PLCB Profit Enhancement Concepts

The following profit enhancement concepts were submitted by members of the Pennsylvania Liquor Control Board's (Board or PLCB) Executive Team. As these are only concepts, specifics regarding implementation may not be available and any noted potential revenue/cost savings are purely estimates. The following concepts would require some degree of legislative change in order to implement, as described in each section:

Sunday Sales

Problem: Under current law, the Board may only operate up to 25 percent of its stores on Sundays – and only from noon until 5 p.m.[1]

Opportunity: Removing both the limitation on the number of stores that may be open on Sundays and increasing the hours during which they may be open should quickly generate $15 million in revenue to the Commonwealth each year.

Solution: Sunday is the second-busiest consumer shopping day of the week. Moreover, the Distilled Spirits Council of the United States (DISCUS) has reported that shoppers tend to spend more on Sundays than on any other day of the week.

- While the typical shopping basket contains only $23.27 of goods Monday through Saturday, the Sunday basket has $28.23 – 21 percent more than other days of the week.[2]
- The PLCB suggests eliminating both the 25 percent store restriction and the limitation on Sunday operating hours in order to capitalize on this busy consumer shopping day and provide greater consumer convenience.

Casino Licenses

Problem: While casinos are clearly a unique type of business that sells alcohol, the Liquor Code only partially recognizes this fact. Unlike sports stadiums and performing arts facilities, casinos do not have their own unique liquor license. Instead, they are generally subject to the same rules and regulations that apply to other retail licensed businesses such as nightclubs and the local corner bar, despite their large and complex licensed configurations and unique business models.

Opportunity: A license could be created unique to casinos that addresses many of the issues casino operators brought to the attention of the PLCB since casinos were first authorized in 2004. Those issues include:

[1] It should be noted that the PLCB is currently operating in excess of the 25 percent allowed by statute. The PLCB believes that the few stores open above the statutory threshold provide valuable convenience and service to rural consumers. The PLCB has previously advised the General Assembly of this fact.

[2] Source: www.discus.org/policy/Sunday. It should be noted that these figures are based on national averages and are not referencing Pennsylvania specifically.

- Allowing alcohol to be served after 2 a.m.
- Increasing opportunities to offer complimentary drinks
- Allowing a concessionaire to manage casino food and drink operations
- Creating a different penalty structure consisting of increased fines rather than license suspensions

Solution: Create within the Liquor Code a license specifically for casinos. The increased privileges would come with an increased fee to be determined.

Creation of Supermarket Licenses

Problem: Unlike hotels and golf courses, supermarkets do not have their own unique liquor license. Instead, a supermarket that wishes to sell beer-to-go must create a restaurant within the supermarket and apply for a retail liquor license.

- Since retail licenses are subject to a quota and their numbers are thus finite, each retail license acquired by a supermarket precludes a more traditional restaurant from acquiring a license to sell alcohol.
- This approach is both inefficient (since the supermarkets often have to maintain a fiction that they are a restaurant when they are not) and sometimes prevents smaller restaurants from being able to acquire liquor licenses (since the smaller restaurants have insufficient resources to outbid the supermarkets when a retail liquor license is available for purchase, as there is a finite number of retail licenses available in each county).
- Supermarkets and casinos, both which are typically owned by large corporations, have the ability to pay far more for an existing retail liquor license. This has the effect of pricing the small businessperson out of the traditional restaurant business, for which those licenses was originally intended.

Opportunity: Creating a retail license specifically for supermarkets would free up some of the existing retail licenses for use by smaller restaurants. It would also allow the Commonwealth to create a license that specifically addresses issues that are unique to grocery stores, such as increased sales for off-premises consumption and eliminating on-premises sales (requiring sufficient tables and chairs).

Solution: Create within the Liquor Code, a license unique to supermarkets to allow them to sell beer-to-go. There is clearly a desire on the part of many supermarkets (and apparently consumers) to sell beer, as evidenced by the fact that at least 245 of them (according to Licensing) have acquired retail licenses.

- The license would allow supermarkets to sell beer-to-go without having to create a restaurant within the supermarket, an inefficient use of space for them.
- By creating a new license outside the quota, the demand for existing retail licenses would decrease, the number of available licenses would increase and more traditional restaurants would be able to acquire licenses.

