Workgroup on Montgomery County Department of Liquor Control
Minutes
Wednesday, August 10, 2016
10:00 am – 12:00 pm
Executive Office Building (EOB), 9th Floor Conference Room, 101 Monroe Street, Rockville, MD 20850

Participants:

Workgroup Members Present:

Pinky Rodgers, Owner, Pinky & Pepe's Grape Escape
Nick Manis, Director, National Beer Wholesalers Association (via teleconference)
Gino Renne, President, Municipal and County Government Employees Organization
Hans Riemer, Montgomery County Councilmember
Jennifer Hughes, Director, Montgomery County Office of Management and Budget
Fariba Kassiri, Interim Director, Montgomery County Department of Liquor Control
Kevin Atticks, Founder, Grow & Fortify; Executive Director, Maryland Wineries Association/Brewers Association of Maryland/Maryland Distillers Guild
Delegate Ben Kramer, District 19: Montgomery County Representative, House of Representatives
for Delegate Charles Barkley, Representative, Montgomery County Delegation
Karen Hawkins, Chief Operating Officer for the Montgomery County Department of Finance**, for Alexandre A. Espinosa**, Director, Montgomery County Department of Finance
Brian Vasile, Managing Partner, Brickside Food and Drink (via teleconference)
Robert (Bob) Mutchler, Sales Manager, Republic National Distributing Company

Workgroup Members Absent:

Joseph A. Giardina, Division Manager, Breakthru Beverage

Guest Presenters:

Monir Aridi, Owner, Seneca Meadows Beer and Wine
Delegate Ben Kramer, District 19: Montgomery County Representative, House of Representatives
Jason Underwood, Government Relations Representative, Sazerac
Jennifer Nordin, Management and Budget Specialist, Montgomery County Office of Management and Budget
Karen Hawkins, Chief Operating Officer for the Montgomery County Department of Finance

Minutes

The meeting was chaired by Bonnie Kirkland, Assistant Chief Administrative Officer for the Montgomery County Executive's Office, and began at 10:02 am. After introductions, Ms. Kirkland reviewed the meeting agenda.

Ms. Kirkland made reference to Delegate Barkley's suggestion at the last meeting that the workgroup hear from other licensees, in addition to the two Workgroup member licensees. Two licensees were introduced, Mr. Monir Aridi of Seneca Meadows Beer and Wine, who was present, and Mark Bucher of Medium Rare, who would connect via teleconference. However, Mr. Butcher was unable to connect. Additionally, a proposal from Arash Tafakor, owner of Downtown Crown Beer and Wine, was submitted by letter and copies were distributed.

Discussion of Organizational Models with Licensees

Monir Aridi, owner of Seneca Meadows Beer and Wine, thanked Mr. Leggett for pulling the workgroup together to review the DLC. He voiced his support for obtaining feedback from the business community and making changes in a thoughtful way. Mr. Aridi stated that the "old DLC" was the problem that has brought us here today. Recklessness, treating licensees like students instead of partners, lack of service, lack of knowledge and responsiveness were listed issues. He explained that there are so many products, and there is a great need for the DLC to run like a business and not a government agency.

Mr. Aridi explained that new staff, including Mr. John Zeltner (Warehouse Operations Manager), are very professional, understand licensee needs and are implementing changes. Because of these changes, including price changes and services, service has vastly improved. He added that the new Communication Center is a great way to get problems solved, citing how it used to be that licensees would have to reach out to elected officials instead of to the DLC.

Mr. Aridi stated that what we have today is a DLC that is on the right track and is standing on a solid foundation. He further stated that the DLC is fulfilling his needs today. While there is still room for progress, improvements have been implemented. As an example Mr. Aridi described that the ordering process with regard to special orders has changed. There is now communication between licensees and DLC on order status. DLC is now communicating problems and tracking products. In the past, he would not know where his product was and there were no answers.

