Representative Roger Solum, Chair
Senator Corey Brown, Vice Chair

First Meeting | **Room 413**
2014 Interim | **State Capitol Building**
June 10, 2014 | **Pierre, South Dakota**

Tuesday, June 10, 2014

The first meeting of the Alcoholic Beverage Shipping and Distribution Committee for the 2014 Interim was called to order by Representative Roger Solum at 9:30 a.m. (CDT) in room 413 of the State Capitol, Pierre, South Dakota.

A quorum was determined with the following members answering the roll call: Representative Roger Solum, Chair; Senator Corey Brown, Vice Chair; Representatives Troy Heinert, Timothy Johns, Tim Rounds; and Senators Jim Bradford, Ryan Maher, Craig Tieszen. Excused was Representative Brock Greenfield.

Staff members present included Roxanne Hammond, Legislative Attorney; Fred Baatz, Principal Research Analyst; Doug Decker, Code Counsel; and Cindy Tryon, Senior Secretary.

NOTE: For purpose of continuity, the following minutes are not necessarily in chronological order. Also, all referenced documents distributed at the meeting are attached to the original minutes on file in the Legislative Research Council office and some can be found on the Legislative Research Council website at http://legis.sd.gov/Interim/CommitteeDocuments.aspx?Session=2014. This meeting was web cast live. The archived web cast is available at the LRC website at http://legis.sd.gov.

Opening Remarks

Representative Roger Solum read the directive received from the Executive Board regarding the focus of the Alcoholic Beverage Shipping and Distribution Committee for the 2014 Interim:

Study Scope: Study alcoholic beverage shipping and distribution regulation in South Dakota. The study should include:

(1) *The three-tier system of alcohol distribution in the state to determine if the current system is necessary and appropriate in today's society;*

(2) *The intrastate and interstate shipping of wine, beer, and spirits. The study should include how the shipping would affect the three-tiered system including equality of taxation, enforcement, equality for retailers - both in-state and out-of-state, social issues, and permits and licenses; and*

(3) *The possibility of creating a direct-to-consumer winery shipping law.*

Representative Solum said that the committee will meet three times during the interim and will then file a report, along with any draft legislation that may come out of the discussions, to the Executive Board at their November meeting.

National Conference of State Legislatures

Ms. Heather Morton, Programs Principal, National Conference of State Legislatures (NCSL), talked to the committee via telephone regarding how the three-tier system applies in other states. Ms. Morton had a copy of her PowerPoint slides distributed to members of the committee ***(Document #1)***.

Every state has a three-tiered distribution system of 1) manufacturers and producers; 2) distributors and wholesalers; and 3) retailers, including stores, bars and restaurants. The three-tier system is meant to provide a checks and balance system for the distribution of alcoholic beverages, ensure that the quality of the product is what it claims, and allow for the most efficient way to apply taxes. However, each state has made certain modifications and exceptions to the three-tiered distribution system to meet their circumstances and needs.

Each state is either a control state or a license state. Control states operate the distribution tier and may participate in the retail tier through state-run liquor stores. In license states, the state does not participate in distributing or selling alcoholic beverages. Seventeen states are control states and the remaining are license states. South Dakota is a license state, as well as Minnesota, Nebraska, and North Dakota. Neighboring states that are control states are Iowa, Montana, and Wyoming.

Ms. Morton said that additional information can be obtained through the NCSL website: http://www.ncsl.org/research/financial-services-an-commerce.aspx.

In response to a question, Ms. Morton said that Minnesota was the first state to enact laws regarding taprooms – Minnesota statutes, §340A.301 subdivision 60. Under those statutes, a taproom must be connected to the brewery/manufacturer and is limited to one taproom per license. The municipalities issue the licenses. If the brewer produces more than 250,000 barrels of beer or 250,000 gallons of wine, then they are not considered a taproom.