Licensee Surcharge

Problem: The fees associated with acquiring a license to sell alcohol have not increased in nearly 25 years, but regulatory costs have gone up in that same period. The license fees were last increased by Act 67 of 1990.

- The Commonwealth spends significantly more money in processing liquor license applications and in supervising the alcohol industry than it generates in fees.
- This inequity has created a system in which the regulatory function is unsustainable without financial support from retail sales of wine and spirits.
- The current license renewal fee for retail licensees (i.e. Hotels, Clubs, Restaurants and Eating Place Retail Dispensers) ranges from $330 to $1,200 (depending on the municipality in which the establishment is located). This includes restaurant licenses issued to casino operators.

Opportunity: For example, adding a $700 annual surcharge to applications submitted for retail (such as Hotels, Clubs, Restaurants, Eating Place Retail Dispensers), wholesale (such as Importing Distributors and Distributors) and other Article IV licensees (such as Breweries) would generate between $11 million and $12 million of additional revenue to the Commonwealth annually, which would help to defray the growing regulatory costs of the agency. Such a surcharge could be imposed at once, or over the course of time to cushion the impact on smaller licensees. In the alternative, a sliding scale could be utilized, taking into account a licensee's location or gross annual sales, for example, in determining the amount of the surcharge.

Solution: While the modification of the licensing fee may not completely cover the costs associated with overseeing the alcohol beverage industry within the state, it would narrow the gap and allow for a greater return to the Commonwealth.

- A fee increase, while placing Pennsylvania on the high end of the regulatory fee schedule, would still be in line with other states.
- For example, the fees in other states[3] for the renewal of a Restaurant liquor license[4] are:
  - Ohio – D3A permit: $938
  - West Virginia – Class A license: $1,150
  - Delaware[5] – Restaurant License: $1,000
  - New York[6] – On-premises Liquor: $1,792-$4,352
  - Utah[7] – Full-Service Restaurant: $2,200 (initial; renewal $935-$1,925

[3] Utah is included because it is the other alcohol control state. Maryland's licensing function is controlled by the state's 23 counties and City of Baltimore.

[4] Some of the privileges for a restaurant licensee are greater than what Pennsylvania affords (i.e. ability to sell off-premises wine)

[5] The licensing term is for two years.

[6] License fees in New York vary depending on the county of the establishment. In addition, the licensing term is three years.

- The PLCB also suggests that a legislative change regarding these fees also be tied to the Consumer Price Index (CPI). Future license fees could be determined by annually applying the CPI-U, NE Cities Index (or similar index) to existing fees. This would allow future license fees to be modified automatically, without the need for a statutory change, in a rational and quantifiable manner.

Procurement of Liquor Products

Problem: The language contained in the Liquor Code requires the PLCB to mark up the alcohol it sells "proportional with prices paid by the Board to its suppliers." The language prevents the PLCB's buyers from effectively negotiating purchase prices from vendors (not the shelf prices at the stores) and limits the PLCB buyer's ability to leverage the Board's purchasing power, since they cannot exercise any discretion in applying a markup based upon a vendor's quoted wholesale price. By giving the Board the ability to adjust the markup on particular goods, vendors will be compelled to quote the best possible wholesale price to the Board for a particular item that will be sold in Fine Wine & Good Spirits stores.

Opportunity: It is estimated that this legislative change, once fully implemented, would result in an additional $47 million to $75 million of revenue to the Commonwealth and local municipalities annually. However, as there will be a period of adjustment both for our buyers and the industry as a whole, we estimate approximately $35 million in additional revenue in the first full fiscal year after implementation.

- It is anticipated that it will take approximately two years to fully modify existing systems, train personnel and allow for vendor adjustment.

- A large lost opportunity to the Commonwealth with the proportional pricing formula relates to how vendors price their products. To achieve relative parity in the region, vendors price so that shelf price is similar in surrounding states. Hence, Virginia and Ohio which have higher product mark-ups than PA are quoted lower cost than PA.

