House Appropriations Committee
2018

Written Remarks Submitted for the Record
On Behalf of the Pennsylvania Liquor Control Board (PLCB)

Tim Holden, Chairman, testifying with
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Chairman Saylor, Chairman Markosek, House Liquor Control Committee Chairman Harris, Chairman Costa, and members of the House Appropriations Committee, thank you for the opportunity to submit remarks for the Pennsylvania Liquor Control Board's (PLCB's) budget hearing.

During Fiscal Year (FY) 2016-17, the PLCB navigated a host of opportunities and challenges as the result of the Liquor Code reforms included in Acts 39, 85, and 166 of 2016. The Board is pleased to have this occasion to brief the committee on the agency's efforts and innovations during the past year, and where we are headed.

We are cognizant of the challenges the General Assembly faces each year during the appropriations process, and consequently it is important to highlight the unique role of the PLCB. In contrast to most other state agencies, the PLCB receives no appropriation from the General Fund, but rather is funded by revenues from the distribution and sale of wine and spirits. In addition to taxes collected by the PLCB, the agency's transfers to the General Fund and other agencies supports essential Commonwealth programs that benefit Pennsylvanians across the state. The Board remains committed to generating a significant return for the Commonwealth each year, and continues to explore new and innovative opportunities to serve our customers, licensees, and stakeholder partners in the beverage alcohol industry.

In FY 16-17, PLCB sales of wines and spirits totaled a record $2.53 billion (inclusive of all taxes). This represented a 3.9 percent increase over the prior fiscal year. Spirit sales grew 2.9 percent and wine sales increased by 5 percent, with robust 24 percent growth in our Chairman's Selection® and Chairman's Advantage® categories. Retail sales to individual consumers grew 1.7 percent, while wholesale sales to licensees increased by 12.3 percent, reflecting the shift in wine sales to wine expanded permit holders including licensed grocery stores and convenience stores.

As a result of our record sales, PLCB contributions to state and local government beneficiaries totaled approximately $765 million for the fiscal year, an increase of more than $138 million, or 22 percent, over the prior year. A breakdown of those transfers is provided below:

- $503.9 million in tax revenue remitted to the General Fund ($361.9 million in liquor tax and $142 million in sales tax), representing an increase of $19.9 million over the prior fiscal year.
- $216.7 million in cash transfers to the General Fund, which represented a $116.7 million increase over the prior fiscal year.
- $28.1 million to fund the operations of the Pennsylvania State Police's Bureau of Liquor Control Enforcement, representing an increase of more than $2 million over the prior fiscal year.
- $9.1 million in local sales taxes collected and remitted to Philadelphia and Allegheny County.
- $4.5 million in license fees collected and returned to local municipalities through the Liquor License Fund.
- $2.5 million to support programs at the Department of Drug & Alcohol Programs.
- $1.1 million to fund alcohol education grants to community organizations, law enforcement agencies, schools and colleges during the second year of the 2015-17 grant cycle.
- $1 million in grants recommended by the Pennsylvania Wine Marketing and Research Board to enhance the Pennsylvania wine industry and increase production of Pennsylvania-made wines.

In addition, the PLCB transferred more than $13 million to other Commonwealth agencies as a result of billing for inter-agency services:

- $3.1 million to the Office of Administration for consolidated data services, classification and pay services, strategic services/SEAP, SAP-based services, and telecommunication charges.
- $944,000 to the Department of General Services for real estate and shared services, employee self and tort insurance, warehouse and distribution services, and Capitol Complex services.
- $4.7 million to the Comptroller.
- $3.1 million to the Auditor General.
- $1 million to the Civil Service Commission.

- $350,000 to Payroll Operations.
- $160,000 to Treasury.

The PLCB continues to prioritize efforts to leverage data and key performance metrics to inform our business decisions and control expenses. As a result, despite the implementation costs related to the 2016 liquor reforms and other fixed costs outside the PLCB's control, last year the agency increased net cash flow from operating activities to $184.9 million, $13.1 million over FY 2015-16. Gross margin decreased to 30.9 percent in FY 2016-17, down from 31.3 percent the prior year, due to a combination of factors including the transition of retail sales of wine to wine expanded permit holders (and the loss in revenue associated with their 10 percent licensee discount) and the statutory reduction in the markup for special orders (formerly special liquor order, or "SLO"). Net income increased to $104.9 million in FY 2016-17. The slight improvement in net income resulted from increases in license fees (surcharges) of $17.9 million and gross profit growth of $16.3 million. Such growth, however, was substantially offset by a $30.3 million increase in operating expenses.

