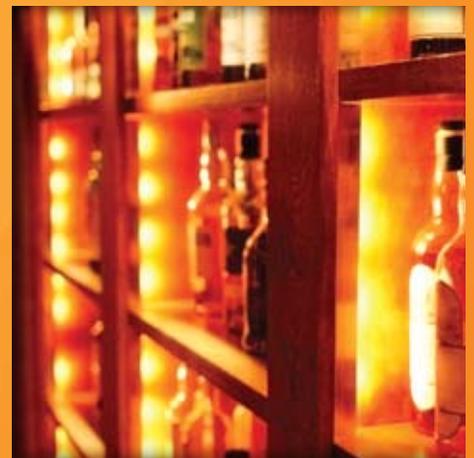


# Understanding LIQUOR Privatization



A Licensee's Guide to Implementing I-1183



ASSOCIATION



# Coming Monday, March 19, 2012

**LiquorExchange.org** – Bookmark it!



- Research how to deal directly with the growing number of craft distillers in Washington state.
- Find the major brands and liquor distributors.
- Search by brand, liquor type or keyword!
- Free registration and member only access.

**Go to [www.LiquorExchange.org](http://www.LiquorExchange.org) today!**



Powered by the Washington Restaurant Association.



A S S O C I A T I O N

# Table OF Contents

I-1183 Gives Licensees The Power.....	page 1-2
So, What’s Happening With the Three-Tier System?.....	page 3-4
On the Road to a New and Improved System .....	page 5-6
Understanding Pricing.....	page 7
Purchasing From Distributors.....	page 8
Purchasing From Retailers .....	page 9-10
Purchasing Directly From Distillers and/or Manufacturers.....	page 11
Central Warehousing .....	page 12

# I-1183 Gives LICENSEES THE Power TO Negotiate THE Best Deal

## History

As the nation came out of prohibition in 1933, Washington state enacted liquor control laws that established the Liquor Control Board as the entity charged with enforcing alcohol laws, preventing over-consumption and licensing of businesses to sell alcohol. Significantly, the Liquor Control Board was also empowered to be the sole distributor and retailer of spirits in Washington state.



Until passage of Initiative 1183 in 2011, Washington was one of a handful of states that retained sole authority to retail and distribute spirits to both business and consumers.

For more than two decades, lawmakers and previous Administrations have offered proposals to allow the private sector to take over the role of distributing and retailing spirits in Washington state. None of these ideas were enacted. In 2010, two initiatives to privatize the system were presented to Washington voters. Although voters turned down both proposals, it was clear there was growing support to let the private sector take over this important function. During the 2011 session of the Legislature, a modified approach was introduced and analyzed by fiscal and policy staff. Based on substantial input from all stakeholders, this proposal was modified and filed as an Initiative to the People (I-1183), which was overwhelmingly adopted by voters in the November, 2011 election.

## What Does I-1183 Achieve?

**Eliminates Washington state's monopoly on the distribution and retailing of spirits.** A spirits distributor license and a spirits retail license are created to take over the spirits distribution and retailing system by June 1, 2012. The Liquor Control Board will retain its authority to regulate, enforce and issue licenses. I-1183 does not change any existing license.



**Provides flexibility for both business and retail consumers.** With the appropriate endorsement, spirits retailers can sell wine (and spirits) in 24-liter quantities to on premise licensees. I-1183 allows quantity discount pricing, and gives licensees the flexibility to cooperatively warehouse spirits and wine to take advantage of potential volume discounting.



**Adds choice and competition for the restaurants:** I-1183 allows restaurants to purchase directly from distillers, from retailers (in 24-liter quantities) and from distributors. Washington will be the only state in the nation that allows retail licensees (restaurants and grocers) to purchase directly from distillers. On-premise licensees can compare pricing and customer service options, and make the choices that best meet their needs.



**Brings in additional revenue for the state:** For the past 78 years, the state controlled the sale, distribution and price of spirits.