  Through an association with NABCA (National Alcohol Beverage Control Association) the PLCB is able to determine prices paid by other control states. In the case of a particular 750ml whiskey brand, VA pays $12.19 while PA pays $14.46 for the same item. If PA could obtain the VA price and maintain current shelf price, we would increase our gross profit by $2.27 per bottle without any increase in prices paid by consumers. That is the equivalent to an additional $2 million annually in profit and tax on that one item.

- Allowing greater pricing flexibility, the Board will be able to drive down the acquisition cost through aggressive negotiating. As a consequence, the Board may be able to leverage its buying power for other States or entities.

Solution: The PLCB recommends that the Liquor Code be amended to allow the agency to more effectively use its buying power to obtain products from vendors at purchase prices in a manner that is both more flexible and more consistent with other retailers.

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[7] License fees in Utah vary depending on how much alcohol has been purchased.

- While pricing will be flexible, the PLCB would assure that a particular item has the same price across the state and that there is no variation in pricing based on the location of the store in which it is sold.

Doing so will help maximize the Commonwealth's return by allowing the Board to negotiate prices with its suppliers and fine-tune the costs to the consumer.

Increase in Fines

Problem: Act 14 of 1987 created the fine structure associated with violations of the Liquor Code ($50 to $1,000 for most violations and $1,000 to $5,000 for major violations).

- The fine structure of $50 to $1,000 was introduced by Act 518 of 1965. The deterrent effect of a $1,000 fine in 1965 was clearly significantly more than the deterrent effect of a fine of the same amount imposed half a century later.

Opportunity: While the discretion afforded to the ALJs in imposing a fine makes estimating the fiscal impact of raising the fine structure difficult, it would generate about $1.5 million a year if the ALJs were to double the fine amounts.

- Increasing the fine structure for citations arising from violations of the Liquor Code and the Board's Regulations will provide a greater disincentive for licensees to risk violating the law in return for higher profits, while at the same time increasing revenue to the Board via the State Stores Fund.

Solution: Increase the current minimum and maximum penalties for violations of the Liquor Code. In Pennsylvania, serving alcohol to minors is punished by a monetary fine of $1,000 to $5,000 for a first offense, but ALJs typically impose fines toward the bottom of the discretionary range. If the ranges were, for example, doubled, the ALJ would continue to have discretion to impose a monetary penalty of as low as $2,000.

Lottery Retailer

Problem: Lottery ticket sales are commonplace at licensed liquor stores in other states. The State Lottery Law already allows "all departments, commissions, agencies and instrumentalities of the State" to be licensed as Lottery Sales Agents. However, the Liquor Code does not specifically authorize the Board to sell lottery tickets.

Opportunity: Pennsylvania Department of Revenue (Revenue) has indicated that if the PLCB were to sell lottery tickets through vending machines in its state store system and retained the 5 percent retail commission (plus bonuses) that other Lottery Sales Agents are permitted to retain, it would generate approximately $3 million of additional revenue for the Commonwealth each year.

Solution: Modify the Liquor Code to specifically empower the PLCB to sell Pennsylvania lottery tickets. The PLCB has, in the past, met with lottery representatives from Revenue, who have encouraged the Board to become a lottery retailer.

Auctioning of "Dead" licenses

Problem: Because there is a quota or limit on the number of retail licenses that may be issued by the PLCB, the costs to acquire retail licenses is generally rising throughout the state, making them more valuable and making it more difficult for smaller restaurants to acquire said licenses. However, according to records maintained by the Bureau of Licensing, the number of active retail licenses *has actually decreased* from 11,040 restaurant and 546 retail dispenser licenses on December 31, 2000, to 10,070 restaurant and 494 retail dispenser licenses on December 31, 2013.

While counterintuitive, the number of retail licenses that are subject to the quota has been steadily decreasing for years. Reasons that would cause a license to cease to exist include:

- unpaid tax liabilities to the Department of Revenue and/or the Department of Labor and Industry;
- revocation by the Office of Administrative Law Judge as a result of a citation;
- non-renewal of a license by the Board under its Nuisance Bar Program;
- death of a licensee and subsequent inaction by the estate; and
- indifference from owners of failing businesses.

Opportunity: Allow licenses that cease to exist to revert back to the Board after providing sufficient notice to the regulated community. Allow the Board to auction said licenses once a year.

