Workgroup on Montgomery County Department of Liquor Control
Minutes
Thursday, September 15, 2016
1:00 pm – 4:00 pm
Executive Office Building (EOB), 9th Floor Conference Room, 101 Monroe Street, Rockville, MD 20850

Participants

Workgroup Members Present:

John Favazza, Deputy Director, Maryland Beer Wholesalers Association
Gino Renne, President, Municipal and County Government Employees Organization
Hans Riemer, Councilmember, Montgomery County
Jennifer Hughes, Director, Montgomery County Office of Management and Budget
John Zeltner, Chief of Wholesale Operations, Montgomery County Department of Liquor Control **for**
Fariba Kassiri, Interim Director, Montgomery County Department of Liquor Control
Kevin Atticks, Founder, Grow & Fortify; Executive Director, Maryland Wineries Association/Brewers Association of Maryland/Maryland Distillers Guild
Charles Barkley, Delegate, District 39, Montgomery County
Alexandre A. Espinosa, Director, Montgomery County Department of Finance
Brian Vasile, Managing Partner, Brickside Food and Drink
Robert (Bob) Mutschler, Sales Manager, Republic National Distributing Company
Joseph A. Giardina, Division Manager, Breakthru Beverage

Workgroup Members Absent:
Pinky Rodgers, Owner, Pinky & Pepe's Grape Escape

Guest Presenters:

Tom Mangels, Vice President of Administration, The Katcef Companies
Harold L. Higgins, Chief Administrative Officer, Worcester County (via teleconference)
Mark Bucher, Owner, Medium Rare, previous owner Burger Joint
Randall Bauer, Director, PFM Group Consulting
John Cape, Managing Director, PFM Group Consulting

Minutes

The meeting was chaired by Bonnie Kirkland, Assistant Chief Administrative Officer for Montgomery County, and began at 1:02 pm. After introductions, Ms. Kirkland reviewed the meeting agenda.

Presenter: John Favazza, Director, Maryland Beer Wholesalers Association (MBWA): MBWA Support

Mr. Favazza of the Maryland Beer Wholesalers Association introduced himself and the association remarking that Montgomery County Department of Liquor Control (DLC) was a member of the association. Mr. Favazza stated that in order for MBWA to support any state law changes effecting Montgomery County, they would need to be consistent with the rest of the state of Maryland.

Tom Mangels, Vice President of Administration, The Katcef Companies: Beer Wholesalers

Mr. Mangels introduced himself and stated that he was going to give an overview of the basic role of a beer distributor. Mr. Mangels further stated that the County is unique because it is the only control jurisdiction that includes malt beverages.

Mr. Mangels described how distribution companies can set up brokerage companies. Mr. Mangels further described how Katcef, Annapolis, MD, is a beer wholesaler that forecasts orders from manufacturers and suppliers and receives them and that the county does the same thing. In addition to this, Katcef has a logistics manager who forecasts and a pre-sales team that works with retailers to provide for product freshness. Mr. Mangels explained that unlike other alcoholic beverages, beer does not improve with age, and freshness is important.

Mr. Mangels stated that in Montgomery County, wholesalers such as Montgomery Eagle, do not place orders.

Mr. Zeltner stated that companies have an option to place orders if they choose to.

Mr. Mangels continued to explain that Katcef delivers beer to accounts, sales reps ensure product is properly rotated and DLC does not have a process to rotate product. Mr. Mangels explained how Montgomery Eagle staff identify out-of-code product, replace it and give clients' refunds. Mr. Mangels stated that, currently, DLC does not assume the cost for these out of date products. Katcef sales and marketing does the same as Montgomery Eagle sales and marketing do, but there is a whole lot more to selling beer. The County does not have product marketing. This is how beer wholesalers add value to the products sold.

Mr. Mangels voiced that wholesalers also have a grievance agreement with their supplier that DLC does not have. Mr. Mangels stated that Anheuser Busch could terminate a contract with a wholesaler if beer is consistently out of date. Mr. Mangels identified that DLC does not have sales reps and does not have this burden.

Mr. Mutschler noted that that is a good thing for Montgomery County.

Mr. Zeltner stated that DLC, by law, cannot have a sales force, and that is why we have a brokerage firm to do this (referring to the private distributor's sales team).

Mr. Mangels reiterated that beer wholesalers operate differently than wine and spirits companies.

General Discussion

There were no specific questions for Mr. Mangels.

Ms. Kirkland acknowledged Mr. Adam Pagnucco, a grassroots organizer and member of the public, as being present on the phone.

At this point Ms. Kirkland introduced Mr. Butcher, licensee and owner of Medium Rare in Bethesda, who was not able to connect at the previous meeting, and, therefore, was invited to speak at this meeting. Ms. Kirkland stated that Mr. Butcher has experience working within three different jurisdictions, including Montgomery County.

