LIQUOR CONTROL IN MONTGOMERY COUNTY

At its June 2015 Annual Meeting, the League of Women Voters of Montgomery County (LWVMC) adopted a study of liquor control in Montgomery County. The study committee began to meet in August, studied background materials and conducted interviews in order to gain information and perspective about the subject. Its focus was on the issues surrounding full control or privatization of the activities of the Department of Liquor Control. This Fact Sheet presents our findings to enable LWVMC members to discuss the issues and reach consensus on liquor control in Montgomery County.

BACKGROUND

After the repeal of Prohibition in 1933, under the 21st Amendment to the Constitution, states were given the responsibility for overseeing the sale and distribution of alcoholic beverages. In Maryland, all laws pertaining to liquor control are state laws so that any changes to the Montgomery County alcohol control system are subject to state law.

Maryland law specifies the following:

- There is a limit of one alcoholic license per person;
- Supermarkets and other large stores are prohibited from receiving licenses;
- Producers must sell products at the same price to all purchasers; and
- Only the State of Maryland can tax the sale of alcoholic beverages.

Montgomery County specific legislation allows the following:

- One individual may hold up to 10 licenses for restaurants;
- Prohibits sale of alcohol in gas stations;
- Requires all licensees to purchase alcohol only from the Department of Liquor Control; and
- Provides for limited wholesalers' licenses from the state to distribute products (mostly craft wine and beer) in Montgomery County.

In general, governance over alcohol is divided between "licensing" where licenses are issued to private sector entities both wholesale and retail, and "control" governance which performs all or part of the wholesaling and retailing activities. Montgomery County is a "control" governmental body in that virtually all wholesale and retail sales are made by the county. Montgomery County has discussed which it should it be several times over the years and has retained the current model since 1934.

The mission of the Department of Liquor Control (DLC) is to "provide licensing, wholesale and retail sales of alcoholic beverage products, enforcement and effective education and training programs, while promoting moderation and responsible behavior in all phases of distribution and consumption. The department diligently promotes, enforces and obeys all laws and regulations governing beverage alcohol while generating revenue for the benefit of Montgomery County's General Fund."

Montgomery County is one of the few counties in the United States that has retained full control over licensing and wholesale and retail sales. (Some states such as New Hampshire have a similar model). Montgomery County issues just over 1,000 licenses to sell alcohol primarily to restaurants but also to

300-400 independently owned retail stores that are permitted to sell wine and beer. The DLC is headquartered in a 210,000 square foot warehouse in Gaithersburg from which all sales, both wholesale and "special orders," are distributed. The DLC has approximately 400 employees half of whom work in 25 county operated retail stores, the rest work in delivery, warehouse and licensing operations. DLC employees are members of Municipal and County Government Employees Organization (MCGEO), which represents many Montgomery County employees.

As a wholesaler, DLC buys spirits, wine and beer in bulk and stores it in its warehouse. Customers order their requirements and they are delivered, generally on a weekly basis, by DLC. "Special orders" are alcoholic beverages that aren't usually carried in the warehouse. These orders are specifically ordered by DLC at the request of the customer and are delivered in the weekly delivery when they arrive – which can range from a few days to months.

No General Fund monies are used to fund DLC. It is entirely self-supporting and, in fact, has a profit of about $30 million per year of which approximately $25 million is transferred to the General Fund. Total revenues are about $270 million per year of which $131.5 million come from retail sales.

Research is mixed on the social impact of "control" jurisdictions which control through the sale of alcohol and "license" jurisdictions which issue licenses but are not involved in sales. Some studies show that lower consumption occurs in "control" jurisdictions while others do not. DLC primarily uses low key advertising and control over the products it has available. Per capita consumption of alcoholic beverages is lower in Montgomery County than in surrounding areas. However, it has been pointed out that the county doesn't have any major sports stadiums or a large university within its borders, both of which generate higher than average sales of alcoholic beverages.

PROBLEMS OF DLC

There has been increasing criticism of the performance of DLC. In its Review of Alcohol Control in Montgomery County in February, 2015, the county's Office of Legislative Oversight conducted interviews and surveys involving over 100 different DLC customers. Of those interviewed, 49% were dissatisfied with DLC's wholesale operations. They had complaints pertaining to information about changes to their system from DLC and the selection and availability of products (especially wine). A total of 38% thought that the regular ordering process did not work well for them. A larger number of customers, 61%, said that the special order process did not work well. Fewer than a third of respondents complained of mistakes in their orders, but about half complained about the mistake resolution process. With regard to wholesale prices, about half felt that prices were comparable to other wholesale prices from other wholesalers – but others felt that wholesale prices for wine were high. They were more satisfied with the prices of liquors.

