OFFICE OF THE COUNTY EXECUTIVE

Isiah Leggett
County Executive

Timothy L. Firestine
Chief Administrative Officer

MEMORANDUM

February 4, 2015

TO: Chris Cihlar, Director, Office of Legislative Oversight

FROM: Timothy L. Firestine, Chief Administrative Officer Timothy L. Firestine

SUBJECT: OLO Draft Report 2015-6: Review of Alcohol Control in Montgomery County

Thank you for providing a copy of the Office of Legislative Oversight's (OLO's) Draft Report 2015-6, Review of Alcohol Control in Montgomery County. The report recommends options to privatize the sale of alcohol in Montgomery County. However, in our opinion, local liquor control has served Montgomery County well. The Department of Liquor Control (DLC) contributes an average of $30 million in annual profit to the County – helping us to fund schools, transportation, help for the vulnerable in our midst, and more. It helps to keep taxes lower. We have lower alcohol consumption and higher revenue for public purposes than other jurisdictions. There are not liquor stores on every corner. Our system makes it harder for underage individuals to purchase alcohol and provides more education for the public and for servers as well. It protects the public health. DLC continues to work hard to improve its operations and to provide better service and better products. There are a number of other efficiencies that we will be capturing through the implementation of the ERP system that will improve service at both the retail and wholesale levels

We agree with the report's recommended Option #5, "Increase efficiency within current structure," which is consistent with the recommendations found in The PFM Group's Strategic Plan Report, the County "Nighttime Economy Task Force Report," and the County Council's own Organizational Reform Commission. Additionally, one option that is unstated in the OLO report – but worth exploring – is the possibility of leasing rather than buying DLC delivery trucks and, indeed, contracting out DLC's delivery operation to the private sector. However, we have concerns with some of the information and methodology in the draft report.

1. **The report does not acknowledge that the overwhelming body of evidence supports the positive public health and safety benefits of public control of alcohol.** The widely-accepted public health and safety advantages of local Liquor Control are supported by the extensive public health body of evidence consistently developed over a long period of time. This body of evidence is primarily scientifically-based, peer-reviewed, published studies

from a wide variety of sources, presented in respected journals and venues, which have become accepted and established sources of public policy information.

While the OLO does cite in Chapter 3 of the report (beginning on page 10) a few recognized reports and studies on the subject, it also cites studies commissioned by the Commonwealth Foundation of Pennsylvania disputing the overwhelming body of evidence. The Commonwealth Foundation is a conservative, free-market political advocacy group. It is not primarily an alcohol research group, and has generated no known studies of the subject on its own.

While the Commonwealth Foundation certainly represents one point of view on the deregulation debate, it hardly provides an equal counter weight to the established science. It seems that giving undue influence to the non-science based minority viewpoint also leads to the report's "Finding #3," found on page 73, which we believe to be misleading.

2. **The report contains inaccurate information on DLC pricing.** On page 20 of the report, a clarification regarding DLC pricing is needed. DLC pricing does not incorporate any sales tax in the price of products. Excise taxes are included in the wholesale price of products in Montgomery County, just as they are with every other wholesale distributor. Also, page 58 states "DLC does not offer volume discounts to licensees." In fact, DLC routinely does offer these discounts to all licensees.

3. **The survey results described in Chapter 6 of the report, beginning on page 42, are questionable.** The feedback for this report is based upon interviews and survey responses with a selected group of Montgomery County licensees. However, only 12 licensees were interviewed. Well less than half of the nearly 1,000 licensees were sent the survey, and only 96 out of the nearly 1,000 responded. Indeed, page 42 states that even "…OLO does not consider the response rate to be high enough to draw statistically valid conclusions." The information presented in this section is, therefore, strictly anecdotal. The identity and location of each Montgomery County licensee is known. More representative feedback from the business community could have been captured and presented for this report.

4. **The report does not include the discussion, debate, and recent decisions by our neighboring states of Pennsylvania and Virginia to reject privatization.**

5. **The pricing comparison section of the report, beginning on page 55, does not compare wholesale prices under the current system or potential future systems on an "apples to apples" basis, despite readily available access to such information.** The wholesale price of each product sold to licensees by DLC is documented and published. Each Montgomery County licensee pays the exact same price for each identical item sold at wholesale. Each of

those products is also currently represented and distributed by a licensed Maryland wholesaler. Those prices are also readily available from each wholesaler. Therefore, the comparison data that would be most useful for this report (and the anticipated discussion it will generate), would be a detailed side-by-side display of wholesale prices from DLC and the private Maryland wholesalers for the same items. Such a comparison would show where comparable prices are lower, higher, or about the same.

