

Thank you Chairman Pyle and Democratic Chair Deasy for allowing us to testify.

The Malt Beverage Distributors Association primarily represents Beer Distributors (D) who sell at retail, mostly to the general public, and also those who also sell to other liquor licensees. Most sales to other licensees are by an Importing Distributor (ID), or wholesaler. We are specialty retailers and in general about 85% of our sales is beer for off premises consumption. However, a few of our members have licensee sales as the bulk of their business. The law narrowly defines what we sell and limits each person to one distributor license. As a general rule, each of us who purchased a “D” license believed they were buying government-created access to a limited market niche.

Overall, if the General Assembly wants to turn the current beer marketplace, which is now well served by local, private, independent small businesses who are active in their local communities, and who have invested most of the value that they have earned throughout their lives in their enterprises, over to predatory multi-state corporations with billions to invest, HB 1644 is the legislative vehicle to get this done.

Simply stated, most your family-based home distributors will be gone within a few years. Those that remain will be severely constrained by economics as to how they operate and serve their customers.

HB1644 claims to improve “customer convenience” without defining this goal. We submit, if passed, it will leave most consumers finding far fewer outlets in competition with each other offering any genuine selection because the marketplace will fall under the control of a few big box stores, all of which can easily make alcoholic beverages a loss leader and limit selection. As has now been demonstrated in other states, this kind of new marketplace attracts predatory businesses – exactly what our current system was designed to prevent. Over a short time, consumers will pay more and have less selection when they shop.

In our state today there is still vigorous competition in the beer marketplace for takeout sales (off premises), just as it has been for the past 80 years. It is primarily between local distributors – at least for those of us who have not been overrun by the existence of several nearby grocery stores or gas stations. Overall, our toughest competitor, when it comes to price, selection, and service, is still another local distributor.

Under HB 1644, as distributors quickly lose market penetration, consumers will be hurt because they will be buying beer in a market environment that is devoid of serious competition. Today, 20% of the beer brands make up 80% of the sales. As time goes by, big box sellers and their ability to engage in predatory loss leader pricing, will eliminate more and more of the beers that do not produce the necessary volumes to justify having a space on their shelves. In other words, it's the craft beers and smaller Pennsylvania brewers who will suffer, and consumers who want both choice and selection will find it increasingly difficult to meet their needs, whether buying beer brewed here or elsewhere.

Our question to you. Does a policy of “convenience” mean that at least a few bottles of wine and malt or brewed beverages should be available at as many outlets as possible? HB 1644 further enables 10,000 plus serious takeout outlets in Pennsylvania. Shifting to a Restaurant licenses (R)-based takeout system will create more and more outlets offering less and less selection – everyone would be primarily retailing those products that move quickly, those that make up 20% of the sales today. A few years ago when the LCB stopped publishing a record of the variety of beers available in our state, the number was at 10,000. Big grocery store chains in the Pittsburgh area advertise that they have “over 200”¹.

¹ Attached is a recent mailer promising “hundreds of varieties” from an area of the state where our members offer more than a thousand. Note the “\$5.00” certificate excludes “alcoholic beverages”.

In every local marketplace it is the home distributor that maintains the best selection.

Does the General Assembly intend to abandon our current system of having licensee-investors who have bought their license to serve their customers, earn a living and provide for their families, grow it and resell it upon retirement? H.B. 1644 is a giant step in that direction with R-based annual permits carrying a \$25,000 yearly fee (or tax) creating a new hybrid license. The protection of license equity is a common value of all industry partners in Pennsylvania². HB 1644 is another step to devalue current licensee's equity and, instead, substitute a permit system – a structure that would make the Commonwealth sole beneficiary of a licensee's innovation, hard work, consumer acceptance and growth.

We believe “consumer convenience” should include more than the ability to “buy beer” everywhere. Consumers do best in a competitive environment in which they have a real choice among vendors. Their response to retailers creates a “market”. That choice goes well beyond selection – which, in and of itself, is extremely important. It includes having personnel who will provide the shopper with friendly service and advice. It is important to have a vendor – such as a home distributor – who is in personal daily contact with his or her customers and is personally accountable to his or her community. If policy makers want retail sellers to be responsive to their customers and offer great selections on the shelves, they want retailers such as the home distributor who really focus on selling malt or brewed beverages.

Just as having too few retailers in a local area hurts competition, a competitive environment also depends upon not having too many. The policy goal is to strike a balance³. We believe the addition of large big

² In its 2011 Annual Report, the PFMA's advocacy included a number of “principles”. Number 4 was “The new system should protect the equity of current license holders.”

³ Commonwealth of Pennsylvania, Office of the Budget, Liquor Privatization Analysis, October 2011,

box outlets will put this state forever out of balance and ultimately hurt consumers. If the state loses this competitive marketplace it will never get it back and there will be far less “consumer convenience”.

It is important to note, if one reviews the literature from the Centers for Disease Control, **that increased access, or as they refer to it – density – is not a social good.** The CDC says, “The Community Preventive Services Task Force (CPSTF) recommends the use of regulatory authority (e.g., through licensing and zoning) to limit alcohol outlet density as a strategy to reduce excessive alcohol consumption and related harms.”