In October, 2014, The PFM Group, a private consultant to governments, issued a Comprehensive Long Range Strategic Business Plan which had been commissioned by DLC. It contains many reasons for higher than expected costs and poor performance by DLC. Some include: too many outlets receive too frequent deliveries and the truck fleet is obsolete and overage. No new trucks have been purchased since 2008 leading to inefficiencies, higher costs, and the potential need for large capital infusions in the near future. There is no regular schedule for store refurbishment, refreshment or replacements and there is no standard methodology for locating new stores. Some stores have limited storage capacity. Special orders take up more time than their share of business profits and can sometimes hinder storage and inventory management. DLC has fewer off premises liquor retail stores per capita than other jurisdictions benchmarked by PFM. The Distilled Spirits Council of the US found that 2 -3 outlets per 10,000 adults is optimal. Montgomery County has 0.34 outlets per 10,000 as opposed to the benchmarked average of 1.23 outlets per 10,000 adults. PFM points out that DLC competes with private retailers but is constrained by public sector requirements. An example: private retailers can hire temporary staff for peak periods, DLC cannot. PFM believes that various county restrictions make DLC "less nimble" than the competition.

LIQUOR CONTROL REVENUE BONDS

In 2009, 2011 and 2013, the county issued Liquor Control 20-year revenue bonds to fund transportation and DLC facility projects with DLC revenues pledged to pay off the bonds. As a result, DLC must make annual payments for debt service principal and interest payments from net profits before it makes any transfers to the General Fund. The county has issued a total of $125.4 million in liquor control revenue bonds with $114 million principal balance remaining at the end of 2014. Annual payments for 2015 are just under $10 million per year.

Since at least a portion of DLC profits are dedicated to repayment of the bonds, there have been questions raised as to the kinds of changes to the liquor control process that would be allowed under the bond agreements. As part of the bond agreement, the county agreed to restrict the sale of DLC assets – e.g. the warehouse - only for governmental purposes.

POSSIBLE CHANGES TO LIQUOR CONTROL STRUCTURE

The Office of Legislative Oversight (OLO) has identified a continuum of possible changes to the Montgomery County liquor control structure ranging from full deregulation to increased efficiency within the system. Each option summarized below would have different fiscal effects, impacts on county jobs and implementation issues. They could also have social and economic development impacts.

Full Deregulation

Fully deregulate the alcohol system in Montgomery County and allow private wholesale distribution and private sale of beer, wine and liquor. This would make the County a "full license" jurisdiction like other Maryland counties. The County would have to address the legal and fiscal implications of the restrictions placed on the revenue bonds. Under this option, the county would lose all of the revenue, except for licensing fees which amount to about $2 million per year, that it currently collects. OLO estimates that there could be as much as $75 million in one-time gains due to sales of assets and the balance of the Liquor Fund. There would be an annual loss of $32-$45 million. About 393 jobs would be eliminated. It would take from three to five years to fully implement this option and would involve extensive consultation and negotiation with the revenue bond holders.

Private Wholesale Distribution of Beer, Wine and Liquor

Allow private wholesale distribution of beer, wine, and liquor to alcoholic beverage licensees, while maintaining county control of the off-premises retail liquor sales. In other words, the county would continue to sell liquor in the county controlled liquor stores. Again, the legal and fiscal implications of the revenue bonds would need to be considered. OLO estimates that there could be a one-time profit of $29-39 million from sale of assets and potential annual losses of $18-21 million. OLO assumed for this option that the wholesale cost of alcoholic beverages and the amount of retail sales would be the same as they currently are. About 165 jobs would be eliminated.

Private Wholesale Distribution of Beer and Wine
Allow private wholesale distribution of beer and wine to alcoholic beverage licensees while maintaining county control of the wholesale and off-premises retail sales of liquor. About 123 positions would be eliminated. OLO made no estimate of changes in revenues but clearly there would be a reduction in net revenues so the impact on the revenue bonds would also have to be considered.

Private Wholesale Distribution of Special Order Beer and Wine
Allow private wholesale distribution of special order beer and wine productions while maintaining county control of the wholesale and retail structures for all other alcohol products. It is estimated that there would be a one-time $170,000 gain because of the sale of a portion of the 42 vehicles owned by DLC. (Since all of the vehicles are at least seven years old, some question their revenue raising potential.) About 15 jobs would be eliminated. There would be a $4 to $6 million annual loss of revenue. (See section on Council Action below).