Mr. Aridi suggested that licensees not turn to elected officials, but instead call into the DLC Communication Center. Concerns are dealt with in a timely manner. He recommended that the DLC be given time to fix issues, stating that he is very happy today, and is not for privatization. Mr. Aridi noted that a benefit of the DLC is that businesses need only work with one distributor. Small businesses may struggle if they must work with multiple distributors.

Mr. Aridi detailed how the special order processes have been changed for the better. He noted that it is hard to rebuild something that's broken. After only a few months, it is apparent that the DLC staff are competent, capable, business oriented listeners.

General Discussion

In response to a question from Mr. Renne, Mr. Aridi stated that he has not had issues with DLC workers lately. Mr. Aridi further stated that he separates the DLC of today from the DLC of the past.

Mr. Aridi described how, in a private market, large businesses that can afford to buy and store many cases at once receive discounts and are able to sell product cheaper. This disadvantages small businesses. Mr. Aridi continued on to say that he likes that the agency's attitude toward customers has changed. Today there is more compassion, and DLC is thinking of licensees as partners. Change has been apparent and the DLC has been very responsive.

Councilmember Riemer stated that during the ad-hoc committee meetings last year there was an Office of Legislative Oversight (OLO) survey done. He would like to see that survey done again, to see how many licensees share Mr. Aridi's sentiment.

Mark Bucher (via teleconference), owner of Medium Rare (Bethesda) and previous owner of Burger Joint (Bethesda), was not able to connect to the phone system. Ms. Kirkland indicated that Mr. Bucher will be invited back to speak at the next meeting in September.

Ms. Kirkland then summarized the written proposal from Mr. Arash Tafakor, owner of Downtown Crown Beer and Wine, which suggested privatizing beer and wine sold to on and off premise stores, adding fees to help make up the funds that would be lost, and to have DLC remain in control of the wholesale and retail sale of spirits. His proposal also included a prohibition on licensing premises over 5,000 square feet.

Ms. Kirkland stated that she had a conversation with Jeff Bobrow, owner of Elby's Beer and Wine, whose brother operates a store in DC. Mr. Bobrow expressed concern that the private wholesale companies' drivers in DC have a very high turnover rate and with multiple distributors there would be an unmanageable number of deliveries scheduled. Ms. Kirkland explained that this licensee had been in favor of privatization in the past but had expressed to her that he has seen a lot of improvement in the DLC in the last six months.

Mr. Bob Mutschler, Sales Manager for Republic National Distributing Company, stated that handling special orders is different than handling stock items.

Ms. Kirkland stated that one of the main areas on the DLC Improvement Action Plan addresses special orders specifically and there has been an experienced manager hired to manage special orders. Ms. Kassiri confirmed this.

Justin McInerny, member of the audience and employee of Capitol Beer and Wine, stated that he believes alcohol markups should be on a sliding scale. Mr. McInerny further stated that he would like to be able to purchase a few bottles of wine from a high end case and not have to invest in the whole case. He detailed how when he gets calls for a few bottles of an especially high end wine he will refer them to Paul's in DC.

Ms. Kirkland replied that pricing is an operational issue, separate from what we are discussing today, and that if there is time after the meeting the group can come back to that. The workgroup was asked if there were any additional questions on Mr. Tafakor's proposal.

Councilmember Riemer, noted that the previous Office of Legislative Oversight (OLO) report had analyzed the outcome of privatizing beer and wine.

In response to Councilmember Riemer, Ms. Kirkland explained that there is a contractor, Public Financial Management (PFM), that will be analyzing the options put forward. PFM has worked in several states conducting control assessments of privatization alternatives.

Presenter, Delegate Ben Kramer: Private Management Contractor Model

Delegate Kramer commended the DLC for making many changes and working very hard to make improvements. He noted that change is a process and that concrete steps have been taken. The delegate suggested that, if it is the will of the County to make changes, there is an option of a public-private partnership. He stated that the concerns he has heard have always been centered around a government entity running wholesale operations.