When the need came to fill a budget gap, the Legislature would often enact budgets requiring the Liquor Control Board to raise prices, eliminate discounts to licensees or both. Under I-1183, the cost of spirits will be determined in the market and not in the political process. I-1183 will, however, generate new revenue for the state by:



- Auctioning off the state's distribution center and retail outlets.
- Removing the costs of running the state system and charging the 17% licensing fee for retailers and 10% for distributors the state's 51.9% markup to retail customers and 39% markup to licensee customers.
  - The distributor license fee will drop to 5% the third year of licensure.
  - If \$150 million has not been raised from distributor license fees by March 31, 2013, then distributor licensees will be billed the balance on a pro-rated basis.
- Retaining current spirit taxes.

Official estimates show the new model will generate more than \$400 million of additional resources, over six years, to support state and local government services.

**Enacts appropriate controls on sales of spirits by retailers:** With the exception of current contract liquor stores, retail licensees must have at least 10,000 square feet of retail space and maintain a process for managing inventory. Businesses must adequately train employees, supervise employees, reduce the opportunity for loss and ensure that the physical security of spirits is not compromised. Failure to comply with liquor laws can result in a doubling of penalties over what is already in place for beer and wine.



The initiative did not make any changes to laws and regulations on the distribution and sale of beer.

This handbook is intended to be a source of information for Washington restaurants that are transitioning to a dramatically different system of distributing and retailing spirits and wine. The following includes:

- Background on the spirits distribution and retailing system.
- Information on the options available for on-premise licenses to acquire spirits.
- Key factors to consider when comparing prices, including information on spirit taxes and license fees. Currently all spirit taxes are simply embedded into the base cost of spirits at state liquor stores. But under the new system licensees need to understand the extraordinary costs of spirit taxes and how they differ between retail and licensee consumers.

**Under I-1183, your business has many options for acquiring spirits and wine, and your business can compare prices, negotiate prices and customer service options that best meet the needs of your business.**

# So, What's Happening With the THREE-TIER System?

## Previous System

After Prohibition ended, Washington state established a “three-tier” system to regulate the sale and consumption of alcohol. The first tier is the manufacturer or supplier—the businesses that make the product. The product is

then transferred to the second tier—the distributor. The distributor then transfers the product to the third tier—the retailer, which represents restaurants, bars and retailers.



This model was created to prohibit “undue influence” Under this model, “undue influence” between tiers was prevented by prohibiting financial interest between the tiers. Each tier had specific functions, and a licensee in one tier could not engage in the business of another tier.

For example, this system prohibited restaurants from co-branding special label products, and banned suppliers from advertising their products in restaurants (including providing promotional materials for restaurant customers).

