



#632  
October 1, 2019

Report to the Mississippi Legislature

# Alcoholic Beverage Control in Mississippi: Warehouse Operations and Policy Considerations for Regulation

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On October 1, 2019 the PEER Committee authorized release of the report titled *Alcoholic Beverage Control in Mississippi: Warehouse Operations and Policy Considerations for Regulation*.

A handwritten signature in cursive script that reads "Becky Currie".

Representative Becky Currie, Chair

**This report does not recommend increased funding or additional staff.**



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## Alcoholic Beverage Control in Mississippi: Warehouse Operations and Policy Considerations for Regulation

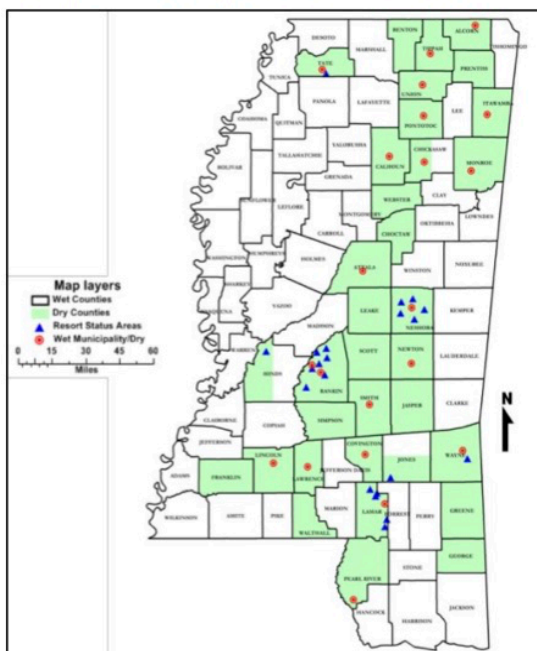
**CONCLUSION:** The Department of Revenue (DOR) should improve ABC warehouse operations by implementing a preventative maintenance plan, addressing worker safety policies, analyzing warehouse product storage and placement issues, tracking and analyzing customer service calls, and analyzing the feasibility of purchasing additional warehouse space. The Legislature and the DOR should consider the future of alcoholic beverage regulation through three forms of privatization - i.e., full divestiture, partial divestiture, or private contract. In addition, the DOR could consider the viability of direct-to-consumer wine shipments and the capping of the total number of retail package store permits.

### Background:

In 1966, the Legislature re-announced prohibition of the manufacture, sale, distribution, transportation, and possession of intoxicating liquor as the policy of the state in MISS. CODE ANN. § 67-1-3 (1972). However, this statute also provides counties, judicial districts, and certain municipalities procedures to “opt out” of prohibition for those areas.

MISS. CODE ANN. § 67-1-19 created the Alcoholic Beverage Control (ABC) Division within the DOR. In addition, MISS. CODE ANN. § 67-1-41 grants the Mississippi DOR sole authority to regulate and wholesale alcoholic beverages throughout the state. MISS. CODE ANN. § 67-1-5 defines an alcoholic beverage as containing more than 5% alcohol by weight and excludes light wine and beer.

Mississippi is one of seventeen control states in the United States. Mississippi regulates alcoholic beverages through licensing of vendors and retailers, taxation at wholesale and retail levels, and wholesaling both distilled spirits/liquor and wine throughout the state. Mississippi is one of five control states that wholesales both distilled spirits/liquor and wine. Mississippi is also one of five control states that only controls alcoholic beverages at the wholesale level.



### How does the state administer alcoholic beverage control?

The Alcoholic Beverage Control Division (ABC) of the Mississippi Department of Revenue (DOR) regulates and wholesales alcoholic beverages throughout Mississippi to licensed ABC permittees. The ABC warehouse operates on a bailment system, which allows vendors of alcoholic beverages to store their products in the state's warehouse without the state having to purchase the product. The ABC warehouse processes orders through each permittee's Taxpayer Access Point (TAP) account. Once orders are placed and processed, the ABC warehouse utilizes two contracted shipping companies to transport product to permittees.

As of July 2019, the ABC warehouse employed 106 employees. The warehouse also held 427,709 cases of alcohol and can ship a maximum capacity of approximately 20,000 cases per day. In FY 2018, ABC warehouse expenditures totaled just over \$5 million. Regarding total revenues, approximately 55% comes from the state markup on the direct sales of alcoholic beverages, 40% comes from taxes, and 5% comes from permit and other fees. In FY 2018, ABC warehouse revenues totaled approximately \$114 million.

### How could the state improve efficiency and effectiveness at the ABC warehouse?

As the sole alcoholic beverage wholesaler, the ABC should focus on both maximizing revenue while providing a high level of customer service. PEER identified several areas for improvement. The implementation of a preventative maintenance plan could increase overall productivity. Equipment failures can create delays in both order processing and shipping operations. The ABC warehouse lacks formal workplace safety policies. Workplace injuries in the warehouse create a direct cost to the state in Workers' Compensation claims. The ABC should maximize efficient use of its warehouse space. The ABC should also document customer service issues in order to identify weaknesses in overall operations. The ABC should conduct a formal study prior to implementing any changes to overall warehouse operations and logistics.

## Warehouse Operations Recommendations:

- The ABC warehouse should create a preventative maintenance plan and track instances in which equipment becomes inoperable and repair parts must be procured.
- The ABC warehouse should create standard operating procedures with an emphasis on safety for warehouse employees.
- The ABC warehouse should determine an equitable storage level for all bailment products stored in the warehouse, and should consider setting a minimum stock level policy for bailment items.
- The ABC warehouse should develop a written facility usage and logistics plan prior to purchasing an additional warehouse facility.

### How will the ABC utilize an additional warehouse facility?

The Mississippi Legislature provided the DOR with additional appropriation authority in Senate Bill 3024, 2019 Regular Session, to purchase additional warehouse space for warehousing needs. The DOR has not created a formal, logistical plan for the usage of the additional warehouse facility. While studies commissioned by the DOR showed that the current ABC warehouse was quickly approaching its maximum storage capacity, none of these studies analyzed how an additional warehouse facility could be incorporated into current ABC warehouse operations. The DOR should ensure that incorporating an additional facility to be used solely for bulk product storage is a viable method for increasing ABC efficiency.

The ABC commissioned several studies from 2015-2016 to review warehouse operations. These studies determined the warehouse was quickly running out of space for additional product to be stored.

### What are policy considerations for the regulation of alcoholic beverages in Mississippi, including the possibilities for maximizing revenue potential?

PEER evaluated policy options for the future of regulating alcohol beverages in Mississippi. Included in these policy options were three methods of privatization. These privatization options were judged for feasibility against three criteria:

- Each option should give the state at least the same amount, or more, of revenue than it currently receives from the wholesaling of liquor and wine.
- Each option should not cause a significant increase in alcohol consumption in the state or rely on a significant increase in alcohol consumption to meet the first criteria of revenue generation.
- Each option should provide permittees and consumers at least the same level of service through wholesale sales and distribution.

## Policy Conclusions and Recommendations:

### Privatization Options:

- Fully divesting the wholesale of liquor and wine would remove the state from being the wholesaler of alcoholic beverages, making private wholesalers responsible for wholesaling alcoholic beverages throughout the state. Academic studies show that control states collect higher amounts of revenue from alcohol sales than license states. PEER determined that converting to a license state would likely reduce the overall revenue collected for the state from alcoholic beverage sales.
- Contracting out wholesale operations would allow a contracted warehouse operator to assume operations of the ABC warehouse including receiving product and shipping orders to ABC permittees. Private companies would be responsible for staffing the warehouse and the DOR would still have administrative oversight of the ABC warehouse operations. Any monies saved from removing state employees from working within the ABC warehouse would likely be used to pay the contract with the private company that would operate the warehouse. PEER determined that this option could likely be revenue neutral, but would likely not save the state a minimum of 10% compared to current operational costs.
- Partially divesting wholesale operations would allow private wholesalers to be responsible for wholesaling wine throughout the state. Partial divestment would allow the state to remain the wholesaler of liquor. PEER determined this option would likely reduce the amount of overall revenue collected, but could benefit warehouse operations.

While current Mississippi Law does not specifically prohibit direct-to-consumer wine shipment, it does make the DOR the sole wholesaler of alcoholic beverages throughout the state.

### Other Policy Options:

PEER reviewed direct-to-consumer wine shipment in Mississippi. Direct-to-consumer wine sales are not specifically prohibited by Mississippi Law; however, current law does make the DOR the sole wholesaler of alcoholic beverages in the state. PEER also reviewed capping the overall number of retail package store permits. Studies show that capping permits could provide a more equitable package store outlet density. The DOR would need to further review these options to ensure their feasibility in the state. If they yield positive results, the DOR should recommend to the Legislature any CODE sections that would need amendment in order to implement either of these policy options.



Alcoholic Beverage Control in Mississippi: Warehouse Operations and Policy Considerations for Regulation | October 2019  
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Representative Becky Currie, Chair | James A. Barber, Executive Director

A copy of the full report is available at: [www.peer.ms.gov](http://www.peer.ms.gov).



# Alcoholic Beverage Control in Mississippi: Warehouse Operations and Policy Considerations for Regulation

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## Introduction

### Authority

The PEER Committee reviewed selected operations of the Department of Revenue's Alcoholic Beverage Control Division. The Committee acted in accordance with MISS. CODE ANN. Section 5-3-51 et seq. (1972).

### Scope and Purpose

In conducting this review, PEER sought to address the following questions:

- How ABC stores and distributes alcoholic beverages at the wholesale level?
- How could the state improve the effectiveness and efficiency of its alcoholic beverage warehouse operations?
- What are policy considerations for the regulation of alcoholic beverages in Mississippi, including the possibilities for maximizing revenue potential?

### Method

In conducting fieldwork, PEER:

- reviewed state laws and administrative code governing the Department of Revenue's Alcoholic Beverage Control Division;
- observed daily operations within the ABC warehouse;
- compared Mississippi's laws and processes for alcoholic beverage control with those of other states;
- reviewed policies and procedures for ABC's warehouse;
- reviewed selected academic studies from 2013 to 2017 on states' control of alcoholic beverages; and,
- interviewed personnel of the Department of Revenue, Alcoholic Beverage Control Division, and the Department of Finance and Administration.

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# Background

This chapter addresses the following questions:

- What is Mississippi’s “local option” law regarding the sale of alcoholic beverages?
- What types of beverages does the state regulate?
- What is the organizational structure for regulating alcoholic beverages in Mississippi?
- What are states’ models for regulating alcoholic beverages and what model does Mississippi use?

## What is Mississippi’s “Local Option” Law Regarding the Sale of Alcoholic Beverages?

***Although prohibition of the sale of alcoholic beverages is Mississippi’s official policy, MISS. CODE ANN. § 67-1-11 (1972) through § 67-1-15 (1972) provides procedures for individual counties, judicial districts, and certain municipalities to allow legal sales of liquor and wine within their boundaries, and thus “opt out” of prohibition.***

Under these CODE sections, counties and counties’ judicial districts may hold local referenda to allow legal sales of liquor and wine if 20% of the qualified electors, or 1,500 qualified electors, sign a petition calling for an election. Certain municipalities specified in statute may hold such elections if 20% of the qualified electors call for an election. After an election on the subject of local option, jurisdictions may not place the subject on the ballot again for at least two years.

State law also allows the sale of alcoholic beverages in certain *qualified resort areas* within the state [MISS. CODE ANN. § 67-1-5(o)(iii) (1972)]. Qualified resort areas are those that customarily attract tourists or vacationers due to recreational facilities or attractions. The CODE specifically designates some resort areas (e.g., the clubhouse at the Lefleur’s Bluff State Park golf course) and also provides authority for the Department of Revenue to approve additional resort areas.

Mississippi has forty-nine “wet” counties that allow alcoholic beverage sales anywhere within their borders and twelve “dry” counties with no judicial districts, municipalities, or resort areas within their borders that allow the sale of alcoholic beverages. Three counties each have one “wet” judicial district and one “dry” judicial district. Eighteen counties are considered “dry,” but some of their local municipalities are “wet” or those counties have established qualified resort areas. The map in Exhibit 1 on page 4 shows the locations of Mississippi’s “wet” and “dry” jurisdictions for the sale of liquor and wine as of September 2019. See Appendix A on page 44 for a list of Mississippi’s qualified resort areas.

## What Types of Beverages Does the State Regulate?

***The state regulates sale and distribution of liquor and wine, which are considered “alcoholic beverages,” in those jurisdictions that have opted to be “wet.” Although beer and light wine contain alcohol, because state law does not consider these to be “alcoholic beverages,” Mississippi regulates them separately from liquor and wine.***

MISS. CODE ANN. § 67-1-5 (1972) defines an *alcoholic beverage* as a distilled spirit (e. g., liquor) or a wine product that contains more than 5% alcohol by weight. The state regulates the sale and distribution of liquor and wine under authority of MISS. CODE ANN. § 67-1-19 (1972). See Exhibit 2, page 5, for definitions of the different types of beverages containing alcohol, their legal definitions, and whether ABC regulates that type.

Although beer and light wine contain alcohol, because state law does not consider these to be “alcoholic beverages,” Mississippi regulates them separately from liquor and wine. MISS. CODE ANN. § 67-3-1 et seq. (1972) addresses the sale of beverages such as beer and light wine throughout the state. Sales of beer and light wine are legal in Mississippi except in those counties or municipalities that have chosen to exclude such. Although the state does not regulate beer and light wine sales, it tracks and maintains a list of which areas of the state are “wet” and “dry” for the sale of beer and light wine. The map in Appendix B on page 45 shows the locations of Mississippi’s “wet” and “dry” jurisdictions for the sale of beer and light wine as of August 2019.