Discussion of Organizational Models with Licensees

Mr. Butcher explained that he has been in the restaurant business since 2008, previously owning three Burger Joint restaurants in Montgomery County, and has two new restaurants opening in Bethesda. Mr. Butcher stated that also he operates two restaurants in Washington, DC and two in Alexandria, VA. Mr. Butcher revealed that his family started Premium Distributing and currently has some ownership in a subsidiary called Walker, that operates in a few northern states on the east coast.

Mr. Riemer asked if this distributor currently operates in MD to which Mr. Butcher replied that his family had sold the company in the early 1960's and that he no longer has a family interest in a distributorship in MD.

Mr. Butcher stated that from his point of view, the Montgomery County system works very well for him because he has one place to order, one place to track inventory, and one shipment to receive. He explained how in DC, his businesses each have multiple providers, three for beer, another for vodka another one for gin all with separate tracking and separate invoices, and they all deliver at different times each week. Mr. Butcher indicated that DC has a monopolistic system. He explained that in the District, one distributor carries each product. If you have a payment issue, all distributors will collectively shut you down. No one will contact you - you have to figure out who you owe and why.

Mr. Butcher stated that if Montgomery County was not in the business then private wholesalers, such as Republic, would become the County, and that is significantly worse. Mr. Butcher further stated that in Montgomery County he can get things on sale, and if he runs low on a product he can get the wholesale price at the DLC retail stores.

Mr. Butcher detailed several challenges in VA: some private delivery trucks are not allowed in certain counties; there are different delivery days; and, there are different payment days. Mr. Butcher further detailed how, if Montgomery County was not a control jurisdiction, there would be four large beer trucks delivering four different times a day in Bethesda with no loading docks or loading zones. This would block traffic and cause problems, and all of these types of issues need to be taken into consideration, Mr. Butcher declared.

Mr. Butcher continued, stating that the County doesn't carry everything - nor do the suppliers in the District. He argued that every wholesaler is lacking something. He explained that if he can't get one product, it has no impact on his operations, and that DLC prices are competitive to surrounding jurisdictions - DC and VA. and that pricing is the same.

Mr. Butcher explained that if there is an item he needs he has never had an issue with picking up the phone and calling DLC directly and asking for the product - the process is easy. Mr. Butcher further explained that in DC or VA, it is very complicated because the product has to be slotted at the warehouse, you have to find the sales rep., which is a lengthy process, etc. He stated there is a flip side, as private wholesalers offer product support, such as helping make up a wine list. He continued, stating that if he needs expertise, or product support, he reaches out to sales reps. Because of the rules in the Montgomery County, he doesn't receive support in the same way but reps are still always available as needed, he said.

Mr. Butcher commented that in Montgomery County you have a level playing field. He detailed how he doesn't have a sales rep swiping a credit card for $500 at his restaurant after he buys 10 cases of Absolut that day. Mr. Butcher indicated that he doesn't care about that, he doesn't need it, and it is a slimy back-end to the business.

Mr. Butcher advised that there are always going to be problems with the man whether it's Montgomery County, Premium, or whomever. He continued, stating that there is always going to be product that is out of stock and that is the way it is. There is never a steady stream of anything year round. Mr. Butcher stated that he is impartial, and from a business standpoint, likes the way Montgomery County is set up.

<u>General Discussion</u>

Mr. Vasile stated that he has been in DC for fifteen years and has had the opposite experience, noting that he and Mr. Butcher may have different business types, and detailing that out of stocks don't happen, and his restaurants within the District get beer promotions.

Mr. Butcher stated that everyone pays the same prices for beer to which Mr. Vasile stated that he disagrees and that prices fluctuate.

In response to a question from Mr. Riemer, Mr. Butcher stated that there are regulated prices, and that private wholesalers cannot cut the price for some businesses. There might be promotions running but there are regulated prices.
Mr. Zeltner stated there are quantity-based deals that can give price differences.

Mr. Mangels cited Title 25, Article 735 and 736, the law that allows the District to have no regulation on pricing. Mr. Mangels noted that in DC the only requirement is to have the price on the invoice, the wholesalers pay the tax.

Mr. Butcher pointed out that whatever the price is, there is only one supplier for each product and there is no competition.

Ms. Kirkland thanked Mr. Butcher.

At this point, Ms. Kirkland briefly described the meeting's attendees to include wholesalers, retailers, local chambers, members of the public and private sectors. She then introduced the next presenter, Mr. Higgins, who had joined via teleconference. Ms. Kirkland described to the workgroup that Mr. Higgins is the Chief Administrative Officer for Worcester County, MD, which was recently privatized. Ms. Kirkland noted that Mr. Higgins will speak on how private distribution coming into play was the genesis of the change for Worcester County. Ms. Kirkland summarized the presentation to include discussion on where they were, where they are, and how the process evolved.

