Six Comments regarding Alcoholic Beverage Policy Considerations

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From: Fred Silverman

To: Montgomery County Council Alcohol Policy Ad Hoc Committee

1. An economic context for the County's alcohol policy questions seems to be missing.

Decisions about County alcohol policy and practices deserve to be seen in a context larger than DLC activities or marketplace anecdotes and complaints. Doing so would help prevent otherwise unforeseen consequences. Debate about revenue replacement should comprehend that changes to alcoholic beverage policy unavoidably cascade into a larger economic pool that includes jobs, business revenue, private investment, retail occupancy, consumer choice and the degree of difficulty running small alcohol related businesses. This larger context is one of the two opposing aspects of all alcohol policy: economic vitality and negative social effects. To help manage the latter, knowledge about the former is required.

2. DLC's history indicates that it may cause significant economic friction, some unwanted.

An appreciation of economic friction should be added. Not part of PFM's work even though labeled "strategic," economic friction is market inefficiency caused by an integral part of the market, not to be confused with operational inefficiency. Any market player, but especially a monopoly, that delays or fails to match environmental changes causes economic friction, expensive and hard to see in the present tense. Some may be appropriate for social or legal reasons like limiting access to alcohol. In effect, Article 2b mandates some in its call for abstinence. But the extent of economic friction should be fully informed. Here are some actual specifics from recent history to consider. The County's drinking age population grew 14% between 2004 and 2013. Of course, its composition changed, too, in terms of age, geographic and ethnic distribution. During that period, DLC's sales rose 53% in absolute terms, but 34% indexed to thousands of 21+ persons. Volumes in thousands of gallons *fell* by 6%. How? During the period, relatively low priced DLC beer volume *fell* 11% while higher priced wine volume grew 7% and still higher priced liquor volume grew 18%, all while the number of dispensaries *fell* by over 12% (all indexed). The decade's change in population *composition* likely delivered a shift of consumption appetites, both geographically and in product tastes. Is it reasonable to assume that DLC's product mix and delivery system matched these shifts in demand routinely, optimizing market efficiency (after thoughtfully allowing for the legal and social imperatives to

constrain access to some articulated degree)? Or is it possible that DLC lagged the demand change over years? An accidental lag that existed (or possibly persists) would result in underperforming operating expenses, rising service complaints and, most important, unrecorded lost sales and profits for purchases that didn't happen, investments that might have been made by prospective license holders that went elsewhere instead, jobs that weren't added. Any of those beyond a deliberate level of restraint is economic friction that should be avoided with a more informed attention to market changes.

3. Reliance on labels favored by "control" jurisdiction defenders muddles policy discussion.

Referring to others as "license" jurisdictions obscures two central facts. First, nearly all jurisdictions, but including *every single* "control" jurisdiction, rely on licensing, law enforcement and taxation, three of the four strategies used to suppress alcohol's social costs by restricting access and supporting consumption prices. The fourth, government market operation, functionally displaces private sector actors and generates revenue in lieu of tax. It is the *only* distinguishing characteristic of "control" jurisdictions, but hardly the sole source of *actual control*. Second, the habitual use of "control" and "license" jurisdiction labels blurs much research and reporting, perhaps not an accident. Stringent police work, tight licensing and restrictive taxation are often ignored as independent variables affecting community outcomes. Put locally, our relatively good social outcomes are due to our high-performing MCPD and State Police, our particular blend of State and local licensing, and our County-operated wholesale and retail businesses (also our tax substitute). It is not proven which of these strategies deserves which part of the credit. Certainly, no one of them deserves all of it. Research that just compares total jurisdiction results and assigns it to whether government market operations exist says little about how the results were created. Please note the last phrase (bolded) from this American Journal of Drug and Alcohol Abuse (1991, Vol 17, #2, p 199-214) abstract (reprinted in full below) about a study called The Role of Formal Law in Alcohol Control Systems: A Comparison among States.

> Formal laws and regulations governing activities of state alcohol beverage control agencies in the United States were classified into 10 categories of physical availability and four categories of economic availability. These categories were subjected to similarity analysis to determine variation among states. Kruskal's stress-one measure revealed three major dimensions of alcohol control laws: forms of retail sales, administrative penalties for violations of alcohol control laws, and price restrictions. This finding suggests that **the license/monopoly distinction frequently used to categorize state alcohol control systems is inadequate to characterize the variations in control systems.**