# Exhibit 1: Mississippi's Wet and Dry Jurisdictions for the Sale of Alcoholic Beverages

## Wet Counties

- Adams
- Amite
- Bolivar
- Carroll
- Claiborne
- Clarke
- Clay
- Coahoma
- Copiah
- Desoto
- Forrest
- Grenada
- Hancock
- Harrison
- Holmes
- Humphreys
- Issaquena
- Jackson
- Jasper
- Jefferson
- Jefferson Davis
- Kemper
- Lafayette
- Lauderdale
- Lee
- Leflore
- Lowndes
- Madison
- Marion
- Marshall
- Montgomery
- Noxubee
- Oktibbeha
- Panola
- Perry
- Pike
- Quitman
- Sharkey
- Stone
- Sunflower
- Tallahatchie
- Tishomingo
- Tunica
- Warren
- Washington
- Wilkinson
- Winston
- Yalobusha
- Yazoo

**Counties with two Judicial Districts. Wet districts include:**  
 Chickasaw 2<sup>nd</sup> Judicial District  
 Hinds 1<sup>st</sup> Judicial District  
 Jones 2<sup>nd</sup> Judicial District

## Dry Counties

- Alcorn
- Attala
- Benton\*
- Calhoun
- Choctaw\*
- Covington
- Franklin\*
- George\*
- Humphreys
- Itawamba
- Lamar
- Lawrence
- Leake\*
- Lincoln
- Monroe
- Neshoba
- Newton\*
- Pearl River
- Pontotoc
- Prentiss\*
- Rankin
- Scott\*
- Simpson\*
- Smith
- Tate
- Tippah
- Union
- Walthall\*
- Wayne
- Webster\*

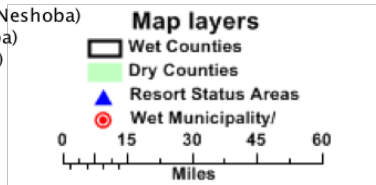
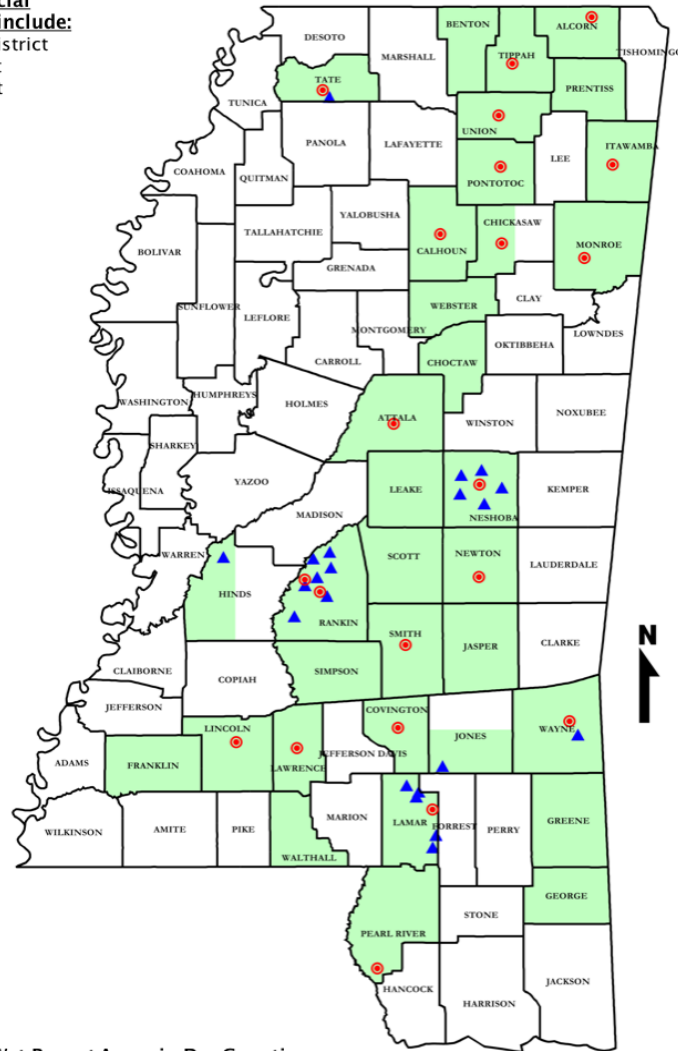
\*Denotes a county that is fully under prohibition, no wet resort areas or wet municipalities within the county.

## Wet Resort Areas in Dry Counties

- Back Acre Country Club (Tate)
- The Barn at Bridlewood (Lamar)
- Canebrake Country Club (Lamar)
- Castlewoods Country Club (Rankin)
- Choctaw Indian Reservation (Neshoba)
  - Silver Star Casino (Neshoba)
  - Dancing Rabbit Golf Course (Neshoba)
  - Golden Moon Casino (Neshoba)
  - Dancing Rabbit Inn (Neshoba)
- Dogwood Venue (Lamar)
- Jackson-Medgar Wiley Evers International Airport (Rankin)
- Long Leaf Plantation (Lamar)
- McClain Lodge (Rankin)
- Pearl, Special District (Rankin)
- Pearl River Valley Water Supply District (Rankin)
- Pine Belt Airport (Jones)
- Pine Creek Golf Club (Lamar)
- Porterhouse Partners, LLC (Rankin)
- Providence Hill (Hinds)
- Reservoir Community District (Rankin)
- The Southern Pearl (Wayne)

## Wet Municipalities in Dry Counties

- Aberdeen (Monroe)
- Brandon (Rankin)
- Brookhaven (Lincoln)
- Collins (Covington)
- Corinth (Alcorn)
- Flowood (Rankin)
- Fulton (Itawamba)
- Hattiesburg (Lamar)
- Houston (Chickasaw)
- Kosciusko (Attala)
- Monticello (Lawrence)
- New Albany (Union)
- Philadelphia (Neshoba)
- Picayune (Pearl River)
- Pittsboro (Calhoun)
- Pontotoc (Pontotoc)
- Raleigh (Smith)
- Ripley (Tippah)
- Senatobia (Tate)
- Waynesboro (Wayne)



SOURCE: PEER created from the DOR FY 2018 Annual Report and information provided by ABC Enforcement as of September 2019.

**Exhibit 2: Beverages Containing Alcohol: Types, Definitions, and Regulation in Mississippi**

| Beverage Type            | Definition  | MISS. CODE ANN. (1972) Reference | Does ABC Regulate Sales and Warehousing? | Does ABC Enforce Applicable Laws? |
|--------------------------|---|----------------------------------|--|-----------------------------------|
| Beer                     | A malt beverage with an alcoholic content of not more than eight percent by weight  | 67-3-3                           | No                                       | Yes                               |
| Light Wine               | Wine of alcoholic content not more than five percent by weight  | 67-3-3                           | No                                       | Yes                               |
| Wine                     | Any product created from the alcoholic fermentation of the juice from grapes or berries with an alcoholic content of more than five percent by weight                         | 67-1-5                           | Yes                                      | Yes                               |
| Distilled Spirits/Liquor | Any beverage containing more than four percent alcohol by weight that is produced by distillation of fermented grain, starch, molasses, or sugar as a distilled spirit/liquor | 67-1-5                           | Yes                                      | Yes                               |

SOURCE: PEER analysis of applicable MISS. CODE ANN. Sections and information from DOR.

**What is the Organizational Structure for Regulating Alcoholic Beverages in Mississippi?**

***The Mississippi Department of Revenue's Alcoholic Beverage Control (ABC) Division regulates liquor and wine under authority of MISS. CODE ANN. § 67-1-19 (1972).***

In FY 2010, the Mississippi State Tax Commission reorganized and became the Mississippi Department of Revenue (DOR). The DOR houses the Alcoholic Beverage Control Division, often referred to as ABC. ABC splits alcoholic beverage control responsibilities between two separate units: ABC Administrative and Warehouse (ABC warehouse) and ABC Enforcement. The DOR handles tax collections from the sale of alcoholic beverages.

## What are States' Models for Regulating Alcoholic Beverages and What Model Does Mississippi Use?

***States use one of two main regulatory systems for alcoholic beverages: "licensing" or "control." Mississippi is considered a "control" state because it controls liquor and wine at the wholesale level.***

In the U.S., states use one of two main regulatory systems for alcoholic beverages: licensing or control. *Licensing* states regulate alcoholic beverages by requiring vendors, wholesalers, and retailers to be licensed through the state and by collecting taxes on alcoholic beverages. *Control* states also license vendors and retailers and collect taxes on alcoholic beverages; however, they also exercise control by acting as the wholesaler, retailer, or both for their states.<sup>1</sup>

Thirty-three states are license states and seventeen are control states. Mississippi is a control state. Alabama is also a control state, but Mississippi's other contiguous states use the license model.

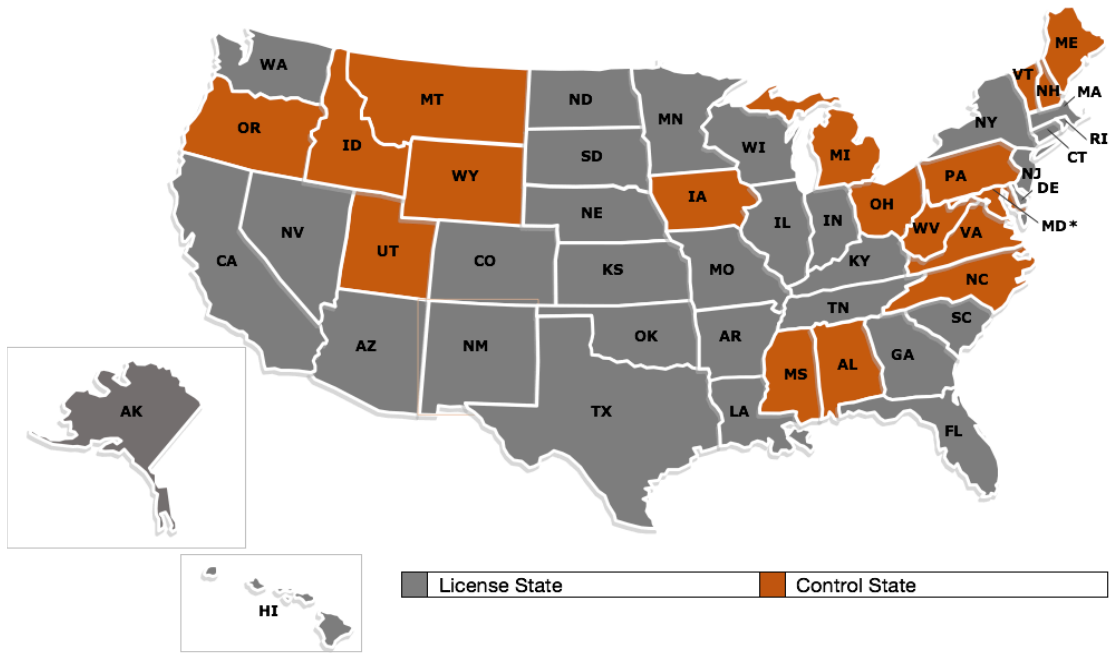
The control model of alcoholic beverage regulation has at least three variations. Control states regulate liquor and wine at the wholesale level, retail level, or both.<sup>2</sup> Exhibit 3, page 7, includes a map showing the regulation model used in each state and summarizes the differences in how control states regulate liquor and wine. Mississippi controls liquor and wine at the wholesale level. The ABC warehouse is responsible for storing and distributing alcoholic beverages at the wholesale level.

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<sup>1</sup> Montgomery County, Maryland, also uses the control model for regulation of alcoholic beverages.

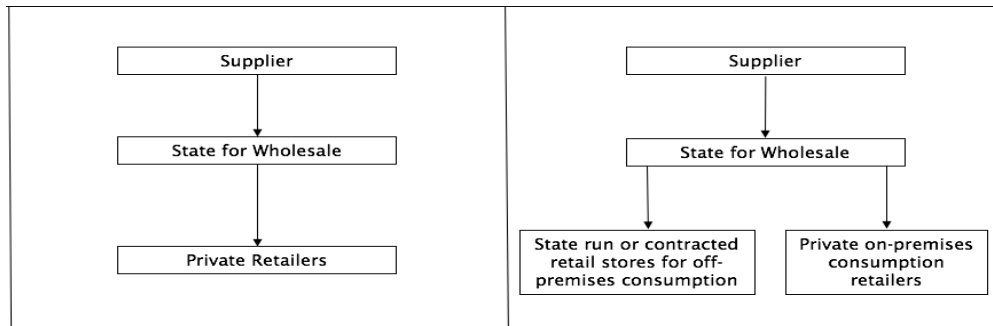
<sup>2</sup>Although Mississippi's ABC does not regulate beer and light wine, some control states also regulate beer.

**Exhibit 3: States' Models for Regulating Alcoholic Beverages as of August 2019**



**Control States (wholesale only)**

**Control States (wholesale and retail)**



| Control States (wholesale of liquor) | Control States (wholesale of liquor and wine) | Control States (wholesale and retail of liquor)        | Control States (wholesale and retail of liquor and wine) |
|--------------------------------------|---|--|--|
| Iowa<br>Michigan<br>West Virginia    | Mississippi<br>Wyoming                        | Alabama<br>Idaho<br>Maine<br>Montana<br>North Carolina | Ohio<br>Oregon<br>Vermont<br>Virginia                    |
|                                      |   |  | New Hampshire<br>Pennsylvania<br>Utah                    |

\*Only Montgomery County, Maryland uses a control system. The rest of Maryland uses a license system.

SOURCE: PEER analysis of National Alcohol Beverage Control Association (NABCA) data as of August 2019.

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## How ABC Stores and Distributes Alcoholic Beverages at the Wholesale Level

**MISS. CODE ANN. § 67-1-41 (1972) gives the Mississippi Department of Revenue (DOR) the authority to serve as the state's wholesale distributor and seller of alcoholic beverages. It also grants DOR the sole right of importation and sale of liquors at the wholesale level. Within the Department of Revenue, the Alcoholic Beverage Control Division—specifically, the ABC warehouse—is responsible for storing and distributing alcoholic beverages at the wholesale level. From FY 2013 through FY 2018, approximately 55% of ABC's total revenues came from net proceeds from liquor and wine sales and approximately 73% of ABC's expenditures were warehouse operating expenditures.**

ABC operates a single wholesale warehouse for alcoholic beverages for the entire state of Mississippi. The ABC warehouse is one building with two separate working spaces: a warehouse space and an office space, which houses ABC administration, purchasing, processing, and accounting.