Presenter: Harold L. Higgins, Chief Administrative Officer, Worcester County: Privatization in Worchester County

Mr. Higgins introduced himself and described Worcester County as a control county that generated about $15M to $18M in sales, of which $10-$12M was generated from wholesale and $5M-$7M was generated from retail sales. Mr. Higgins explained that their business plan had been based on a service model with deliveries any time of the week. The main warehouse was located in Snow Hill and most of the retailers were located in the town of Ocean City. He stated there were two retail stores within wholesale operations that ran out of the back for the convenience of the licensed businesses in Ocean City. He detailed how a couple of years ago, there was a change where Worcester County opened the market to private wholesalers as well, and this action generated questions as to why Worcester County was in the liquor business and led ultimately to a movement to privatize Worcester County. Mr. Higgins specified that there was an offer for Baltimore-based private wholesalers and distributors to buy it; however, this model was not advantageous to Worcester County. Still, commissioners wanted to privatize and are now on that track to cease operations, with product liquidation, by June 30, 2017.

Mr. Higgins pointed out that their size is very different than Montgomery County. For example, for off-premise sales, there were only nine or ten stores selling beer, wine, and liquor, and that most licensees in Worcester County are bars and restaurants. Mr. Higgins described how, as the political environment was moving toward privatization, they held work sessions. Businesses chose to proceed with the privatization model, and now he believes the big guys are happy. Mr. Higgins detailed how the small- and medium-sized businesses have indicated they are not happy with the new setup. Mr. Higgins further detailed how Worcester County did not charge for broken cases like the wholesalers now do and how businesses are also limited to two-day deliveries during the summer, which does not work well for small businesses that don't have the storage capacity like the larger businesses.

General Discussion

Ms. Kirkland asked for confirmation that Worcester County was out of the wholesale business currently.

Mr. Higgins responded that as of September 30, 2016, Worcester County will be out of the wholesale business and as of June 30, 2016, they were out of the retail business. The retail outlets are currently working on dissolving the last of the inventory. This process may be extended another 60 - 90 days' maximum.

In response to Mr. Renne's question on the impact of the lost revenue, Mr. Higgins stated that in their heyday, there was $400,000-500,000 net revenue going back to Worcester County. However, in the last few years they were operating at a loss., and revenue went down to $150,000-$160,000 in 2010-2015. It was hard to find replacement revenues. They had a total of 25 to 40 people employed.

In response to a question from Mr. Renne, asking what happened to the workers, Mr. Higgins stated that some were reabsorbed or relocated, some took retirement incentives, and that Worcester County had to supplement with temporary personnel to get through the last few years.

In response to a question from Mr. Mutschler, asking if getting out of the business was the plan or if it was just how it evolved, Mr. Higgins stated that when 20% of large businesses were accounting for 80% of the sales and they supported the movement, it became difficult to justify why Worcester County was in the business. Mr. Higgins stated that Worcester County had the best delivery but not always best price. Also, Worcester County's system prided itself on public safety so when liquor store staff were caught serving to a minor, those persons were automatically fired.

Ms. Redicker, President and CEO of the Greater Silver Spring Chamber of Commerce, asked Mr. Higgins if it would it be possible to get a copy of the survey from businesses who said they are unhappy with the new privatized system.

Mr. Higgins stated that there are a lot of small businesses that would rather not stir it up, and that he won't disclose their names. Mr. Higgins advised that getting out a list at this point would not help because they have already been sending out mass e-mails reading they are out of the business. Additionally, many businesses would not be blunt with the Chamber about how business is going for them.

Mr. Riemer, who had to leave early, stated that as he sees it, the ball is in the County Executive's court and that stakeholders will have to weigh in with the County Executive.

In response to a question from Mr. Cape, asking if there is any debt left over, Mr. Higgins stated, yes, the warehouse had a long term lease that will be paid off soon. Additionally, there was an interagency loan between the general fund and the liquor department, specifically a working capital loan, that will be dissolved as sales are liquidated.

Ms. Kirkland introduced PFM and distributed copies of the draft report. Ms. Kirkland stated that PFM has completed extensive studies in other states, some lasting a year. They have been given a very short turn around in this case, and the report is not complete. However, PFM will review models, gather feedback, and share a final report.

Presenter, Randall Bauer, Director, PFM Group Consulting; and John Cape, Managing Director, PFM Group Consulting: Process and Next Steps

Mr. Bauer stated he has worked with most of the control states, worked previously as a legislative analyst, and operated in this industry for more than 30 years. He further stated that he has advised on performance and analytics with control state changes and with forming a public authority. Mr. Bauer identified PFM as independent financial advisors to Montgomery County. Mr. Bauer stated that they will be detailing highlights of the report.

Ms. Kirkland explained that each option will be reviewed and then they will take questions for that option, reminding the workgroup not to focus on any topic for too long as there about nine to cover.