He questioned why the County shouldn't seek out best practices from the private sector and partner with them. If the private sector is willing to help the department, he asked, why not have that conversation.

He stated that he is not for total privatization and detailed how the public health and welfare is an exceedingly important issue. A year does not go by where dozens and dozens of bills are not introduced annually to extend alcohol hours and alcohol accessibility. He emphasized that public welfare needs to be considered. Privatization reports show a dramatic increase in consumption, outlets and related social problems including domestic violence, child abuse and drunk driving and this needs to be kept in the forefront.

Delegate Kramer further emphasized the importance of keeping the current protection for citizens and described how a monopoly of large stores such as Costco, if allowed to sell alcohol, would harm small businesses.

Delegate Kramer explained that the County can bring in private partners and still protect its revenue. He further explained that the generation of any new tax revenue from the sale of alcohol will benefit the State, not Montgomery County. He described how, if an additional tax is assessed, border state sales will go up dramatically. He specified how Washington state went from 300 to over 1,500 stores, and added a tax (additional 17%), to replace lost revenue from privatization, that drove up prices and border state sales went up dramatically. Under his proposal, the County can retain the relationship with public employees. While management improvements are evident, there is an opportunity to introduce private sector expertise to the DLC.

General Discussion

In response to questions from Councilmember Riemer on incentives, Delegate Kramer stated that a for profit distributor may contract or partner with the DLC for a percentage of sales or a set dollar amount. Councilmember Riemer noted that private distributers may be able to distribute special orders.

Delegate Kramer clarified that his plan would have the private sector being responsible for day-to-day operations since they would have the expertise to run the DLC. One or multiple partners could be used. David Torne, for instance, may be interested.

Councilmember Riemer expressed concern that there would have to be a strong profit incentive to draw in a large distributor and asked if the DLC would be run as an authority. Delegate Kramer responded that the DLC would not run as an authority; the County would still be in control but that the warehouse would be run by the private partner.

Mr. Renne explained that he and Delegate Kramer have been struggling with DLC issues since the last set of meetings to privatize under former Montgomery County Executive Douglas Duncan. The DLC is a lucrative asset owned by the taxpayers. It was decided overwhelmingly then that a privatization model would not be beneficial to tax payers. As a government agency, there is a fundamental charge to protect the community. When we consider changing operations we are looking at changing the community.

Mr. Renne described his trip to Washington State after it had privatized its operations. Costco was behind the initiative and that company was not interested in the public safety and benefit of the community. Mr. Renne recommended that the County should be listening to front line workers and licensees who have been complimentary of changes that have been made at the DLC. The County sees Liquor Control as a profit center. Private industry may be able to run it better.

Ms. Hawkins stated that the County would need to ensure that any management contract was reviewed for compliance with IRS rules, since the warehouse that would be used and overseen by a management company was built with tax exempt bonds.

Mr. Mutschler stated that a business is a sales driven company that will grow business and make people happy by growing sales and growing distribution.

Ms. Rodgers raised concern over the fact that a good percentage of revenue would be given to this private company, and asked where this money would be coming from. She asked if it would be new revenue or if fees would have to be assessed. Delegate Kramer indicated that initially, funding would have to be made available. Would this funding be pulled from current revenue? Would there be a cost increase on products?

Ms. Kirkland stated that Delegate Kramer's proposal does not spell that out.

Presenter, Jason Underwood, Sazerac: Various Models in Other States

Mr. Underwood introduced himself as the Government Relations representative for Sazerac, the largest global manufacturer of distilled spirits. Sazerac, a privately held company based in New Orleans, works in all 50 states and is, by volume, the largest maker of distilled spirits, with more than 350 brands including Pappy Van Winkle, Buffalo Trace and Blanton's. Mr. Underwood explained that his company likes working with control states. It is not the company's intention to sell alcohol everywhere they can, nor is it appropriate to sell everywhere. Sazerac is in favor of the national three tier system and was against the privatization that took place in Washington state, despite the fact that their business increased by 33% in Washington state after privatization. Still, privatization in Washington state was a mistake. Sazerac believes that alcohol has to be highly regulated given its potential harmful health impacts. The three tier system provides an impediment to aggressive sales tactics.