Department of Revenue

Mr. Jason Evans, Deputy Director, Special Taxes Division, SD Department of Revenue, gave a PowerPoint presentation regarding the regulation of alcoholic beverage sales and the taxes that apply to those sales ***(Document #2)***. Through the three-tier system, only manufacturers are allowed to sell alcohol to wholesalers, only wholesalers can sell to retailers, and only the retailers can sell alcohol to the end consumer. This system maximizes control over the industry and minimizes the administrative costs of taxation and enforcement.

Alcohol taxes are collected by the state at the wholesale tier. There are currently 60 alcohol taxpayers including wholesalers, farm wineries, malt beverage manufacturers, and artisan distillers. Collections in FY13 for the per gallon occupational tax were $14,221,504. Collections for the 2% wholesale tax for FY13 were $1,647,547.

Liquor wholesalers must post the prices of their products and if the price changes they must notify the Department of Revenue. When purchasing spirits, the retailer can have up to 30 days to pay, but the retailer must pay for beer when it is delivered.

There are currently 5,394 retail liquor/beer licensees. The liquor licenses are renewed each January 1 and beer licenses are renewed each July 1. Local officials have first approval of alcohol license applications. In FY13, the sales of these licenses totaled $454,147.

Mr. Evans pointed out that the Special Taxes Division has a very small staff and because of the three-tier system, that staff is able to administer the laws and regulations regarding alcohol sales and distribution. He asked the committee to be mindful that if the three-tier system is changed, the office may need additional resources.

Mr. Evans explained that there are three exceptions to the three-tier system. The first exception was implemented in 1989 and applies to malt beverage manufacturers who produce 5,000 barrels or less and sell the product for on premise consumption only. There are 10 such licensees at this time and there is a $500 annual license fee.

The second exception was implemented in 1996 and allows farm wineries that produce up to 150,000 gallons annually to sell their product for either on-premise or off-premise consumption. Currently, there are 26 such licensees and the license costs $100 annually.

The third exception to the three-tier system is the artisan distillers. An artisan distiller can produce up to 50,000 gallons annually and can sell their product for either on-premise or off-premise consumption. The artisan distiller may sell to wholesalers and to end consumers but cannot sell directly to retailers. There are 4 such licensees and the license costs $500 annually.

In 2003, the legislature enacted a law (SDCL Chapter 35-12A) which allows the consumer to purchase wine not currently in distribution in South Dakota by going through a licensed retailer. In response to a question, Mr. Evans explained that there is an exception to the brand label fee when bringing wine into South Dakota through SDCL Chapter 35-12A. In response to another question, Mr. Evans said that retailers are not required to order these wines for their customers but it is a service they can provide. He added that there is no special tax number that would allow for tracking of these sales.

In response to a question regarding how the tax is applied, Mr. Evans explained that once a product is being shipped to the distributor in South Dakota, the manufacturer must notify the Department of Revenue by sending copies of the invoices. Those invoices are then compared to the reported sales from the distributors. At the time the distributor receives the product into South Dakota, the tax is owed and must be paid within two months. The tax is based on when the product is received not by when it is sold.

Mr. Evans continued by explaining that a portion of the occupational tax goes into an alcohol fund with quarterly reversions to the municipalities based on population. The remainder of that revenue goes into the general fund. The 2% wholesale tax goes into the general fund.

In response to questions from the committee, Mr. Evans explained that liquor wholesalers must post the prices of their products, send a copy of the price list to the Department of Revenue, and they must notify the state when those prices change. Those price lists are then shared with other wholesalers. Mr. Evans said that, as far as he knows, the price list has never been distributed to the public and that he has never had a request for a copy of the list.

Senator Craig Tieszen asked if it is a matter of law or a matter of practice that the Department receives those price lists and distributes them to other wholesalers. Mr. Evans said that he was not sure but that he did not think that it is in statute.

Senator Corey Brown told Mr. Evans that he would like to request a copy of the wholesale alcohol price lists that are on file with the Department of Revenue. Mr. Evans replied that the request is duly noted.