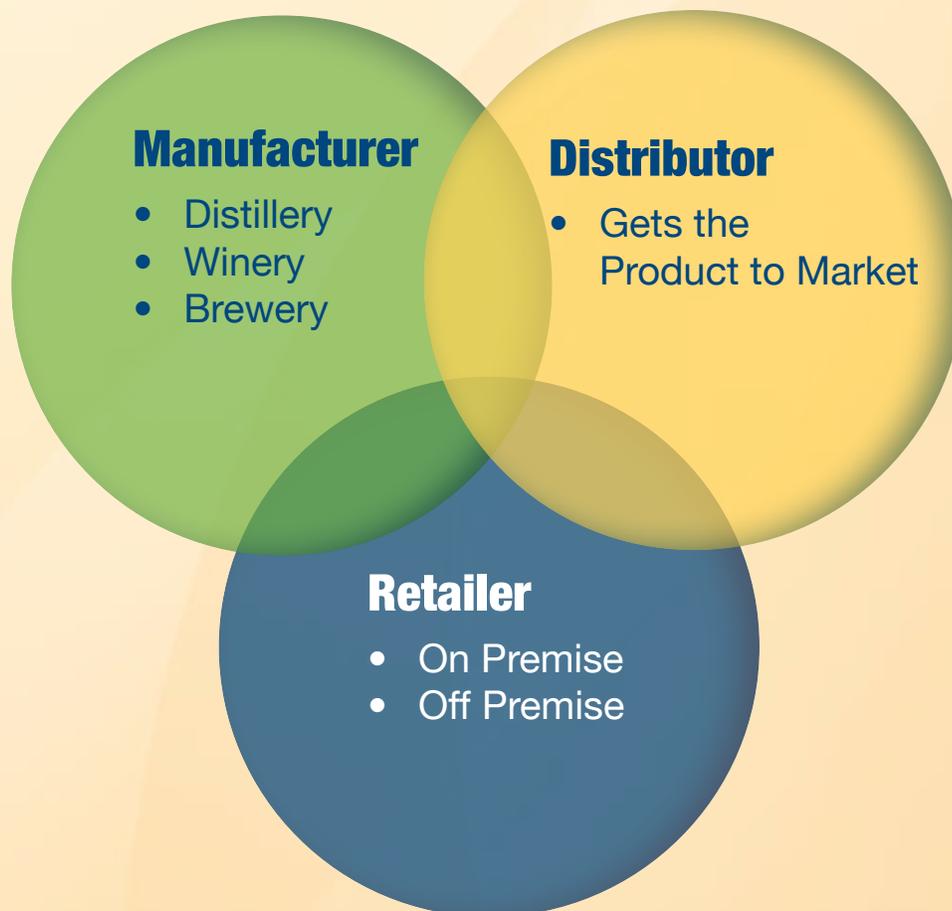
## New System

---

### A Modified System Will Emerge Under I-1183

Initiative 1183 made some significant changes to the three-tier system. Instead of outright prohibitions of activity between the tiers, I-1183 allows for a system more aligned

with today's economic and market realities. While the tiers are kept distinct, there are some shared activities between them.



### Significantly:

- A manufacturer can now act as its own distributor and sell directly to retailers.
- A retailer, or group of retailers (including restaurants), can purchase product directly from the manufacturer, from a retailer or a distributor. They can also centrally warehouse the product that has been purchased, and distribute it to their own locations. Cooperative arrangements are permitted.
- On-premise retailers (restaurants, bars, taverns) can purchase directly from a retail licensee (grocery store) in 24-liter increments.
- The requirement for uniform pricing is repealed, allowing businesses to negotiate price and customer service options that meet their needs (including quantity discounts).

# On the ROAD to a New and IMPROVED System

## Implementation TIMELINE

The transition to a privatized system will be quick. Here is a detailed look at how it has developed so far and will continue to unfold:

### December 6, 2011

Secretary of State certifies the election results, 1183 becomes Washington law. Upon certification, several sections of the initiative became effective:

**Central Warehousing:** The ban on central warehousing is repealed, allowing for licensees to warehouse and inventory their product off site.

**Wine Retailer Reseller License Endorsement:** The initiative creates an endorsement available to grocery store licensees, allowing for restaurants to purchase wine from retailers, in 24-liter amounts.

**Uniform Pricing Repealed:** The Liquor Control Board's authority to set uniform pricing is repealed. The Board will continue to keep prices uniform during the transition.

**Quantity Discounts:** With the repeal of uniform pricing, licensees are now permitted to bargain for quantity discounts on wine and spirits. Restaurants can enter into business relationships based on competitive business practices that best suit their needs, based on pricing and customer service.

### November 8, 2011

Election Day.  
Voters overwhelmingly approve Initiative 1183.



### March 1, 2012

Spirits Distributor licensees are allowed to sell to retail and on-premise licensees. They are required to pay 10% of their gross sales as a licensing fee. At this point, restaurants can continue purchasing from the state, or can acquire spirits from distributor licensees (similar to beer and wine distributors).

Licensees will be able to purchase directly from distillers holding a Certificate of Approval License.

### **March 31, 2013**

Distributor license fees must have delivered \$150 million to the Liquor Control Board. If the Board has not received at least \$150 million in distributor license fees, the Board will bill distributor licensees on a prorated basis, based on sales for the outstanding amount, to be collected by May 31, 2013.

### **January 1, 2014**

Distributor license fees will begin to decline to 5%.



### **June 1, 2012**

All state-run liquor stores will no longer be permitted to sell liquor. State stores will begin inventorying product and auctioning off assets and the rights to sell spirits in the former locations.

Spirits Retail licensees will begin sale of spirits and must pay 17% of their gross sales to the Liquor Control Board. Restaurants will be able to purchase from retailers in 24-liter amounts.

### **June 1, 2013**

Any remaining Liquor Control Board assets pertaining to the retail and distribution of spirits will be turned over and managed by the Department of Revenue.

