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BILL ANALYSIS

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Senate Bill 259 (Substitute S-3 as passed by the Senate)
Sponsor: Senator Mat J. Dunaskiss
Committee: Local, Urban, and State Affairs

Date Completed: 5-3-95

RATIONALE

Among the types of alcohol-based beverages currently being marketed is mixed spirit drink, which refers to a mixture of distilled spirits and nonalcoholic beverages and contains no more than 10% alcohol. Under the Michigan Liquor Control Act, mixed spirit drink is subject to a tax of 48 cents per liter and may be sold at retail by specially designated distributors (SDDs), which are hotels or merchants authorized to sell spirits for off-premises consumption (e.g., package liquor stores). Apparently, most of the mixed spirit drink manufactured and sold actually contains less than 7% alcohol. Many people believe, therefore, that these so-called "spirit coolers" should be subject to the same regulation and taxation as wine coolers, or mixed wine drink. Mixed wine drink is a mixture of wine and plain, sparkling, or carbonated water, containing less than 7% alcohol, and is subject to the tax imposed on wine, which generally is 13.5 cents per liter. Wine coolers may be sold at retail by specially designated merchants (SDMs), which are persons licensed to sell beer and wine for off-premises consumption. Since spirit coolers and wine coolers contain the same amount of alcohol, some people contend that it would equitable to market and tax them in the same manner.

CONTENT

The bill would amend the Michigan Liquor Control Act to regulate the sale of low alcohol drink. In particular, the bill would allow licensed vendors to sell low alcohol drink for on-premises consumption; provide for the licensure of low alcohol drink manufacturers and outstate sellers; include these manufacturers and sellers in the Act's sales territory provisions; and impose a tax on low alcohol drink made from grain, fruit, or other farm products not grown in this State. The bill also would regulate the business relations between wholesalers and suppliers of low alcohol drink. The bill would define "low alcohol drink" as a premixed drink or similar product containing less than 7% alcohol by volume, consisting of wine or spirits and plain, sparkling, or carbonated water, and containing any of the following: nonalcoholic beverages, flavoring, coloring materials, fruit juices, fruit adjuncts, sugar, carbon dioxide, and/or preservatives.

Sale and Taxation of Low Alcohol Drink

Under the bill, low alcohol drink (LAD) could be sold by Class A and B hotels, taverns, Class C licensees, and clubs. In addition, the Liquor Control Commission (LCC) could issue a special license for the sale of LAD, and a specially designated merchant (SDM) could obtain a license to sell LAD at retail. The bill would include low alcohol drink in provisions imposing a license fee on SDMs, Class A and B hotels, taverns, Class C licensees, and clubs.

The bill also would provide for the licensure of a low alcohol drink manufacturer (a person licensed to manufacture in this State LAD and to sell LAD to a wholesaler), and an outstate seller of low alcohol drink (a person licensed to sell LAD not manufactured in this State to a wholesaler in this State according to rules promulgated by the LCC). The bill would impose a license fee of $300 on outstate sellers of low alcohol drink, delivering or selling LAD in this State; and a fee of $100 on low alcohol drink manufacturers.
Currently, for purposes of rules promulgated bythe LCC, a mixed spirit drink manufacturer and outstate seller of mixed spirit drink must be considered a wine manufacturer and outstate seller of wine, respectively, but they are subject to rules applicable to spirits for purposes of

manufacturing and labeling. The bill also would require an LAD manufacturer and an out-state seller of LAD to be considered a wine manufacturer and outstate seller of wine for purposes of Commission rules. The bill would delete the provision that mixed drink manufacturers and outstate sellers are subject to the rules applicable to spirits for purposes of manufacturing and labeling.

The bill would extend the Act's bonding requirements to LAD manufacturers and outstate sellers of LAD, and to special licensees selling low alcohol drink.

Currently, the LCC is required to collect a tax of 13.5 cents per liter on all wines containing 16% or less of alcohol sold in this State and manufactured from grapes or fruit not grown in Michigan. The bill would include low alcohol drink in this provision, and would refer to wine and LAD made from grapes, fruit, "or any other farm products" not grown in this State. The bill also would include LAD in provisions requiring the tax to be refunded if the drink is sold to a military installation or an Indian reservation in this State or is lost as a result of fire, flood, casualty, or other occurrence, or if it is shipped outside of this State for sale and consumption.