Continuing to answer questions, Mr. Evans said that the distributor must sell the liquor to each of the customers within their territory at the same price. However, the manufacturer does not have to sell to each distributor at the same price. A retailer cannot sell below the wholesale price. When a municipality is the sole owner of a liquor license, they are allowed up to a 5% markup on the product. That is not considered a tax and is not submitted to the Department of Revenue. Mr. Evans surmised that the markup fees are sent directly to the city finance office.

When asked how the territories are determined, Mr. Evans explained that the state is not involved in establishing territories. The territories are decided upon by the wholesaler and the distributor. Mr. Evans said that he believes there are so few territories because the license fee is $5,000 and that contracts are already in place regarding the wholesaler/distributor relationships.

Senator Ryan Maher asked if a retailer in one territory cannot purchase a product from his/her distributor, can the retailer go outside the territory to another retailer to purchase the product. Mr. Evans said that would be illegal as that purchase would be outside the three-tier system.

Senator Jim Bradford asked if the wineries are regulated as far as selling to minors. Mr. Evans said that the wineries must comply with state law regarding the sales of wine to minors. The Department of Revenue is not involved in compliance checks but rather local law enforcement is responsible for enforcing these laws.

Mr. Evans said that another resource is http://healthyalcoholmarket.com/pdf/IssueBriefs2014.pdf which is a compilation of 16 issue briefs about alcohol regulation designed for community leaders, elected officials, and policy-makers.

South Dakota Beer Distributors' Association

Mr. Bob Riter, Jr., registered lobbyist for the South Dakota Beer Distributors' Association, gave a PowerPoint presentation, "Regulating Alcoholic Beverages: States' Rights and Responsibilities" ***(Document #3)***.

Mr. Riter gave a summary of the history of alcohol sales in South Dakota going back to before prohibition. After prohibition, the three-tier system was adopted to help address the social ills that had led to prohibition. In 1990, the legislature set forth policy to provide for and facilitate the regulation of the importation, distribution, use and control of the sale of malt beverages (SDCL §35-8A-1).

In 1980, there were less than 50 brewers in the United States. Today, there are over 2400 brewers in the United States. In South Dakota, there are 11 beer distributors and they have 6,397 licensed accounts. There are 180 manufacturers/suppliers who work with those 11 distributors. In 2013, the South Dakota Beer Distributors paid over $6.3 million in state excise taxes. Also, in 2013, the malt beverage industry paid over $13.3 million in federal excise taxes.

Representative Timothy Johns, asked what the logic is behind the exclusive territories for beer distributors being mandated by statute. Mr. Riter said that territories exist to make sure the product is fresh and is distributed properly. The chapter that applies to territories directs the nature of the relationship and it is important that there be certain parameters. This insures that the manufacturer's requirements are met. The law also protects the distributor in that the manufacturer cannot choose not to uphold that end of the agreement. Mr. Riter continued by explaining that the exclusive territories address the quality control issue and it applies only to beer because it is a perishable product.

Senator Brown said that beer is unique in that any other product, such as cheese, is pulled from the shelf by the retailer when there is a recall, not by the distributor. Mr. Riter commented that he is only familiar with the business he works with, which is the beer distributors.

Senator Brown continued saying that South Dakota has mandates that retailers have no say in the agreement between the manufacturer and the distributor. The Senator asked if the retailer should be able to opt out of one territory and choose a different distributor. Mr. Riter said that the distributors are also responsible for collecting the taxes and allowing retailers to change territories would make that tax collection more difficult.

Senator Brown said that he is not opposed to the brewer defining the geographical boundaries but would like to know why a price in one territory can be so different from a price in another territory, with both territories within South Dakota boundaries. Senator Brown asked why there is not price parity throughout the state. Mr. Riter explained that there have been discussions regarding price parity. He said that there are special occasions, like the Sturgis Motorcycle Rally, when brewers want to promote a specific product in one territory and not in another.