# Understanding PRICING

Under the previous system, liquor prices were effectively set by the Legislature. Within the old system, the state marked up liquor by 39% for licensees and 51.9% for retail customers, and imposed the highest liquor taxes in the nation. Although the WRA was successful in

blocking the Legislature's most recent markup hike for licensees, proposals to eliminate discounts to licensees have been discussed in recent bienniums by the Legislature (2009-2011), and are subject to the ebb and flow of the political process.

## Previous System

### Base Price

*Includes bottle cost from:  
Spirits Broker  
Federal Taxes  
Delivery/Freight  
Cost of "doing business" for the state*

### +39% Markup

*(Just 2 years ago, licensees were paying the 51.9% markup when the legislature directed the LCB to increase its markup)*

*In a private market, this could be referred to as "margin" as costs are included in the base price.*

### +13.7% Spirit Sale Tax

### +\$2.44/Liter Tax

### = Total Cost



## Under I-1183:

### Spirit Taxes remain unchanged:

- The retailer, manufacturer or distributor is responsible for collecting and remitting these taxes to the state. On premise retailers continue to collect and remit sales tax.

### The state's markup is removed, as they are no longer in the business of retail and distribution of spirits:

- The markup will be replaced by pricing in the private sector, based on a competitive market.
- Factors affecting those business decisions are:
  - 17% license fee on gross sales by retailers (may not apply for retail -to- on premise retail sales).
  - 10% license fee on gross sales by distributors (which drops to 5% in third year of licensure).
    - If \$150 million has not been collected from these fees by March 31, 2013, distributor licensees will be billed on a pro-rated basis for the balance.

### With market-based pricing, on-premise retailers can:

- Negotiate pricing and customer service options.
- Seek volume discount pricing.
- Centrally warehouse spirits and distribute to their locations.

**Understand the math:** if a supplier is going to charge a price higher than the state's, you have the ability to negotiate, and if you choose, purchase from a different supplier.

On-premise licensees should be aware of the significant differences in spirits taxes between retail and licensee customers - under the previous system, those taxes simply were incorporated into the price paid to state liquor stores.

# Purchasing FROM Distributors

- Beginning March 1, 2012, licensees can purchase and take delivery from Spirits Distributor licensees.
- There are no restrictions on the ability of a distributor to provide delivery to on-premise licensees or to schedule deliveries that meet their customers' needs.
- There are no limitations on the number and/or size of distributor licensees.

## Factors to Consider:

- I-1183 continues to prohibit “below acquisition cost pricing,” unless the item being sold under the acquisition cost has been stocked by the seller for at least six months, and may not be restocked for at least a year. RCW 66.28.330 (1)
- **There is no change in the tax structure under I-1183.** For on-premise licensees, the effective taxes that must be collected by the distributor include:
  - 13.7% sales tax (based on the distributor's price to the customer).
  - \$2.44/liter volume tax.
- Distributors must also remit to the state the 10% license fee (based on gross sales) for the first two years. This fee is reduced to 5% in the third year of licensure.
- Restaurants can compare pricing from retailers and manufacturers, and have the flexibility to negotiate volume discounts. Restaurants will no longer be paying for the cost of the state to run the retail and distribution of alcohol, which was embedded in the bottle price. These costs will be absorbed by private businesses, many which already distribute beer and wine.

## Additional Considerations:

- The annual fee for a distributor license is \$1,320 plus 10% of gross sales (declining to 5% in the third year of licensure).
- Distributor license fees must provide \$150 million by March 31, 2013. If that amount has not been collected, the remaining balance will be pro-rated among existing licensees based on sales.

It is important to keep in mind that liquor sales were approximately \$900 million in Washington last year. The \$150 million fee is a fairly insignificant investment for an entire industry segment and will help compensate the

state for the privilege of taking over their spirits distribution business, similar to if a restaurant chooses to invest in upgrades or renovations, in order to get a competitive advantage. Nothing requires a distributor to recoup their investment by increasing your costs.