Regarding operating expenses, as with all state agencies, the PLCB continues to navigate the challenges involved with rising expenses related to Commonwealth-negotiated benefit and pension costs. Salary and wages increased by $7.5 million, or 4.4 percent, due largely to commonwealth-negotiated rate increases and higher overtime associated with expanded Sunday and holiday sales hours. In FY 2016-17, benefit expenses increased by $16 million over the prior year, which was primarily engendered by an increase in pension costs ($10.3 million) and worker's compensation ($4.3 million).

In 2016, the most significant changes to the Liquor Code in more than a generation were passed by the General Assembly and signed into law by Governor Wolf. These reforms fundamentally altered many of the PLCB's business and regulatory operations. The implementation of all the changes resulting from Acts 39, 85, and 166 of 2016 is a multi-year endeavor; however, the PLCB has worked quickly to enhance customer convenience and generate additional revenue as the result of these changes.

The 2016 liquor reforms provided opportunities for the PLCB and the beverage alcohol industry to respond to changes in customer shopping habits and interests. As a result of the flexibility afforded by Act 39, the PLCB currently operates 328 Fine Wine & Good Spirits stores on Sundays, more than half of all stores. In addition, the PLCB, in partnership with the Pennsylvania Lottery, moved rapidly to install the necessary equipment and now maintains PA Lottery machines at 312 stores. Further, the PLCB has flexible pricing discretion with respect to the top 150 most sold brands and product types of wine and spirits, as well as limited-purchase and discontinued items, allowing the

PLCB to actively negotiate with suppliers to obtain better product acquisition costs while seeking to maximize Commonwealth revenue on the sale of wine and spirits.

Wine expanded permits (WEPs) and direct wine shipping were two other elements of Act 39 that were designed to enhance customer convenience and access. The PLCB has issued more than 600 WEPs to licensees (including grocery and convenience stores), and the PLCB's sales of wine to WEPs has now exceeded $100 million. Approximately 950 direct wine shipper licenses are maintained by wine producers, who are able to ship wine to PA residents for their personal consumption (wine excise tax and sales tax collected by direct wine shippers are remitted to the PA Department of Revenue, not the PLCB).

Act 39 authorized the PLCB to auction expired restaurant licenses that have been not renewed, were revoked or are ineligible for safekeeping. The agency, through a sealed bid process, conducted four license auctions since the passage of Act 39, which included a total of 190 licenses, and we recently introduced 30 more licenses in the fifth auction, to be concluded in April. Funds collected from the license auctions are held in escrow until the license transfer is approved and completed. Auction revenue recognized in FY 2016-17 and so far in FY 2017-18 totals $14.1 million, and another $9 million is in escrow pending resolution of the transfer applications. The PLCB expects to conduct three to four license auctions annually for the next several years.

The special order process also saw changes in 2017 stemming from the 2016 liquor reforms. Licensees and retail customers benefitted from a reduction in the PLCB's markup from 30 percent to 10 percent on special orders, which are items that the PLCB does not carry in inventory but facilitates the sale between suppliers and customers. To empower our licensee community and increase the efficiency of the special order program, special orders can now be made online through the PLCB's eCommerce site. Licensees can also approve orders that suppliers have entered on their behalf through the Licensee Online Order Portal (LOOP). These changes have improved the accuracy and accountability of the special order process for consumers, licensees, and suppliers. We continue to evaluate feedback from our suppliers and the licensee community and will continue to work together to improve the special order process.

The implementation of these liquor reforms is a multi-year endeavor. In 2018, the PLCB will continue to evaluate a potential customer relationship management program, redesign its e-commerce website, develop a buy-online-pick-up-in-store program, work on direct-to-licensee and direct-to-consumer delivery, and leverage marketing opportunities and flexible pricing in collaboration with our supplier partners.

While the fiscal impact of some aspects of the recent liquor reforms can be easily quantified since the inception of Act 39—such as the $16.6 million received from the $700 license surcharge fee, the $1.3 million received from the conversion of eating place retail dispenser to restaurant licenses, and the aforementioned $14.1 million from license auctions—other elements, like the impact of Sunday sales, and cannibalization of PLCB wine sales by direct shipping and sales by WEPs—are difficult to fully ascertain. Because the liquor reforms included a plethora of interconnected changes that continue to evolve the marketplace for beverage alcohol in Pennsylvania, the isolation of any one factor is increasingly challenging over the course of time.

