



Washington State  
Liquor Control Board

RETAIL DIVISION – P.O. Box 43081, Olympia, Washington 98504-3081

January 11, 2012

Michael Transue, Attorney and Counselor at Law  
State and Local Governmental Affairs – Lobbying and Advocacy Services  
5420 North Commercial  
Ruston, WA 98407-3114

Re: Contract Liquor Store Questions

Dear Mr. Transue:

Thank you for the questions you recently submitted on behalf of the Contract Managers Advisory Council (CMAC) regarding the impact of the passing of Initiative 1183 on Contract Liquor Stores (CLS). The Washington State Liquor Control Board (WSLCB) appreciates the need for a timely and succinct response. Since formal contract amendments would be required to implement most of the changes you have requested, the purpose of this letter is to respond to your inquiries and explain the direction the Board intends to take in the coming weeks. Your questions will be addressed in the order in which they were provided in your original document and do not indicate a particular priority. As a frame of reference, all questions are related to the current CLS contract, which went into effect July 1, 2011.

Before we address the questions, I want to address an important point that I know our Contract Liquor Store Managers (CLSMs) are very concerned about. **The Board has consulted with our Assistant Attorney General and determined that current Contract Liquor Store Managers have the right to transfer or sell their business to a qualified liquor applicant. We will be establishing by rule the process and requirements for transferring their business if they elect to do so in the future.** We suggest that if a CLSM is considering relocating they do so prior to June 1, 2012, because of provisions in section 103(3)(c) which state the Board may not deny a spirits retail license to an otherwise qualified contract liquor store at its contract location (exception to the 10,000 square footage requirement).

#### Questions and Answers

1. Section A(2), Inventory Levels – we'll need more flexibility to increase inventory. Are there rules for storing inventory off site?

Due to audit requirements, the WSLCB must follow this section of the contract as it is currently written because the State owns the inventory. Extra storage makes accounting and auditing more challenging, and increases the opportunity for inventory error. However, if a CLSM purchases liquor, either from the WSLCB or a newly licensed supplier or distributor, it becomes their property, and may be stored as they choose. Said inventory may not be sold

until June 1, 2012. It must be noted that warehouses may come under Federal oversight, and as such, would likely require some type of permit to store liquor product. They would also be required to register warehouses with the Board under Initiative 1183, Section 103(3)(d). Therefore, all property of the State will be subject to current contract language. Stock that belongs to the contractor may be stored off-site as it is not subject to the contract. As an option to consider, a CLSM could consider relocation if their current space is inadequate.

2. Section E, Compensation – adjusted so that we can better capitalize our inventory. Commission Class H discount amount was discussed previously; do we have time to address it here?

The WSLCB has to follow this portion of the contract as it is written. The WSLCB does not have the authority to modify the commission structure of the CLS operations. This would require approval from the Office of Financial Management (OFM) based on a compelling business case from CMAC. Due to the State's budget conditions we do not think an increase would be supported at this time. Further, given the many tasks that are currently taking place throughout this transition, we will not pursue this issue further.

3. Exhibit A, Section 2.4, Licensee Accounts – remove licensee solicitation prohibition.

The Board intends to prepare a contract amendment to address this request. Specifically, we intend to repeal the following language: "The WSLCB shall assign Licensee Accounts to a State or Contract Liquor Store. Contractor *shall not solicit* Licensee Accounts." The amended language will be as follows (or very similar to): "Contractor *may solicit* Licensee Accounts."

4. Exhibit A, Section 2.6, Product Transfer – do you see any reason to alter this section so as to maintain the greatest flexibility? Especially when inventory at the DC begins to decrease?

It has been the practice of the WSLCB to give CLSMs priority of stock transfers, understanding how CLS compensation is derived. As such, the WSLCB intends to continue this priority practice and reinforce the practice with our district managers. While the WSLCB understands the need for flexibility the language must be left as written. It does not alter the intent or practical application of transfers. Approval for transfers is still required so that we may track what is being moved and the rationale for the transfer. Finance must account for inventory moves, and the current controls in place facilitate an orderly process.

5. Exhibit A, Section 2.10, Store Location – we would like to have an expedited process for relocation requests. Do we want to address the delivery prohibition? Distributors will be able to deliver spirits as will manufacturers, directly to restaurants. We should have the same ability.

The WSLCB understands the need for an expedited process and will pursue opportunities for streamlining while maintaining appropriate checks and balances. A document outlining the process is forthcoming and will be distributed to all CLSMs. Regarding the delivery of product, we agree a change is in order. The intent is to replace contract language stating “shall not deliver” with “may deliver.”

