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BILL ANALYSIS

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Senate Bill 1171 (Substitute S-4 as passed by the Senate)
Sponsor: Senator Bill Bullard, Jr.
Committee: Economic Development, International Trade and Regulatory Affairs

Date Completed: 12-9-96

CONTENT

The bill would amend the Michigan Liquor Control Act to allow authorized distribution agents (ADAs) to distribute alcoholic liquor in the State, specify the eligibility criteria for appointment as an ADA, require written contracts or agreements between ADAs and suppliers of spirits, specify penalties for violations by ADAs, require ADAs to make a good faith effort to employ displaced State employees, prohibit a specially designated distributor from selling or delivering spirits to any person licensed to sell spirits for consumption on the licensed premises, and require the Liquor Control Commission (LCC) to pay vendors a per-case offset.

"Authorized distribution agent" would mean a person approved by the Liquor Control Commission to do one or more of the following:

-- Store spirits owned by a supplier of spirits or the LCC.
-- Deliver spirits sold by the LCC to retail licensees.
-- Perform any function needed to store spirits owned by a supplier of spirits or by the LCC or to deliver spirits sold by the LCC to retail licensees.

"Supplier of spirits" would mean a vendor of spirits, a manufacturer of spirits, or a primary source of supply. "Primary source of supply" of domestic spirits would mean the distiller, producer, owner of the commodity at the time it became a marketable product, or bottler, or the exclusive agent of any such person. "Primary source of supply" of imported spirits would mean either the foreign distiller, producer, owner of the bottler, or the prime importer for, or the exclusive agent in the United States of, the foreign distiller, producer, owner, or the bottler.

Following is a more detailed description of the bill.

Distribution Rights

Currently, the Act prohibits the sale, delivery, or importation of alcoholic liquor, including alcoholic liquor for personal use, in this State unless the sale, delivery, or importation is made by the LCC or its authorized agent or distributor, a person licensed by the LCC, or by prior written order of the LCC. The bill also would make an exception to the prohibition for an authorized distribution agent approved by order of the LCC.

ADA Eligibility and Appointment

The bill specifies that if the LCC privatized any portion of the system existing on the effective date of the bill under which spirits were warehoused or distributed, the LCC would have to appoint by order ADAs to warehouse and deliver spirits in this State to ensure that all retail licensees continued to be properly serviced with spirits. An ADA would be subject to uniform requirements, including business operating procedures, which the LCC would have to prescribe by rule.

A person would be eligible for appointment as an ADA if the person satisfied all applicable LCC rules prescribing qualification for licensure; entered into a written agreement or contract with a supplier of spirits for the purpose of warehousing and delivering a brand or brands of spirits of that supplier; and had an adequate warehousing facility located in this State for the storing of spirits from which all delivery of spirits to retail licensees would have to be made.

An ADA could not have a direct or indirect interest in a supplier of spirits or in a retailer, and a supplier of spirits or a retailer could not have a direct or indirect interest in an ADA. Further, an ADA could not hold title to spirits nor could an ADA be licensed as a vendor representative or a salesperson.

Beginning September 24, 1996, the LCC could not license an ADA as a wholesaler and could not appoint or certify a wholesaler as an ADA.

An ADA would have to service each retailer located in its assigned distribution area on at least a weekly basis. A retailer could pick up the product at the ADA's warehouse. To avoid emergency outages of spirits, a retail licensee could make up to 12 special emergency orders to an ADA per calendar year. An emergency order would have to be made available to the retail licensee within 18 hours of the placing of the order. A special emergency order placed on Saturday or Sunday would have to be made available to the retail licensee before noon on the following Monday. An ADA could impose a fee of up to $20 to deliver a special emergency order to a retail licensee; otherwise, an ADA could not charge a delivery fee or a split-case fee for delivery of spirits sold by the LCC to a retailer.

Contracts and Agreements

An ADA or prospective ADA would have to maintain and make available to the LCC or its representative, upon notice, any contract or written agreement it had with a supplier of spirits or other ADA for the warehousing and delivery of spirits in this State.

All contracts or agreements between an ADA or prospective ADA and a supplier of spirits would have to be in writing and would have to include such uniform terms as the LCC prescribed by rule, including, but not limited to, the following provisions:

-- The duration and method for renewal of the contract or agreement.
-- A listing of the brand or brands of spirits subject to the contract or agreement.
-- The ADA's service area, and delivery, warehousing, and other responsibilities with respect to the brands of spirits subject to the contract or agreement.
-- The ADA's compensation under the contract or agreement.
-- The supplier's obligation to provide safe, saleable products to the ADA on a regular and timely basis.
-- Requirements for, or limitations upon, subcontracting of the ADA's duties under the contract or agreement.
-- A procedure by which the ADA would be notified of and afforded a reasonable opportunity to correct any deficiencies for its performance under the agreement.
-- The obligation of good faith that would be imposed upon the parties to the contract or agreement.