The ABC warehouse has storage shelving throughout the warehouse, a conveyor system, a semi-cooled wine room, and six docking bays for trucks to ship and receive product. According to ABC staff, the warehouse has over one and one-half miles of conveyor system.

ABC warehouse employees operate two shifts per day, with each shift working ten hours per day. The day shift handles receiving shipments from vendors and stocking products within the warehouse. The night shift fills and prepares orders for shipment and replenishes stock within the warehouse, if necessary. ABC administrative staff work five days per week, eight hours per day. As of July 15, 2019, the ABC warehouse had 106 employees.

This chapter addresses the following questions:

- How does the ABC warehouse obtain and store alcoholic beverages for sale to permittees?
- How does the ABC warehouse receive and fill permittees' orders?
- How does the ABC warehouse distribute product to permittees?
- What revenues does the state collect related to the sale and taxation of alcoholic beverages?
- What expenditures does the state incur related to the warehousing and distribution of alcoholic beverages?



## How Does the ABC Warehouse Obtain and Store Alcoholic Beverages for Sale to Permittees?

***The ABC warehouse receives alcoholic beverages from vendors and stores them until it ships them to permittees. The majority of the items stored in the ABC warehouse are owned by the vendors, who electronically monitor the inventory levels of their products and send replacement items when their stock is low. ABC warehouse staff do order and store special-order items for permittees upon request.***

Because the ABC warehouse runs on a *bailment system*, the state stores vendors' or distillers' product in the warehouse without the state having to purchase the product. Vendors own the product within the warehouse and the state stores it until it can be sold to a Mississippi permittee. ABC's warehouse staff are not responsible for ordering product to stock the bailment floor. Liquor and wine vendors have electronic access to view real-time inventory levels at the ABC Warehouse and when they notice their product is low or needs replenishing, they contact ABC to schedule delivery of additional product.

The warehouse staff does order and store *special-order* items for permittees at their request. Special-order items are a direct cost to the state because the state must purchase these items in advance in order to have them shipped to the ABC warehouse. Once a special-order item ships to the permittee, the permittee then pays the warehouse for the special-order item.

The ABC warehouse utilizes both bulk storage and shelving areas. Products that move quickly through the warehouse are found in large stacks throughout the warehouse (i.e., bulk storage). Other products are stocked into shelving to be pulled later for shipping. As of July 11, 2019, the warehouse held 3,809 bailment items and a total of 427,709 cases of alcoholic beverages, including both bailment and special-order items.

Items belonging to vendors that are broken while stored in the ABC warehouse represent a direct cost to the state. Once items are broken or damaged, the state must purchase them. Damaged products are processed through the warehouse's damage room where they are cleaned and sorted. They are repackaged if they are in good condition and put back on the bailment floor. These items are then sold first on future orders to ensure that the state recoups its money as quickly as possible. Items that are not in good condition (e.g., have stained or scratched labels) are repacked and placed in boxes to be sold at a salvage sale so that the state can recoup at least some of the expense incurred from paying for the damaged goods.

## How Does the ABC Warehouse Receive and Fill Permittees' Order Requests?

***The ABC warehouse receives orders through permittees' accounts on the Taxpayer Access Point (TAP). Warehouse employees fill orders each evening on a first-come, first-served basis.***

Each ABC permittee has a Taxpayer Access Point (TAP) account. Through this TAP account, permittees have electronic access to place orders,<sup>3</sup> make payments, receive notifications from the ABC administration, apply for permits, and place bids on salvage sales. When permittees log into their TAP accounts to place orders, they are able to see a real-time status inventory of which products are available and how much of each product is available. Periodically, the warehouse may offer special prices on particular items within the warehouse that are set by the vendors of the items on the bailment floor. ABC notifies permittees of these special prices through their TAP accounts. Exhibit 4, page 11, illustrates the permittees' process of ordering alcoholic beverages through the ABC warehouse.

The ABC warehouse receives and fulfills orders on a first-come, first-serve basis. If a permittee places an order for an in-demand item first, then it is the one to receive the product. However, if for any reason that permittee changes or modifies its order in any way, that order receives a new time stamp and is moved to the bottom of the orders received list. Orders that do not make "the cut" on the same day they were placed are the first orders filled the next business day based on the time stamp the order was placed through the TAP account.

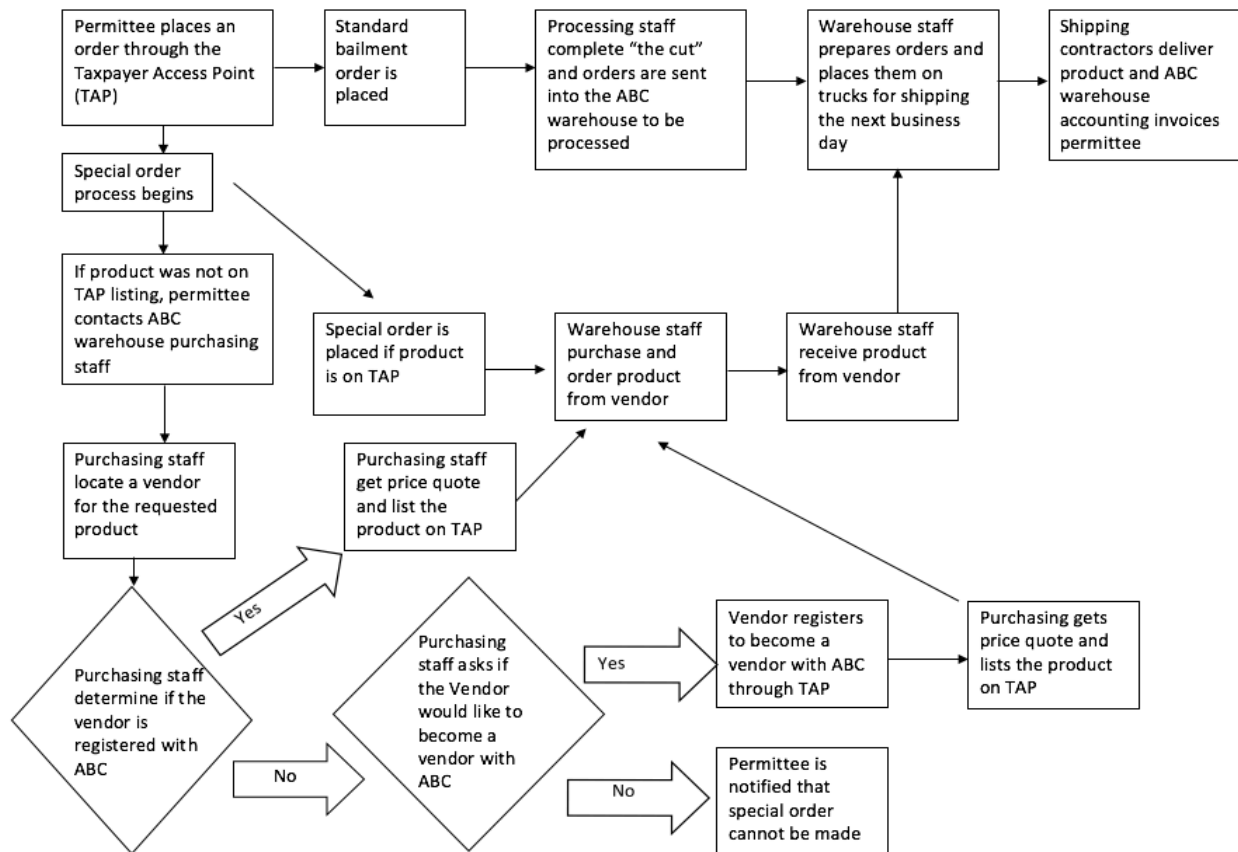
The ABC warehouse also distributes *allocated* items (i.e., items pre-sold by vendors or brokers) that are sold through the warehouse. Vendors or their brokers travel around to permittees around the state pre-selling the particular product. Once they have sold the product, they submit a list to the ABC warehouse. The warehouse, upon receiving the product, invoices and ships that particular product to the permittees on the pre-sold list from the vendor or broker. Many times, these allocated items are items that are rare or high-demand products.

As noted, the ABC night shift warehouse employees fill and prepare orders each evening for shipment and replenish stock, if necessary.

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<sup>3</sup> ABC allows a small number of permittees to place orders through phone calls and paper forms through the ABC processing staff due to lack of internet access.

## Exhibit 4: Permittees' Process of Ordering Products through the ABC Warehouse



Note: The cut stops order intake for orders that will be fulfilled and shipped that business day. This process sends order information from inside the ABC warehouse office into the ABC warehouse floor for the warehouse night shift employees to pull and ship the orders.

SOURCE: PEER created from data provided by DOR.

## How Does the ABC Warehouse Distribute Product to Permittees?

***Permittees who place their liquor and wine orders before ABC's daily cut-off time typically receive their orders the next business day. The ABC warehouse contracts with two shipping companies to deliver orders to permittees.***

Permittees who place their orders before ABC cuts off orders each day receive their orders the next business day. A permittee is not invoiced for an order until it is loaded onto the truck and shipped to the permittee, typically the next business day. The ABC warehouse's maximum order and shipping capacity is approximately 20,000 cases per day.

Once warehouse employees have pulled an order from the shelving within the warehouse, they place it onto a conveyor system. The conveyor system takes the product from its location in the

warehouse to the docking bays where it is loaded onto trucks for delivery.

The ABC warehouse contracts with two shipping companies to deliver orders. Once ABC warehouse staff remove the products from the conveyor system and place them on the shipping truck, the state no longer owns the product; the shipping companies own the product and are responsible for its delivery to permittees. One company delivers in the Jackson metro area, and the other company delivers to the rest of the state. Once the product is delivered to the permittees, ownership of the product then lies with the permittees.

In the event of breakage during shipping, if the retailer/permittee will accept the broken bottles, the trucking company is responsible for repayment. The retailer/permittee files a claim with the trucking company. The trucking company then pays the retailer directly for the broken bottles. If the retailer/permittee will not accept the broken bottles, the shipper brings the broken product back to the ABC warehouse and the ABC warehouse credits the permittee for the broken product. If product is missing upon a truck's arrival at a permittee's location (possibly due to theft), the shipper is responsible for paying the permittee for the missing product. In such cases, ABC warehouse staff review the warehouse's product inventory to determine whether the product might not have been loaded on the truck for delivery to a permittee, instead of being missing due to theft.

## What Revenues Does the State Collect Related to the Sale and Taxation of Alcoholic Beverages?

***Approximately 55% of ABC's total revenues for FY 2013 through FY 2018 came from net proceeds from liquor and wine sales. The remainder of ABC's revenues came from collection of alcohol-related taxes and from permit fees and penalties.***

The ABC derives revenues primarily from a combination of the state markup on liquor and wine sales and various taxes imposed on liquor and wine sales. ABC also receives a considerably smaller amount from permit fees and penalties.

When the ABC warehouse sells an alcoholic beverage product, the final sale price includes:

- the distiller's cost for the product;
- state markup rate at 27.5%, including the 24.5% base markup rate and the 3% tax for the Mental Health Programs Fund, also known as the Alcohol Abuse Tax;
- wholesale sales tax at 7%;
- state excise taxes at \$2.50 per gallon for distilled spirits, \$1.00 per gallon for sparkling wine and champagne, and \$.35 per gallon for other wines, including native wines; and,

- freight costs.<sup>4</sup>

Exhibit 5, page 14, details the components of the price of liquor and wine in Mississippi based on the average cost of a bottle of liquor or wine as specified by the Department of Revenue in its FY 2018 Annual Report.

MISS. CODE ANN. § 27-71-11 (1972) and MISS. CODE ANN. § 27-71-7(2) (1972) established the 27.5% markup rate. DOR levies other alcohol-related taxes under authority of MISS. CODE ANN. § 27-71-11, § 27-71-7(1) (1972), and § 27-65-25 (1972). Each permittee also collects retail sales tax and may take a credit for the wholesale sales tax paid pursuant to MISS. CODE ANN. § 27-65-26 (1972).

Annual reports of the Mississippi Department of Revenue (formerly the State Tax Commission) include information on the total revenues ABC collected from FY 1967 forward. With the exception of a few years, the overall total revenue collected by ABC has continued to grow, from \$11,246,363 in FY 1967 to \$114,232,525 in FY 2018. Approximately 55% of the revenue collected by ABC from FY 2013 through FY 2018 came from net proceeds from sales of alcohol beverages from the ABC warehouse.

Exhibit 6, page 15, shows the total ABC revenue, by source, from FY 2013 through FY 2018.

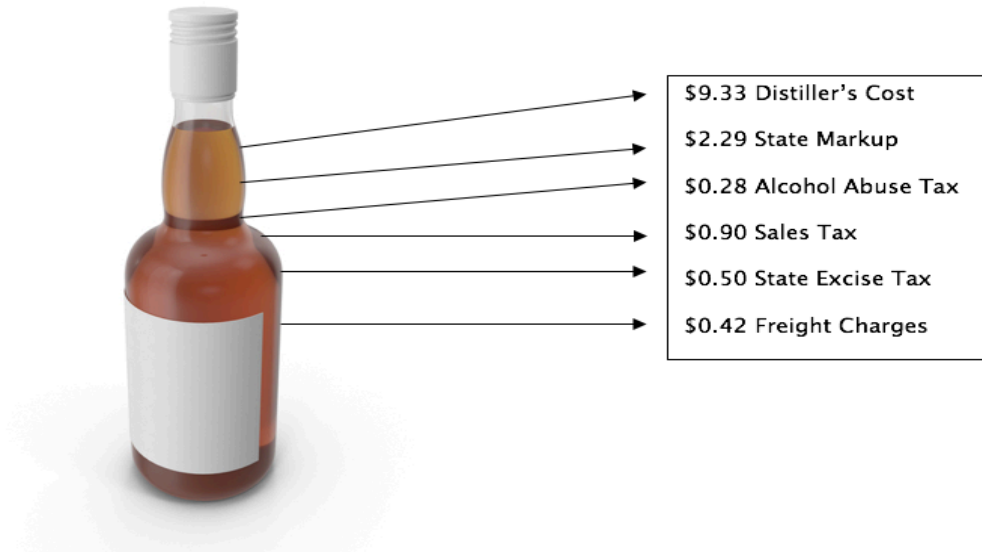
The Department of Revenue also receives an annual appropriation from the Legislature for its operations, including ABC operations. Prior to the FY 2018 appropriation, the Legislature usually appropriated the funds to DOR in aggregate without specifying amounts for each of the DOR's divisions. However, several of DOR's appropriation bills included additional amounts for specific ABC operations. These additional amounts included: 1 million each in FY 2014 and FY 2015 for the repair and renovation of the ABC warehouse and \$70,000 in FY 2016 for ABC warehouse purposes. As part of its performance-based budgeting effort, the Legislature, beginning with FY 2018, included specific amounts in the Department of Revenue's appropriation bill for its six budgetary programs, one of which is the Alcoholic Beverage Control Division.