Mr. Underwood described the Great Britain experiment. He detailed how there is an epidemic of alcohol abuse in Great Britain due to alcohol deregulation that started in the mid-nineties. It included legislation for 24-hour alcohol service and large grocery stores selling alcohol. There was a grocer, Tesco, who in 2002/3 sold alcohol at a loss to boost sales of grocery items. There was a monopolization by these large retailers. Currently, they still have a virtual monopoly as grocery stores control 75% of the market and allow for cheaper alcohol to be sold widespread. The more alcohol outlets, the more alcohol that is sold cheap, and the more negative the public health effects.

Mr. Underwood compared Great Britain to the US, where one third of the country does not drink and teen drinking is at a historic low. Still, in the US, 80,000 people are dying every year due to excessive alcohol use. Additionally, the US loses 5,000 persons under the age of twenty-one due to alcohol misuse.

Mr. Underwood explained that the US prevents monopolies with the three tier system. The 21st amendment grants states and local governments the power to regulate alcohol. The US wants and rightfully needs to control alcohol access and the monopolies that are now wreaking havoc in Britain.

He went on to summarize the work of an economist from the University of Michigan, Professor Ronald Zullo, who studied control states versus open with regard to four topics:

1. Alcohol Consumption
2. State Finances
3. Alcohol Related Auto Fatalities
4. Crime

Zullo's Study findings include:

- State monopolies potentially generate 2-3 times the alcohol related income than private license systems.
- Alcohol monopolies generate more alcohol related revenues from taxes, liquor licenses and sale of products. License states get revenue only from licenses and taxes.
- The gain can be 82.4% gain if you own wholesale, 90% if it also owns the retail system.
- States that control the point of sale have lower rates of crime and lower consumption rates.
- Days and hours of sale do not have a huge effect on consumption. The stronger the monopoly, the more revenue and fewer health issues seen.

Mr. Underwood advised Montgomery County to improve the current system but not to dismantle it.

The study showed that the best financial scenario was found in states that ran the wholesale operations and owned the outlets in highly populated areas and had agency stores in less populated areas.

Additionally, states with dram shop laws were associated with decline (5.1-7.9%) in driving fatalities.

Mr. Underwood stated that if you think government should not be in the business - he agrees - but if you're looking to privatize and not apply large fees or not lose revenue you're looking at an impossibility. He added that it is custom in the (alcohol) market to have markups; private wholesalers have a markup of 20-25% and retailers have a 25% markup of the wholesale price. No one has been able to keep alcohol competitively priced while dismantling a control system. In fact, the last three states that implemented privatization, Washington, Iowa and West Virginia, have all resulted in higher consumer prices, less choice and less revenue.

Mr. Underwood introduced the research behind what occurred in Washington state, which privatized in 2012, as a result of a referendum of which 99.5% of funding came from Costco ($25 million). The enacted legislation favored volume sellers, and small retailers were driven out of business.

Additionally, after privatizing Washington state had the highest prices in the country. Border sales went up and alcohol outlets (off-premise) went from 329 outlets to 1,680. He stated that now, 60% of the off premise businesses are out of business. Alcohol license fees went up. Small "mom and pop" operations can only carry so many products. Costco has a lot of product, and qualifies for discounted prices, but not much choice. He explained that Costco carries about 5 brands of bourbon, including their own label which is deeply discounted. Washington state now has a duopoly, where 93% of the market is controlled by two national companies.

Of the 20 top selling stores, 16 are big box chains and others are large retailers.