An ADA's appointment would have to remain in effect as long as it had one or more agreements with a supplier of spirits for the warehousing and delivering of spirits in this State, unless the agreement were revoked, suspended, or forfeited.

Violations by ADAs

If an ADA violated the Act, rules promulgated under the Act, or the terms of an order appointing an ADA, the ADA would be subject to the suspension, revocation, forfeiture, and penalty provisions of the Act. An ADA aggrieved by a penalty imposed by the LCC could invoke the hearing and appeal procedures of the Act, and LCC rules promulgated under it.

Displaced State Employees

The appointment by the LCC of an ADA would have to remain in effect as long as the ADA demonstrated that it had made a good faith effort to provide employment to former State employees displaced by the privatization of the spirits distribution system by obtaining from the LCC a list, including names and addresses, of those former State employees and mailing an application for employment with the ADA to those displaced former State employees. The LCC would have to make available to an ADA a list of former State employees displaced by the privatization of the distribution of spirits.

Uniform Prices

Currently, the Act requires the LCC to establish uniform prices for the sale of alcoholic liquor in State liquor stores and by specially designated distributors. The prices cannot return to the LCC a gross profit of less than 51% or more than 65%. The bill would limit the maximum gross profit to 56%.

Per-Case Offset

The bill specifies that in addition to paying a vendor of spirits the acquisition price for purchasing spirits, the LCC would have to pay the vendor an additional amount of at least $4.50 but not more than $7.50 for each case of spirits purchased as an offset to the costs being incurred by that vendor in contracting with an ADA for the warehousing and delivery of spirits to retailers. The payment could not be included in the cost of purchasing spirits by the LCC and would not be subject to the LCC's markup, special taxes, or State sales tax. The per-case offset could be increased by the State Administrative Board each January to reflect reasonable increases in the ADA's cost of warehousing and delivery. "Case" would mean a container holding twelve 750ml bottles of spirits or other containers containing spirits that were standard to the industry.

MCL 436.3 et al.

Legislative Analyst: L. Burghardt

FISCAL IMPACT

Privatization

This bill would allow the Michigan Liquor Control Commission to privatize its Merchandising and Warehousing divisions. The bill would authorize the Commission to contract with private distribution companies, referred to in the bill as "authorized distribution agents", to perform the functions of these divisions.

Under the current structure the Commission orders liquor from a distiller or manufacturer, which then ships the product to one of the two State warehouses located in Lansing and Lincoln Park. The Commission assesses a bailment charge of 83 cents per case on the manufacturer for storage, which is estimated to total about $4.0 million annually in revenue. The cost for performing this function is estimated to be $4.9 million annually. The product then is shipped from these warehouses to a third State warehouse in Escanaba and to the 63 regional warehouses located Statewide. Another 25 cents per case is charged to the distiller to cover this cost of distribution, which is estimated to total about $2.0 million in revenue annually. The cost for performing this function is estimated to be $1.6 million annually. All three State warehouses and the 63 regional stores are staffed by approximately 400 State employees. The State owns the Lansing and Lincoln Park warehouses and leases the Escanaba and the 63 regional warehouses from private owners. The Commission estimates that the cost of these leases and other contracts needed for maintenance and utilities is about $22.2 million annually.

If the Commission chose to privatize these functions, it would have to close the two State warehouses, terminate the leases on the Escanaba and the 63 regional warehouses, and lay off all State employees currently working out of these locations. The distillers and manufacturers would be responsible for setting up contractual agreements with private distribution companies, or authorized distribution agents, to warehouse and distribute the liquor to licensees. These authorized distribution agents would have to be approved by the Commission. The Commission would no longer assess the 83-cent bailment fee or the 25-cent distribution fee, as it would no longer be performing these functions. The Commission still would order and purchase the liquor from the distiller or manufacturer directly and would pay the distiller an additional per-case fee ranging from $4.50 to $7.50 to offset the cost to the distiller for distributing the product. This money would be used by the distiller to pay the cost of contracting with an authorized distribution agent for the warehousing and delivery of the distiller's product.