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<sup>4</sup> The state adds a \$5.00 per case delivery fee. The trucking companies that deliver shipments to permittees have delivery fees based on weight plus distance or a flat delivery fee.

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**Exhibit 5: Components of the Cost of a Bottle of Liquor<sup>1</sup> or Wine<sup>2</sup> in Mississippi, FY 2018**



Note: Based on an average cost per bottle of liquor at \$13.72 according to the DOR FY 2018 Annual Report.



Note: Based on an average cost per bottle of wine at \$8.87 according to the DOR FY 2018 Annual Report.

SOURCE: PEER created from data included in the DOR FY 2018 Annual Report.

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**Exhibit 6: Alcoholic Beverage Control: Breakdown of Revenues from Sales, Collection of Related Taxes, and Revenues from Additional Sources, FY 2013 through FY 2018**

| <i>Revenue Source</i>                        | <i>FY 2013</i>      | <i>FY 2014</i>       | <i>FY 2015</i>       | <i>FY 2016</i>       | <i>FY 2017</i>       | <i>FY 2018</i>       |
|--|---------------------|----------------------|----------------------|----------------------|----------------------|----------------------|
| <b>Net Proceeds from Sales</b>               |                     |                      |                      |                      |                      |                      |
|  | \$55,213,167        | \$60,319,567         | \$56,685,955         | \$58,758,806         | \$62,054,742         | \$63,858,394         |
| <b>Related Tax Collections</b>               |                     |                      |                      |                      |                      |                      |
| Sales Tax                                    | \$20,908,166        | \$21,756,871         | \$23,185,457         | \$23,868,993         | \$24,563,382         | \$25,264,938         |
| Excise Tax                                   | 11,674,915          | 11,965,220           | 12,515,225           | 12,639,827           | 12,739,090           | 12,871,422           |
| Alcohol Abuse Tax                            | 6,442,912           | 6,691,056            | 7,157,153            | 7,371,914            | 7,599,823            | 7,828,701            |
| Subtotal of Related Tax Collections          | \$39,025,993        | \$40,413,147         | \$42,857,835         | \$43,880,734         | \$44,902,295         | \$45,965,061         |
| <b>Revenues from Additional Sources</b>      |                     |                      |                      |                      |                      |                      |
| Permit Fees                                  | \$5,700,880         | \$5,711,625          | \$5,965,585          | \$3,930,466          | \$4,266,204          | \$4,400,570          |
| Other*                                       | 5,109               | 11,759               | 10,000               | 4,193                | 16,000               | 8,500                |
| Subtotal of Revenues from Additional Sources | \$5,705,989         | \$5,723,384          | \$5,975,585          | \$3,934,659          | \$4,282,204          | \$4,409,070          |
| <b>Grand Total</b>                           | <b>\$99,945,149</b> | <b>\$106,456,098</b> | <b>\$105,519,375</b> | <b>\$106,574,199</b> | <b>\$111,239,241</b> | <b>\$114,232,525</b> |

\*Other comprises warehouse Surcharge, Permit ID Fees, Interest Earned, Miscellaneous, Permit Fines, and Refund of Prior Warrant.

SOURCE: PEER created from data included in the DOR FY 2018 Annual Report.

For FY 2018 through FY 2020, the Legislature appropriated the following amounts specifically for ABC operations:

- FY 2018: \$7,205,376 (\$5,128,492 in general funds and \$2,076,884 in special funds);
- FY 2019: \$6,880,546 (\$5,347,090 in general funds and \$1,533,456 in special funds); and,
- FY 2020: \$11,497,053 (\$7,034,524 in general funds and \$4,462,529 in special funds) designated for ABC operations. (As noted on page 26, the FY 2020 appropriation included an amount of up to \$4 million for the purpose of purchasing additional warehouse space.)

### What Expenditures Does the State Incur Related to the Warehousing and Distribution of Alcoholic Beverages?

*Approximately 73% of ABC's expenditures for FY 2013 through FY 2018 were warehouse operating expenditures. The remaining expenditures were for enforcement, including the costs to issue permits and enforce alcoholic beverage laws.*

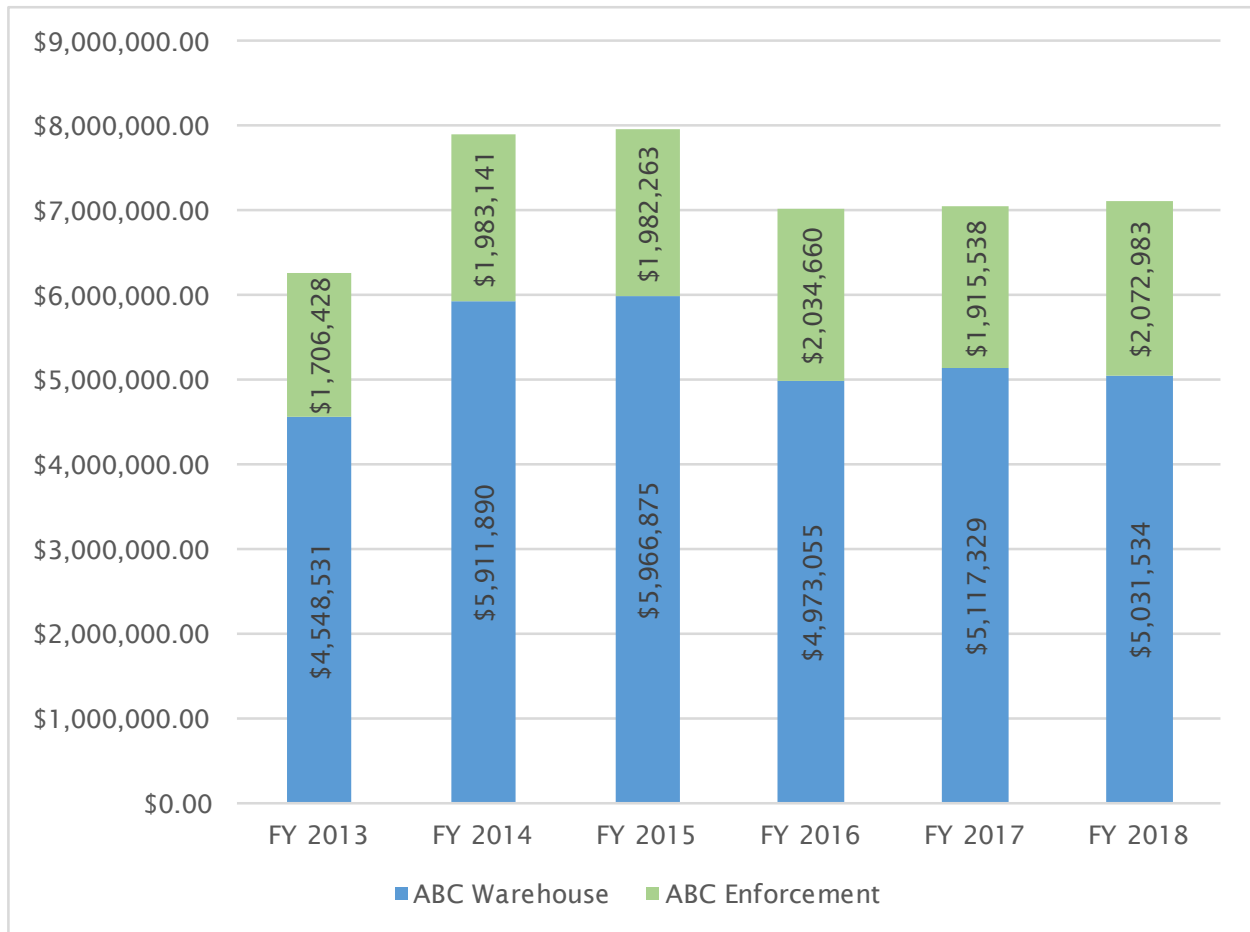
Exhibit 7, page 17, shows the total ABC operational costs for the ABC warehouse and ABC Enforcement expenditure categories from FY 2013 through FY 2018. Exhibit 8, page 18, lists expenditures for the ABC warehouse operations by major budget category from FY 2013 through FY 2018.

The majority of ABC warehouse operational expenditures each year may be attributed to the salaries for personnel. Overall, salary expenditures have exhibited slight growth over the six fiscal years reviewed, with a slight decline in FY 2018. These salary expenditures ranged from approximately \$3.57 million in FY 2013 (78.4% of total expenditures) to approximately \$4 million in FY 2017 (78.3% of total expenditures).

As shown in Exhibit 8, ABC warehouse expenditures peaked in fiscal years 2014 and 2015. In FY 2014, there was a significant increase in contractual spending of \$1,158,740 over the amount expended in FY 2013. Additional smaller increases were noted in salaries, equipment, and commodities, respectively. In FY 2015, the largest expenditure increases were noted in the commodities (\$511,868) and equipment (\$355,950) categories in comparison to FY 2014. DOR executives attributed these increases to receiving an additional \$1,000,000 per year through legislative appropriations for fiscal years 2014 and 2015 designated to ABC warehouse repairs and renovations. While there was a decrease in contractual expenditures (-\$852,469) in comparison to the prior fiscal year, the overall total expenditures in FY 2015 were still slightly higher than FY 2014. For the remaining three fiscal years, the overall total expenditures leveled out with only slight fluctuation.



**Exhibit 7: Alcoholic Beverage Control Operational Costs, Warehouse and Enforcement, FY 2013 through FY 2018**



SOURCE: PEER created from data provided by DOR as of August 20, 2019.

As noted previously, ABC enforcement expenditures include the costs to issue permits and enforce alcoholic beverage laws. As shown in Exhibit 7 above, enforcement expenditures ranged from \$1,706,428 in FY 2013 to \$2,072,983 in FY 2018.

**Exhibit 8: Alcoholic Beverage Control Warehouse Expenditures by Major Object Category, FY 2013 through FY 2018**

| <b>Budget Category</b> | <b>FY 2013</b>     | <b>FY 2014</b>     | <b>FY 2015</b>     | <b>FY 2016</b>     | <b>FY 2017</b>     | <b>FY 2018</b>     |
|------------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| Salaries               | \$3,567,079        | \$3,694,005        | \$3,730,664        | \$3,829,650        | \$4,007,686        | \$3,910,718        |
| Travel                 | 1,457              | 1,016              | 3,998              | 3,835              | 605                | 2,898              |
| Contractual            | 630,474            | 1,789,214          | 936,745            | 765,920            | 738,552            | 822,000            |
| Commodities            | 178,662            | 216,777            | 728,645            | 367,532            | 304,636            | 272,055            |
| Equipment              | 170,859            | 210,873            | 566,823            | 6,118              | 65,850             | 23,863             |
| Subsidies              | 0                  | 5                  | 0                  | 0                  | 0                  | 0                  |
| <b>Total</b>           | <b>\$4,548,531</b> | <b>\$5,911,890</b> | <b>\$5,966,875</b> | <b>\$4,973,055</b> | <b>\$5,117,329</b> | <b>\$5,031,534</b> |

SOURCE: PEER created from data provided by DOR as of August 20, 2019.

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# Conclusions Regarding ABC's Warehouse Operations

In reviewing ABC's management of its warehouse operations, PEER found a pattern of missed opportunities. These include missed opportunities to increase productivity, reduce the potential for workplace injuries, maximize revenue potential, make efficient use of warehouse space, collect more accurate information for planning and budgeting, and correct weaknesses in customer service.

This chapter addresses the following conclusions regarding ABC warehouse operations:

- The ABC warehouse does not have a comprehensive management system for its warehouse equipment that includes tracking conveyor system breaks and implementing a preventive maintenance system plan.
- The ABC warehouse lacks written warehouse safety and operating procedures for its employees.
- The ABC warehouse does not require each of its vendors to keep minimum amounts of alcoholic beverage stock on hand in the warehouse.
- Although the DOR has begun the process of purchasing an additional warehouse, it does not have a formal written plan for the logistics of incorporating the additional warehouse into the operations of the existing warehouse.
- Although the ABC warehouse has written customer service procedures in place, it does not ensure that employees follow these procedures and track customer service calls, complaints, and comments.

## No Comprehensive Management System for Warehouse Equipment

*The ABC warehouse does not have a comprehensive management system for its warehouse equipment that includes tracking conveyor system breaks and implementing a preventive maintenance system plan. Thus, the ABC warehouse may often experience more down time and lost productivity than necessary, as well as lost revenue opportunities. Lack of a comprehensive equipment management system also hampers ABC's ability to make accurate budget projections and funding requests to the Legislature.*

As with any warehouse operation, the ABC warehouse staff uses material-handling equipment, such as forklifts, stock pickers,<sup>5</sup> hand trucks, and conveyor belts, to move stock from the receiving dock to storage shelving and then to the shipping dock for delivery to retailers. To ensure an efficient warehouse operation and timely

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<sup>5</sup> Stock pickers are similar to forklifts, but have a platform that can raise an employee in the air alongside the product for the employee to stock the product on higher shelving.

deliveries to retailers, the equipment must be in good condition and well maintained—i.e., downtime must be minimized.