Mr. Cape pointed out the page on methodology, stating that they collected much data in a short time. Excel was used for a great deal of data collection to be able to extract data sets. The data was collected by a couple of other analysts who have a background in data collection and have gone through advanced training.

Mr. Cape then directed the workgroup to page four of the report, where a snapshot of Montgomery County is given. Mr. Cape acknowledged how much larger Montgomery County's operation is than Worcester County's was. He stated that three quarters of the $34M in annual profit comes from wholesale business and one fourth comes from retail sales. He noted that wholesale operations are "where the money is," and further noted that the chart will aid in analyzing the models. He gave the example that if you were to eliminate beer, it is evident how much it costs and how much revenue will be effected.

Mr. Cape referenced page eight, showing the debt profile. Mr. Cape identified that the debt profile makes Montgomery County very unique as bonds have been issued and secured by the DLC. Mr. Cape explained that while they are financial advisors to the County, they are also the largest financial advisor to County and State governments in the country and are in the market about 1,000 times a year. Mr. Cape noted they are in the market more than the big money banks, and have the opportunity to see how municipal debt behaves.

Mr. Cape directed the workgroup to page nine, showing how cash runs from net profits and is trapped into an account to be able to pay for the bonds and then the left over falls into revenue for the County. Mr. Cape explained that in FY16, there was $32M in profit, less about $10M of debt service, leaving about $22M as the net available to the county.

Mr. Cape, referred to page ten, and detailed how all of the net profits are pledged to the bonds. The rating agencies, and the DLC bonds are rated high at AA, look at the fact that DLC is a monopoly and all revenue has been pledged as security. Mr. Cape explained that there is three times as much net profit as there is debt, giving the rating agency comfort that there will always be sufficient funds to cover debt. Mr. Cape added that any change in that will have a material effect on bonds. Mr. Cape further explained that if there is any change to the system, you have to go to the bond holders and ask if changes concern them. You would have to enlist bond counsel, and it would be extremely laborious going to all bond holders. Mr. Cape reiterated that if there were any change to this process as it functions currently, you would need to enlist bond council even if there are still more funds than needed for bonds. Mr. Cape summarized that the rule of thumb is that if tax free bonds are issued for government use, those bonds cannot be changed without being reclassified.

General Discussion

Mr. Pagnucco, via teleconference, stated that he had a proposal before the workgroup that he did not see analyzed in the report, which was to combine DLC bonds with County cable franchise fees. He continued, stating that these fees net $14M a year, greater than the $11M debt. Mr. Pagnucco asked if this combined would satisfy the bond holders.

Mr. Cape explained that the pledged bond revenue is still changing. Additionally, cable revenue would have to flow into DLC, in order for that to work and you would have to get permission from bond holders to allow those funds to count as DLC revenue. You could pay off the bonds and re-issue them but there are costs involved and PFM would advise against that.

Ms. Hughes stated that the $14M in cable revenue is being used for priorities of both the Executive and County Council - it is not free money that has been set aside and is not available for refunding purposes.

Mr. McInerny asked if something could be done that was immaterial, that would not affect the bond holders, how many bonds were secured by the DLC, and what percentage of County debt was created by the DLC bonds.

Mr. Cape stated he did not know what percentage of the County's debt it represented but that the principal amount outstanding is a little less than $105M. He explained that the problem is that if you change the monopoly, it automatically makes it material. He further explained that if there were a $500,000 profit change, that may be something you could do but bond counsel would have to advise on the case with the models, all with a more than 20% change in revenue stream and this trips the scenario making material.

Mr. Espinosa stated that DLC funds were pledged.

Ms. Kirkland stated that the County is looking to raise revenue and support the bonds.

Mr. Espinosa added that even if you come up with a different source, this is different than the original pledge and, therefore, causes risk.

Ms. Hughes stated that when going to market with other bonds, there are variables in joining with other revenue streams. Ms. Hughes inferred that County bond types are not exclusive of each other so other County bond ratings could be impacted by a change in the liquor bonds.

Ms. Kirkland concluded that it is clear from the presentation that this is very serious and that any material change would have to be signed off by bond counsel.

Mr. Butcher asked if the bonds could be redeemed early and new bonds issued.

Mr. Cape replied that he cannot speak specifically to how you would structure that. There are new FCC regulations on who can council you on restructuring but in general there are costs associated with refunds. Apart from a change in interest costs, which can be high, the cost of issuance and principal are typically put into the new principal.

Ms. Kirkland directed the conversation back to Mr. Bauer who introduced the issues of repatriation and revenue.

Presenter, Randall Bauer, Director, PFM Group Consulting:

Mr. Bauer stated that a common argument for repatriation is that Montgomery County is a fairly wealthy county with a significant population and per capita sales numbers in comparison are lower than surrounding, wealthy counties. Mr. Bauer further stated that while there is a logical understanding that sales may be happening outside of Montgomery County, retailers have assessed trends and patterns as to where people buy things, like where they work, but there is so much more to consider. The way the system is set up may or may not be a consideration for capturing any sales and it would be very difficult to report on how many sales would be recaptured with changes in the control system.