Cost for Distribution as Proposed in Senate Bill 1171 (S-4)

The bill proposes that the Commission pay a per-case fee to the distillers to offset the cost of warehousing and distribution. The fee would range from $4.50 to $7.50 per case, and it is assumed that a set fee would be established for all distillers, which could be adjusted by the State Administrative Board each January as distribution costs changed over time. An estimate as to what the cost of this per-case fee would be can be made by comparing the current cost of distribution to the State and that proposed in this bill.

As outlined in the table below, the cost to the State for ownership and leases of central warehouses, leases of 63 regional warehouses, staff, utilities, and maintenance is approximately $22.2 million annually. In addition, the actual cost for storage of the liquor and distribution of the product is estimated at $4.9 million and $1.6 million, respectively. The total annual cost of these items, $28.7 million, is offset by warehousing and distribution fees totaling $6.0 million, charged to distillers. This results in a net cost to the State of approximately $22.7 million.

TYPE OF COST	**AVERAGE ANNUAL AMOUNT**
Administrative Cost to State	$22,188,750
Warehousing Cost	4,855,576
Distribution Cost	1,644,827
Total Distribution Costs	**$28,689,153**
Warehousing Fee Revenue	(4,043,126)
Distribution Fee Revenue	(1,954,990)
Net Cost to State	**$22,691,037**
Average Cost per Case	$ 4.54

To compare the cost for the current distribution system to the one proposed in Senate Bill 1171 (S-4), the current total cost for distribution must be divided by the average number of cases sold per year, which the Commission estimates to be approximately 5,000,000. This factors out to a per-case cost to the State of $4.54. Under the proposed plan, the minimum per-case fee would be $4.50, which is $.04 per case lower than what it currently costs the State to distribute liquor. If the fee were set at a higher rate within the range, then the State reimbursement to the private sector for the distribution of liquor would exceed the current amount the State is paying for distribution. This cost could range from $2,308,963 annually, if the fee were set at $5.00 per case, to $14,808,963 annually, at the $7.50 level.

Cost to the State as a Result of Privatization

This bill also would reduce the upper limit of the range at which the markup price of liquor can be set from 65% to 56%. This limit would lower the markup by 9%, which the Commission estimates could result in the loss of approximately $28.8 million in revenue to the State.

If this reduction in the markup resulted in a direct reduction in the retail price, the State liquor taxes also would generate less revenue. As the table below indicates, there are currently four liquor taxes as well as the 6% sales tax, which are all applied to the marked up price. The estimated total loss of revenue for these various taxes would be $3.0 million with $1.3 million of this amount affecting the School Aid Fund.

TYPE OF TAX	**PROJECTED LOSS OF REVENUE TO THE STATE**
4% to School Aid Fund	$(600,000)
4% to General Fund	(600,000)
4% Convention Facilities Tax	(600,000)
1.85% to Liquor Purchase Revolving Fund (Substance Abuse)	(300,000)
Subtotal Liquor Taxes	(2,100,000)
6% Sales Tax*	(900,000)
Total Loss of Revenue	$(3,000,000)

*73% earmarked for School Aid Fund

In addition to the costs outlined above, there also would be some one-time costs to the State for unemployment, severance pay, and annual and sick leave balance payoffs for some portion of the estimated 400 State employees who currently work in the State and regional warehouses. It is difficult to estimate the exact cost the State would incur as a result of these layoffs as there is no way to predict how many of these employees would a) be hired by the private authorized distribution agents, b) be placed into new positions through the Civil Service system, or c) be eligible to retire at the time the layoffs would occur. The Commission estimates that its maximum liability for unemployment, severance, and supplemental insurance for all 400 employees could be as high as $11,319,119 if none of these employees were retained, were hired elsewhere, or retired. The estimated maximum liability for payoffs of annual and sick leave balances could be as high as $3 million as some of these employees would be eligible to have their balances paid off if they were not retained as State employees. It is also important to note that these costs would be incurred only in the first year the privatization took place as most personnel issues should be concluded within the first 12 months of the privatization.

These one-time costs could be offset by any revenue gained from the lease or sale of equipment and supplies by the Commission following the closure of the warehouses. It is difficult to estimate what level of revenue these items could bring in as it is dependent upon the sale price. Recently, a one-year $924,000 lease agreement (which may be extended for up to five years) has been entered into by the Commission and a private distribution company for the occupation of the Lincoln Park warehouse starting in January. The revenues generated from this or any other lease arrangement could be used to offset a portion of the one-time costs associated with the privatization of the liquor distribution system.

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