Picking “winners and losers”

Clearly, this is a bill that not only increases density but also has the government picking winners and losers – strongly and intentionally favoring those that qualify as a mega-corporation big box store with gross sales in the billions with unlimited capital to invest. Take a look at the market and you’ll see the independent grocery stores closing and selling to the mega big box giants.⁴

Home distributors are small, independent private businesses serving local consumers in “niche markets”, as described by the Pennsylvania Supreme Court in its Wegmans decision. We made an investment – a risk venture. Many of us have been able to grow these markets (businesses), but some, particularly because of the Court’s decision to allow grocery stores in the marketplace, are now fighting for their economic lives or have already closed. We bought the licenses and the government has changed the rules. The government’s policy was designed to prevent broad-based statewide retailing; we have played by

⁴ Last week in Lancaster County a 94-year-old 3-store independent grocery chain announced it was selling to Giant, with its stores to be added to their 181 locations. The seller cited “consumer buying habits” and competition as the prime reasons for throwing in the towel.

these rules for more than 80 years, and it is unfair now to allow national big box stores with their unlimited resources to drop into the equation.

Give us the tools

Give us the tools to meet our customer's expectations, don't throw us to the predators, and your constituents will be happy and our members will grow.

We do believe that your allowing distributors to sell any package of beer in any quantity is indeed customer convenience. Our customers buying habits tell us that. Your constituents like this. This has been good for our customers and for most in the Pennsylvania beer business. Our distributors report that where at one time they would see customers come in and quickly "buy" beer, they now observe them "shop", asking for recommendations and making comparisons. Some of our stores now have personnel trained as a cicerone (the beer version of a sommelier), to provide better service.

Our growth works for the consumer, because our ability to sell the greatest selection and have a prosperous business enables us to cater to the needs of all our customers – not just those who are only interested in buying the fastest-moving beers.

If you want to see us grow, and improve, give us stability and a level playing field with existing competitors. While we are limited primarily to one product – beer – our new competitors come into the marketplace with significant advantages:

- Grocers have thousands of other products to create foot traffic and the ability to sell wine, giving them an unfair edge in the marketplace, including high volumes with thousands of other products that allows for predatory pricing of beer.
- Gas station convenience stores -- Following a series of gas price wars in earlier decades that has virtually eliminated their small business competitors, gas stations are fewer in number and have

a product that all consumers must buy – gasoline – and inside food that, most would agree, “ain’t all that bad”, while offering more choices than the other chain alternatives.⁵

It is the laws of economics dictating that our ability to carry a wide selection, particularly a large number of limited distribution craft beers, is predicated on a healthy market for nationally-known beers. Without that volume, the laws of economics also forces distributors to limit their selection to the fastest moving beers⁶, if they can survive at all.

The “tied house” and “consumer convenience”

As local beer distributors, who buy either from an ID or a self-distributing Pennsylvania brewer, we often find ourselves competing to obtain units of certain popular seasonal products that are released in smaller quantities. This problem for us has become more challenging with grocery stores in the mix since certain brewers will promise these products in larger quantities to the large chains based on national accounts, leaving distributors with a very limited supply, despite the fact that we beat those competitors with non-seasonal sales. We, and our customers, become frustrated when these seasonal products are unavailable through the wholesaler, due to a practice that violates the three tier system and creates less customer convenience⁷.

⁵ Remember, after the General Assembly passed it’s last road tax increase, one state convenience store chain complained publicly because their customers will now pay more for fuel and thus have fewer dollars to spend inside where their profit margins are higher. These stores want to sell beer to bring customers into the store. Thus, there is little selection and they can engage in predatory pricing.

⁶ A Pittsburgh area grocery store has put up large banners advertising 200 selections. That’s about one fifth of the selection offered by local distributors. It is our ability to provide overall good prices, selection and service that has kept us profitable. Our distributors are the prime competitor to the grocery store with their documented need to cull shelves of unprofitable products.

⁷ To their credit, some wholesalers decline to engage in this practice, standing up for their customers, including the distributor.

Meanwhile, retailers with large numbers of stores, such as Wal-Mart, Trader Joe's and Kroger, have created private label beer – products that will not be available to us or our consumers through the state's three tier wholesale system. Examples are Wal-Mart's Trouble Brewing After Party Pale Ale, Kroger's Dieselpunk Pilsner, and Trader Joe's Josephbrau Plznr (sic). As more and more private label beer is produced, consumers will find that certain brands are unavailable to their neighborhood distributor, or to any other local licensee. Thus, there will be less “consumer convenience”.

The three tier system is designed to regulate alcohol and to provide a level playing field for retailers by eliminating the “tied house”⁸ – domination of local markets by sellers who are contractually bound to a single brewer. This is an important element of “consumer convenience”. Private labels will cut out the local Pennsylvania merchants. (This topic could be, we suggest, a subject for one or more public hearings since it can, without doubt, eliminate a substantial element of what our customers view as “consumer convenience.”) This “private label threat”, as discussed in the Harvard Business Review⁹, has been a concern in the world of marketing for a long time, but is only now becoming a front-burner issue relevant to the sale of malt or brewed beverages in our Commonwealth.