In response to a question from Fred Silverman, audience member, Mr. Bauer stated that although they have done that comparison before, it is tricky. For example, Fairfax County in VA, is also a control jurisdiction, and it still may have impacts of a control system. Comparisons of scope have the same problem: a lot gets lost and consumer patterns are not always captured.

In response to another question Mr. Fred Silverman posed, Mr. Bauer explained that you cannot compare areas against each other because you lose value. You can use input and output values to figure out some of that but consumer patterns are not fully captured and numbers are not always accurate.

Mr. Cape made reference to the Office of Legislative Oversight (OLO) report, which makes a repatriation estimate showing that beer sales are low in Montgomery County and wine is close to the same. Mr. Cape noted that they use a number of variables including that a portion of the workforce is migrating to other areas. When you have a county surrounded by other counties with different models, the accuracy deteriorates.

Delegate Barkley stated that agency stores are a way to raise revenue and are not listed in report.

Ms. Kirkland stated that agency stores are not seen as a privatization model, but can still be used in combination with any of the models. Ms. Kirkland further stated that as models are discussed, agency stores will be revisited.

Delegate Barkley further stated that agency stores are still DLC stores and that spirits sales are down because of the lack of density of these stores, and noted that it may not be feasible to build that many more DLC stores.

Mr. Bauer agreed and supported this comment with the fact that the County is underserved and investing in additional stores was a recommendation made in a report PFM had previously done for Montgomery County. It is his understanding that DLC has currently been moving forward opening more stores.

Delegate Barkley reiterated that agency stores are an important idea and that he wants to make sure that it's not lost in the discussion.

Ms. Hughes referenced the Office of Legislative Oversight (OLO) report and stated that the County has significant issues with notations in that report.

Mr. Bauer made reference to the Maryland State Comptroller report advising that state taxes generated would not benefit Montgomery County.

In response to a question from Mr. Giardina, Mr. Bauer stated that PFM began analytics on August 24, 2016, noting they have been working for a couple of weeks with the Montgomery County Office of Management and Budget and the Department of Liquor Control to collect data.

Mr. Ozgo stated that there is an outlet shortage in Montgomery County. Mr. Ozgo further stated that, excluding Montgomery County, the consumption rate is 2.4 gallons per capita in MD versus Montgomery County where you have a rate of 1.4 gallons per capita. Mr. Ozgo reiterated that outlet density is extremely low, there are three stores for every 10,000 people in MD and in Montgomery County there are .34 outlets for every 10,000 - even lower that the average of 1.84 in control states.

Ms. Kirkland noted that this information was presented at the first meeting and that discussion and handouts on this topic are available on the website.

Mr. Bauer stated that one factor that other Counties don't have is that Montgomery County shares borders with Washington, DC.

In response to a question from Mr. Giardina, who asked if only Montgomery County information was used, Mr. Bauer stated yes, they used Montgomery County statistics and because they work with a lot of control jurisdictions, they know what to look for. As a follow up, Mr. Giardina asked if non-control jurisdiction data was used for comparisons. Mr. Bauer said yes, licensed states were also considered for comparisons.

A member of the audience pointed out that Montgomery County is the only place in the Washington Metropolitan Area that has two Seventh Day Adventist Hospitals and a Mormon temple. He identified that both of these communities do not consume alcohol and no other surrounding region has these sizable populations.

Mr. Bauer, referring to revenue, said that the state of Maryland jealously and closely guards the revenue from alcohol sales tax. Mr. Cape chimed in that this is true and, in his experience, more so than in most states. Mr. Bauer pointed out that local Counties are not allowed to impose an alcohol tax and that the County not having a tax structure for alcohol is a significant impediment. Mr. Bauer stated that if part of the County revenue stream is going to be removed and replaced with others, like property tax, then the many people in the County who don't drink are not going to be happy with that arrangement; and, it will be an issue with many voters.

Mr. Bauer explained that a monopoly is hard to replace with other revenue because the first thing the state will look at when they are having shortfalls is what they can keep for themselves that they are sharing now. Mr. Bauer advised that even if you can get the state to dedicate a stream of revenue, it can always be taken away. Local governments are creatures of the states. In most states, the state assumes power over counties. Maryland is a Dillon's rule state, as are 39 other states, meaning the local government may engage in an activity only if it is specifically sanctioned by the state. Mr. Bauer added that there are fees you could asses in the liquor system, and in most instances those fees can generate what it costs to run the system, but anything over that is a tax and the state has to give you the authority to do that and can also take it away.

Mr. Bauer advised that Montgomery County has had recent property tax increases and is at the maximum level of personal income tax - all significant impediments to a different revenue stream.

