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LIQUOR DISTRIBUTION: ONLINE ORDERING

Senate Bill 527 with House committee amendment
First Analysis (12-12-01)

Sponsor: Sen. Shirley Johnson
House Committee: Regulatory Reform
Senate Committee: Economic Development, International Trade and Regulatory Affairs

THE APPARENT PROBLEM:

Currently, spirits are distributed to liquor licensees by Authorized Distribution Agents (ADAs) who are appointed and licensed by the Liquor Control Commission to be the distributors of spirits in the state. The ADAs in turn contract with spirit distillers to distribute that distiller's products in approved geographic regions. Some ADAs have statewide rights to distribute a particular brand, where other brands may be delivered to different regions by several ADAs. The result is that package stores and bars and restaurants may have to order needed spirits from several different ADAs, necessitating several phone calls to place regular orders. Some feel that developing an online ordering system could streamline the spirit-ordering process.

In a separate matter, when the distribution of spirits was privatized in early 1997, a concern was raised about protecting the distribution of wine brands by beer and wine wholesalers. Under the three-tiered system regulating the delivery of beer and wine to retailers and bars and restaurants, beer and wine wholesalers are restricted to delivering a particular product within an assigned territory. The concern was that since some wine brands are owned or distributed by distillers, that an ADA would automatically acquire the rights to distribute wine brands owned or distributed by the distiller that it contracted with, leading to an encroachment on territory assigned to established beer and wine wholesalers. To protect the beer and wine wholesalers, language was placed in the Liquor Control Code that after September 24, 1996, an ADA who became a licensed wine wholesaler could not sell or distribute a brand of wine in an area being served by another wholesaler. A wholesaler who became an ADA could not sell or distribute a wine brand in an area that another wholesaler was assigned to, if the wholesaler who had become an ADA had not been selling or distributing that brand prior to September 24, 1996.

This language has subsequently been the source of several disagreements between ADAs and wholesalers and has resulted in at least one commission declaratory ruling and a pending lawsuit. Some believe that this provision in the code should be rewritten to better reflect the intent at the time that the privatization was implemented

THE CONTENT OF THE BILL:

The bill would amend the Michigan Liquor Control Code to require the Liquor Control Commission (LCC) to provide for an integrated online ordering system by which retail licensees could place orders for spirits from authorized distribution agents (ADAs). The system would have to be operational no later than January 1, 2003. The system would have to allow retailers to order all brands and types of spirits from the commission and provide the order to the appropriate ADA.

The commission could enter into agreements with or contract with private or other public entities as provided for or allowed by law to establish the online ordering system. Neither a liquor licensee nor an ADA could have a direct or indirect interest in the person with whom the commission contracted to establish the integrated online ordering system. The commission would retain ownership of the online ordering system. In addition, the bill would permit the commission to allow, through issuance of an order, banner advertising in conjunction with the online ordering system as a way to defray the operating or maintenance costs, or both.

Currently, an ADA is required to deliver to each retailer located in its assigned distribution area on at least a weekly basis if the retailer's order meets the minimum requirements. The bill would allow the commission – in weeks that accompany a state holiday – to order a modified delivery schedule provided that a retailer would not wait longer than nine days between deliveries due to the modified delivery schedule.

Under the code, ADAs have to provide retailers with access to a computer application that includes the capability to determine whether certain spirits are currently available for delivery. The bill would require ADAs to continue to provide this computer application until the online ordering system was activated. In addition, the commission would have to require that any ordering system for spirits in existence on the bill's effective date be continued even after the online ordering system was established.

Additionally, the bill would rewrite a provision pertaining to ADAs who become licensed wholesalers and wholesalers who become ADAs to specify that, after September 24, 1996, an ADA or an applicant to become an ADA who directly or indirectly became licensed subsequently as a wholesaler could not be appointed to sell a brand of wine in a county or part of a county for which a wholesaler had been appointed to sell that brand under an agreement required by the code. Further, a wholesaler who directly or indirectly became an ADA could not sell or be appointed to sell a brand of wine to a retailer in a county or part of a county for which another wholesaler had been appointed to sell that brand under an agreement required by the code, unless that wholesaler had been appointed to sell and was actively selling that brand to retailers in that county or part of that county prior to September 24 1996, or unless the date and appointment was the result of an acquisition, purchase, or merger with the existing wholesaler who had been selling that brand to a retailer in that county or part of that county prior to September 24, 1996.

HOUSE COMMITTEE ACTION:

The committee adopted an amendment to allow the commission to allow, through issuance of an order, banner advertising in conjunction with the online ordering system as a way to defray the operating or maintenance costs, or both.

FISCAL IMPLICATIONS:

According to the House Fiscal Agency, the bill would increase state costs by an indeterminate amount. The costs that the new system would impose are unclear, but could be significant. The amount of costs would depend upon how the LCC implements the system, the amount of costs borne by ADAs, retailers, or other entities as opposed to the state, and the extent to which the system could be maintained by existing state employees versus contractors.

Further, the potential revenue impact of banner advertising is indeterminate at this time. Any costs borne by the state and not met using banner advertising revenue would likely be paid from the Liquor Purchase Revolving Fund, which is made up of revenue generated from liquor sales and is used to finance a large portion of the LCC's budget. Since additional revolving fund revenue above and beyond what is needed to finance the administration of the LCC is deposited into the general fund, any new state costs related to the system would take away from state general fund revenue.