In interviews with PEER, ABC warehouse managers noted that the warehouse's conveyor system negatively affects timely delivery of product because the conveyor belt becomes inoperable at times, which causes product to remain on the belt. In such cases, warehouse workers must manually move the product to the shipping dock or wait until the conveyor system is repaired. Despite the warehouse managers' concerns regarding the conveyor belt system, the managers could not provide PEER with any documentation regarding the number of times the conveyor system became inoperable or the length of time that the system was out of service.

One potential cause for the periodic breakdowns of the conveyor system is the fact that the ABC warehouse does not have a preventative maintenance plan. Warehouse workers attempt to repair equipment on an ad hoc basis without following any type of routine inspection and repair schedule. According to industry experts, a preventative maintenance plan has the following direct benefits:

- minimizes asset failure and breakdowns;
- reduces down time;
- safety;
- prolongs assets' productive life; and,
- improves production.

Once established, a preventative maintenance plan should be regularly reviewed and updated.

ABC managers assert that they have not implemented a preventative maintenance plan because they do not know from fiscal year to fiscal year how much money the Legislature will appropriate to the Department of Revenue (DOR) and what portion of those funds could be used by ABC for maintenance needs. The managers also contend that maintenance of the warehouse equipment that is leased is the responsibility of the owners of the equipment. While DOR, as are all other state agencies, is dependent on the Legislature to appropriate funds for its operations, without a preventative maintenance plan or documentation of the warehouse's equipment repair costs, ABC managers cannot inform the Legislature regarding the need for funds to address ongoing equipment maintenance and repair needs.

The need for a preventative maintenance plan for the ABC warehouse has been conveyed to ABC managers in the past. In 2016, the Mississippi State University Center for Advanced Vehicular Systems (MSU CAVS) conducted a study on the efficiency

of the ABC warehouse and recommended, among other improvements, that the warehouse implement a preventative maintenance plan. Despite this recommendation, ABC managers chose not to implement such a plan.

Having a preventative maintenance plan could result in less down time for the ABC warehouse. In addition to increasing productivity, such a plan, along with replacement of parts that have outlived their usefulness, could possibly prevent lost revenue opportunities through product deliveries that are not timely.

### Lack of a Warehouse Safety Plan

***The ABC warehouse lacks written warehouse safety and operating procedures for its employees. This could result in workplace injuries at the warehouse that might otherwise be avoided.***

Within the ABC warehouse's operational hours, multiple pieces of machinery are operating at all times. At the same time, employees are moving around stocking shelves, unloading shipments, and moving product in and out of the damage room.

While the administrative staff at the ABC warehouse has standard operating procedures, the ABC warehouse has no written standard operating procedures or guide for warehouse operations. Basic rules for warehouse employees include no open-toed shoes, no headphones, and no smoking in the warehouse. However, ABC does not have a formal safety plan for the warehouse or routine, periodic safety training for warehouse employees.

ABC staff stated that trainers and managers explain most safety and procedural rules verbally to warehouse staff during the interview and orientation process. New warehouse employees are trained by other employees who work in the same capacity. Until the trainer signs off saying the new employee understands the rules and duties of the job, the new employee is not allowed to work alone. Also, according to ABC staff, once per quarter a select group of warehouse employees walks through the warehouse and reports potential safety concerns to the ABC director.

Because the ABC warehouse is owned by the State of Mississippi, it does not fall under Occupational Safety and Health Act (OSHA) jurisdiction. Section (3)(5) of the Occupational Safety and Health Act of 1970 specifically excludes OSHA's authority over employees of state and local government stating:

*For the purposes of this Act...The term 'employer' means a person engaged in a business affecting commerce who has employees, but does not include the United States (not including the United States Postal Service) or any State or political subdivision of a State.*

However, ABC could consider implementing OSHA guidelines in operating the warehouse to help ensure employee safety.

The state has an interest in safe working conditions for ABC warehouse employees, as well as employees of all other state agencies. While even the safest work environment sometimes experiences incidences that result in injury or illness, the state's workers' compensation program provides wage replacement payments, medical expense reimbursements, and other benefits to employees who suffer a work-related injury or illness.

The Mississippi State Agencies Self-Insured Workers' Compensation Trust (Trust), administered by the Department of Finance and Administration's Office of Insurance, provides workers' compensation coverage for the more than 25,000 employees of the approximately 100 state agencies, boards, and commissions participating in this program. The Trust currently contracts with a third-party administrator (TPA) to process any claims resulting from injury or illness. In an effort to promote workplace safety and reduce the number of workers' compensation claims, the Trust provides all of its participating entities with a *Safety Resource Manual*, which includes safety guidelines that participating entities can adapt to the needs of their particular workplaces.

The Trust also utilizes its TPA to conduct risk assessments of its participating entities to identify potential safety risks and recommend improvements of workplace conditions. Several of the components targeted by these assessments include: the status of an employee safety training program; the status of formal safety policies; the presence or absence of progressive discipline or positive rewards for safety standards; the frequency of workplace accidents; the physical condition of the premises; and, the condition of the equipment.

PEER reviewed ABC's risk assessment results for the period June 2015 through July 2019, with the following observations being made by the TPA's risk managers:

- The ABC warehouse had no safety policies or safety training program. As a result, the warehouse had no progressive discipline or positive rewards in place for safety issues.
- While the condition of the warehouse office area was "average," the condition of the warehouse itself was "poor" from a housekeeping standpoint. Broken glass was noted in the warehouse.
- Forty percent of the ABC warehouse's workplace-related injuries were incurred by staff who had less than three years of experience, with many of those being "repeater" claims.
- The ABC warehouse had an injury frequency rate twenty times greater than the rest of the Department of Revenue employees.

Some of the risk managers' observations were carried over from one assessment report to another. Two of the 2019 assessment reports noted that ABC managers had established a safety committee and had begun working with Holmes Community College to develop a safety training program, which consisted of the training of five forklift operators.

While inspecting the ABC warehouse during fieldwork for this project, PEER confirmed many of the observations made by the TPA's risk managers. PEER also observed broken materials on the warehouse floor and ABC warehouse employees working in an unsafe manner—e.g., not being harnessed to equipment when they were working on elevated forklift platforms. According to DOR staff, the ABC warehouse implemented a harness and lanyard safety program for all personnel who use a stock picker, effective on July 23, 2019.

In addition to potential for harm to employees, workplace accidents and injuries also represent a cost to the state. From July 1, 2012, through June 7, 2019, the ABC warehouse had 162 workers' compensation claims that resulted in a total cost to the Trust of \$670,284. Another state agency that operates a stock warehouse is the Mississippi Industries for the Blind (MIB), which had fifty-six workers' compensation claims during the same reporting period. While MIB was not the focus of PEER's review and PEER did not analyze the type and severity of the agency's claims, workers' compensation claims for the ABC warehouse were approximately three times higher than MIB's for the same reporting period.

Having clearly defined written policies, procedures, and safety standards would allow ease and consistency in enforcing such standards and potentially prevent most workplace accidents and reduce workers' compensation costs associated with such accidents.

### No Assurance of Efficient Use of Warehouse Space

***The ABC warehouse does not require each of its vendors to keep minimum amounts of stock on hand in the warehouse. This practice does not assure that ABC utilizes its warehouse space as efficiently as possible or that sufficient amounts of each product are available for purchase, thus maximizing potential revenues to the state.***

According to Brian Hudock, Vice President of Supply Chain Solutions at Tompkins International, there is an old saying in warehousing that states, "if there is available space, someone will eventually fill it." Hudock asserts that there are three types of space issues that occur in a warehouse: having too much of the right inventory; having too much of the wrong inventory; and using existing warehouse space poorly. Because Mississippi is a control state for alcoholic beverages and ABC serves as the only wholesaler of the product, efficient utilization and maximization of available warehouse space are of paramount importance.

In 2015, a study by the National Alcohol Beverage Control Association (NABCA) on behalf of ABC researchers concluded that the ABC warehouse had a capacity of 450,000 cases. The study noted that in 2015, the daily ending inventory of product during the warehouse's peak period, October through December, ranged from 360,000 to 499,000 cases. The study projected that by 2019 the warehouse would exceed its capacity, leading to serious space and operational inefficiencies.

As described on page 9, the ABC warehouse primarily operates on a bailment system. According to the Department of Revenue's bailment agreement with vendors, "a bailment warehouse program is defined as meaning the vendor will own the stock in the ABC Liquor Distribution Center [warehouse] until it is withdrawn from bailment for shipment to the ABC permittees." The agreement allows ABC to determine the location of alcoholic beverages stored in the warehouse and provides ABC with the right to manage warehouse space allocation.

The bailment agreement requires vendors to comply with the inventory management guidelines established by ABC. Vendors who do not comply may be stopped from listing new products and/or offering special purchase allowances, at ABC's discretion. Prior to January 1, 2019, for a vendor's spirits to be placed in bailment, a product must have had a sales quota of \$4,500 over a nine-month period as a special-order item. For a vendor's wine to be placed in bailment, a product must have had a sales quota of \$3,500 over a nine-month period as a special-order item. Effective January 2019, ABC changed the sales quota amounts to \$9,500 for spirits and \$8,000 for wine. Once a product reaches the required criteria to become a bailment item, it remains a bailment item and vendors are allotted six weeks worth of storage space in the ABC warehouse until the item does not meet the sales requirement and is delisted.<sup>6</sup>

ABC's warehouse staff are not responsible for ordering product to stock the bailment floor. Each day, ABC warehouse staff send a report to NABCA detailing the inventory level of each product in the warehouse. Vendors have access to this information through the NABCA as well as their account in the Department of Revenue's Taxpayer Access Point (TAP) system. When vendors notice their product is low or needs replenishing, they call the ABC warehouse receiving staff and schedule an appointment to have a truck replenish their stock in the warehouse. When scheduling appointments, vendors do not disclose what product or quantity of product they will deliver to the ABC warehouse--i.e., ABC warehouse staff are not aware of what the vendor is delivering until the truck arrives and shipment documentation is provided to ABC.

As the state's sole wholesaler of alcoholic beverages, all floor space within the ABC warehouse has "value" and is capable of holding

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<sup>6</sup> Products are *delisted* or removed from the ABC warehouse bailment system if they do not meet the required sales quota. Delisting of bailment items happens twice per year.



product and creating revenue through sales to permittees and the collection of relevant taxes. Given the current bailment system, vendors are provided a significant level of control over the quantity of stock in the warehouse. ABC's primary method of controlling stock and maximizing space allocation is the limitation of a vendor's six-weeks supply of available product.

Prior to the MSU CAVS report in 2016 regarding ABC operations, ABC allowed vendors to stock eight weeks worth of product in bailment. The MSU CAVS report addressed the fixed amount of ABC warehouse capacity and recommended increasing the efficiency of product flow by reducing a product's inventory level and requiring more frequent deliveries of product from the vendors. Based on this recommendation, ABC reduced the amount of product inventory vendors can stock in the warehouse to six weeks worth of product. A new product that has been added to the ABC warehouse bailment floor is allowed two pallets of storage for the product, but typically will ship the maximum allowed six weeks worth of product to the warehouse upon its initial listing as a bailment item.

While ABC sets a total maximum amount of product that each vendor is allowed to store in the ABC warehouse--i.e., an estimated six-weeks' supply<sup>7</sup>--ABC does not set a minimum amount of product that vendors must keep in the warehouse for sale to Mississippi permittees. Setting a minimum amount of product that each vendor must keep on hand would ensure that the warehouse has a sufficient amount of product available for shipping to permittees.

Of the seventeen control states listed in Exhibit 9, page 30, twelve states require vendors to stock minimum quantities of product in their warehouses. Some control states charge fees when vendors do not maintain the minimum amount of product in the warehouse for purchase. Because ABC does not require vendors to keep a minimum amount of product in the warehouse, permittees could potentially experience longer wait times than necessary for orders to be filled if a particular product is not available in the warehouse. In contrast, having six weeks' worth of inventory might not be appropriate for all products, especially if a product does not move as quickly as others.

## No Logistical Plan for Incorporating an Additional Warehouse into ABC Operations

***During the 2019 Regular Session, the Legislature appropriated an amount of up to \$4 million for purchasing an additional warehouse for ABC operations. Although the DOR has begun the process of purchasing the additional warehouse, it does not have a formal, written plan for the logistics of incorporating the additional warehouse***

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<sup>7</sup> Three times per year the ABC warehouse staff run a report of how much of each product sells in six weeks. ABC warehouse reviews the report and if a vendor has more than their estimated six weeks of sales' worth of product in the warehouse, they are required to come pick up the excess.

***into the operations of the existing warehouse. Lack of such a plan could reduce efficiency of warehouse operations or reduce revenue potential for the state.***

From 2015 through 2016, the Department of Revenue (DOR) commissioned studies<sup>8</sup> to review how space in the current ABC warehouse could be used more efficiently. Among other recommendations, these studies concluded that the ABC warehouse was near its capacity and recommended additional storage space for new products.

During the Legislature's 2019 Regular Session, DOR executives used the capacity conclusions of these studies to request funding authority from the Legislature to purchase a soon-to-be vacant warehouse near the current ABC warehouse to be used for bulk storage of product. (The proposed warehouse to be purchased is located across the road and to the west of ABC's warehouse.) Senate Bill 3024, 2019 Regular Session, included "an amount less than Four Million Dollars (\$4,000,000,00)... for the purpose of purchasing additional warehouse space for the Department of Revenue warehousing needs." (DOR had not completed the purchase of the additional warehouse by the conclusion of PEER's review.)

Despite having legislative authority to purchase additional warehouse space, neither DOR executives nor ABC staff have developed a formal, written plan for the logistics of incorporating the additional warehouse into the operations of the existing warehouse. DOR executives stated to PEER that their plan, at this point, is to receive product at the current warehouse, transport it to the additional warehouse across the road for bulk storage, and then transport it back to the current warehouse where it will be picked from shelves to be shipped to permittees. ABC warehouse staff plan to contract with the shipping companies they currently use to deliver product to permittees to move product from the additional warehouse to the current warehouse for it to be packaged and shipped. (ABC staff did not provide PEER with an estimate of the projected costs associated with this intra-warehouse shipping of product.)