Instead, OLO researched the retail prices of similar products offered by licensed establishments in various jurisdictions. Listed menu or retail shelf prices for similar products introduces a wide array of potential additional variables that are not the subject of this report (rents, taxes, non-product overhead costs, market forces, business models, etc.). The retail prices charged to the consumer by licensees does not directly reflect the wholesale cost of products. Indeed, five Montgomery County businesses could very likely charge five different prices on the same day for the exact same item, yet we know each of those businesses paid the exact same price at wholesale for those identical items.

6. **The report contains invalid assumptions about County per capita alcohol consumption.** On page 61, the report cites higher per capita consumption in Howard, Frederick, and Prince George's counties as evidence that County businesses lose alcohol beverage sales to stores in neighboring jurisdictions. Yet there is no evidence presented by OLO to support this assumption. Possible demographic and venue location differences with these jurisdictions are not addressed. Fairfax County per capita consumption of distilled liquor is even lower than that of Montgomery County.

7. **To operate outside of the current DLC structure and authority could have the immediate as well as long-term effect of raising product cost.** The first four options that OLO advances to "make up" for the $30 million in revenue lost for the County, in part or whole, involve increasing fees and costs to County licensees and/or imposing (requiring State approval) a County liquor "piggyback" tax. Though all would raise product costs in the County, no mention is made that this might reduce the competitiveness of Montgomery County in comparison to other jurisdictions.

8. **The potential impact of each of the five options presented at the end of the report will have to be explored and developed in detail.** Legal, legislative, regulated trade practice provisions, operational, and logistical elements will all have to be researched in detail to provide a realistic forecast of any structural business changes. Of critical importance is ensuring that any analysis of Options 1 through 4, which involve privatization in whole or part, involves a thorough and complete analysis of the complex legal and tax considerations involving the outstanding revenue bonds, and the private use restriction on the warehouse built with the bonds. That analysis should integrally involve the County's bond counsel, to ensure the specific provisions of this revenue bond structure are considered. There is also

approximately $1.6 million of short-term debt outstanding that was used to pay for certain DLC equipment and systems. The legal and tax implications of that debt would need to be considered under Options 1 through 4 which involve the sale of all or part of the fleet.

Particularly in need of expert analysis are the "Estimated Fiscal Impact" sections associated with the various option scenarios. The potential financial benefit to be captured by the sale of the existing delivery fleet, for instance, appears to be questionable. The report cites the value of the fleet from the County's annual financial statements; however, those reported values are depreciated values required for financial reporting, and may bear no reasonable relationship to the estimated market value of the fleet that could be generated upon sale. As noted above, the report also does not reference the fact that equipment notes are outstanding, which may affect the fiscal impact cited. Also, under Option 1, all administrative costs are assumed to be eliminated; however the report does not address whether the administrative support functions currently provided to the Licensing, Regulation, and Enforcement Division would be absorbed at no cost by another County department, or if additional support costs could be required. We believe that input or analysis from private sector experts would be valuable to this discussion.

The Maryland wholesalers, who would automatically assume operational control of the Montgomery County market under several of the proposed options, are currently operating in other parts of the State under existing state law, and are regulated by the Office of the Comptroller of Maryland. Their wholesale prices are published, and their sales and delivery practices are well-known and experienced by Maryland licensees every day. Similarly, the role and business practices of product suppliers are well established in the Maryland marketplace. These private sector entities and other interested parties could have been included in the development of this OLO study, and should be invited to provide input to the County Council Ad Hoc Committee.

We stand ready to assist OLO and the Council's Ad Hoc Committee on Liquor and look forward to providing more detailed information and analysis as needed. Thank you for the opportunity to review the draft report and present our comments.

TLF:gg

cc: Joseph Beach, Director, Department of Finance
George Griffin, Director, Department of Liquor Control
Jennifer Hughes, Director, Office of Management and Budget
Fariba Kassiri, Assistant Chief Administrative Officer
Patrick Lacefield, Public Information Officer