In addition, the bill provides that an outstate LAD manufacturer or outstate seller of LAD could not be licensed as an SDM or specially designated distributor (SDD) or permitted to sell or deliver alcoholic liquor at retail; and an SDM or SDD could not hold a license as an LAD manufacturer or outstate seller of LAD. Further, an LAD manufacturer or outstate seller of LAD could not aid or assist any vendor by gift, by loan of money or property, or by giving premiums or rebates; and could not have a financial interest in a vendor. (Currently, these provisions apply to other drink manufacturers, outstate sellers, and wholesalers.)

The bill also would include LAD manufacturers and outstate sellers of LAD in provisions requiring mixed drink manufacturers and outstate sellers to grant to each of their wholesalers an exclusive sales territory; requiring mixed drink manufacturers and outstate sellers to assign a brand extension to the wholesaler that was granted the exclusive sales territory for the brand from which the extension resulted; and making an exception to the brand extension requirement for assignments made before January 1, 1994.

Currently, the Act prohibits a person from conducting samplings or tastings of alcoholic liquor for a commercial purpose except at licensed premises, and generally prohibits vendors from giving away alcoholic liquor. The Act specifies that these provisions do not prevent vendors, manufacturers, or outstate sellers from conducting samplings or tastings of a product before it is approved for sale, with prior approval of the LCC. The bill would include low alcohol drink in these provisions.

In addition, the bill would include wine-based low alcohol drink in provisions permitting local units to vote on Sunday sales of beer and wine, and would include spirit-based LAD in provisions allowing local units to vote on Sunday sales of spirits and mixed spirit drink.

<u>Business Relations Between Wholesalers and Suppliers</u>

The bill would add a section "to provide a structure for the business relations between a wholesaler of low alcohol drink and a supplier of low alcohol drink". These provisions would apply to agreements in existence on the bill's effective date, and agreements that were entered into or renewed after that date. ("Supplier" would mean an LAD manufacturer or an outstate seller of LAD, or a master distributor, i.e., a wholesaler who acted as an LAD manufacturer or outstate seller for a brand or brands of LAD to other wholesalers. "Agreement" would mean any oral or written agreement between a wholesaler and a supplier by which a wholesaler was granted the right to offer and sell a brand or brands of low alcohol drink by a supplier.)

The bill describes specific activities a supplier could not take in regard to a wholesaler. These include coercing a wholesaler to take delivery of LAD that had not been ordered or that was properly canceled; coercing a wholesaler to do any illegal act by threatening to cancel an agreement; requiring a wholesaler to assent to any condition limiting the wholesaler's right to sell the brand or brands of LAD of any other supplier anywhere in this State unless their acquisition would materially impair the quality of service of the brand or brands of the supplier presently being sold by the wholesaler; requiring a wholesaler to purchase one or more brands of LAD in order to purchase another brand or brands for any reason; requesting a wholesaler to submit financial records as a requirement for renewing or retaining an agreement; withholding delivery of LAD ordered by a wholesaler or changing a wholesaler's quota if the withholding or change were not made in good faith; requiring a wholesaler to participate in any advertising fund controlled by the supplier; failing to provide each wholesaler of the supplier's brand or brands with a written agreement that contained the supplier's agreement with each wholesaler and designated a specific sales territory; fixing the price at which a wholesaler could sell any low alcohol drink; taking any retaliatory action against a wholesaler that filed a complaint regarding an alleged violation by the supplier of State or Federal law or an administrative rule; requiring or prohibiting any change in the manager or successor manager of any wholesaler who had been approved by the supplier as of the bill's effective date, or, after that date, interfering with the appointment of a manager or successor manager unless the person failed to meet the supplier's reasonable written standards for Michigan wholesalers; or requiring that any dispute arising out of the agreement be determined through the application of the law of any other state.

Notwithstanding the terms or conditions of any agreement, a supplier could not amend any agreement unless the supplier were acting in good faith. ("Good faith" would mean honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade, as defined and interpreted under Section 2103 of the Uniform Commercial Code.)

Except as otherwise provided in the bill, a supplier could not cause a wholesaler to resign from an agreement, and could not cancel, fail to renew, or refuse to continue under an agreement unless the supplier had satisfied the bill's notice requirements, had acted in good faith, and had good cause for the cancellation, nonrenewal, discontinuance, or forced resignation. Good cause would exist when the wholesaler failed to comply with a provision of the agreement that was reasonable and of material significance to the business relationship, the supplier had first acquired knowledge of the failure not more than two years before the date notice was given, the wholesaler was given written notice of failure to comply and was given a reasonable opportunity to assert good faith efforts to comply, and the wholesaler was given 25 days to submit a plan of corrective action and another 75 days to cure the noncompliance.