4. DLC wholesale and retail business activities should be plainly visible, but aren't.

In your attempt to fairly consider alternatives to complement DLC operations, you will undoubtedly evaluate the effects on County revenue and expense. Those are not the only impacts, however. Alterations to either DLC's "retail" or "wholesale" businesses need to be clear to see the effect of change on the served markets. Today, the internals of those businesses including true revenue, costs and profitability are, more or less, unknown. For example, an unpublished study of all $146M of 2011 Montgomery County licensee purchases showed that 63% of distilled liquor purchases by license holders (and 6.8% of wine and 1.2% of beer) were made at dispensaries, not from the warehouse, and not for retail prices. Were one option to privatize dispensaries, how would such crucial access to licensees be affected? Since these purchases were $13.3M and 12% of all dispensary sales made at less than retail prices, what is the profit from the actual "retail" business of selling to consumers? Shouldn't dispensary costs be allocated among the two in some way? It is obviously tempting to equate warehouse with wholesale and dispensaries with retail, but misleading. The "retail" business seen as dispensaries is overstated in revenue, both over and understated in costs, leaving profit unknown. The "wholesale" business is understated in revenue and also under and overstated in costs if the warehouse is its proxy. Even though DLC revenue, most expense and profit *totals* are clear, not the OLO nor PFM nor any routine DLC reporting to either the State or County helps you see the pieces well. They must be constructed from data swimming in the financial minestrone of DLC's warehouse, delivery and dispensary costs and revenues. And some expenses, impossible to ignore by any normal business measures like inventory carrying costs, are missing altogether. Perhaps we're content with DLC serving as an ATM. Looking behind its cash drawer isn't necessary. Or those who do look forget or don't appreciate DLC as a $250M goliath that would get far greater scrutiny as a private entity. Fair treatment of today's "wholesale" monopoly business would track the sale of inventory to dispensaries, charging them wholesale prices as if they were class A licensees. The dispensaries would properly reflect their own inventories and the various elements of their revenues: sales to consumers at retail, sales to licensees or even sales to other dispensaries at various prices, some marked up and some discounted. Dispensary costs would be allocated to the "retail" and "wholesale" businesses. Delivery operations would properly be fully charged as a cost of the "wholesale" business, perhaps with some delivery revenue in some instances.

5. A better way to substitute DLC revenue.

Few alcohol consumers or even wholesale licensees object to Federal ad valorem and State excise taxes being in the price of every alcoholic beverage, either because they don't know the taxes are there or that they are fair. Consumers and licensees are certainly aware of

sales tax, however, an already stiff 9%. An excise surtax embedded in the price, while equally tainted with the dreaded "tax" word, would still be more digestible compared with an add-on sales tax that raises the same amount of revenue. The same kind of Article 2b changes (and resistance that might exist) is needed either way, but one approach calls attention to itself with every purchase and the other does not.

[Author's aside omitted]

6. Is the County mistakenly operating contrary to State law and getting less for doing so?

Maryland's Article 2b, the law that governs 100% of alcoholic beverage regulation everywhere in the State, spells out its two core objectives:

"...to obtain respect and obedience to law and to foster and promote temperance"

Whether you prefer today's common meaning of "temperance" – *moderation* - or its older more righteous *abstinence from alcohol*, you get an instant sense of 2b's degree of difficulty. It (grudgingly) allows, but sternly restrains alcoholic beverages. Its severe style shows when it specifically adds respect for the law as an umbrella goal of the hundreds of pages of convoluted instructions that follow. 2b *requires* a regulatory structure in every county, a Board of License Commissioners, and *permits* an optional structure to conduct market operations, a Liquor Control Board (in 1951 renamed DLC). 2b gives no power to either to govern the other where both exist (emphasized in AG Gansler's 2010 Opinion 95OAG164 about Wicomico County). 2b imposes two crucial limiters (paraphrased): for something to be legal, it must be explicitly allowed and also not be explicitly prohibited. Silence cannot be interpreted as permission, but rather must be interpreted as prohibition. AG Opinion 97-13 was solicited by then CE Duncan who asked two questions. AG Curran strongly affirmed the CE's sole, complete and unfettered authority over DLC, so complete as to put DLC beyond the reach of the Council's legislative powers, overriding the County Charter. If the CE wants DLC to paint its warehouse and trucks pink and can find the money to do it, the Council will have no say. Curran explained that 2b explicitly extended this power to the CE, and is silent on the Council. The Council may request and receive reports, offer advice and exercise its say over budgets and funding, but has no legislative authority over DLC. The second question CE Duncan asked was whether DLC could let private contractors operate dispensaries for DLC (note: DLC dispensaries are unlicensed). Given the CE's unlimited reign over DLC, one might expect the AG would say "Sure." But, he instead said "No." Yes, CE, you have authority over DLC. But 2b prohibits any *unlicensed entity* that isn't specifically allowed. And, yes, 2b specifically allows unlicensed *government operated*

dispensaries in Montgomery County. But it does not specifically allow *private* unlicensed dispensaries. So "No" was the AG's answer to CE Duncan's question.