These recent enactments have also benefitted Pennsylvania alcohol producers. Licensed breweries, limited wineries, and limited distilleries are now able to sell each other's products for consumption at their licensed premises. Further, two industry promotion boards were created to seek ways to enhance Pennsylvania's winery and brewery businesses. Last year, the PLCB awarded nearly $1 million in grants based on grant applications submitted by the Wine Marketing and Research Board. We anticipate receiving grant applications from the Wine Marketing and Research Board and the Malt and Brewed Beverages Industry Promotion Board for up to $2 million for FY 2017-18. The PLCB also has a "Pennsylvania Proud" program designed to assist limited wineries and limited distilleries by allowing them to select up to 10 of their products to sell at 10 Fine Wine & Good Spirits stores, enabling them to market new products and enhance their visibility.

The pace of legislative change with respect to the Liquor Code and the PLCB did not slow in 2017. The General Assembly passed, and the Governor signed, three additional pieces of legislation that impacted the liquor industry: Acts 42, 44, and 75 of 2017. While these enactments included several narrow provisions primarily impacting licensees, the most notable provision with respect to the PLCB relates to the provision in Act 44 related to the much publicized "stop and go" issue. Act 44 permits the PLCB to suspend a licensee's authority to sell alcohol if the premises is found, by a PLCB licensing analyst, to no longer meet the statutory or regulatory requirements for the license, including square footage, seating, food, health license, or room requirements.

In response to this new grant of authority, the PLCB developed the Licensee Compliance Program. Through an email resource account, community members and other stakeholders can submit complaints about a particular establishment relative to these compliance issues. If the complaint falls within the jurisdiction of the compliance program, a PLCB investigation is scheduled or, if the nature of the compliant falls outside of the scope, the complaint is referred to the Pennsylvania State Police Bureau of Liquor Control Enforcement (BLCE) or other appropriate authority. The agency developed fact sheets regarding the Licensee Compliance Program, which are available on the PLCB website. These fact sheets were distributed to licensees and community groups to provide guidance on how a complaint may be filed, detail the investigatory and suspension process, and identify the various license requirements.

Beginning in January 2018, PLCB licensing personnel, in partnership with BLCE officers who concurrently conduct separate investigations relative to their enforcement authority, began inspecting licensed premises based on complaints received through the resource account. As of February 9, 66 complaints were recorded as compliance checks, resulting in 70 inspection attempts: 66 in Philadelphia, two in Dauphin County, one in Delaware County, and one in Lackawanna County. In 49 of those 70 inspection attempts, the licensed premises was found to be compliant, but in 14 cases the PLCB determined the premises was not compliant and immediately suspended the licensee's operating authority (the PLCB was unable to conduct an inspection in the remaining seven attempts). In all 14 instances of suspension, when the PLCB came back at the request of the licensee for reinspection, the licensee was deemed to be compliant again, and operating privileges were restored.

Finally, while the PLCB is charged with acting as the Commonwealth's responsible seller of wines and spirits, a critical component of the agency's mission is to help prevent underage and dangerous drinking and promote socially responsible consumption of alcohol. The PLCB recently launched the *Know When. Know How.* campaign, targeting parents of children ages eight through 12. This statewide education and prevention campaign is designed to educate parents about the importance of beginning a conversation about underage drinking with their children at an early age. Research has demonstrated that talking with children at an early age about why and how to avoid underage drinking is critical to preventing underage drinking as children grow older and face peer pressure to consume alcohol. This campaign provides parents with the information, tools and confidence they need to engage their children and create an ongoing conversation about the issues surrounding underage drinking. The *Know When. Know How.* campaign includes digital and traditional media elements, all driving to www.KnowWhenKnowHow.org, where parents and partners in promotion will find the tips and resources they need to begin having meaningful conversations about underage drinking early and often.

In conclusion, we want to take a moment to recognize the dedicated PLCB employees throughout the Commonwealth, whose efforts to adapt to operational and regulatory changes over the past year have been tremendous. The Board sincerely appreciates their service to our customers and commitment to the success of the agency.