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BILL ANALYSIS



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Senate Bill 1171 (as enrolled)

PUBLIC ACT 440 of 1996

Sponsor: Senator Bill Bullard, Jr.

Senate Committee: Economic Development, International Trade and Regulatory Affairs

House Committee: Regulatory Affairs

Date Completed: 1-22-97

CONTENT

The bill amended 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, specify penalties for violations by ADAs, require ADAs to make a good faith effort to employ displaced State employees, and permit the Liquor Control Commission (LCC) to pay vendors a per-case offset; allow the LCC to issue up to 50 tavern or Class "C" licenses in addition to the current quota limit on such licenses; make certain on-premises escrowed licenses available to liquor license applicants; and allow the ownership or operation of condominiums by manufacturers, wholesalers, and vendors of alcoholic liquor under certain circumstances.

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

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, by a person licensed by the LCC, or by prior written order of the LCC. The bill makes an exception to the prohibition for an authorized distribution agent approved by order of the LCC.

The bill defines "authorized distribution agent" as a person approved by the LCC to do one or more of the following:

ADA Eligibility and Responsibilities

- 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.

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

"Supplier of spirits" means a vendor of spirits, a manufacturer of spirits, or a primary source of supply. "Primary source of supply" of domestic spirits means the distiller, producer, owner of the commodity at the time it becomes a marketable product, or bottler, or the exclusive agent of any such person. "Primary source of supply" of imported spirits means either the foreign distiller, producer, owner of the bottler, or the prime

A person is eligible for appointment as an ADA if the person satisfies all applicable LCC rules prescribing qualification for licensure; enters 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 has an adequate warehousing facility located in this State for the storing of spirits from which all delivery of spirits to retail licensees must be made.

An ADA may not have a direct or indirect interest in a supplier of spirits or in a retailer, and a supplier of spirits or a retailer may not have a direct or indirect interest in an ADA. Further, an ADA may not hold title to spirits.

After September 24, 1996, an ADA or an applicant to become an ADA who directly or indirectly becomes licensed subsequently as a wholesaler may not be appointed or authorized to sell or distribute a brand of wine in an area for which a wholesaler has been assigned or authorized to sell or distribute that brand under an agreement required by the Act. A wholesaler who directly or indirectly becomes an ADA may not be appointed or authorized to sell or distribute a brand of wine to a retailer in an area for which another wholesaler has been assigned or authorized to sell or distribute that brand under an agreement required by the Act, if the wholesaler was not selling or distributing that brand to retailers in that area on or before September 24, 1996.

An ADA must deliver to each retailer located in its assigned distribution area on at least a weekly basis if the order meets the minimum requirements. The minimum requirements must be set by the LCC and be a sufficient number of bottles to constitute not more than two cases and not less than one case. A retailer may pick up the product at the ADA's warehouse. To avoid occasional emergency outages of spirits, a retail licensee may make up to 12 special emergency orders to an ADA per calendar year. An emergency order must 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 must be made available to the retail licensee before noon on the following Monday. An ADA may impose a fee of up to \$20 to deliver a special emergency order to a retail licensee; otherwise, an ADA may not charge a delivery fee or a split-case fee for delivery of spirits sold by the LCC to a retailer.

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

Violations by ADAs

If an ADA violates the Act, rules promulgated under the Act, or the terms of an order appointing an ADA, the ADA is subject to the suspension, revocation, forfeiture, and penalty provisions of the Act in the same manner as a licensee is subject to the provisions. An ADA aggrieved by a penalty

imposed by the LCC may invoke the hearing and appeal procedures of the Act, and LCC rules promulgated under it.

SDD: Spirits to On-Premises Licensees

Under the bill, a specially designated distributor (SDD) may sell up to nine liters of spirits to an on-premises licensee during any one-month period and an on-premises licensee may purchase up to nine liters of spirits during any one-month period. Notwithstanding any other provision of the Act or rule promulgated under the Act, an SDD is liable only for knowingly violating the bill's provisions concerning the appointment of ADAs, eligibility for ADA appointment, ADAs' interests in spirit suppliers, ADAs licensed as wholesalers, wholesalers licensed as ADAs, delivery requirements for ADAs, delivery and split case fees, contracts and written agreements, and penalties for violations of the Act by ADAs. Records verifying purchases of the spirits must be maintained by the on-premises licensee and be available to the LCC upon request.