Delegate Barkley asked when the alcohol excise tax had last changed, and Mr. Bauer stated it is the lowest in the country. Amy Samman, legislative analyst for Montgomery County, stated that it was year 1972 or 1974.

Mr. Butcher said that it may be possible to pay credit card companies for credit card data by zip code. One such example is Data-Planet as that company will provide data on credit card purchases for liquor, powerful information in assessing where people are spending.

Delegate Barkley, referencing pages 40-41 in the PFM report, identified that Montgomery County used to have a lot of revenue sharing with the state and that it has been almost all taken away.

Ms. Hughes, reinforced that the first place the State goes to fill gaps in budgets is to the counties they share funds with.

An audience member, from the Wine Institute, voiced concern that the PFM report is using current operation revenues and expenses and that additional funding will be going toward boosting customer service such as new trucks and software, thereby increasing costs if DLC stays in the businesses.

Ms. Kirkland, explained that while there may be possible increased costs, there is also probable additional revenue generation. For example, the implementation of new stores will bring in revenue from sales.

Mr. Zeltner stated that the DLC is making progress with investments and that efficiency will drive revenue, adding that there will be less employee overtime etc.

Mr. Fred Silverman stated that past revenue was probably inflated due to missed maintenance which is now being remedied.

Ms. Kirkland explained that there is realization that expenditures may go up and that revenue may go up, but because they are not currently quantifiable, we are looking at current numbers.

Ms. Kirkland asked Mr. Bauer if he would take the workgroup through the options, starting on page 12 of the report.

Option Review

Mr. Bauer stated that **Option 1 - Privatizing Wholesale Distribution**

Mr. Bauer specified that the fiscal impact analysis was done by using volume to see how much income would be reduced and that it would likely cause a loss of $5M dollars. This is still considered a material change. There is some ability to make improvements but they are going to occur over time. There are also upfront costs that would include the labor force if people leave, such as payouts and vacations. Mr. Bauer quantified that in the short term the County may see a reduction, or impact, of about $10M.

Mr. Bauer implied that this would have an impact on businesses because they would be receiving multiple deliveries, multiple separate bills, and dealing with multiple distributors. There may also be a change to products offered.

Mr. Cape stated that supply chains need to have conversations with the private wholesalers to ask about access and availability.

Mr. Favazza stated that currently having duel distributorships in one territory is against the law and NBWA would oppose any change to that law for a hybrid option of having DLC and Katcef brothers selling the same product.

Mr. Mutschler proposed that with special order wines if DLC increases stock than that problem would go away.

Mr. Giardina advised that it would be economically infeasible for private wholesalers to just deliver to on-premise businesses and just special order products.

Mr. Bauer referenced alternative (a) and (b) and stated that the impact on debt is still significant. Mr. Bauer advised that if only beer was not sold, such as other state models operate, it would have a big impact to the bonds. In reference to (c), Mr. Bauer stated there would be a material impact on bonds but the County might be able to keep coverage ratios. There would be a rating downgrade but not as significant as some other options. Mr. Bauer further stated that beer is a different animal as kegs are heavy and have expiration dates. The reduction on the expenditure side needs to be looked at but there would still be a material concern, there would be an estimated $23.2M reduction in the revenue stream. This may not be practical but wholesalers would be willing to take that up. In reference to (d) Mr. Bauer detailed that there would be some savings but that it is not practical from the wholesalers' system.

Mr. Ken Silverman, chief of staff to Councilmember Riemer, asked if PFM explored the County selling beer franchises. Mr. Bauer answered yes, there is an estimated $50M tied to that but there are many ways to look at this. Mr. Cape stated that PFM used all data to come up with that figure, including private sector data. Mr. Cape further stated that this would be a one-time revenue that would not be dependable and added that most other control states do not control beer.

In response to a follow-up question from Mr. Ken Silverman, Mr. Cape stated that this has been done before in West Virginia. That state auctioned liquor licenses but they could have generated more revenue, as the auction process was not optimal for maximizing return. The process is tricky because it has to be fair and has to have minimal requirements set.

Mr. Bauer introduced **Option 2** **- Private Management or a Public-Private Partnership**

Mr. Bauer stated there are two approaches within this option. The first, (a) is having a private management contract, where you pay a base price and then offer additional payment for performance. There is a IRS regulation concern of private benefit from use of public facilities paid for with tax free bonds. There is some safe harbor that generally requires that the incentive payment is not more than 100% of the base payment and they cannot benefit from certain things. Mr. Bauer voiced that there is no other warehouse that has adopted this model making it difficult to gauge if this model would work.