**Bottle Cost**  
(Cost of Acquisition)

**Distributor Markup**  
(Negotiable)

**+13.7% Spirit Sale Tax**

**+\$2.44/Liter Tax**

**= Total Cost**



### Spirits Distributor License: What the law says

66.24.055 (1) – A spirits distributor license is created for the wholesale of spirits to on premise licensees (restaurants) and off premise licensees (grocery stores), and to other distributors.

66.24.055 (2) – The board must begin issuing spirits distributor licenses beginning Jan. 1, 2012.

66.24.055 (3)&(4) – Spirits Distributor licenses are \$1,320 annually. In addition, a 10% fee on all gross sales in the first two years of licensure is due, 5% in the third year and every year after. In the case where a distributor may sell spirits to another distributor, the fee is due only on the first transaction, and cannot be calculated more than once. By March 31, 2013, spirit distributors must have collectively paid \$150 million in licensing fees, calculated for sales during the calendar year of 2012. If the Liquor Control Board does not receive \$150 million, they are to collect the outstanding balance by May 31, 2013. If the Liquor Control Board receives more than \$150 million, they must credit spirits distributor licensees for future fee obligations.

66.24.055 (5) – There is no minimum facility size or capacity for spirits distributor licenses, and no limit on the number of licenses that can be issued. Spirits distributors must provide physical security of the product.

# Purchasing FROM Retailers

- Beginning June 1, 2012, on-premise licensees can acquire spirits from Retail Spirits licensees (e.g. grocery stores) in amounts not to exceed 24 liters per sale.
- There are no limits on the number of sales, nor limits on the timing of those sales.\*
- On-premise licensees can continue to purchase spirits from contract liquor stores that opt to continue in business after June 1, 2012.
- The 24-liter per sale limitation does not apply for purchases from these stores.
- Restaurants can compare pricing from retailers, manufacturers and distributors, and have the flexibility to negotiate volume discounts.

## Reporting Requirement

If a restaurant licensee purchases spirits from a spirits retail licensee, they must keep documentation of their transactions. These records will be available for Liquor Control Board inspection and for distributors and distillers. The Liquor Control Board will develop record keeping requirements for licensees, but at the time this document was published, had not done so yet.

## Factors to Consider:

- On-premise licensees can acquire spirits from retailers at their favorable spirit tax rate, but it will require documentation with the retailer, or necessitate filing a tax refund with the Washington Department of Revenue. The difference is significant:

### Spirit Taxes for On-Premise Licensees

Value Tax = 13.7% of sales price

Volume Tax = \$2.44/liter

### Spirit Taxes for Retail Customers

Value Tax = 20.5% of sales price

Volume Tax = \$3.77/liter

- Retailers will pay a 17% license fee based on gross sales. This fee does not apply to sales to restaurants.\*
- I-1183 continues to prohibit “below acquisition cost pricing,” unless the item being sold under the acquisition cost has been stocked by the seller for at least six months, and may not be restocked for at least a year.

## Other Considerations:

- The annual fee for an off-premise Spirits Retail license is \$166 plus 17% of gross sales.
- A retail licensee must be at least 10,000 square feet in size (with the exception of contract liquor stores or in underserved areas).
- Retail licensees must have adequately trained employees, an inventory management system and physical security to prevent pilferage.

Additionally, the WRA’s Mandatory Alcohol Server Training Program (MAST) has been affirmed by the Liquor Control Board to meet the training requirements for retailers to be certified under their “responsible vendor” program.

\* Subject to pending interpretation by the LCB. The WRA will continue to advocate for restaurants on both of these issues.

# Purchasing FROM Retailers CONTINUED

## Restaurants

**Bottle Cost**  
(Cost of Acquisition)

**Distributor Markup**  
(Retailers have the option of purchasing direct from distillers)

**Retail Markup**  
(Retailers are not subject to a 17% fee when selling to restaurants)

**+13.7% Spirit Sale Tax**

**+\$2.44/Liter Tax**



## General Public

**Bottle Cost**  
(Cost of Acquisition)

**Distributor Markup**  
(Retailers have the option of purchasing direct from distillers)

**Retail Markup**

**+20.5% Spirit Sale Tax**

**+\$3.77/Liter Tax**



### Spirits Retail License: What the law says

66.24.630(1) – A spirits retail license is created for retail sale of spirits, and for sale for resale to restaurants in 24 liter quantities.