PEER questions ABC's ability to incorporate the warehouse into its current operations efficiently for the following reasons:

- The timing of the movement of product from bulk storage in the additional new warehouse to the current warehouse could be problematic. The movement would have to occur either during the day shift, when ABC warehouse workers are receiving product from vendors, or during the night shift, when ABC workers are picking product to be shipped to permittees.

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<sup>8</sup> David Jackson (National Alcoholic Beverage Control Association), "Mississippi Plan 2025" (Presentation, 2015); Chet Willey (Chet Willey Associates), "Mississippi Liquor Warehouse Utilization Analysis" (Presentation, 2015); H. Glenn Dennis and Jonathon Curtis (Mississippi State University Center for Advanced Vehicular Systems), "Recommendations to ABC-LDC" (Presentation, 2016).

- Both the current ABC warehouse and the additional warehouse are located in the Central Mississippi Industrial Center in Madison County. Both warehouses are located at the front of the industrial center and sit adjacent to the only road of ingress by which all industrial center tenants access their property. Traffic could impede the safe and efficient shipment of product from one warehouse to the other.
- DOR executives contend that the additional warehouse will allow ABC to increase its shipping capacity, which is currently 20,000 cases per day. However, it is unclear how shipping capacity could be increased given that the current ABC warehouse has only six shipping bays, with no plans to add more docks. In addition, ABC currently has no plans to increase its staff when the additional warehouse becomes operational. PEER questions how using the additional warehouse only for bulk storage would allow more product to be shipped from the current warehouse on a daily basis.

According to DOR executives, the department's overall goal for acquiring the additional warehouse is to convert the ABC warehouse operation to a pallet picking system in lieu of using the conveyor system. ABC managers expect pallet picking to be a more efficient system of order fulfilling due to less down time from conveyor breakage. In a pallet picking system, the order picker uses a lift truck, picks up the entire order, and loads it onto a pallet. It is then staged in a shipping area until loaded on a truck for shipment. DOR executives have not provided PEER with any empirical evidence to justify this potential shift in warehouse operations.

Given DOR's and ABC's lack of formal planning for the proposed use of an additional warehouse, it is incumbent upon the DOR to focus on efficiency and revenue potential with analytical rigor with regard to future warehousing decisions.

### **Failure to Implement Procedures Requiring Tracking of Customer Service Calls**

***Although the ABC warehouse has written customer service procedures in place, it does not ensure that employees follow these procedures and track customer service calls, complaints, and comments. Thus, ABC loses potential opportunities to correct weaknesses in its service to permittees.***

As the state's sole wholesaler for alcoholic beverages, ABC warehouse staff must assist the more than 2,000 permittees by responding to questions regarding permits, products, orders, accounts, and shipping. To ensure good customer service, ABC has developed customer service procedures, a portion of which state the following:

*The main goal of the Customer Service area is to correct problems due to incorrect ordering, shipping, or data entry. The process begins upon receipt of phone calls from retailers about errors on received*

*orders. The Customer Service area answers calls and logs them on an ABC Call Sheet. The following information is noted: permit ID, name, phone number, data, order ID number, and description of error, such as items not shipped, or overcharged, etc.*

*The Customer Service area records weekly totals to track the number of calls received regarding shipping issues. This area researches the reported error and works to resolve the issues. To resolve issues, it may be necessary to contact the retailer and the freight company.*

Currently, ABC warehouse processing staff field calls from permittees when they have questions about their orders. This staff also troubleshoots problems when permittees have issues with orders, online accounts, payments, or shipments.

While the procedures for customer service require the documenting of information provided by permittees on a “call sheet,” ABC warehouse staff discontinued this practice in 2015 when the Department of Revenue launched a new computer system--i.e., the Mississippi Automated Revenue System (MARS). With regard to ABC’s operations, MARS is primarily used for the ordering of product and financial transactions of permittees. However, the computer system is not used to collect descriptive information regarding the reasons for calls by permittees to ABC.

By tracking and trending permittee calls, as its written customer service procedures require, ABC managers could proactively identify operational deficiencies and customer service issues. Permittee calls can serve as helpful indicators of possible weaknesses in processes, training, or controls. By foregoing this step, ABC loses potential opportunities to correct weaknesses in its service to permittees.

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# Policy Considerations for Regulation of Alcoholic Beverages in Mississippi

Should they choose to do so, the state’s decisionmakers regarding regulation of alcoholic beverages—the Legislature, the Department of Revenue, and the Alcoholic Beverage Control Division—could consider options for changing how Mississippi regulates alcoholic beverages. These options include: modifying the state’s model of regulation, which could incorporate some level of privatization; capping the number of retail permits issued; or allowing direct sales of wine to consumers. Any decisions regarding these or any other policy options should focus on potential revenues balanced with the financial, social, and public health costs of any policy change.

This chapter presents the following policy options for consideration when the Legislature, DOR, and ABC make future decisions about regulating alcoholic beverages in Mississippi:

- consider modifying Mississippi’s control model;
- consider privatizing warehousing operations;
- consider capping the number of retail permits issued; or,
- consider allowing direct sales of wine to consumers.

## Consider Modifying Mississippi’s Control Model

***Control states regulate alcoholic beverages through a variety of methods of control, types of products that are controlled, organizational structures, markup rates on products, and degrees of privatization of certain operations. Each control model variation is accompanied by costs and benefits that should be considered.***

As noted on page 6, control states regulate through licensing and tax collection. They also control distribution by acting as the wholesaler, retailer, or both for alcoholic beverages in their state. While Mississippi is one of the seventeen control states, there are variations in each state’s policies in how alcoholic beverages are regulated: methods of control, type of product that is controlled, organizational structure, markup rates on product for tax collections, and privatization of certain aspects of operations.

Within the control system model for regulating alcoholic beverages, states may be categorized as having one of four primary methods of control:

- *retail control states*: control alcoholic beverages at both the wholesale and retail level;
- *agency store states*: control wholesale and retail of alcoholic beverages, but contract out the retail sale on behalf of the state;

- *combination states*: control alcoholic beverages at both the wholesale and retail levels and use a combination of state-owned and contracted retail sales; and,
- *wholesale states*: control alcoholic beverages only at the wholesale level.

Exhibit 9 below denotes which method of control each of the seventeen control states have implemented.

**Exhibit 9: Alcoholic Beverage Control Methods of All Control States, as of February 11, 2019.**

| Retail Control                              | Agency Store  |
|---|---|
| North Carolina<br>Pennsylvania*<br>Virginia | Maine<br>Montana<br>Ohio<br>Oregon<br>Vermont                 |
| Combination                                 | Wholesale   |
| Alabama<br>Idaho<br>New Hampshire*<br>Utah* | Iowa<br>Michigan<br>Mississippi*<br>West Virginia<br>Wyoming* |

\*These states also control the distribution of wine.

SOURCE: The Program Evaluation Division of the North Carolina General Assembly report entitled *Changing How North Carolina Controls Liquor Sales Has Operational, Regulatory, and Financial Ramifications* (February 11, 2019).

Mississippi is one of five control states that operates using a wholesale method of control, controlling the sale of alcoholic beverages only at the wholesale level. The other twelve states control alcoholic beverages at both the wholesale and retail levels.

Mississippi is also one of five control states that regulates the distribution of wine in addition to liquor. Of these five states, Mississippi and Wyoming control the sale of wine and liquor at only the wholesale level. The other three states, New Hampshire, Pennsylvania, and Utah, control the sale of both wine and liquor at both the wholesale and retail levels. The remaining twelve states only control the distribution of liquor.

Regarding the organizational structure of the seventeen control states, ten states house the lead entity responsible for overseeing operations of alcoholic beverage control internally within another agency, as Mississippi does at the Department of Revenue. The other seven states have created stand-alone agencies for overseeing the operations of alcoholic beverage control in their states. See Appendix C, page 46 for a comparison of control states.

Approximately 55% of revenues generated by the ABC in Mississippi come from the direct proceeds of alcohol sales, primarily resulting from the state markup on alcoholic beverages. Mississippi's markup on alcoholic beverages is 27.5%, which includes a 24.5% base markup and a 3% alcohol abuse tax. Markup rates in the other control states range from 17.6% (Wyoming) to 86% (Utah). Mississippi's markup on liquor and wine is the second lowest of the control states according to data collected by the National Conference of State Legislatures.

One policy consideration that repeatedly arises among the control states is whether to privatize all or some aspects of the regulation and distribution of alcoholic beverages in the state. The Program Evaluation Division of the North Carolina General Assembly recently released the report *Changing How North Carolina Controls Liquor Sales Has Operational, Regulatory, and Financial Ramifications* (February 11, 2019), which shows that five of the seventeen control states have privatized their respective state's alcoholic beverage warehouse operations. These states still own the warehouses and wholesaling operations, but have contracted out running the warehouses to private companies. In 2017, Mississippi's Department of Revenue inquired into the possibility of contracting out wholesale operations of the state ABC warehouse (see pages 52-54).

While privatization of operations is often considered, the most comprehensive change in regulating alcoholic beverages occurred in June 2012 when Washington state transitioned from a control state to a license state. The following section presents three privatization options that could hold merit for Mississippi, including transitioning to a license state.

### Consider Privatizing Warehouse Operations

***PEER analyzed the feasibility of implementing three privatization options: fully divesting the state of alcoholic beverage sales, privatizing wholesale alcoholic beverage operations through contracting out, and divesting wholesale wine sales.***

Based on the information regarding control systems in other states and as a follow-up to PEER Report #473 entitled *The State Tax Commission's Office of Alcoholic Beverage Control: A Management Review and Policy Analysis* (December 7, 2004), PEER evaluated three possible policy options for privatization of Mississippi's wholesale system to determine whether there is a more efficient opportunity for regulating alcoholic beverage sales. Options from PEER's 2004 report that still merit consideration are:

- Option One: fully divesting wholesale alcoholic beverage sales, in essence becoming a licensing state;
- Option Two: privatizing wholesale alcoholic beverage operations through contracting out or another similar method, with the state remaining the wholesaler by law, setting wholesale prices and choosing which products to sell; or,

- Option Three: divesting wholesale wine sales, while continuing to be the wholesaler for liquor (i.e., becoming a license state for wine).

Following are PEER's conclusions regarding each of these three privatization options. The Technical Appendix, page 47, provides PEER's feasibility criteria, as well as a detailed analysis of each of the options, including the method of analysis and potential effects on revenues, consumption, service, and potential one-time revenue and cost savings.

### **Option One: Full Divestment of Wholesale Sales of Liquor and Wine**

*If Mississippi fully divested itself of wholesale sales of liquor and wine, it would in essence become a license state, licensing wholesalers and allowing vendors direct control over wholesale sales of alcoholic beverages to permittees. If the state converted to a license system, it would need to increase taxes to keep the current level of revenue that ABC brings into the state each year.*

This option would fully divest the state of wholesale sales of liquor and wine. The state would provide licenses to wholesalers and allow vendors direct control over the wholesale of alcoholic beverages to permittees throughout the state. These wholesalers and vendors would still remit excise tax as a percentage of their sales to the state. If this option were implemented, Mississippi would become a licensing state like thirty-three other states.

Converting to a license system of controlling alcohol would likely not be a good option for Mississippi. The state would have to increase taxes to keep the current level of revenue that ABC brings into the state each year. As a control state, Mississippi currently levies taxes at both the wholesale and retail level. If the state were to consider ending its control over the wholesaling of alcohol, revenue would need to be generated in other areas to recoup the 27.5% markup and excise taxes collected during the wholesale of alcohol products from the ABC warehouse to the permittee. Of the seventeen control states, Mississippi has the second lowest markup<sup>9</sup> rate.

As noted on page 2, the state's policy regarding alcoholic beverages is prohibition by default, but to require strict regulation of alcohol where it is allowed. The current local option system affords each county the opportunity to vote regarding whether they want to be under the law of prohibition. ABC enforcement patrols the entire state, enforcing local option laws to ensure that prohibition is enforced in dry areas. Transitioning to a license state would eliminate the state's wholesale warehouse, but would retain enforcement of local option laws by ABC.

Transitioning to a license state could also increase per capita consumption of alcoholic beverages. As noted by both recent research and shown by experience in the state of Washington, the number of package stores increased significantly when it moved

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<sup>9</sup> Markup information for Idaho, Maine, and Oregon was not used in this comparison.



from a control state to a license state system. Studies by The Community Preventive Services Task Force conclude that privatization often results in increases of excessive alcohol consumption and related harms<sup>10</sup> and that a positive relationship exists between outlet density and excessive alcohol consumption and related harms.<sup>11</sup>

Amendment of relevant state laws would be necessary to implement this policy option.

See the Technical Appendix, page 48, for a detailed analysis of Option One.

### **Option Two: Contracting Out Wholesale Operations**

*If Mississippi contracted out its wholesale operations, the state would collect the markup and taxes from contractors that would house inventory, take orders, and process and deliver the orders. While there would be a greater possibility for revenue neutrality than for Option One, it is likely that any increased costs from the private wholesaler's cost per case would be passed along to the permittees and ultimately the consumer.*

In this option, the state would contract out wholesale operations including warehousing, ordering, and purchasing but would remain the wholesaler by law, would set prices, and would still receive the sales revenue. Revenue collection and service delivery requirements would be set in the state's contracts with the private contractors.

The state would collect the markup and taxes from the contractors who would simply house inventory, take orders, process, and deliver the orders. The state would likely pay a contractor a per-case fee for order processing, warehousing, and distribution.

Privatizing the ABC warehouse operations would likely not save the state 10% or more compared to current operational costs. While there is a greater possibility for revenue neutrality, it is likely that any increased costs from the private wholesaler's cost per case would be passed along to the permittees and ultimately the consumer. The increase in overall retail prices of product could potentially result in less revenue to the state.

While the Department of Revenue believes that it has statutory authority to privatize warehouse operations, it would be prudent for the DOR to seek legislative guidance prior to departing from the state's current system for managing alcohol distribution.