Increase Efficiency within Current Structure
Maintain the current structure of liquor control and enhance DLC's effectiveness and efficiency by adopting recommendations as part of DLC's long range strategic business plan. Many potential changes were identified in the long range strategic plan based on the recommendation of the PFN adopted in July 2014. According to the director of DLC, 150 actions were identified and about half had been implemented by September 2015. Problems with the new Oracle computer system are being resolved allowing for gathering of new kinds of information. A new manager of wholesale operations and others who have experience in the private wholesale sector have been hired. While the fiscal impact of these changes is difficult to project, it would be expected that customer service and revenues would be affected in a positive way. Progress in implementation of the changes is being tracked by DLCstat a part of the CountyStat statistical and analytical monitoring tool. Meetings are held monthly to track progress and to determine what needs to be done to stay on track. Plans are being made to replace some of the old and inefficient equipment, perhaps through leasing.

PFM recommended that the county explore establishing DLC as a **Revenue Authority (RA).** It would be similar to the already existing Montgomery County Revenue Authority which operates the county golf courses and the county airpark. No county General Funds are used. The Authority issues bonds for various county capital projects which are paid off by the revenues. The Revenue Authority has "supported important public purposes as far reaching as education, transportation, human services, economic development, recreation and the arts" according to the Authority's statement on the county website. Projects financed by RA revenue bonds include the Bethesda North Conference Center, the Health and Human Services Building, and Montgomery College Arts Center among others. PFM and officials that we have talked to, agree that the additional flexibility allowed under the aegis of a revenue authority would allow DLC to operate more efficiently and more like a private sector business. However, the county would lose control over the use of the funds to some degree and there seems to be a feeling that the proposal has "not made its case." It is possible that a revenue authority could be structured so that transfers of profits could be made to the General Fund rather than being dedicated to debt service.

State Comptroller Peter Franchot, a Montgomery County resident, announced that he would have a bill filed which would give restaurants and retail stores the option of purchasing beer, wine and liquor from EITHER the county dispensary or a private wholesaler/distributor. In 2011, the Legislature passed a similar bill for Worcester County. He says that it has been very successful in steering the liquor control system in Worcester County toward privatization. No estimates of revenue losses have been made available. District 16 Delegate William Frick has said he is filing a bill which would accomplish the same thing but would include a referendum in Montgomery County before it passes.

REPLACING LOST REVENUES

Since, in Maryland, the state collects all excise or sales taxes on alcoholic beverages, Montgomery County would need to either forego the lost revenues in Options 1-4 or would have to find other sources. Following are four options developed by OLO all of which would require changes in state law.

Wholesale Distribution Charge

A wholesale distribution charge that would require private distributors to pay a fee to distribute alcoholic beverage products in the county. The fee could be a set annual fee per wholesaler or could be a variable fee based on the volume of alcoholic beverages distributed in the county. Depending on the rate, a per ounce wholesale distribution fee could raise between $7 and $29 million. Currently, such a fee structured like an excise tax on the volume of sales has been included in the proposed legislation. OLO estimates that there could be a fee that would be comparable to DLC's current markup so that it would have little impact on prices. Such a fee could raise about $5 million.

Retail Liquor Licensing Fee

The county could allow new or existing off premises beer and wine stores to sell hard liquor and charge an additional or new licensing fee. These fees could generate up to $229,000 in additional revenues. Of course, these liquor sales would reduce the income of the county's retail stores.

Sell/Auction Rights to Operate County Retail Stores

The county could make these stores attractive by giving them the exclusive right to sell liquor in the county. Based on sales of similar stores in the state of Washington and West Virginia, it is estimated such sales would generate $4.5 – $5 million on a one-time basis.

Enact a County Alcohol Sales Tax

The county could ask the state to authorize a county sales tax on alcohol. The current state sales tax at the point of sale is 9%. If the county were able to establish a sales tax, it would generate approximately $3 million for every 1% of tax.

COUNTY COUNCIL ACTION IN JULY 2015

Because of the complaints described in Problems of DLC in this Fact Sheet, in December of 2014 the County Council established an Ad Hoc Committee on Liquor Control "to conduct a thorough examination of the structure and operations of DLC and determine appropriate changes to the structure of alcohol distribution in Montgomery County." After several meetings and a public hearing, the council adopted a request to the Maryland Legislature based on the recommendations of the ad hoc committee which would:

> Enable Montgomery County to allow private license Maryland wholesalers to sell and distribute special order beer and wine products to retail licensees in Montgomery County. DLC would also continue to take and deliver special orders and would maintain control of all stock beer and wine products.

Allow the county to establish a fee or charge on private wholesalers selling special order beer and wine to Montgomery County licensees. It would be set by the county and be based on the volume of alcohol sold by private distributors only to retail licensees in Montgomery County.

