of spirits to consumers for off-premises consumption and to permit holders;
- sale of spirits for resale to retailers licensed to sell spirits for on-premises consumption (defined as "on-sale" retailers), subject to limitation; and
- export of spirits.

The sale of spirits for resale is limited to 24 liters in a single sale unless the sale is by a former contract liquor store manager at the contract store location. An on-sale retailer must maintain specified information regarding spirits purchased from retail spirits licensees and must provide a report of the quantity of items purchased to the distributor of the spirits for the licensee's geographic area or the distiller acting as distributor.

Central warehousing is permitted. Licensees may accept delivery at the licensed premises or at warehouse facilities registered with the Board. From a warehouse, a licensee may deliver to its premises, on-sale retailers to which it has sold spirits, other registered warehouses, and lawful purchasers outside the state. Facilities may be used by cooperatives and other groups of retailers.

Eligibility/Requirements. Spirits retailer premises must be at least 10,000 square feet of fully enclosed retail space within a single structure, and licensees must maintain systems for inventory management, employee training and supervision, and product security substantially as effective as state liquor store systems. However, the Board may not deny a license to a former contract liquor store at its contract location or the holder of the operating rights of a former state liquor store because of the location, nature, or size of the premises. In addition, the premise size requirement does not apply if there is no retail spirits license holder in the trade area, the applicant meets operational requirements established by the Board, and the applicant has not committed more than one public safety violation within the preceding three years.

Licensees must provide training regarding spirits laws and rules for employees selling spirits or managing others who sell spirits. Individuals must be trained before selling spirits and at least every five years. If a grocery store or beer and/or wine specialty shop sells spirits and allows employees under age 21 to sell spirits, at least two adults age 21 or over must supervise the sale of spirits.

Responsible vendor program. The Board must adopt rules regarding a responsible vendor program (program) to reduce underage drinking, encourage use of best practices to prevent sales to minors, and give licensees an incentive to provide on-going training to employees. Minimum requirements for participating in the program are that the licensee:

- provides on-going training,
- accepts only certain forms of identification,
- adopts policies on alcohol sales and checking identification,
- posts specific signs, and
- keeps records verifying compliance with the program's requirements.

Licensees apply to the Board to participate in the program and receive a certificate if the qualifications are met. The program must be free, voluntary, and self-monitoring. A training program that incorporates a responsible vendor program is presumptively sufficient for purposes of meeting the retail spirits licensee training requirement.

Penalties. Penalties are doubled for violations relating to the sale of spirits by retail spirits licensees. The doubling does not apply to a single violation in any 12 calendar months by a licensee who joins the responsible vendor program and maintains all of the program's requirements.

Spirits Distributor License.
Privileges of the License. The spirits distributor license allows the:
- sale of spirits purchased from suppliers to other distributors and to retailers who sell spirits, including spirits retail licensees and on-sale licensees; and
- export of spirits.

Eligibility/Requirements. It is explicitly stated that there is no minimum facility size or capacity and no limit on the number of licenses. Licensees must provide product security substantially as effective as the state distribution center.

Certain applicants (those who on the effective date have the right to purchase spirits for resale, or their agents) are entitled to a license unless the Board determines that issuance of a license to the applicant is not in the public interest.

Spirits Certificate of Approval.
The Board must provide by rule for the issuance of certificates of approval for out-of-state spirits suppliers.

Other License/Approval Privileges and Requirements.

Central warehousing of spirits is permitted for certain on-sale licensees.

Distillers and spirits certificate of approval holders (out-of-state) may distribute spirits of their own production or foreign-produced spirits they import directly to retailers. A distiller or certificate of approval holder distributing its products must comply with distributor provisions. A distiller may maintain a warehouse for distribution of its products if the warehouse is approved by the Board.

Hotel and motel authority to provide beer and wine without charge to guests is modified to include spirits. Hotels may cater events on distillery and brewery premises, in addition to winery premises. The authority for special occasion licensees to sell beer and wine for off-premises consumption with Board approval is changed to include spirits.

The prohibition on price discrimination by wine and beer manufacturers is made applicable to spirits manufacturers. However, price differentials based on certain specified factors (e.g., costs of servicing a purchaser's account) or other bona fide business factors, to the extent the differentials are not unlawful under trade regulation laws, are permitted. Distributors and licensees acting as distributors may not sell spirits below cost except for close-out items. If an allegation is made that spirits are unlawfully sold at a discounted price, defenses under applicable trade laws, including absence of harm to competition and good faith meeting of a competitor's lawful price, are available.

The requirement to notify and give local governments, schools, churches, and public institutions an opportunity to object to a license generally applies to the issuance of spirits retailer and spirits distributor licenses. However, a prohibition on license issuance if a school objects does not apply to the issuance of a spirits retail licensee to an existing grocery store licensee or to the issuance of a spirits distributor license to an existing distributor licensed to sell beer and/or wine.