66.24.630(2) – Spirits retailers must provide reporting to the board about any sales to on-premise licensees, their purchases from distributors, and purchases from distillers.

66.24.630(3) – A spirits retailer must be at least 10,000 sq. feet of retail space. Spirits retailers must have adequately trained employees, show a process for inventory management, and provide physical security of spirits to limit pilferage.

66.24.630(4) & (5) – the licensing fee for a spirits retailer is 17% of gross sales, and an annual license cost of \$166.

66.24.630(6) – as a condition of licensure, spirits retailers must provide adequate training for employees, and the board must create a voluntary “responsible vendor program” created by the Liquor Control Board.

66.24.630(7) – Maximum penalties for fines and suspensions for beer and wine sales are doubled for violations occurring during sales of spirits.

66.24.630(8) – Licensees who participate in a “responsible vendor program” as determined by the board are not subject to the doubling of penalties.

# Purchasing Directly FROM Distillers AND/OR Manufacturers

- On March 1, 2012, on-premise licensees can purchase directly from a distiller that has a license or certificate of compliance (approval) to act as its own distributor.
- Distillers acting as their own distributor must comply with all the conditions applicable to distributors.
- Local craft distillers and regional manufacturers will likely take advantage of the flexibility this provides to market their products.

## Factors to Consider:

- Distillers must remit the 10% license fees based on gross sales to the state if they opt to self-distribute.
  - These distillers are not obligated to contribute to any shortfall in the \$150 million distributor license fee if that occurs.
- Distillers must collect and remit to the state the appropriate spirit taxes.

### Base Price

Includes bottle cost from:  
Spirits Broker  
Federal Taxes  
Delivery/Freight  
Cost of "doing business" for the state

### +39% Markup

(Just 2 years ago, licensees were paying the 51.9% markup when the legislature directed the LCB to increase its markup)

In a private market, this could be referred to as "margin" as costs are included in the base price.