Representative Troy Heinert said that the high prices charged by distributors in some areas can seem like price gouging, especially the rural areas. He said that he supports the three-tier system but does not like the prices being imposed unfairly between territories. Mr. Riter said that his organization is willing to discuss this further and see if a solution can be found.

Republic National Distributing Company

Mr. Jeremiah Murphy, registered lobbyist for the Republic National Distributing Company (RNDC), a wholesale wine and liquor distributor, spoke to the committee about the role the distributor plays in the three-tier system. Most businesses collect and remit taxes to the state, however, liquor distributors pay the tax to the state first and then collect it from the retailers. This practice means that there is a carrying cost to the distributors. Tobacco taxes are also paid in this manner.

Mr. Murphy said that the three-tier system helps address the dangers of alcohol. He said that in countries that do not use the three-tier system, the dangers of alcohol increase immensely.

RNDC's territory is the entire State of South Dakota. The producers expect the distributor to find ways to add value to the product, thus increasing sales. If the distributor does not do that, the producer will go with another distributor. Different distributors may have exclusive franchises for different brands.

Mr. Murphy said that RNDC would not be opposed to a direct shipment law regarding wine sales as long as those laws are consistent with existing liquor laws. Farm wineries are exempt from the 2% wholesale tax. Distributors do not have an issue with that exemption, but they do expect equitable taxation regarding the direct shipment of wine into South Dakota with the products sold through a distributor.

Mr. Matt Feichtinger, RNDC, joined Mr. Murphy at the podium to help answer questions from the committee. Mr. Feichtinger said that RNDC probably has about a third of the liquor distributorship sales in South Dakota. Representative Heinert asked how direct shipment sales of wine would impact RNDC. Mr. Feichtinger said that it would affect only a very small percentage of their overall sales and would have a minimal impact.

Senator Maher said that it is a challenge to purchase certain product especially in the western part of the state. The Senator asked why the retailer cannot purchase product from another supplier when the retailer's distributor does not have it available. Mr. Feichtinger said that the manufacturer makes those decisions and the requirements they have in place are to protect the best interest of all parties.

Senator Brown asked Mr. Murphy to work on a template for a workable law regarding direct shipment of wine. Mr. Murphy said that he would be willing to do that.

Licensed Beverage Dealers of South Dakota

Mr. Tim Dougherty, registered lobbyist for the Licensed Beverage Dealers of South Dakota, said that his client works on the retail level of the 3-tier system. The direct shipment of wine into South Dakota creates several challenges for the wholesalers and retailers licensed to do business in South Dakota. It is difficult for those licensed businesses to compete with those who operate outside the three-tier system. Mr. Dougherty said that he will work with Mr. Murphy on Senator Brown's request for draft legislation regarding direct shipping of wine

Mr. Dougherty pointed out some of the inequities of direct shipment of wines, such as: retailers have to purchase their product from a South Dakota wholesaler and does not have the option of purchasing on-line as does the consumer; the companies shipping the wines do not pay the same taxes as South Dakota companies; a retailer has to pay the municipal mark-up when operating in that type of community and the direct shipper does not; retailers must pay for advertising to entice people into their stores, they cannot set up a website and take orders online; and, the retailer has to enforce the age limits and can be penalized for failure to do so – the direct shipper does not. Mr. Dougherty asked that the committee keep in mind that direct shipment law must treat South Dakota retailers fairly, which means, at the very least, it must include licensing, tax remittance, and verification of the age of the purchaser.

Senator Tieszen asked Mr. Dougherty about price parity for alcoholic beverage sales in South Dakota. Mr. Dougherty said that he had not discussed that with the Licensed Beverage Dealers of South Dakota, but he also represents Anheuser Busch and that company is opposed to price parity. Mr. Dougherty said that there are states that require distributors to have uniform pricing but the prices will still vary from retailer to retailer.