A supplier or wholesaler who terminated, discontinued, or did not renew an agreement would have the burden of showing that it had acted in good faith and complied with the applicable notice requirements, and that there was good cause for the termination, discontinuance, or nonrenewal.

Except as otherwise provided, a supplier would have to give a wholesaler written notice of a termination, nonrenewal, or discontinuance of an agreement at least 15 days before the effective date of that occurrence. A supplier immediately could terminate or cancel an agreement, however, if the wholesaler became insolvent; a bankruptcy or receivership petition were filed by or against the wholesaler; the wholesaler's license were revoked by the LCC, making the wholesaler unable to service its sales territory for more than 60 days; or the wholesaler, or an individual who owned more than 10% of the stock of a corporate wholesaler, had been convicted of a felony.

Notwithstanding the preceding provisions, upon at least 15 days' prior written notice, a supplier could terminate, fail to renew, or discontinue an agreement if there were fraudulent conduct on the part of the wholesaler in dealings with the supplier; the wholesaler failed to confine its sales of a brand or brands to the assigned sales territory (unless there were a dispute between two or more wholesalers as to the boundaries of the assigned territory and the boundaries could not be determined by a reading of the description in the agreements); or the wholesaler sold any of the supplier's brand or brands that the wholesaler knew were ineligible for sale prior to the actual sale to the retailer.

A supplier could terminate, not renew, or discontinue an agreement upon at least 30 days' prior notice if the supplier discontinued production or distribution in this State of all of the brands sold by it to a wholesaler. This would not prohibit a supplier, upon at least 30 days' notice, from discontinuing the distribution of any particular brand or package of LAD. This also would not prohibit a supplier from conducting test marketing of a new brand of LAD or of a brand not currently being sold in the State if the supplier had notified the LCC of its plans. A market testing period could not exceed 18 months.

The bill would prohibit a wholesaler from selling or delivering LAD to a retail licensee located outside the sales territory designated by the supplier of a particular brand or brands of low alcohol drink, although specific provisions would apply during periods of temporary service interruptions. A wholesaler would be required to devote reasonable efforts and resources to sales and distribution of all of the supplier's products that the wholesaler had been granted the right to sell and distribute, and would have to maintain reasonable sales levels.

A supplier could not withhold consent to any transfer of a wholesaler's business if the proposed transferee met the material and reasonable qualifications and standards required by the supplier. A wholesaler would have to give the supplier written notice of intent to transfer its business, and the supplier could not unreasonably delay a response to a request for a proposed transfer. A transfer that was not approved by the supplier, however, would be null and void. A supplier could not interfere with, or prevent the transfer of the wholesaler's business if the proposed transferee were a designated member (i.e., the spouse, child, grandchild, parent, or sibling of a deceased individual who owned an interest in a wholesaler, who was entitled to inherit that individual's ownership interest under his or her will, or who otherwise had been designated in writing by the deceased individual to succeed him or her in the wholesaler's business, or was entitled to inherit ownership interest under the laws of intestate succession (in the absence of a will) of this State).

As part of a written agreement with a wholesaler, a supplier could require the wholesaler to designate a successor manager who would be subject to the supplier's prior approval. If the designated successor failed to assume the role of approved manager or for any reason did not continue to manage the wholesaler's business, after assuming that responsibility, any successor would be subject to the supplier's prior approval, notwithstanding the transferee's interest as a designated member.

A supplier that amended, terminated, or refused to renew any agreement, caused a wholesaler to resign from an agreement, or withheld consent to any assignment or transfer of a wholesaler's business, except as provided in the bill, would have to pay the wholesaler reasonable compensation for the diminished value (including goodwill) of the wholesaler's business and/or of any ancillary business that had been negatively affected. At any time, either the supplier or the wholesaler could determine that mutual agreement on the amount of reasonable compensation could not be reached, and that party would have to notify the other party of its intention to proceed with arbitration. Arbitration could proceed only by mutual agreement of the parties. An arbitration panel would consist of two representatives selected by the supplier but unassociated with it, two selected by the wholesaler but unassociated with it, and an impartial arbitrator. The panel would have to convene within 30 days after its final selection, and render a decision within 20 days from the conclusion of arbitration. If either party failed to abide by the bill's time limits for the selection of arbitrators, failed to make the selection, or failed to participate in the arbitration hearings, the other party would have to make the selection and proceed to arbitration. The party who failed to comply would be considered in default. A party in default would waive all rights that party would have had in the arbitration and would be considered to have consented to the panel's determination.