Mr. Bauer identified that it would be hard to estimate the cost to have a private management firm come in and make decisions on where stores should be located as well as make high level management decisions. However, there is a model of Convention Centers that can be analyzed. Mr. Bauer established that these are publicly funded, tax exempt, and managed by private management companies. The Pennsylvania Convention center pays SMG, a management company, about $600,000 a year to manage their facility, and this may be comparable to Montgomery County. Even if that model proves to be feasible, there may be a wholesale conflict of interest for wholesale companies, and it is not clear as to who might take it on.

Mr. Cape mentioned that SMG can make a profit because they have more than 50 contracts nationwide.

Ms. Kirkland underscored that, unlike the convention center model, the private contractor would still need to bring in management level contractors adding additional costs.

Mr. Cape agreed that there may or may not be a company that is structured to handle this but he does not know of any and that there is risk.

Ms. Kirkland, detailed how the County would still have to pay for high-level employees and the County would still have to manage the contract.

Mr. Cape reiterated that the expertise in merchandising, marketing, and management may offer more profit, citing that there is an incentive for a contractor because they don't earn money unless they generate revenue.

Ms. Kirkland introduced Mr. Zeltner to the workgroup and identified him as the new Chief of Wholesale Operations for the DLC. She noted that he worked previously in the private sector of the alcohol industry and has hired several top managers, also hailing from the private industry. Ms. Kirkland stated that she wanted to make sure that the workgroup was aware of some of the changes in DLC management and to highlight that the assumption of this option was to bring in this type of talent. She further stated that Mr. Zeltner has been a great resource and hopes that he will continue to do the great work he's done along with his colleagues.

Mr. Bauer stated that he has enjoyed working with Mr. Zeltner and that he has been really helpful and is a good resource.

Mr. Renne stated that management is the best it's been, but they are still handcuffed by the County in many ways in areas of efficiency. Mr. Renne further stated that it won't matter who runs it if they're not given cart blanche power to make changes.

Mr. Zeltner answered that he has been with DLC a year next week and that he has not been told no to anything he has asked for yet, voicing that the County is fully vested.

Mr. Fred Silverman, audience member, noted that he would appreciate an easy understanding of the rating of the models.

Ms. Kirkland responded that at the last meeting there was a matrix with list of models and impacts. Ms. Kirkland explained they are planning to complete that matrix within a few days and it will serve as a snapshot of each option.

Mr. Bauer introduced the second portion of the option, (b) the Maine Model. After re-contracting in 2014, after the original 2004 contract ended up being too convoluted, they contracted out for transpiration and warehousing, and 6.2% of revenue was taken. Mr. Bauer stated that there was an incentive on the contractor's part to grow revenue. Mr. Bauer further stated that because of the private use issue he is not sure Montgomery County could use this model with the current bonds. IRS regulation does not apply to Maine's bonds as they are taxable. There would be a debt aspect to consider.

Mr. Cape also suggested that there would be a labor impact to consider, as the workers would not be union employees.

In response to a question from Mr. Katcef, as to what is marketing, Mr. Bauer stated it would include listing and delisting, specials, and signage among other duties.

Mr. Cape introduced **Option 3** - **Establishing a Liquor Authority**

Mr. Cape explained that a liquor authority would implement merchandizing and that licensing and compliance would not be moved.

Mr. Fred Silverman, audience member, stated that he believes regulation and operations are supposed to be separate and that for reasons of County convenience, the Board of License Commissioners (BLC) changed to become part of DLC years ago. He further stated that even in control states the licensing function is separate, and he believes the current structure in Montgomery County is a breach of law.

Mr. Cape stated that in other control states like Pennsylvania these functions are also combined. Mr. Cape further stated that there is not a big benefit to a public authority but it does allow for issued debt because pledged revenue doesn't change. In this instance, bonds from DLC would move to the Montgomery County Liquor Authority, and the County could refund the bonds and reissue them under the new authority. If it's done correctly, he noted, there is not an impairment on the bonds and it should not disturb the current rating. There would be a Board and CEO in place as well as public accountability. Again if it's done correctly, there would not be a significant debt impact. Mr. Cape advised that an authority would likely be seen as more positive but emphasized that the model cannot be fully analyzed.

Mr. Renne voiced that the County Executive has tremendous authority to change the department model as he sees fit. He continued, stating that he is hearing consumers complain that they want less bureaucracy not more and when an issue gets political, a lack of transparency is usually the result. If there is a new Executive and Council and Boards and Commissions are appointed, then the County is stuck with them and they are not efficient vehicles for effective service to the community. Mr. Renne asked that the Executive or County Attorney explore the full scope of the Executive's authority to achieve some of the goals that an authority would bring. He said that creating another County agency is not going to be helpful. Mr. Renne then asked if the flow of funds would continue to fund the County's general fund.

Mr. Cape responded that he agrees that creating transparency is very important and that, under this model, the revenue from the authority would have the same flow of revenue into the general fund.