This brings us to my assertion that a mistake was made in 2007. It has the County operating outside the law. From 1933 to 2006, the County's Board of License Commissioners was an independent agency with its own staff. Perhaps with Council assent, in 2007 the County embedded the Board inside DLC administratively. Did the Board ask for this or agree to it? The Board's staff and inspectors became the nucleus of DLC's LRE department. Perhaps the County was dissatisfied with the Board, its staff or both, or the Board was unhappy with its own situation. The Board could have sought new staff leadership. The CE and Council could have replaced absent or dysfunctional license commissioners. The common goal could have been to reconstitute a strong, effective independent Board with a competent staff. Instead, legitimate CE authority over DLC was presumably interpreted to mean authority over *all-things-alcohol* including licensing. But just as with private unlicensed dispensary operators, no matter how convenient or efficient, 2b must explicitly allow it to be legal. 2b explicitly gives all things license-related to each County's Board of License Commissioners. License commissioners are State officers. Their only function is serve State law (the Governor appoints most other license commissioners throughout the State), and there is no County prerogative. 2b gives the Montgomery County Executive the power to appoint and remove license commissioners with Council approval. 2b further says that the Board's rules of procedure (no mention of Regulations) are subject to County Council approval (no mention of the CE). 2b explicitly reserves review of any Board decision for Circuit Court. 2b instructs license commissioners about what decisions to make and how to make them and, importantly, tells the Board to create whatever rules it deems necessary, subject to no local authority. While 2b stipulates that the chair of the Board sit on DLC's Advisory Board, it provides for no Board advisory group nor any CE or DLC involvement in Board matters. 2b says that the Board "may have" a staff and inspectors. The County presumably reads this to mean that the CE and/or Council can decide *whether* the Board "may have" a staff and inspectors. Another reading is that the Board "may have" a staff or inspectors *if it wants* and *as it wants*. The Board might foolishly elect to have no staff or request that it be staffed by another department like the police (some state license authorities are administratively served by their State Police agency). The point, though, is that the structural decision rests with the Board, not the CE or Council.

What I believe is a legal and structural mistake has costs. First and foremost, it's an outright failure to honor one of 2b's prime directives, respect and obedience to law. Even though 2b is convoluted and troublesome, for a government to not observe its requirements sets a bad example for the people. Seek to change it. Follow it. But don't flaunt it. There may be a temptation to assume that DLC monitors the Board and keeps it performing at a high level. Even were that true, it's beside the point. And it may not be true. What periodic reviews of

Board activity or licensing issues have occurred? What communication has there been between the CE, the Council and the Board? What training is provided license commissioners before and as they exercise their considerable punitive and license granting powers? What reports does anyone get about licensee behavior, violations, geographic distribution or hearings activity? I was once told a prophetic anecdote by a very senior County officer. The anecdote was attributed to some previous staff director for the Board. His strategy was to treat license commissioners like mushrooms. They are to be kept in the dark and covered with manure. Did he have the interests of the County at heart? Was I told this so I'd understand not just a joke or an obsolete approach, but the County's actual attitude? If so, I am a terrible mushroom.

The current arrangement yields extensive confusion and misdirected expectations. To the disadvantage of the citizens, it allows and even cultivates Board passivity regarding its obligations (making rules, for example, or seeking corrective legislation) instead of vigilance. This has forced at least one well-intended County officer to appear compromised, the subject of not one, but two recent IG reports that explored license related aberrations. The IG, believing that DLC is the responsible authority, missed the cause: missing and incomplete Board rules and procedures. The Board (certainly some of its commissioners) was oblivious (in the dark) and DLC didn't think to involve it. The OLO mistakenly gives DLC credit for license fees, fines and rules even though 2b gives those only to the Board. DLC engenders confusion with a "mission statement" that says it "provide(s) licensing." DLC reports licensing revenue with no attribution to the Board. The Board of License Commissioners is made to appear a DLC appendage. Unlike treatment afforded other statutory organs, whether State or County, (e.g., Ethics Commission, Board of Appeals), the County's website does not list the Board of License Commissioners as part of government but as one of dozens of mostly advisory groups. The Board's existence is fragmented and essentially buried inside DLC's own web pages. Since the CE rules over DLC and the Board appears as part of DLC, it's not hard to see why this would be inferred as correct. CE representatives, for example, presume to guide Board decisions to support CE aims for complaint avoidance and the promotion of a welcome business climate. The County's master contact list provided to the State shows the Board as a subsidiary of DLC and flatly states that the Board "assists" DLC.

The greatest cost to the County is that the current arrangement undercuts the likelihood, let alone the legal fulfilment, of a strong and independent regulatory agency now and into the future. Given County consideration of more and different private actors to augment DLC, as well as more licensees of increasing diversity, a quality Board would have growing value to protect communities as the State's law envisioned and expressed.