There are other potential revenue sources available to the LCC that could be used on a one-time basis to meet some of these costs and minimize the general fund impact. These include:

1) Roughly $2.7 million in retained earnings in the Liquor Purchase Revolving Fund.

2) $2.5 million in carry-forward licensing fee revenue.

The Liquor Control Code provides that these revenues be used for "licensing and enforcement" purposes. It is likely that the code would need to be amended if the ordering system is not deemed to be a "licensing" or "enforcement" activity. A third option would be for the LCC to reduce the per-case payment made to vendors of spirits to help offset the costs of contracting with ADAs. (12-12-01)

ARGUMENTS:

For:

Before the privatization of the spirit distribution system, liquor licensees needed to place only one call to the Liquor Control Commission to order their spirits. Now, each brand of liquor must be ordered from the ADA authorized to deliver that product. This means a licensee has to call several ADAs in order to restock his or her establishment. Some feel that the ordering process could be more efficient if the commission developed an online system that could interface with the ADAs in such a way that when an order was placed by a licensee, the software application could separate the request for various brands and forward the orders to the appropriate ADA. What is now a cumbersome ordering process for licensees could be greatly simplified by such an online system.

Against:

An online ordering system could be quite expensive to develop, implement, and maintain, and the bill is silent on who would fund the project. Since many liquor licensees are small "mom and pop" establishments, it is unlikely that many of them would have the equipment or know-how to use an online system. Though the bill would require the current phone-in system to be continued, it is conceivable that down the road, should this provision be eliminated, licensees could be pressured or required to buy computers and pay monthly Internet access fees just to place their liquor orders. This could prove a hardship for small operations. Technology should be an option, not a mandate. And, it could also be an expensive proposition for small establishments if, on top of buying computers, the licensees had to pay either a start-up fee or regular monthly fees to access the online ordering system.

Response:

The bill would allow the commission to permit banner advertisements on the online ordering system. Revenue from the fees could be used to offset costs related to the operation and maintenance of the ordering system.

For:

The bill would clarify a confusing provision pertaining to rights to distribute wine brands. Under the wholesale delivery system, a wholesaler gets the rights to distribute a beer brand or a wine brand only within an assigned territory. However, ADAs are also authorized to be licensed as wine wholesalers, and vice versa. This has resulted in a situation where a wholesaler may have the rights to a wine brand for a particular territory, and an ADA may also have the rights to a wine brand because the spirit distiller that the ADA contracts with may be the distributor to that same brand and the territory is within the ADA's assigned distribution area. The liquor industry refers to this situation as "wine duals", meaning in some geographic areas, under the provision in the code, an ADA and a wholesaler may own the rights to distribute the same wine brand in the same territory. However, since privatization was implemented, disputes as to the meaning of this provision have arisen, especially with regard to who has the rights to deliver a wine brand when an ADA or wholesaler acquires or merges with another wholesaler. At the urging of some members of the liquor industry, this provision has been rewritten. Under the new language, after September 24, 1996, an ADA who became a licensed wholesaler could not sell a brand of wine in an area where another wholesaler has the right to that brand. However, a wholesaler who becomes an ADA could sell a brand of wine in an area that another wholesaler has the right to sell <u>if</u> the wholesaler who became the ADA had been actively selling that wine brand to retailers in the particular region prior to September 24, 1996. Also, a wholesaler who became an ADA could sell a wine brand in a territory in which another wholesaler sells the same brand if the wholesaler/ADA acquired, bought, or merged with the existing wholesaler who had been selling the wine brand to retailers in that territory prior to September 24, 1996.

Though still a bit confusing, the new language would in effect restrict the number of "wine duals" that could arise when existing ADAs become licensed as wholesalers or wholesalers become ADAs. In a nutshell, an ADA basically would be prohibited from picking up a wine brand already assigned to a wholesaler; therefore, only a new wine brand would be available for the ADA to acquire the rights to sell. A wholesaler who became an ADA, however, could sell a wine brand in an area where another wholesaler was also selling the wine brand <u>if</u> the wholesaler/ADA had the rights to the wine brand and was actively selling the wine brand in that area prior to the Sept. 1996 date. Therefore, a wholesaler who becomes an ADA could not be part of a "wine dual" even if that wholesaler/ADA had the rights to sell the wine brand in a particular area prior to the Sept. 1996 date, but did not exercise that right by actively selling it at that time.

POSITIONS:

The Michigan Licensed Beverage Association supports the concept of the bill. (12-11-01)

General Wine and Liquor supports the concept of the bill. (12-11-01)

The Michigan Liquor Control Commission is in support of developing an online ordering system, but has no position on the new language regarding ADAs and wholesalers. (12-11-01)

A representative of the Michigan Restaurant Association indicated support for the bill. (12-11-01)

A representative of NWS/Michigan indicated support for the bill. (12-11-01)

A representative of the Michigan Grocers Association indicated support for the bill. (12-11-01)

A representative of the Michigan Beer and Wine Wholesalers Association indicated support for the bill. (12-11-01)

Analyst: S. Stutzky

■This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.