(The Act defines "specially designated distributor" as a person engaged in a business licensed by the LCC to distribute spirits and mixed spirit drink in the original package for the commission for consumption off the premises.)

Displaced State Employees

An ADA must demonstrate that it has made a good faith effort to provide employment to those former State employees who were terminated due to the privatization of the liquor distribution system. An ADA can demonstrate a good faith effort by performing at least the following actions:

- Seeking from the LCC a list of names and resumes of all such former State employees who have indicated a desire for continued employment in the distribution of liquor in Michigan.
- Providing a list of employment opportunities in the distribution of liquor in Michigan to each individual whose name and resume are transmitted from the LCC.
- Providing an opportunity for application and interview to any terminated State worker who indicates an interest in pursuing a job opportunity with the ADA.
- Providing a priority in hiring for those individuals who apply and interview under this process.

Any former State employee terminated due to privatization who has reason to believe that an

ADA has not made a good faith effort to provide him or her with employment opportunities may file a complaint with the LCC, which must hear the complaint and make a determination on its validity. If the LCC determines that the complaint is valid, the violation may be treated as a violation of the Act and the ADA may be subject to the suspension, revocation, forfeiture, and penalty provisions specified in the Act.

Per-Case Offset

The bill specifies that in addition to paying a vendor of spirits the acquisition price for purchasing spirits, the LCC may 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 may not be included in the cost of purchasing spirits by the LCC and is not subject to the LCC's markup, special taxes, or State sales tax. The per-case offset may be increased by the State Administrative Board each January to reflect reasonable increases in the ADA's cost of warehousing and delivery. "Case" means a container holding twelve 750 ml bottles of spirits or other containers containing spirits that are standard to the industry.

Tavern and Class C Licenses

The bill specifies that in addition to any licenses for the sale of alcoholic liquor for consumption on the premises that may be available in the local governmental unit under the quota system specified in the Act, and the resort licenses authorized under quota system, the LCC may issue up to 50 tavern or class "C" licenses to persons who operate businesses that meet all of the following conditions:

- The business is a full service restaurant, is open to the public, and prepares food on the premises.
- The business is open for food service at least 10 hours per day, five days a week.
- At least 50% of the gross receipts of the business are derived from the sale of food for consumption on the premises. For purposes of this requirement, food does not include beer and wine.
- The business has dining facilities to seat at least 25 persons.
- The business is located in a development district with a population of not more than 50,000, in which the authority, after a public hearing, has found that the issuance of the

license would prevent further deterioration, and promote economic growth, within the development district. The LCC may not issue the license unless the local unit of government within which the authority is located, after holding a public hearing, passes a resolution concurring in the findings of the authority.

- The business demonstrates to the LCC that an escrowed license is not readily available in any local unit of government in which the development district is located.

(The Act defines "class C license" as any place licensed to sell at retail beer, wine, mixed spirit drink, and spirits for consumption on the premises. "Tavern" means any place licensed to sell at retail beer and wine for consumption on the premises only.)

The bill permits the LCC to issue the tavern and Class C licenses without regard to the order in which the applications for the licenses are received. Only one tavern or Class C license, however, may be issued under these conditions to any individual, partnership, limited partnership, limited liability company, corporation, or any combination of any of the above, including stockholders, general partners, and limited partners. Further, the LCC may not issue a specially designated merchant license, a specially designated distributor license, or any other license that allows the sale of alcoholic liquor for consumption off the premises in conjunction with a tavern or Class C license issued under these provisions, or at the premises for which a tavern or Class C license has been issued.

If, in any licensing year, the sale of food for consumption on the premises of the business represents less than 50% of the gross receipts for the business, the LCC, after due notice and proper hearing, must revoke the license.

The bill defines "development district" as any of the following:

- An authority district established under the Tax Increment Finance Authority Act.
- An authority district established under the Local Development Financing Act.
- A downtown district established under the downtown development authority Act.
- A principal shopping district established under the shopping areas redevelopment Act, before January 1, 1996.