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<sup>10</sup> Community Preventive Services Task Force, "Recommendations on Privatization of Alcohol Retail Sales and Prevention of Excessive Alcohol Consumption and Related Harms," *American Journal of Preventative Medicine*, 42, no. 4 (2012): 428-429.

<sup>11</sup> Task Force on Community Preventive Services, "Recommendations for Reducing Excessive Alcohol Consumption and Alcohol-Related Harms by Limiting Alcohol Outlet Density," *American Journal of Preventative Medicine*, 37, no. 6 (2009): 570-571.

See the Technical Appendix, page 52, for a detailed analysis of Option Two.

### **Option Three: Partial Divestment of Wholesale Operations**

*The ABC could consider a partial divestment of wholesale operations and limit its control solely to liquor, essentially becoming a license state for wine. Under partial divestment, overall revenues would likely decrease and the state would need to generate revenues from other means in order to retain budget neutrality. Although ABC would likely not have a significant reduction in the overall warehouse expenditures, it could expand its liquor storage capacity within the existing warehouse and might not need to purchase an additional warehouse for bulk storage.*

Similar to the option of full divestment of wholesale operations, Mississippi could consider partial divestment of its wholesale alcoholic beverage operations to limit control solely to liquor. This would allow Mississippi to remain a control state for liquor, but essentially be a licensing state for wine. Currently, Mississippi is one of only five control states that regulates wine in the same manner as liquor.

Under partial divestment, the state would provide licenses to wholesalers and allow vendors direct control over the wholesale of wine to permittees throughout the state. These wholesalers and vendors would still remit excise tax as a percentage of their sales to the state.

As noted previously, license states typically earn less revenue in comparison to control states. License states rely mainly on taxes at the retail level for revenue, while control states are able to capture revenue from the actual sale of wine at the wholesale and retail level. Therefore, it would be safe to assume that should Mississippi divest itself of the wholesale operations of wine, overall revenues would likely decrease and the state would need to generate revenues from other means in order to retain budget neutrality.

A combination of the private wholesaler markup and additional taxes imposed on wine by the state could potentially increase wine prices for the consumer or might require an increase in wine sales volume or in licensing fees to make up for the reduction of wine wholesale revenue for the state.

Divestment of wine warehousing responsibilities would essentially privatize the wholesale of wine and therefore could allow ABC to expand its liquor storage capacity. Ultimately, this could negate the need for purchasing an additional warehouse for bulk storage.

Amendment of relevant state laws would be necessary to implement this policy option.

See the Technical Appendix, page 54, for additional information on Option Three.

## Consider Capping the Number of Retail Permits Issued and Allowing Direct Sales of Wine to Consumers

***Mississippi could consider policy options recently implemented in other states that include: imposing a cap on the number of retail permits issued and allowing direct sales of wine to consumers. Decisionmakers would need to consider carefully the costs and benefits of each option and in each case, implementing these options would require amending state law.***

### Imposing a Cap on Retail Permits

*Some states cap the number of alcohol permits and licenses to achieve a desired outlet density, address alcohol consumption, prevent oversaturation, protect the value of existing permits, or all of the above.*

Mississippi currently operates under a free market system when issuing retail permits to applicants. If an applicant meets the required criteria, the state issues a permit. The only restriction is that MISS. CODE ANN. § 67-1-51 (1972) limits the number of liquor licenses to one per single entity and one per household. [MISS. CODE ANN. § 27-71-5 (4) (1972) also states that the department shall not restrict or limit the number of permits on a population basis.] Exhibit 10, page, 40, shows a map of package stores and their locations, by county, as of July 11, 2019.

A recent report from the Program Evaluation Division of the North Carolina General Assembly, entitled *Changing How North Carolina Controls Liquor Sales Has Operational, Regulatory, and Financial Ramifications* (February 11, 2019), compared data from twelve southeastern states. The report utilized data from the NABCA and the Distilled Spirits Council of the United States to compare five control states (Alabama, Mississippi, North Carolina, Virginia, and West Virginia) and seven licensure states (Arkansas, Florida, Georgia, Kentucky, Louisiana, South Carolina, and Tennessee).

Of the twelve states compared in the North Carolina report, Mississippi had the highest alcohol retail outlet density among the five control states reviewed, at 3.50 outlets per 10,000 adults during Fiscal Years 2016 and 2017. Also, Mississippi was listed as having the highest adult per capita liquor consumption among the five control states reviewed, at 2.12 wine gallons per capita consumption<sup>12</sup> in Calendar Year 2015.

The 2019 North Carolina Program Evaluation Division report found that the following southeastern states limit the number of stores authorized to sell liquor:

- West Virginia sells liquor licenses every ten years, determines a fixed number of stores for the state, and allocates them regionally.

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<sup>12</sup> A wine gallon is equivalent to a standard United States bulk or liquid gallon. *Adult per capita liquor consumption* measures how much liquor is consumed in each state by dividing the total amount of liquor sold (in wine gallons) by the number of adults over a one-year period. An adult is defined as a person of legal drinking age (twenty-one or older).

- Florida limits the number of liquor stores in each county based on a ratio of 1 store per 7,500 people residing in a county and holds quota lotteries when population increases allow for new licenses within a county.
- Kentucky limits the number of liquor stores in each county to a ratio of 1 store per 2,300 people residing in a county. In 2018, the Kentucky Alcohol Beverage Control Board proposed ending the population-based license quota for retail package liquor stores because of its limited competition. The Kentucky General Assembly responded to this proposal by enacting state law to preserve the quota.
- South Carolina authorizes its alcohol regulatory agency to limit the further issuance of retail dealer licenses in a political subdivision if it determines that the subdivision's citizens are more than adequately served because of the number of existing retail stores, the location of the stores within the subdivision, or other reasons.
- Tennessee enacted a three-year moratorium on the issuance of new retail package store licenses in 2018.

Each of these states has implemented permit caps for various reasons, whether it is to address consumption, prevent market oversaturation, or both. Multiple research articles note the direct relationship between outlet density and consumption. Furthermore, decreased density (and therefore, consumption) has been linked to decreased social and public health costs. For example, an article in *Alcohol Research & Health*<sup>13</sup> states, “whenever alcohol sales can be measured, greater outlet densities are directly related to use.” Also, a study by The Community Preventive Services Task Force<sup>14</sup> states: “government control over retail alcohol sales generally results in lower alcohol outlet density. In addition to potential public health benefits, lower outlet density may improve quality of life by reducing property damage and public disturbance.”

In addition to addressing outlet density and consumption, some states that have recently expanded the sales of alcoholic beverages by increasing the number of permits an entity may have or by allowing larger retailers to sell liquor or wine (e.g., wine sales in grocery stores) have implemented a cap on the total number of permits issued. Some proponents of a license cap contend that a license has a generally known value and is considered as an

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<sup>13</sup>P. J. Gruenewald, “Regulating Availability: How Access to Alcohol Affects Drinking and Problems in Youth and Adults,” *Alcohol Research & Health: The Journal of the National Institute on Alcohol Abuse and Alcoholism*, 34, no. 2 (2011): 248-256.

<sup>14</sup>Community Preventive Services Task Force, “Recommendations on Privatization of Alcohol Retail Sales and Prevention of Excessive Alcohol Consumption and Related Harms,” *American Journal of Preventative Medicine*, 42, no. 4 (2012): 428-429.

economic “asset” similar to other assets, such as furnishings, equipments, and leasehold improvements.

For example, Tennessee’s three-year moratorium was enacted in 2018 in order to limit the expansion of stores while also protecting smaller businesses. In order to buy a new or additional retail liquor license, one would have to purchase a license from someone who already owns such license.

In Colorado in 2016, an initiative by grocery stores and their allies gained momentum to place a measure on the ballot to ask voter approval to expand alcohol sales of liquor and wine in grocery stores and larger retail outlets. In order to strike a balance among those wanting to expand alcoholic beverage sales and those wanting to protect the smaller traditional retail outlets, the Colorado Legislature enacted SB 16-197 during its 2016 legislative session. This bill enacted some caps on the number of licenses that could be expanded upon in order to phase in the additional retail outlets.

In making decisions regarding capping the number of retail permits in the state, DOR could consider conducting a market saturation study that would include the number of retail package stores in specified areas in comparison to those areas’ demographics. Such study should also include consideration of the possibility of how any resulting increase of alcohol sales and consumption and corresponding social costs could potentially offset any additional revenues.

Regarding revenues, one could assume that at least the current level of ABC revenues could be maintained if the current number of permits would be the number capped. Capping the number of retail permits could increase the value of individual permits for retailers who currently hold such permits should the Legislature decide to amend the Mississippi CODE to allow for an expansion in the types of retail outlet stores that can sell alcoholic beverages or to increase the number of permits a single entity or household may hold.

The Legislature would need to amend relevant Mississippi CODE sections to implement this policy option.

### **Allowing Direct Sales of Wine to Consumers**

*The Legislature could consider allowing direct sales of wine to consumers. If direct wine sales were implemented, the state would either need to increase tax rates on wine or wine sales would need to increase in order to achieve revenue neutrality. One possibility of increasing revenues would be to require wineries to purchase direct shipper permits. As with partial divestment, allowing direct sales of wine to consumers could possibly allow ABC to expand its liquor storage capacity within the existing warehouse and thus it might not need to purchase an additional warehouse for bulk storage.*

In addition to partial divestment, many states allow the direct sale and shipment of wine to consumers. Currently, Mississippi law does not specify in statute whether direct-to-consumer wine sales are allowed (MISS. CODE ANN. § 67-1-41 [1972]). However, MISS. CODE ANN. § 67-1-41 (1972) states that the department is the wholesale distributor and seller of alcoholic beverages. The section further states that the department is granted the sole right to import and sell intoxicating liquor at wholesale and that no permittee shall purchase any intoxicating liquors from any source other than the department. According to the National Conference of State Legislatures, only four states explicitly prohibit direct wine shipment: Alabama, Delaware, Oklahoma, and Utah.

If Mississippi considers direct wine shipment, the state would need to decide whether it would continue the wholesale responsibilities of wine or move to only wholesaling spirits. Currently, Pennsylvania and Wyoming control the wholesaling of both liquor and wine, while allowing the direct shipment of wine.

- Pennsylvania allows direct wine shippers who receive a permit through the Pennsylvania Liquor Control Board (PLCB) to ship up to thirty-six cases (up to nine liters per case) per year to a Pennsylvania resident for personal use. Wines sent via direct shipment may also be wines available through the PLCB.

If Mississippi were to enable direct wine shipment similar to Pennsylvania's model, then the DOR could potentially alleviate some of the ABC warehouse's space burden by reducing the amount of wine that would need to be stored at the warehouse and thus freeing space for additional liquor product. This would also allow for consumers to have increased variety in the wines that could be purchased.

- Wyoming allows direct wine shipments from those out-of-state shippers that receive a license from the Wyoming Department of Revenue Liquor Division. These licensees may ship up to thirty-six liters to any one household per year. However, these out-of-state wine shippers may only ship wines not listed through the state wholesaler.

If Mississippi were to enable direct wine shipment similar to Wyoming's model, then the DOR would still be the primary wholesaler for wines, but would also allow consumers to have an increase in the variety of wines that could be purchased other than those stored and processed through the ABC warehouse.

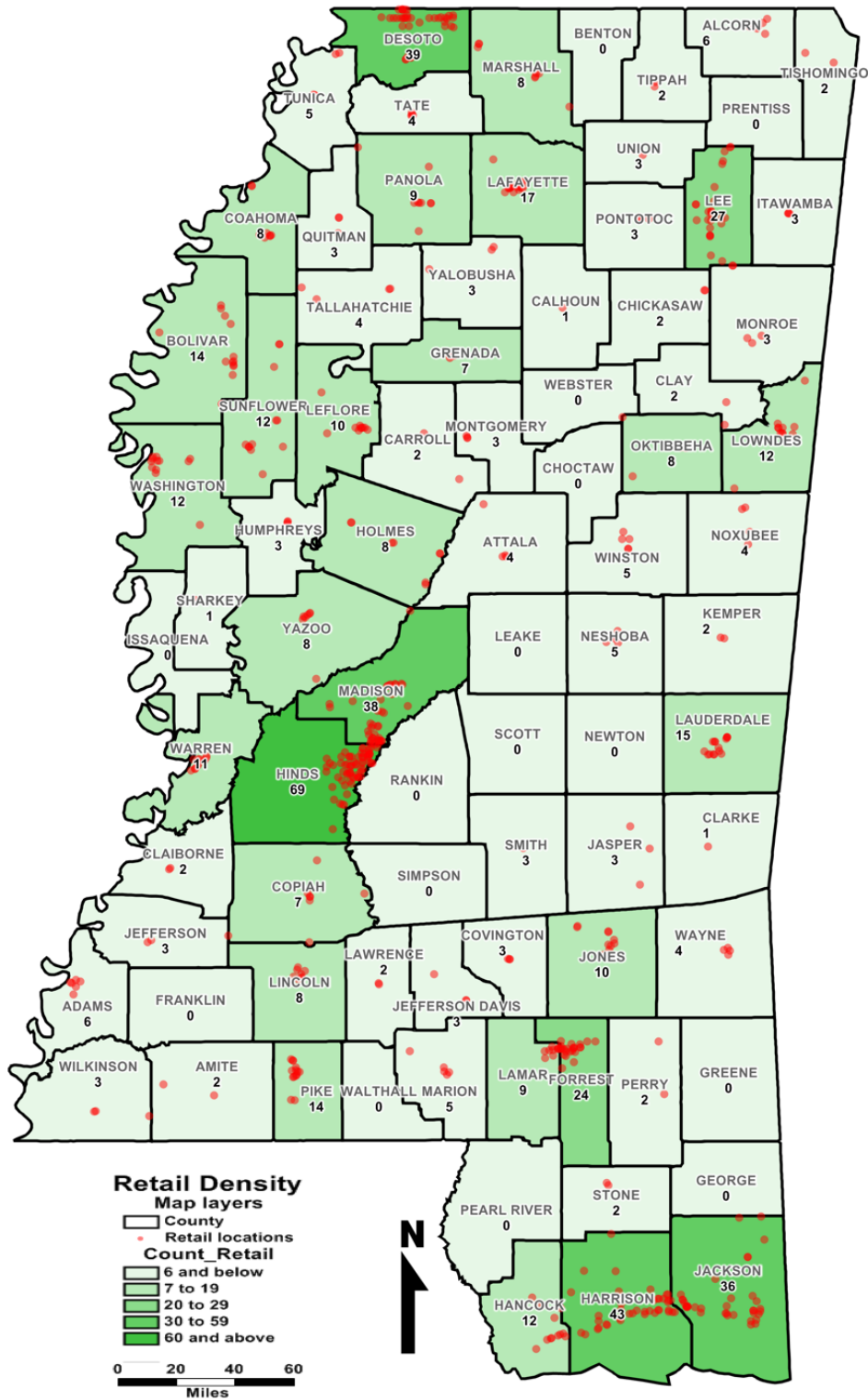
As noted previously, if implementing direct wine shipment, the state would either need to increase tax rates on wine or wine sales in order to achieve revenue neutrality. Both Pennsylvania and Wyoming require that both sales taxes and excise taxes be collected from direct wine shipments.