Senator Bradford asked if Anheuser Busch charges each distributor the same price for their products. Mr. Dougherty said that they offer discount programs and other promotional deals in order to compete with other brewers and promote their products at various events. He said that other things, such as transportation, can also affect the price.

Wine Institute

Mr. Jim Hood, registered lobbyist for the Wine Institute, presented a PowerPoint presentation ***(document #4)***. The Wine Institute represents 800 wineries of all sizes and has worked with states for years on direct to consumer shipping of wine statutes.

Direct to consumer shipping of wine is critical for small wineries which account for 51% of direct shipments of wine. At this time, South Dakota prohibits the direct to consumer shipping of wine. Forty-one states and the District of Columbia allow for direct to consumer distribution of wine. North Dakota collected almost $200,000 in fees and taxes from out-of-state shippers last year.

Special mailing labels attached to the wine shipments require the receiver of the package be at least 21 years of age. FedEx and UPS have wine shipping programs that embed these requirements into their automated system.

In response to a question, Mr. Hood said that he thinks it is illegal to ship wine into the United States from another country.

South Dakota for Better Wine Laws

Ms. Dianna Miller, registered lobbyist for South Dakota for Better Wine Laws, said that South Dakota for Better Wine Laws wants the freedom to choose buying wines that are not just offered by South Dakota distributors. Ms. Miller had presented legislation during the past session, SB114, which addressed this issue. She distributed an information sheet that compares what her bill would have done in comparison to what neighboring states are currently doing ***(Document #5)***. After getting through the Senate, the bill was killed in the House Commerce Committee.

Wholesalers in South Dakota cannot possibly carry every wine available and are not willing to risk buying a shipment from a small boutique winery. However, South Dakotans want the ability to order these wines from the boutique wineries and have the wine delivered to their homes.

Ms. Miller said that this issue is also about economic development for South Dakota. It promotes tourism and wineries in South Dakota. The permit fees could generate up to $300,000 for South Dakota. This is something South Dakota taxpayers want.

Ms. Miller said that the malt beverage industry should have to pay the 2% wholesale tax just as the liquor industry has to pay. That requirement would make for a more level playing field.

Ms. Miller offered several reasons why people underage will not be able to use direct shipping to purchase wine ***(Document #6)***. The shipping companies used by the wineries for delivering the wine are all equipped to insure only those 21 and older can receive the shipment.

Ms. Miller said that the taxes and penalties can be written into the law and will make this a workable process.

Representative Johns said that putting penalties into law doesn’t help if the offenders are not prosecuted. He asked how many violations have been prosecuted in other states. Ms. Miller did not have that information available but said that she would try to find it and get it to the committee.

Committee Discussion

Senator Tieszen asked that the LRC staff summarize what has happened legislatively with this issue over the years.

Representative Heinert said that there are many different facets to all the information gathered and testimony heard at today’s meeting. He suggested that these issues should not all be lumped together.

Representative Solum said that they will continue to look at all of the issues as directed by the Executive Board and then generate a final report. If the committee agrees on legislation that should be drafted, that will be presented to the Executive Board with the final report.

Next Meeting

A MOTION WAS MADE BY REPRESENTATIVE ROUNDS, SECONDED BY SENATOR TIESZEN, THAT THE NEXT MEETING BE HELD ON JULY 7. The motion prevailed on a voice vote.

The next meeting of the Alcoholic Beverage Shipping and Distribution Interim Study Committee will be Monday, July 7, 2014, in room 413 of the State Capitol in Pierre. Senator Brown said that he has a prior commitment on that day and will not be able to attend.

Representative Solum said that, in addition to the agenda speakers, the committee will hear public testimony at the July 7 meeting.

Adjourn

SENATOR TIESZEN MOVED, SECONDED BY REPRESENTATIVE ROUNDS, THAT THE ALCOHOLIC BEVERAGE INTERIM STUDY COMMITTEE BE ADJOURNED. The motion prevailed unanimously on a voice vote.

The Committee adjourned at 4:00 p.m.