"Escrowed license" means a license in which the rights of the licensee in the license or to the

renewal of the license are still in existence and are subject to renewal and activation as provided in administrative rules. "Readily available" means available under a standard of economic feasibility, as applied to the specific circumstances of the applicant, that includes, but is not limited to, the fair market value of the license, if determinable; the size and scope of the proposed operation; and the existence of mandatory contractual restrictions or inclusions attached to the sale of the license.

License Quotas

The Act restricts the number of public licenses that may be granted for the sale of alcoholic liquor for consumption on the premises to one license for each 1,500 of population or major fraction of population. The bill adds that on-premises escrowed licenses issued under this quota provision are available to an applicant whose proposed operation is located within any local governmental unit in a county with a population of under 500,000 in which the escrowed license was located. If the local governmental unit within which the former licensee's premises were located spans more than one county, an escrowed license is available to an applicant whose proposed operation is located within any local governmental unit in either county. If an escrowed license is activated within a local governmental unit other than that local governmental unit within which the escrowed license was originally issued, the LCC must count that activated license against the local governmental unit originally issuing the license. The escrowed licenses are available subject to the Act's provisions concerning the issuance of full- and part-year licenses, license transfers, and approval of the licenses by local governmental units.

Acquisition of Property

The Act allows a brewer, or its parent company, subsidiary, or affiliate if it is located in Michigan, to acquire, develop, sell, lease, finance, maintain, operate, or promote real property occupied or to be occupied by another vendor, except a wholesaler if certain conditions are met. A wholesaler is specifically prohibited from being a party to, directly or indirectly, an arrangement or contract under these provisions. The bill made an exception to this prohibition. Under the bill, a manufacturer, mixed spirit drink manufacturer, warehouseman, wholesaler, ADA, outstate seller of beer, outstate seller of wine, outstate seller of mixed spirit drink, or vendor of spirits may acquire, develop, sell, lease, finance, maintain, operate, or

promote a condominium project or own a condominium unit as its sole property, if that unit is not the licensed premises owned separately by a retailer and if all of the following apply:

- Condominium assessments in the condominium project are based on the proportional area each condominium unit has to the total area.
- A condominium unit operating as a licensed premises operates under a separate name from the condominium project except that cooperative advertising must be permitted among owners of condominium units for the purpose of promoting the condominium project if the name of a brand or brands of an alcoholic liquor is not mentioned in the advertising.
- Ownership of a condominium unit and participation in a condominium association are not considered a financial interest, interest by ownership, or interest by interlocking directors on stock ownership prohibited under the Act.
- A retailer separately owning a separate condominium unit as sole property does not directly purchase alcoholic liquor from the manufacturer, warehouseman, wholesaler, outstate seller of mixed spirit drink, or vendor of spirits who owns, leases, maintains, finances, or operates the condominium project.
- A wholesaler who has a direct or indirect interest in a condominium unit in which a retailer is located does not sell alcoholic liquor to any licensed retail business in which that retailer, or any person having an ownership interest in that retailer, has an ownership interest; and, a retail licensed business in which that retailer, or any person having an ownership interest in that retailer, has an ownership interest does not purchase alcoholic liquor from a wholesaler who has a direct or indirect interest in a condominium or condominium unit in which that retailer is located.
- A retailer acquiring a separate condominium unit as sole property pays the fair market value for the unit.

These provisions do not apply to a manufacturer, mixed spirit drink manufacturer, warehouseman, wholesaler, ADA, outstate seller of beer, outstate seller of wine, outstate seller of mixed spirit drink, or vendor of spirits with a direct or indirect interest in a license under the Michigan Gaming Control and Revenue Act. Further, these provisions do not

prohibit a direct physical connection between a condominium unit that is the licensed premises and a condominium unit that is not the licensed premises.

Brewpubs/Micro Brewers

The Act prohibits a manufacturer, mixed spirit drink manufacturer, warehouseman, wholesaler, outstate seller of beer, outstate seller of wine, outstate seller of mixed spirit drink, or vendor of spirits from having a financial interest, directly or indirectly, in the establishment, maintenance, operation, or promotion of the business of any other vendor. The bill made an exception to that prohibition, and deleted a prohibition against having an interest, directly or indirectly in more than one brewpub. The bill specifically allows a brewpub to have an interest in up to two other brewpubs so long as the combined production of all the locations in which the brewpub has an interest does not exceed 5,000 barrels of beer per calendar year.