6. Exhibit A, Section 4.2, Assignment – would like the ability of a CLS to place (assign) the business into a different entity, e.g., LLC or corporation prior to May 31<sup>st</sup>.

The Board intends to prepare a contract amendment to address this request. We agree that this section should reflect a change that will allow a CLS to register as a LLC or corporation prior to May 31, 2012. This change reflects language suggested by CLSMs who are considering or have an interest in the future transfer or “good will sale” of their business. Any CLSM that does wish to transfer the current contract to an LLC or other corporation that they form must alert Victoria Hoy, Contract Specialist to this change, so that their contract can be amended to reflect the new party to the contract.

7. Exhibit A, Section 5.3, Force Majeure – does the WSLCB consider I-1183 a force majeure event? If so, could CLSM’s who want to cease business sooner rather than later use this provision to terminate early?

The WSLCB does not consider I-1183 as a force majeure event. However we recognize some CLSMs may want to terminate their contract prior to May 31, 2012. We intend to prepare an amendment to section 6.4 to require a more reasonable notification period of thirty (30) days. This allows communication and notification to the market area and those who may be affected by such a closure, such as auditors and other Finance Division staff. This applies to the following question as well (see below).

8. Exhibit A, Section 6.4, Termination at Contractor’s Request – would like the 180 day minimum notice to terminate requirement lessened. Would like the damage sentence also revised.

We can agree to a shorter notification process per question (7) above, but must leave the damage term as it is written in the contract. A 30-day notification is reasonable given it is not the WSLCB’s intent to seek a replacement contractor. The damage terms prevent unreasonable termination periods by the contractor and allow for an orderly termination of the contract.

9. Exhibit A, Section 6.7, Termination for Conflict of Interest – should this provision be suspended given the provisions of I-1183?

While we agree that some accommodation will likely be necessary for certain qualified conflicts of interest, we do not believe that this section should be suspended. Any conflicts that arise due to Initiative 1183 may be waived by the WSLCB, as stated in Section 6.7 of the CLS agreement which states “The WSLCB reserves the right to grant exceptions to the

financial interest requirements contained in this Contract on an individual basis.” The WSLCB has a history of fair and equitable response to requested exceptions.

10. Section 4.10, Retention of Records – will the six year requirement be lifted and/or will the Board want all of a CLSM’s records, except those each CLSM may want to keep for their own records, after the final audit?

The WSLCB must keep this requirement in the contract as it is written. Audits and the finalization of audits, not to mention State records retention requirements, compel us to maintain this as it is related to liquor sales and liquor sales only. CLSMs not wishing to store records may forward all related records for archiving by the WSLCB. The WSLCB will develop a method for the collection of these records and work with CLSMs to accomplish this.

11. Sections 6.8 - 6.10, Termination for Non-Allocation of Funds, Withdrawal of Authority, and Procedures should be re-examined...we assume the WSLCB would not exercise their authorities under these Sections but want to be certain and would appreciate any thoughts you have here.

This section must remain intact as written because it outlines the specific obligation the WSLCB has to contractors addressing this event (I-1183). The contract specifies seven days notification of such events and also states the WSLCB will “work with the contractor to arrive at a mutually acceptable resolution of the situation.” Since notification is well in advance of the event (more than seven days) the number of meetings, informational sessions in addition to work for modification of the contract are more evidence of good will. In addition these sections articulate the specific rights of both parties such as the “return of product to the WSLCB in good condition” and providing the contractor with final commissions owed, as an example.

12. In addition, another question has come up that we’d like your thoughts on. Restaurants and spirit retailers will be able to receive shipments after March 1<sup>st</sup> from distributors under Section 102 of I-1183. CLS sales to restaurants between March 1 and May 31 will comply with current WSLCB price rules for such restaurant sales. If distributors are able to offer a restaurant a price that’s less than the CLS mandated WSLCB price, CLSs will be put at a competitive disadvantage for that three month period. How would you suggest we best address this concern?

Pricing structure is in statute and as such, manipulation of purchase price, temporary price reductions (TPR’s) would have to be considered. This is resource and capacity prohibitive given our broad product selection and our directive to transition all stores to the private sector. Further, it is unknown if distributors will have an actual competitive advantage over the contract stores in regards to pricing.

13. Can the final answer add the words “or sell” or “sell for good will” after the word “transfer”? Being able to “sell” the business and its goodwill has special meaning (legal and otherwise) we think and invokes more of what the Initiative intended. We would note that the Initiative gives purchasers of prior State liquor store locations the “right” to operate at that location and that the “right” is freely alienable. As discussed below, we would like to see similar rights attached to a prior CLSs sale of its business.

The phrase “or sell” after the word “transfer” was added. See paragraph two of this document.