- This initiative could potentially generate an additional $3.75 million to $7.5 million for the Commonwealth each year.[8]

Solution: Permitting the PLCB to auction these licenses, which would otherwise cease to exist under law, allows the PLCB to maintain the existing number of retail licenses. It would also provide a source of revenue for the PLCB's Bureau of Licensing at a time when it is operating at a deficit in part because licensing fees have remained stagnant for decades.

- The minimum bid amounts of $100,000 for licenses in larger counties and $50,000 in smaller counties would help prevent third parties from speculating on said licenses; that being said, these amounts are still lower than the current market price for said licenses in most counties.

Direct Shipping of Wine to Consumers' Homes

Problem: Various measures have been introduced in both houses of the General Assembly in the last several sessions to address the issue of direct shipment, in light of recent cases addressing the disparities of the direct shipping privileges of in-state and out-of-state wineries, and due to increasing consumer interest in having wine, regardless of its point of origin, shipped directly to a consumer's residence. We receive numerous inquiries very year from Pennsylvania citizens wanting to know whether they can have wine shipped directly to

[8] This figure is based on the assumptions that 75 restaurant liquor licenses and four eating place retail dispenser licenses continue to disappear each year, and that the minimum auction amounts discussed above were to be implemented.

their homes from their favorite wineries. As a result of recent court decisions, any winery that produces less than two hundred thousand (200,000) gallons of wine annually, whether located in-state or out-of-state, that applies for and obtains a limited winery license from the PLCB may ship wine directly to Pennsylvania residents, at their homes, who have placed orders to such entities via telephone or the Internet. Such wines are subject to the applicable 6 percent sales tax, but not the 18 percent "Johnstown Flood Tax." In the absence of legislation in the aftermath of these court decisions, however, many out-of-state wineries have not sought a limited winery license, choosing to remain on the sidelines until legislation is passed, and most consumers remain confused about whether they may purchase wine from out-of-state wineries and have it delivered to their homes.

Opportunity: Allowing direct shipment of wine from out-of-state will improve consumer convenience, allow residents of Pennsylvania to obtain limited quantities of wine at their doorsteps for their personal consumption, and allow the Commonwealth to collect tax revenue on such sales.

Solution: Amend the Liquor Code to allow the direct shipment of wine by wineries to individual consumers' homes, for their personal consumption only. The legislation should contain certain safeguards to ensure that wine does not come into possession of minors, and that taxes, including the 6% sales tax and the 18% liquor tax, are being properly collected and remitted to the Commonwealth.

Allow for Sales and Shipment Outside of Pennsylvania

Problem: Current provisions of the Liquor Code suggest that sales and shipment outside of Pennsylvania are not contemplated. As such, the Board is not actively marketing or pursuing out of state sales.

Opportunity: Allowing sale and shipment outside of Pennsylvania would open substantial opportunities within new markets. It should be noted that shipment outside of Pennsylvania would implicate the laws of the several states as well as federal regulations. As a result, the Board's ability to sell and ship would be limited by the laws of the receiving jurisdiction.

Solution: The Liquor Code would need to be amended to allow sales and shipping outside of Pennsylvania.

Marketing Flexibility

Problem: The Liquor Code currently prevents the PLCB from recognizing and rewarding regular customers and from utilizing common retail practices to increase sales opportunities.

Opportunity: It is estimated that modification to allow for some common marketing practices could add an additional $10 million to the Board's bottom line.

Solution: Enactment of the following legislation: (1) allow communication to customers with offers and coupons from the Board, not just the vendors; (2) allow the Board to work with other retail merchants to have Board coupons in their stores to grow sales; (3) offer wine classes / seminars for a fee to cover expenses and offer the wines tasted at the event at a discount price; (4) allow the Board to establish customer loyalty programs similar to those utilized by other retailers; and (5) allow the Board to sell advertising on its vendor portal.

It should be noted that the United States Tobacco Tax and Trade Bureau ("TTB") has previously advised that the sale of advertising to vendors on the vendor portal could violate federal law.

Shipping Special Liquor Orders (SLOs) directly to consumers

Problem: The PLCB implemented a direct-shipment policy, allowing online purchase of wines and spirits to be shipped to a Pennsylvania resident's home or business. The next step to enhance customer convenience will be to develop a method for the customer to pay online for Special Liquor Orders (SLO) and have the product shipped from the supplier directly to an address the customer chooses. The current system is labor intensive and inefficient.