A wholesaler could not waive any of the rights granted by the bill, and the bill could not be construed to limit or prohibit good faith dispute settlements voluntarily entered into by the parties.

A successor to a supplier that continued in business as a LAD manufacturer, an outstate seller of LAD, or a master distributor would be bound by all terms and conditions of each agreement of the supplier with a licensed wholesaler in effect on the date on which the successor received the distribution rights of the previous supplier.

If a supplier or wholesaler engaged in prohibited conduct, a wholesaler or supplier, respectively, with whom the offending party had an agreement could maintain a civil action against that party to recover actual damages. A supplier or wholesaler who violated the bill would be liable for all actual damages and all court costs and reasonable attorney fees incurred by the other party as a result of the violation. A court also could award exemplary damages if it found that a supplier had not acted in good faith in amending, terminating, or not renewing an agreement, or had unreasonably withheld its consent to any assignment, transfer, or sale of a wholesaler's business. In addition, a supplier or wholesaler could bring an action for a declaratory judgment or injunctive relief.

With certain exceptions, the procedure for resolving a violation by a supplier against a wholesaler, or by a wholesaler who made sales outside of its designated sales territory, would be the procedure prescribed by the Liquor Control Act and the Administrative Procedures Act. Any other violation or dispute, except a dispute on the amount of reasonable compensation that was resolved by arbitration, could be resolved only by a civil action in court.

MCL 436.2 et al.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The bill would eliminate the unfair discrimination that currently exists in the distribution of low alcohol drink. If the alcohol content is the same, it should make no difference whether it was produced through distillation or fermentation, or from grain or grapes. The alcohol in a spirit cooler is exactly the same as the alcohol in a wine cooler and should not be subject to a higher rate of taxation or a more limited marketing scheme. By allowing all low alcohol drink to be taxed at the same rate and to be sold at retail by SDMs, the bill would bring fairness to the industry, open the market for spirit coolers, and accommodate the societal trend toward lower alcohol consumption.

Opposing Argument

The bill not only would blur the traditional distinction between beer, wine, and spirits, but also would create two categories of mixed spirit drinks--those with less than 7% alcohol and those with 8% to 10% alcohol--which would be subject to separate rates of taxation. In addition, by allowing SDMs to sell spirit coolers, the bill would undermine the value of a package liquor license. Furthermore, the bill would create overlapping categories of mixed wine drink and low alcohol drink. While all wine coolers would fall under the new definition of "low alcohol drink", the bill also would retain a separate definition of mixed wine drink, which conceivably could subject wine cooler manufacturers and sellers to duplicative regulation.

Opposing Argument

Mixed spirit drinks, because of their packaging and marketing, apparently have become the drink of choice among young consumers. By increasing the availability of spirit coolers, the bill could lead to increased abuse by underage drinkers.

Opposing Argument

Lowering the tax on spirit-based low alcohol drink could result in a loss of revenue to the State of approximately $350,000. Although sales of spirit coolers probably would go up, the Liquor Control Commission anticipates that this increase would come at the expense of other alcoholic beverages.

Legislative Analyst: S. Margules

FISCAL IMPACT

The tax rate for mixed spirit drink, including spirit-based low alcohol drink, currently is 48 cents per liter. The revised tax rate of 13.5 cents per liter (which currently applies to wine-based low alcohol drink) for all low alcohol drink would reduce revenue from this source by approximately $350,000, according to the Liquor Control Commission. According to Commission records, approximately three-fourths of the mixed spirit drink sold in Michigan has an alcohol content of less than 7%.

There is only one manufacturer of low alcohol drink. The increase revenue from this fee would be $100.

The only outstate seller of low alcohol drink is currently paying a $300 license fee as a seller of mixed spirit drink. Since the license fee for sellers of low alcohol drink also is $300, there would be no net increase in license revenue for sellers of low alcohol drink.

Fiscal Analyst: K. Lindquist

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.