### +13.7% Spirit Sale Tax

### +\$2.44/Liter Tax

### = Total Cost



## Your Options Under a Private Market

### Distributor

**Bottle Cost**  
(Cost of Acquisition)

**Markup**  
(Negotiable)

**+13.7% Spirit Sale Tax**

**+\$2.44/Liter Tax**



### Retailer

**Bottle Cost**  
(Cost of Acquisition)

**Distributor Markup**  
(Retailers can purchase directly from distillers)

**Retail Markup**  
(17% fee does not apply)

**+13.7% Spirit Sale Tax**

**+\$2.44/Liter Tax**



### Distiller

**Bottle Cost**

**+13.7% Spirit Sale Tax**

**+\$2.44/Liter Tax**



# Central WAREHOUSING

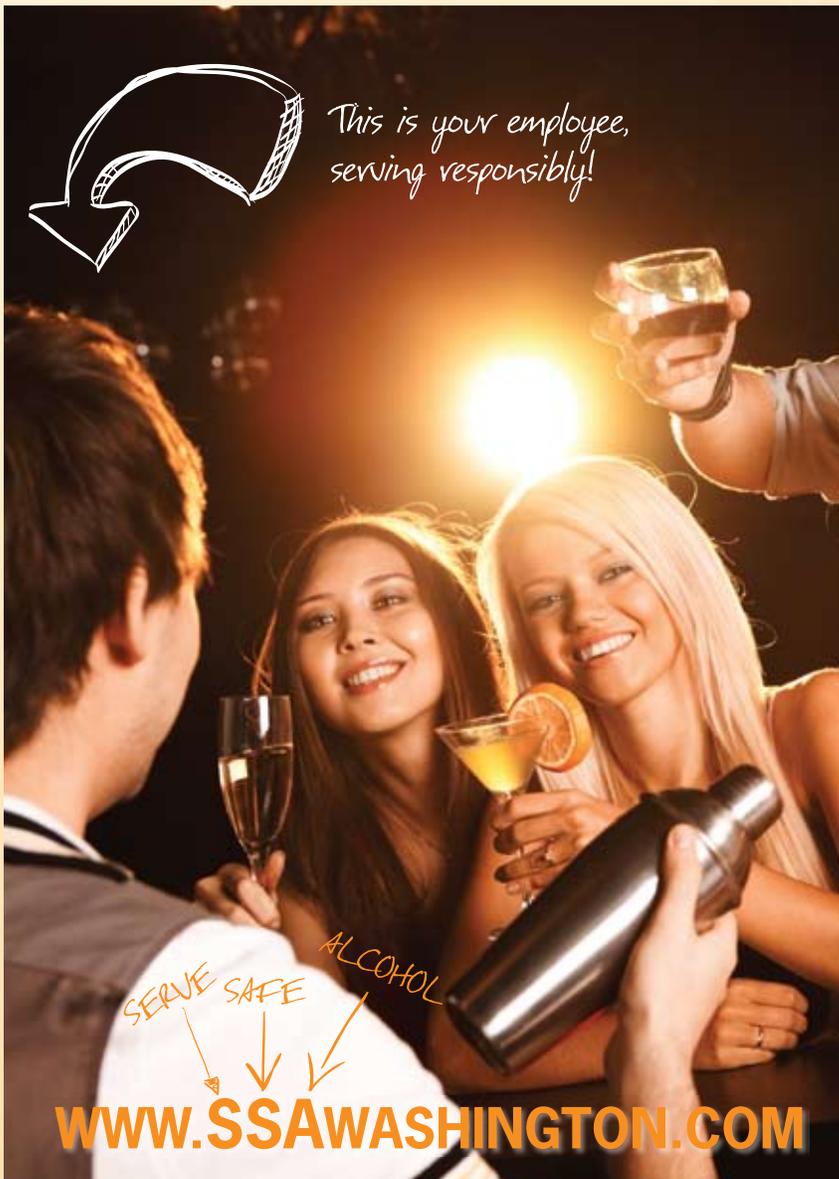
An important aspect of Initiative 1183 for restaurateurs was creating the ability to centrally warehouse product, allowing restaurant operators to take advantage of quantity discounts. With the ability to negotiate these discounts, it also was important for smaller single owner operators to collectively warehouse product and negotiate quantity discounts collectively. For this reason, a provision was contained in the initiative to allow central warehousing and cooperatives to form.

However, when the Liquor Control Board adopted emergency rules to implement I-1183, the language seemed to make the possibility for co-ops nearly impossible.

**The emergency rules are in place for 120 days, and currently the WRA is still working with the Board on permanent rules that will:**

- allow restaurateurs to collectively warehouse spirits and wine inventory.
- allow restaurateurs to collectively negotiate quantity discounts for spirits and wine.

Currently, the emergency rules permit a restaurant or restaurants to centrally warehouse their spirits and wine, and distribute to their own locations so long as they are all held under the same ownership. Licensees of different ownership may collectively warehouse so long as their product is separated by physical barriers.



**Serve responsibly.  
Get certified.  
Do it online.**

ServSafe Alcohol® is a vital, practical and current responsible alcohol service training program available and accepted in 47 states, including Washington. Get your Washington state mixologist class 12 and 13 permits along with your certification. The ServSafe Alcohol® Online Course and Exam puts current and comprehensive responsible alcohol service training program at your fingertips.



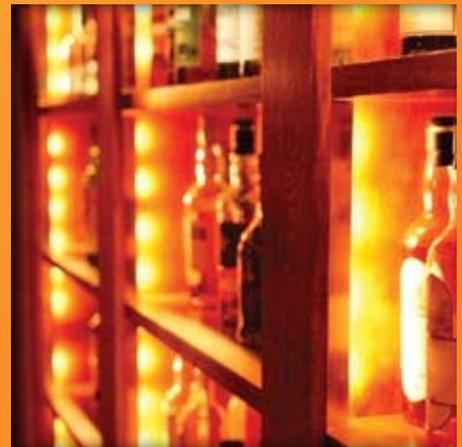


ASSOCIATION

510 Plum Street S.E., Suite 200  
Olympia, WA 98501-1587

PRSRT STD  
US POSTAGE  
PAID  
OLYMPIA, WA  
PERMIT NO 668

# Your GUIDE TO Understanding LIQUOR Privatization



A Licensee's Guide to Implementing I-1183