The Act defined “brewpub” as a license issued in conjunction with a class C, tavern, class A hotel, or class B hotel license that authorized the person licensed with the class C, tavern, class A hotel, or class B hotel to manufacture and sell at that licensed premises not more than 2,000 barrels of beer per year for consumption on that premises only. The bill changed the definition to refer to a license issued in conjunction with a class C, tavern, class A hotel, or class B hotel license that authorizes the person licensed with the class C, tavern, class A hotel, or class B hotel to manufacture and brew not more than 5,000 barrels of beer per calendar year in Michigan and sell at that licensed brewery premises the beer produced for consumption on or off the licensed brewery premises in the manner provided for in the Act and the bill. (Previously, brewpubs could sell beer for on-premises consumption only.)

The bill requires each location of a brewpub to have a manufacturing operation on the licensed premises that complies with Federal malt beverage regulations. A brewpub must apply for and obtain a license for each location of that brewpub. In determining the 5,000-barrel threshold, all brands and labels of the brewpub produced in this State must be combined.

The Act defined “micro brewer” as a brewer that produced in total less than 20,000 barrels of beer per year and who could sell at the licensed brewery premises the beer produced to

consumers for consumption on or off the licensed brewery premises. The bill amended the definition to increase from less than 20,000 barrels to less than 30,000 barrels the number of barrels of beer that a micro brewer may produce per year.

MCL 436.2aa et al.

Legislative Analyst: L. Burghardt

FISCAL IMPACT

Privatization

This bill allows the Michigan Liquor Control Commission to privatize its Merchandising and Warehousing divisions. The bill authorizes 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 chooses to privatize these functions, it will 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 will 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 must be approved by the Commission. The Commission will no longer assess the 83-cent bailment fee or the 25-cent distribution fee, as it will no longer be performing these functions. The Commission still will order and purchase the liquor from the distiller or manufacturer directly and will 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 will 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

The bill permits the Commission to pay a per-case fee to the distillers to offset the cost of warehousing and distribution. The fee will range from \$4.50 to \$7.50 per case, and it is assumed that a set fee will be established for all distillers, which may be adjusted by the State Administrative Board each January as distribution costs change over time. An estimate as to what the cost of this per-case fee will be can be made by comparing the current cost of distribution to the State and that provided for 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. This results in a net cost to the State of approximately \$22.7 million.

<u>TYPE OF COST</u>	<u>AVERAGE ANNUAL AMOUNT</u>
Administrative Cost to State	\$22,188,750
Warehousing Cost	4,855,576
Distribution Cost	<u>1,644,827</u>
Total Distribution Costs	\$28,689,153
Warehousing Fee Revenue	(4,043,126)
Distribution Fee Revenue	<u>(1,954,990)</u>
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 provided for in Senate Bill 1171, 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 new plan, the minimum per-case fee will be \$4.50, which is \$.04 per case lower than what it currently costs the State to distribute liquor. If the fee is set at a higher rate within the range, then the State reimbursement to the private sector for the distribution of liquor will exceed the current amount the State is paying for distribution. This cost may range from \$2,308,963 annually, if the fee is 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

In addition to the costs outlined above, there also will 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 will incur as a result of these layoffs as there is no way to predict how many of these employees will 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 occur. The Commission estimates that its maximum liability for unemployment, severance, and supplemental insurance for all 400 employees may be as high as \$11,319,119 if none of these employees are retained, are hired elsewhere, or retire. The estimated maximum liability for payoffs of annual and sick leave balances may be as high as \$3 million as some of these employees will be eligible to have their balances paid off if they are not retained as State employees. It is also important to note that these costs will be incurred only in the first year the privatization takes place as most personnel issues should be concluded within the first 12 months of the privatization.

These one-time costs may 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 may 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 may be used to offset a portion of the one-time costs associated with the privatization of the liquor distribution system.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.