Mr. Underwood described how when prices go up, premium brand sales go down and cheaper brand sales go up, health problems go up and revenue collected from purchases goes way down.

He described how, ideally, you want consumers to be spending more money on higher end products, not on volume.

Furthermore, in Washington state, teen drinking and shoplifting became a major problem. High school students interviewed (for The Olympian, an investigative newspaper) said it's easy to steal bottles of liquor from grocery stores, because "you're not an automatic suspect when you walk in a grocery store." Individual stores reported losing as much as $30,000 to $50,000 in the first three months of privatization.

Mr. Underwood stated that he hears the argument that if alcohol is made more convenient to purchase, sales would rise. Washington increased retail stores fivefold but two years after privatization their revenues are down.

He argued that convenience is not the main factor (in sales); price is the determining factor. Mr. Underwood stated that adding outlets does not create new customers. By way of example, a 35-year-old who does not drink will not begin to drink if a store is added down the street. Mr. Underwood expressed his belief that additional outlets are needed in Montgomery County and can be added without disrupting the balance of responsible selling.

Iowa

Mr. Underwood stated that in Iowa, profits were lost. In the last year before privatization in 1986, $71.6 million was generated after expenses. In the first full year after privatization the state earned $46.3 million. It took Iowa until 2004 to make up the lost profits and reach pre-privatization levels.

West Virginia

Mr. Underwood mentioned that in West Virginia the last year before privatization, 1990, $9.7 million was sent to the state after expenses. In the first full year after privatization the state earned $6.6 million. It took twenty years to make the same profit.

Mr. Underwood suggested to never privatize the wholesale operation – but the County could consider leasing it.

Maine Model

Next Mr. Underwood introduced the Maine Model. He detailed how Maine had a significant healthcare budget shortfall and in response, they released a request for a proposal (RFP) to outsource its wholesale operation as collateral for a $220 million revenue bond. He noted that the state expected to receive $450 million over ten years from the winning bidder. They received $46 million the first year.

Mr. Underwood cautioned that the first contract they entered into, which they terminated, would produce only about $190 million over 10 years.

He explained that the subsequent winning bidder owns and manages the warehouse, and manages the employees and trucking and back office operations. The wholesaler gets 4.7% profit and the wholesaler covers operating costs but not carrying cost. The State owns the product; the wholesaler does not pay for inventory.

Mr. Underwood made mention that Ohio operates under a variation of this model and makes 6% while the contactor makes 4%.

Mr. Underwood stated that Virginia has adopted an authority model.

Mr. Underwood further stated that in Montgomery County twelve new outlets could be supported. He suggested limiting private superstores, because they limit choice. He added that the Montgomery County DLC should look into opening its own superstore.

He warned that increasing prices just pushes sales to border states. That convenience comes at a cost; private stores are only going to order a case for a customer.

In summary, Mr. Underwood highlighted that privatization will have a negative impact on the County's finances. There is less tax revenue and more problems associated with increased drinking. Increased prices mean you will lose sales to border states but the problems associated with alcohol will be the County's. Customers will be charged higher prices for fewer choices. The government monopoly is traded for a private one where the government and its citizens have less influence when problems arise - and they will.

Mr. Underwood pointed out that lessons learned include being careful of regulatory changes. Once deregulation sets in it is impossible to reverse the changes. A balanced market is good for public safety and allows for small, local, large and international markets to all be reasonably successful.

General Discussion

Nick Manis, National Beer Wholesalers Association, noted that each of the three states mentioned did not wholesale beer. He further noted that it is important to recognize that these control states are controlled at a state level; this is not the case in Maryland where Montgomery County is a jurisdiction among other counties that are open. Kentucky is bordered by seven states; in Montgomery County, a microcosm, the competition is bordering counties.

Mr. Manis described how he has been in talks with Delegate Kramer, who reached out to him, and they have discussed private partnerships.