Distribution and Sale of Wine

A wine retailer reseller endorsement to a grocery store license is created. The endorsement allows a grocery store licensee to sell wine for resale to on-sale retailers, limited to 24 liters in a single sale unless the sale is by a former contract liquor store manager of a contract liquor store at the location of the grocery store. The annual fee for the endorsement is $166 for each store. Grocery store wine resellers must comply with laws that apply to wine distributors.

Certain provisions governing pricing and delivery by beer and wine suppliers and distributors are eliminated for wine. (These provisions are retained for beer.) The requirement to maintain price lists and the ban on quantity discounts is eliminated. The prohibition against price discrimination by a manufacturer is retained; however, price differentials are permitted under the same conditions as allowed for spirits. Defenses to an allegation of the unlawful sale of spirits at a discounted price are also available for the alleged unlawful sale of wine.

Warehousing of wine is permitted. Wine sold to retailers may be delivered to the retailer's licensed premises, a location specified by the retailer and approved by the Board, or to a carrier engaged by either party. Certain warehousing is also permitted by wine retailer resellers.

Liquor Revenue

Spirits distributor licensees pay a license issuance fee of 10 percent of total revenue in each of the first two years of licensure, and 5 percent of total revenue in subsequent years. The first spirits distributor to receive the spirits from the distiller pays the fee. The Board must calculate collective distributor license fee payments as of March 31, 2013. If the total payments are less than $150 million, the Board must adopt rules to collect the difference between $150 million and actual receipts from spirits distributor licensees, ratably based on 2012 spirits sales. If total payments are more than $150 million, the difference must be credited to future spirits distributor license fees. Licensees also pay a $1,320 annual license renewal fee.

Spirits retail licensees pay a license issuance fee equivalent to 17 percent of all spirits sales revenue. The Board must adopt rules regarding the timing of payments with the first payment due October 1, 2012. Licensees also pay an annual license renewal fee of $166, subject to adjustment by the Board. Licensees selling for resale pay the distributor license fee if a distributor license fee has not been paid.

Spirits retailer and spirits distributor license fees are deposited into the Liquor Revolving Fund. The distributions to counties, cities, and towns must be made in a manner such that each category receives not less than it received from the Liquor Revolving Fund during prior comparable periods. An additional $10 million must be provided each year from spirits license fees to counties, cities, and towns for enhancing public safety programs.

Sales and liter tax rates are unchanged. The taxes apply to sales by spirits distributor licensees and licensees acting as spirits distributors, and to sales by spirits retail licensees. Taxes apply to sales by the Board so long as the Board makes such sales. Purchases by the federal government for resale at military installations are expressly exempt from tax.

Other

The Wholesale Distributor/Supplier Equity Agreement Act (Act) is made applicable to suppliers and distributors of spirits. Distillers producing less than 60,000 proof gallons of spirits annually are excluded.

The Board's powers related to state and contract liquor stores, including distribution and setting of prices, are repealed. Other references to state and contract stores are deleted. The Board's power is for the conduct of its regulatory rather than business functions. The Board's rule-making authority with respect to license conditions is extended to spirits licenses. The Board has no authority to restrict advertising of lawful prices.

The Department of Revenue must develop rules and procedures to address claims that the initiative unconstitutionally impairs any contract and provide a means for reasonable compensation of valid claims, funded first from revenues based on spirits licensing and sales.

Intent language regarding the value of Washington's three-tier system for the distribution of beer and wine is deleted as are references to the orderly marketing of alcohol and encouragement of moderation in consumption.

Spirits purchased for various special permits must be purchased from a spirits retailer or distributor rather than the Board or a restaurant.

Accredited representatives of spirits distillers, manufacturers, importers, and distributors are no longer limited to contacting retail licensees only in goodwill activities.

The Board may require seals on liquor packages in certain circumstances.

The list of acceptable cards of identification for liquor purchases is repealed.

Timeline Summary

January 1, 2012	• Certain spirits distributor licenses issued.
February 8, 2012	• Spirits distributor and retailer license applications received by this date must be processed for beginning of sales.
March 1, 2012	• Sales by spirits distributors begin.
May 31, 2012	• State liquor store inventory depleted (goal).
June 1, 2012	• Sales by spirits retailers begin. • State liquor stores closed.
October 1, 2012	• First retail spirits licensee payments due.
March 31, 2013	• $150 million in collective spirits distributor fees due.
June 1, 2013	• Assets sales by Board end. (Remaining assets managed by Department of Revenue after this date.)

Effective Date: The Initiative states that it takes effect upon approval by the voters.

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