A bill has been submitted to the Montgomery County delegation. It would allow private licensed Maryland wholesalers to sell and distribute light wine products not purchased from the Department of Liquor Control in Montgomery County. A surcharge will be established to be paid by the private wholesalers based on the volume of alcohol sold by the private licensed wholesaler and set at a level sufficient to replace the revenues lost by the DLC.

The ad hoc Committee also urged the County Executive to implement, as quickly as possible, the Improvement Action Plan adopted by DLC based on the PFM Group report and to expand the number of county-owned stores which it believed would improve customer experience and generate additional profits for the county. Since current county stores generate annual profits at an average of $795,000, it was assumed that an additional three stores would generate at least $2.3 million in profits per year. It is believed that the increase in the number of stores and the wholesale fee would make the proposal revenue neutral. The county does plan to open three more stores soon and has a long range goal of 40 stores or 15 more than we have now. On this basis MCGEO is supporting the proposal since it appears that the loss of jobs would be minimal.

Discussions with the Montgomery County legislative delegation are currently under way. The bill will be carried by the chair of the delegation.

Assuming that the bill passes, the County Council will have to pass enabling legislation and regulations will have to be written and promulgated. It could be a couple of years before the changeover is actually accomplished. One question that has arisen is whether wholesalers, which generally make their money from large orders, will be willing to take on just the special orders which tend to be much smaller. Some of the larger wholesalers have already indicated that they are not interested in special orders while some of the smaller wholesalers have said they would be interested. Another issue that needs to be addressed is how the division between the private and public sectors will react to the changing market. What happens if a special order wine becomes popular over time to the point where it would normally be a stock order? What happens when certain products lose their popularity over time? Just consider the changes in people's tastes over the past 10-15 years. Unless it can take over products that become more popular, will DLC be faced with ever declining sales? OLO believes that this may not be a serious problem since stock brands tend to be quite stable over time.

PROS AND CONS OF PRIVATIZATION

Those who favor full or partial privatization fall into two camps – one believes that government simply doesn't belong in the liquor business. They point out that Montgomery is the only county in the country that is as fully immersed as it is. Others look more at the customer service angle – they think that better customer service – especially to restaurants – will encourage more high-end restaurants to locate in the county and thus will enhance the quality of life and will help lead to more successful urban districts. They argue that revenues lost due to privatization can be made up in fees, taxes, etc. as well as increased taxes on restaurant meals and improved business generally. Prices of products may drop because of competition among wholesalers. Many of the people who lose their jobs may well be hired by wholesalers who come into the county to do business

Opponents to privatization question whether revenues can be fully replaced. They believe that the proposed replacement revenues would necessarily increase the cost of alcohol and/or county taxes and would make Montgomery County retailers less competitive. Some believe that there is enough evidence to support public control of alcohol because of the positive public health and safety benefits. The issue of the revenue bonds needs to be explored in greater depth. There is no guarantee that the jobs lost due to privatization will be replaced in the private sector with comparable wages. The primary concern is the loss of a stable, fairly predictable source of revenue.

As a few of the officials that we talked to indicated, we have a choice between privatized alcohol sales and either higher taxes and fees or loss of services paid from the General Fund.

CONSENSUS QUESTIONS

Overall, should Montgomery County fully or partially privatize its liquor control operations?

Which of the following options should the League support (choose as many as you wish).

1. Full Deregulation
2. Private Wholesale Distribution of Beer, Wine and Liquor
3. Private Wholesale Distribution of Beer and Wine
4. Private Wholesale Distribution of Special Order Beer and Wine
5. Increased Efficiency within the Current Structure
6. Establish a Liquor Control Revenue Authority
7. Give retailers the option of purchasing beer, wine and liquor from either the county or private distributors/wholesalers.

REFERENCES

The ad hoc Committee on Alcohol Control has a web page on the county website which contains much information. http://www.montgomerycountymd.gov/COUNCIL/Committee/adHocComm.html

Comprehensive Long-Range Strategic Business Plan. Montgomery County Maryland Department of Liquor Control. Final Report. The PFM Group, Philadelphia, PA, October 23, 2014

MCRA, Montgomery County Revenue Authority. HYPERLINK http://www.mcra-md.com

Resolution to Support Reforms to Improve the Department of Liquor Control Operations and Expand Choice for Consumers and Business. Agenda Item #3-A. Montgomery County Council, June 30, 2015

Review of Alcohol Control in Montgomery County. Craig Howard and Leslie Rubin, Montgomery County Office of Legislative Oversight, February 10, 2015

Bill # MC7-16 Montgomery County – Purchases from the Department of Liquor Control – Exception for Wholesalers

INTERVIEWS

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