Opportunity: It is estimated that allowing direct shipment of SLO orders to licensees and consumers will yield between $6 million to $8 million in savings.

Solution: Amend the Liquor to allow customers to purchase SLOs through the online website and allow direct shipment from the vendor / supplier to the customer.

Distribution Center (DC) realignment

Problem: The Board currently utilizes three separate DCs; each operated by a separate private third party logistics provider. The current system has a number of inefficiencies that, if addressed, could result in significant cost savings.

Opportunity: Prior estimates showed network operating savings of $10 million annually against projected future costs of a network that included the Board's current DCs in Pittsburgh and Scranton, and a relocated, non-automated, Philadelphia DC. However, the PLCB estimates that it would need to make an initial investment of approximately $10 million to implement this consolidation initiative. Further, one-time savings of $10 million working capital are also anticipated through reduction of duplicate non-bailment safety stock. Moreover the sale of the Philadelphia DC (the physical structure is owned by the Commonwealth) would yield capital which could then be utilized or reinvested to help establish the Board's new distribution solution.

Solution: The program calls for a full redesign and revamp of the PLCB fulfillment infrastructure including DC facilities, delivery practices and service footprint.

In order to maximize the returns, the initiative should be executed outside standard state procurement practices by selecting the partner, then doing the network design study, and then finally executing the design. The new DC agreement should be established as either as a cost-plus contract or a gain-sharing contract, enabling the Board to participate in cost savings improvements as they occur in the future.

New capabilities should include single bottle fulfillment as part of the project, at a single location for the commonwealth. Use the bottle fulfillment system for home delivery or for licensee delivery of any items available in the fulfillment center. Also use it for fulfillment of licensee bottle orders for LDP delivery accounts. Stores would continue to use case fulfillment, not the bottle fulfillment center.

Independent Funding of Liquor Enforcement Operations

Problem: The Liquor Code requires the General Assembly to make an annual appropriation of money from the State Stores Fund to the Pennsylvania State Police, Bureau of Liquor Control Enforcement (BLCE) for the operational expenses of the Bureau, which is charged with enforcement of the liquor laws of the Commonwealth.[9] The Board does not, however, know how those funds are actually expended by the BLCE, and is not provided with a specific accounting of what the monies are used for from year to year. This has led to confusion at most Appropriations hearings, as the Board is not able to answer questions raised by legislators related to funding or sufficiency of liquor enforcement operations.

Opportunity: Require that liquor enforcement be funded via the General Fund through an appropriation to the PSP for BLCE operations. This will free up additional monies in the State Stores Fund, while at the same time hold BLCE accountable for its actual expenditures in enforcing the Liquor Code and the Board's Regulations.

Solution: Amend the Liquor Code by removing the requirement that the General Assembly make an appropriation from the State Stores Fund to provide for the operational expenses of the BLCE.

Immediate Budgetary Relief by Recapitalizing the PLCB

Problem: The Commonwealth of Pennsylvania is facing a projected budget deficit of nearly $1.8 billion.

Opportunity: An examination should be undertaken to determine if recapitalization of the Board, in effect, selling all or a portion of the future revenue stream to bondholders and leveraging the agency at favorable interest rates that exist in the market today is financially viable. Backed by the monopoly characteristic of liquor distribution in Pennsylvania, the Board should be able to issue highly rated municipal bonds at much lower interest rates than the current general obligation bonds of the commonwealth. A very rough estimate would be an issuance of $500 million in bonds at an annual debt service cost of around $31-$35 million at interest rates of 4.5% - 5.0%. Interest paid to the bondholders would be tax-free. The commonwealth receives an immediate infusion of $500 million and pledges less than half of the current $80 million annual dividend to pay for the bonds. With other modernization relief, particularly the freedom to negotiate purchase price, the amount of debt service could easily be recouped and preserve at least an $80 million annual payout.

Solution: Enabling legislation would need to be enacted authorizing the sale of revenue bonds against the future receipts of the Board.

[9] For FY 2013-2014, more than $24 million was appropriated from the State Stores Fund to the BLCE.