14. As you know, the right to sell liquor at a State store location is to be auctioned off to the highest bidder. Given this, we are wondering how involved you envision the process being.

As of this writing we have formed a task team who will submit a recommendation that may contain several alternatives. However, we have not developed the process per se. Of course, any recommendation will need legal review before a draft can be completed for review. At this time we do not have a projected date for the process to be finalized.

15. While not specifically discussed in this paragraph, our discussion around the “transfer or sale” of a CLS business focused a lot on the trade area for current CLSs. Specifically, we discussed things like whether a bank would be willing to provide credit to a CLS if they don’t know their sales territory/trade area; how a solid business plan that consists of estimating future profit and loss will rely critically on knowing the trade area; how landlords could potentially raise lease rates if they know we won’t have the flexibility to move our business; how the Board already determines trade area to some extent because its current liquor store siting process uses whether a particular area is “adequately served” for spirit sales as part of its analysis; and how critical the trade area information is in determining whether to continue in this business after June 1, 2012.

In sum, we would like the Board to consider determining existing CLS trade areas as soon as possible so that the most informed business decision(s) can be made by CLSMs, especially those who are thinking they might continue on in the retail spirit business.

As discussed previously, trade area is a complex issue. It is fully appreciated that determining financial terms may be linked to such definition. As many contract stores are rural in nature, trade areas may be a consideration, but in those particular communities, the number of potential competitors who may qualify for a retail license (the 10,000 sq. ft. retail space parameter) may be more important than trade area. The Board does not have enough information to make a determination of trade areas at this time and does not intend to define trade area until it has a better idea of how many CLSs continue to operate, number of auctioned off State stores that will obtain spirits retail licenses and the number of locations that apply for spirits retail licenses (greater than 10,000 square feet). However, Contract Managers be informed of progress with trade area definition as it becomes known.

16. Relocation prior to June 1. We wanted to ask here whether the Board has thought about how it will address location change request by previous CLSs after June 1? How do you anticipate “at its contract location” will be defined – will CLSs have some flexibility here or will there be a more strict definition of the phrase? Will a proposed relocation within the CLSs particular trade be treated differently than a proposed relocation outside of the CLSs particular trade area or will they be treated the same?

Relocation of a contract store can take place prior to June 1, 2012, specifically, in the communities where they are currently located. There is a current process that accommodates relocations and a streamlined process is being developed as previously mentioned.

After June 1, 2012, the relocation process has not been defined. The Board is aware of the issue and it's been placed on the priority list for resolution.

17. We would like to approach OFM to discuss commission changes. We believe that adoption of the Initiative constitutes a “compelling business case” that warrants a re-examination of the commission level at this time – even if it is only for a short period of time.

This is not a new topic of discussion. While reasons for a commission increase are understood, agency capacity issues in addition to commissions being a perennial topic make this unsupported by staff. If the topic were again brought forward to OFM, there would be heavy reliance on the Contract Managers to develop the necessary analysis, documentation and administrative support for the presentation. We also do not believe that the State's budget climate would support a commission increase at this time because of the negative impact on the general fund.

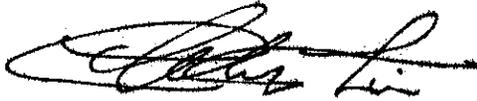
### **Conclusion**

There will be four contract amendments noted in the responses above. We are in the process of drafting changes with the intent to distribute to CLSMs for review. While we are unable to provide an exact date of distribution, the WSLCB will do everything in its power to work with our CLSMs to make the execution of any amendments as quick and efficient as possible. We place a very high value on our relationship with the CLSMs and appreciate their input and patience as we navigate this transition together.

One additional note, perhaps a caveat, is that in the event that I-1183 is overturned in the legal process, the WSLCB will express the right to return to original contract language in any future amendment. This statement is to ensure that there are no unintended consequences in the event the legal process changes direction and we are reverted back to our previous business model.

Thank you for the inquiries you brought to our attention. Please do not hesitate to contact me should you have further questions or feedback on this response.

Sincerely,

A handwritten signature in black ink, appearing to read "Chris Liu". The signature is fluid and cursive, with a large initial "C" and "L".

Chris Liu  
Retail Director, Washington State Liquor Control Board

cc: Sharon Foster, Board Chair, WSLCB  
Ruthann Kurose, Board Member, WSLCB  
Chris Marr, Board Member, WSLCB  
Pat Kohler, Administrative Director, WSLCB  
Rick Garza, Deputy Administrative Director, WSLCB  
Pat McLaughlin, Director of Business Enterprise, WSLCB  
Contract Managers Advisory Committee (CMAC)

CL:ks