Mr. Cape introduced **Option 4** - **Full Privatization**

Mr. Cape identified that there are a lot of logistics in getting out of the system and that would have a catastrophic effect on debt. You would have to pay in full the bond's return. Mr. Cape stated that this option has been analyzed in other places.

Mr. Bauer reported that the implementation phase is 24 months and that the warehouse evaluation will not be at face value because of how it was acquired. Additional considerations include employees, including payouts.

Mr. Renne stated that DLC has about 400 employees.

Ms. Kirkland mentioned that Virginia recently looked at privatization and went to an authority model that will be going into effect in 2018.

Mr. Bauer introduced **Option 5** - **Bailment System**

Mr. Cape explained in this model that wholesalers own the product in the warehouse and DLC takes over the product in its stores or once it is sold. Pennsylvania went to this model in 2012 and $100,000 capitol was freed up because they no longer owned the inventory. Manufacturers are willing to do this and many control jurisdictions have done this. Some states such as in Idaho and Maine charge rent to hold product for the manufacturers. Manufacturers are charged for storing the product.

In response to a question by Mr. Ozgo asking if Mr. Bauer believes a fee would be tacked on to the consumer price, Mr. Bauer responded that this is being done everywhere and that manufacturers operate this way in many areas and simply deal with it. Mr. Bauer added that product that doesn't move is the manufacturers' problem.

In response to a question from Mr. Renne, on if it would solve any of the critics' issues, Mr. Bauer stated that it may allow for more special orders to be stocked.

Mr. Zeltner stated that it would be important to figure out how that would benefit the special orders. Currently, the DLC already has more skews than most and they have had new racking put in to increase product inventory.

In response to Mr. Zeltner's question on who places the orders, Mr. Cape answered that DLC does and added that if they don't provide enough inventory, then the wholesaler can be penalized.

Mr. Giardina stated that the current state law would have to be changed to operate under a bailment.

In response to a question posed by Mr. Mangels, on how theft and breakage would be handled, Mr. Bauer stated that would have to be worked into the contract. Mr. Bauer further stated that Vermont had great issues with this but that their warehouse was not nearly as good as Montgomery County's.

Ms. Kirkland thanked PFM for turning the analysis around in such a short time. Ms. Kirkland stated that during these meetings she learned a lot about the bonds. Ms. Kirkland further stated that next steps are to the have the preliminary report completed and added that if anyone has additional input it should be submitted within the next two weeks maximum. Ms. Kirkland advised that this would give a short timeframe to develop legislation if needed and that the County needs to get back to PFM on any additional analysis needed as well. Additionally, Ms. Kirkland stated that matrix will be completed and sent out within the next few days. Ms. Kirkland reminded the group that the one sentence, within the two-page matrix, will not represent the whole analysis. All of these items will be pulled together for Mr. Leggett.

In response to a question by Mr. Renne, regarding if the workgroup will be brought back together, Ms. Kirkland stated that she did not think the workgroup would need to be called back as a group. She said the report will be inclusive of all models that were submitted. They will be added to the main report. Also, Mr. Leggett will likely want additional input to be gathered.

Mr. Heyboer, staff member from Councilmember Riemer's office, asked if Mr. Leggett would be making a decision within the next month. Ms. Kirkland stated that it is up to him but that he does know Ms. Wenger's deadline for legislation purposes.

Delegate Barkley stated that legislation would be needed by October 6th and that anything done would need legislation.

Mr. Thompson, of the Restaurant Association of Maryland, stated that restaurants have seen a lot of improvements although some still have issues, noting that the most recent licensee survey took place more than a year ago. In response to Mr. Thompson's question on identifying needs, Ms. Kirkland stated that CountyStat will be conducting a survey this fall and that the exact timing and format is currently in process.

Mr. Zeltner stated that DLC has come a long way but he knows there are still a lot of improvements to be made; and, management is by no means satisfied with the department's current operations.

Ms. Hughes pointed out that there is a budget for DLC improvements and that everything requested had been funded.

Ms. Kirkland stated that she has been astounded at the CountyStat meetings, where the data reviewed showcases DLC's great strides.

Mr. Zeltner pointed out that improvements will have a positive future fiscal impact as well.

In response to a question posed by Mr. Renne, on if legislation is what is intended, Ms. Kirkland responded not necessarily.

Mr. Renne stated that there has been a remarkable improvement in morale among DLC staff but warned that there are still a lot of external pressures. Mr. Renne continued to state that many people believe they understand the issues but they do not and they overlook the tremendous amount of energy and commitment by government employees. Mr. Renne warned that radical changes should not be pushed without allowing the current changes to take hold. He added that there is an issue of job security to consider as many of the employees are under educated and, if their positions are eliminated, will not be left with many employment options.

Ms. Redicker, president of the Greater Silver Spring Chamber of Commerce, stated to Mr. Renne that he had a constituency to represent and so does she.

Ms. Kirkland thanked all of the attendees and adjourned the meeting at 4:00 pm.