Mr. Underwood stated that we can learn from Maine. It made a $250-million-dollar mistake when it first contracted out wholesale operations. We should look at how Maine's current set up may work for Montgomery County.

Mr. Renne, noted that incentives are often given to hire former employees but because so many stores went out of business (referring to privatization) that it didn't matter.

Mr. Atticks stated that there are 220 licensed distributors in neighboring counties.

Councilmember Riemer asked if Maine has a monopoly on beer, spirits and wine. Mr. Underwood stated that he believes they do.

Adam Pagnucco, an attendee of the meeting, noted that the National Alcohol Beverage Control Association (NABCA) paid for Dr. Zullo's research. Mr. Underwood said that fact does not mean that the report is biased since NABCA is not the alcohol industry and is not a lobbying group - research is part of what they do.

Ms. Kirkland thanked Mr. Underwood and turned to Jennifer Nordin to explain the matrix.

Presenter, Jennifer NOrdin, on Evaluation Matrix

Ms. Nordin described the organizational model matrix, stating that the workgroup now has multiple options for organizational models to be analyzed. They need to be evaluated on how well they meet objectives, including fiscal impact and legal implications.

Ms. Kirkland explained that the matrix is just a shell, and that we will have an expert do the analysis. The County is currently in discussion with PFM to do this. They have done this work in the past with DLC in the county and in other control states.

Presenter, Karen Hawkins, Chief Operating Officer for the Montgomery County Department of Finance

Ms. Hawkins reiterated that some complexity is involved because of the bonds issued on alcohol sales revenue and that this would have to be evaluated. Additionally, she stated that there were $250 million in bonds issued and this was an irrevocable revenue repayment, meaning that net revenue of alcohol sales must be used to pay the bonds. We meet the bond covenant, and any change to that pledge requires the majority of bond holders to sign off. Legal bond advice would need to be sought and that scenario is unlikely to happen. This would also raise risks to a market response because a secure revenue stream was taken and changed. Then you run the risk of potential bond ratings dropping. Additionally, there is the use of the warehouse - tax exemptions limit the use of it.

An independent authority could issue its own debt. There could be a combination of paying off debt and refinancing or there is an option of fully refinancing and replacing current revenue with basic revenue bonds. In that case taxpayers become responsible for paying it off and the County will see higher tax rates.

At this point Ms. Kirkland opened up the floor to questions from the audience.

Questions from the Audience

Jane Redicker, President of the Silver Spring Chamber of Commerce, asked that the impact of consumers, restaurants and hotels be added to the matrix. Mr. Renne, asked that the effect of employees be added to the Matrix as well.

Ms. Kirkland stated that the workgroup will be looking closely at the effects of privatization models and that if anyone has ideas on additional models the group will try to address them at the next meeting. She further stated that if there are operational concerns, they will likely be forwarded to Fariba Kassiri, Interim Director of DLC.

Mr. Renne recommended that the group consider the creation of subcommittees to compose the list of recommendations and have subcommittees look into vetting those recommendations. He added that only two more hours have been allocated to this and he believes more time will be needed.

Ms. Kirkland noted that a company, likely PFM, will aid in this as well and that his recommendation will be taken into consideration. Additionally, there are a few more options to be added to the current list. Ms. Kirkland thanked and commended Mr. Underwood for his presentation and mentioned that it crystalized a lot of issues.

In response to Councilmember Riemer, Ms. Kirkland stated that PFM will be given a list of options, including the Office of Legislative Oversight (OLO) report and all the recommendations from the workgroup. The County Executive will look at the analyzed options and determine which have the fewest negative outcomes.

Ms. Kirkland concluded the meeting at 12:12 pm.

Future Meetings
September 15, 2016, 1:00 pm - 4:00 pm, Executive Office Building (EOB), 101 Monroe Street, 9th Floor, Rockville, MD 20850

Call-in Number: 641-715-0700; Access Code: 206260