⁸ As the California Supreme Court explained, “by enacting prohibitions against ‘tied-house’ arrangements, state legislatures aimed to prevent two particular dangers: the ability and potentiality of large firms to dominate local markets through vertical and horizontal integration . . . and the excessive sales of alcoholic beverages produced by the overly aggressive marketing techniques of larger alcoholic beverage concerns” 5 Cal. 3d 402, 407–408 (1971)

⁹ Quelch and Harding, Brands Versus Private Labels: Fighting to Win, Harvard Business Review, January-February 1996.

More outlets will lead to less competition, worse selections and less “consumer convenience.”

This bill provides no additional consumer convenience while, at the same time, seriously eroding the ability of home distributors to continue offering a viable, strong business model that often offers five times as many products and service. Don't believe me, ask the clerk at the big box store to carry your beer to the car or ask them if they have the latest limited non-seasonal release from a local or regional brewery (it is usually gone before it gets approved by “corporate” to make it into the product set).

As you walk down the aisle of any retail store, be aware there is a serious battle going on around you. It is for your attention, and reaction, by making a purchase. Each product is reaching out to become your choice and thereby make a payment to the retailer on that day's rent for the privilege of being on it's shelf. Though currently illegal selling beer in the Keystone State, it is considered acceptable practice for purveyors of retail products to kick back to the store as they vie for your attention.

- Companies pay **slotting fees** to introduce a new product.
- They follow up with **pay-to-stay fees**, which could a discounts or free bonus cases.
- And there are **display fees**, intended to put certain products where they will most like attract the eye of a consumer.

Currently, these are not allowed in Pennsylvania. However, these kinds of restrictions are impossible for the LCB to police when the licensees have business locations outside of our Commonwealth, where these kinds of arrangements are legal. This is an example of the kinds of influences that can impact the competitive marketplace in Pennsylvania and, in the final analysis, hurt our consumers.

If you want quality selection and service in the sale of malt or brewed beverages in an adult oriented local business, the D distributor

needs to be enabled. We know the market is king, and the most serious competition in any Pennsylvania beer marketplace is a locally owned independent beer distributor. It a place where the owner-investor and the employees know the customers, their likes and dislikes, and receive immediate feedback on that which is occurring in the marketplace.

HB 1644 adds steroids to the concept of R-based selling of takeout beer which primarily benefits only the big box stores. In most marketplaces, it will eliminate the strongest competitive retailers in the marketplace for consumers to buy beer – it will instead enable consumers to only buy beer from a big box grocery retailer, creating a parallel disincentive against those Pennsylvania residents who shop at and maintain other smaller specialty stores.

A new beer tax

The \$25,000 annual fee will have to be paid by the beer customer. **This is a new tax!** Vendors with these licenses will have to compete and recover these charges from the customer. This will become easier for them to do as they force out the smaller competitors in each marketplace.

If this committee truly wants to provide better “customer convenience”, we would offer just two suggestions:

1. Work carefully with all industry partners to craft limited necessary incremental changes with an already privatized industry and, most of all, create multi-year stability in the marketplace to allow current D licensees to mature and grow their home-grown Pennsylvania small businesses.
 - a. In Pennsylvania, the act of buying a liquor license is that of buying access to a particular market – nothing more. It does not guarantee success and investors rely upon the state enforcing all the rules to keep the playing field level.

- b. Eliminate the consideration of bills that alter the market investments of licensees thereby creating an atmosphere of uncertainty – this makes it difficult to innovate and, particularly, to borrow money to invest. Why would a home distributor borrow to improve the store if they may be out of business next year because you have changed the rules? Why would a banker lend to a distributor at this time?
2. Level the playing field on sales taxes for off premises sales in the portion of the state outside of Philadelphia and Pittsburgh.
- a. A level playing field is fair to all. It improves the competitive environment and is good for the consumer.
 - b. In Pittsburgh and Philadelphia, all off premises customers pay what they see as a sales tax, no matter what kind of license the retailer carries.
 - c. You have a number of options. We suggest you pick one.

Again, thank you for the opportunity to state our case. While you care about consumer convenience, we do too as we compete every day to provide it in a fashion that is better than the retailer down the street – a private business selling an identical product. Brewers compete by working to create a better beer; we compete by providing consumer convenience, selection and providing a better shopping experience.

Please don't let your consumers and us down!



Create YOUR OWN 6 PACK

Choose from *hundreds of varieties* of beer.
Mix one up today and find your new favorite brew!

Great Beer & Fine Wines!



- Featuring hundreds of varieties of crafts, imports & more!
- Choose from our large selection of single serve beer & wine.
- Relax at our cafe seating with a store made pizza and a cold beverage.

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VALID THROUGH 08/21/11
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Savings redeemable with this coupon, your club card and the purchase of \$25 or more. Excludes postage stamps, money orders, milk, cream, lottery tickets, cigarettes, tobacco products, gift cards, alcoholic beverages, gasoline purchases, reservations, phone and utility payments, Western Union and where prohibited by law. Cannot be combined with other basket offers in the same transaction.

\$5.00 OFF
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