Many states that allow direct shipment of wine require wineries to purchase a direct shipper permit that allows them to sell wine

within their state, which could increase permitting revenues. For example, Pennsylvania charges \$250 annually for a direct wine shipment permit, whereas Wyoming charges \$50 annually. Both Pennsylvania's and Wyoming's direct shipment laws have a provision that requires direct shipment permit holders to allow the state to review their records upon request to help ensure that the state is not losing potential tax revenue.

The Legislature would have to amend relevant Mississippi CODE sections to implement this policy option, including establishing a direct wine shipper permit.

Exhibit 10: Number of Package Stores and Locations, by County, in Mississippi, as of July 11, 2019



SOURCE: PEER created using data provided by the DOR as of July 11, 2019.



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## Recommendations

- 1) The ABC warehouse managers should systematically track instances in which equipment becomes inoperable and repair parts must be procured. In addition, the managers should develop a preventative maintenance plan to extend the useful life of warehouse equipment and limit the time that the equipment is offline during critical shipping periods. A tracking system could provide the managers with useful information to estimate the funds that should be earmarked for preventative maintenance purposes.
- 2) The Commissioner of the Department of Revenue should direct ABC managers to develop standard operating procedures for warehouse operations, with specific emphasis on warehouse safety. The Mississippi State Agencies Self-Insured Workers' Compensation Trust offers guidelines and policies that could be amended to fit the specific needs of the ABC warehouse. Having written operating and safety procedures provides a baseline of expectations for employees.
- 3) The DOR should determine an equitable storage level for all bailment products in order to maximize the efficient use of warehouse space. The ABC warehouse has the ability to "live monitor" the amount of each product that is in the warehouse at any given time. Inventory storage levels should be set by sales quantities for faster and slower selling products. The ABC warehouse should also consider creating a minimum stock level policy for all bailment items. Ensuring that all warehouse shelving and bulk storage space is stocked consistently with moving product would maximize potential sales revenue per square foot to generate state revenues.
- 4) Although the Department of Revenue received appropriation authority from the Legislature for the purpose of purchasing additional warehouse space, the Commissioner of Revenue should require ABC managers to develop a written facility usage and logistics plan prior to purchasing such warehouse space. The plan should specifically address how any additional warehouse space will be incorporated into the existing warehouse operations and at what costs.
- 5) The ABC managers should analyze the current methods for receiving and responding to customer service contacts, specifically by telephone. Information provided by customers during such contacts should be systematically analyzed in order to modify or improve operational practices.
- 6) Should they choose to do so, the Legislature and the DOR could consider options for changing how Mississippi regulates alcoholic beverages. Any decisions regarding these or any other policy options should focus on potential revenues balanced

with the financial, social, and public health costs of any policy change.

The DOR, in evaluating the potential privatization options, should:

- a. ensure, at minimum, the same level and quality of service be provided (e.g., delivery times and ordering process);
- b. establish quality of service performance measures and track these measures over time. Some of these measures could include, but not be limited to: the number of next day deliveries made, time to fulfill special orders, number of times an item ordered is out-of-stock and time span of order fulfillment, the number of and time to successfully resolve customer service issues, etc.;
- c. ensure budget neutrality and that overall revenue provided to the state be comparable to the existing ABC system, or ensure that the same ROI be achieved;
- d. ensure that the option does not rely too heavily on consumption or outlet density levels, especially an increase, in order to maintain current revenue; and,
- e. that any privatization proposals for ABC warehouse operations compete with existing operations and maintain a similar level of service with at least a 10% savings.

The DOR may wish to consider any or all of the three options provided within this report for additional study: full divestment of wholesale sales of liquor and wine, contracting out wholesale operations, and partial divestment of wholesale operations. Upon consideration of any of these policy changes, should they yield positive results, the DOR should recommend to the Legislature any applicable changes to Mississippi CODE sections for implementation.

- 7) The DOR could consider additional policy options for changing how Mississippi regulates alcoholic beverages. Any decisions regarding these policy options should focus on the overall benefit to the state. Should they choose to do so, the DOR should conduct a feasibility analysis in order to determine if the following options are viable:
  - a. establishing a statewide maximum number of package store permits that may be issued based on a market saturation study; and,
  - b. allowing the direct shipment of wine within the state, with consideration of any tax changes, if applicable, and the establishment of a direct wine shipper permit to

conduct business with either consumers, package stores, or both.

Upon conclusion of either of these studies, should they yield positive results, the DOR should recommend to the Legislature applicable changes to Mississippi CODE sections for implementation.

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## Appendix A: Qualified Resort Areas in Mississippi, as of July 2019

### Wet Areas in Dry Counties (i.e., qualified resort areas) for Alcoholic Beverages:

Back Acre Country Club (Tate County) \*\*  
The Barn at Bridlewood (Lamar County)\*\*  
Canebrake Country Club (Lamar County)\*\*  
Castlewoods Country Club (Rankin County)  
Choctaw Reservation (Neshoba County)\*\*  
    Silver Star Casino\*\*  
    Dancing Rabbit Golf Course \*\*  
    Golden Moon Casino\*\*  
    Dancing Rabbit Inn\*\*  
Dogwood Venue (Lamar County)\*\*  
Jackson-Medgar Wiley Evers International Airport (Rankin County)  
Long Leaf Plantation (Lamar County)\*\*  
McClain Lodge (Rankin County)  
Pearl, Special District (Rankin County)  
Pearl River Valley Water Supply District (Rankin County)  
Pine Belt Airport (Jones County)\*\*  
Pine Creek Golf Club (Lamar County)\*\*  
Porterhouse Partners LLC (Rankin County)  
Providence Hill (Hinds County)  
Reservoir Community District (Rankin County)  
The Southern Pearl (Wayne County) \*\*

\*\*Denotes wet areas in dry counties for beer/light wine also.

SOURCE: PEER analysis of data provided by ABC Enforcement as of July 2019.

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# Appendix B: Mississippi's Wet and Dry Jurisdictions for the Sale of Beer and Light Wine

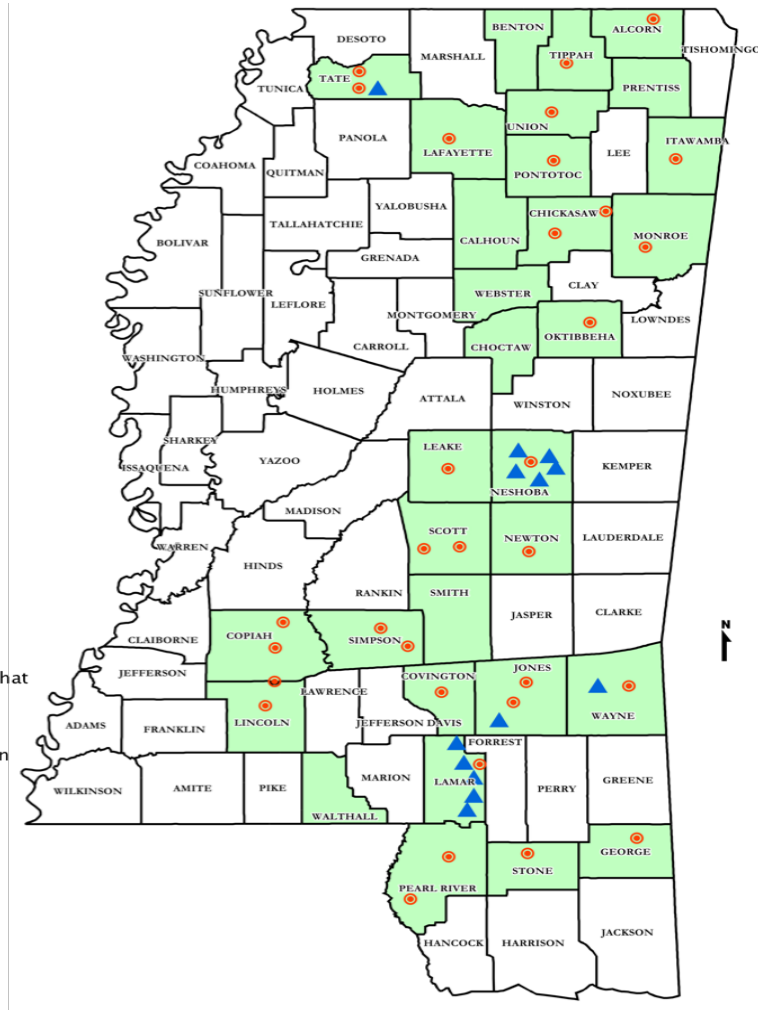
## Wet Counties

Adams  
Attala  
Amite  
Bolivar  
Carroll  
Claiborne  
Clarke  
Clay  
Coahoma  
Desoto  
Forrest  
Franklin  
Greene  
Grenada  
Hancock  
Harrison  
Hinds  
Holmes  
Humphreys  
Issaquena  
Jackson  
Jasper  
Jefferson  
Jefferson Davis  
Kemper  
Lauderdale  
Lawrence  
Lee  
Leflore  
Lowndes  
Madison  
Marion  
Marshall  
Montgomery  
Noxubee  
Panola  
Perry  
Pike  
Quitman  
Rankin  
Sharkey  
Sunflower  
Tallahatchie  
Tishomingo  
Tunica  
Warren  
Washington  
Wilkinson  
Winston  
Yalobusha  
Yazoo

## Dry Counties

Alcorn  
Benton\*  
Calhoun\*  
Chickasaw  
Choctaw\*  
Copiah  
Covington  
George  
Itawamba  
Jones  
Lafayette  
Lamar  
Leake  
Lincoln  
Monroe  
Neshoba  
Newton  
Oktibbeha  
Pearl River  
Pontotoc  
Prentiss\*  
Scott  
Simpson  
Smith\*  
Stone  
Tate  
Tippah  
Union  
Walthall\*  
Wayne  
Webster\*

\*Denotes a county that is fully under prohibition, no wet resort areas or wet municipalities within the county.

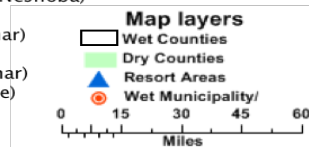


## Wet Municipalities in Dry Counties

|                          |                           |
|--------------------------|---------------------------|
| Aberdeen (Monroe)        | Wesson (Copiah)           |
| Coldwater (Tate)         | Hazlehurst (Copiah)       |
| Brookhaven (Lincoln)     | Oxford (Lafayette)        |
| Corinth (Alcorn)         | Waynesboro (Wayne)        |
| Carthage (Leake)         | Okolona (Chickasaw)       |
| Fulton (Itawamba)        | Starkville (Oktibbeha)    |
| Hattiesburg (Lamar)      | Forest (Scott)            |
| Lucedale (George)        | Morton (Scott)            |
| New Albany (Union)       | Mendenhall (Simpson)      |
| Philadelphia (Neshoba)   | Magee (Simpson)           |
| Picayune (Pearl River)   | Collins (Covington)       |
| Crystal Springs (Copiah) | Ellisville (Jones)        |
| Pontotoc (Pontotoc)      | Laurel (Jones)            |
| Ripley (Tippah)          | Poplarville (Pearl River) |
| Senatobia (Tate)         | Wiggins (Stone)           |
| Houston (Chickasaw)      | Newton (Newton)           |

## Wet Resort Areas in Dry Counties

Back Acre Country Club (Tate)  
The Barn at Bridlewood (Lamar)  
Canebrake Country Club (Lamar)  
Choctaw Indian Reservation (Neshoba)  
Silver Star Casino (Neshoba)  
Dancing Rabbit Golf Course (Neshoba)  
Golden Moon Casino (Neshoba)  
Dancing Rabbit Inn (Neshoba)  
Dogwood Venue (Lamar)  
Long Leaf Plantation (Lamar)  
Pine Belt Airport (Jones)  
Pine Creek Golf Club (Lamar)  
The Southern Pearl (Wayne)



SOURCE: PEER created from the DOR FY 2018 Annual Report and information provided by ABC Enforcement as of August 2019.

## Appendix C: Control State Comparison

| State          | Markup Rate | What alcoholic beverages are regulated? | Who operates the ABC warehouse? | ABC housed internally in an agency or as a stand-alone agency? |
|----------------|-------------|---|---------------------------------|--|
| Alabama        | 30%         | Liquor                                  | State                           | Stand Alone  |
| Idaho          | Unavailable | Liquor                                  | State                           | Stand Alone  |
| Iowa           | 50%         | Liquor                                  | State                           | Internal   |
| Maine          | Unavailable | Liquor                                  | Private                         | Internal   |
| Michigan       | 65%         | Liquor                                  | Private                         | Internal   |
| Mississippi    | 27.50%      | Liquor and Wine                         | State                           | Internal   |
| Montana        | 40%         | Liquor                                  | State                           | Internal   |
| New Hampshire  | 46.5 %, 57% | Liquor and Wine                         | State, Private                  | Stand Alone  |
| North Carolina | 39.5%, 3.5% | Liquor                                  | State, Private                  | Internal*  |
| Ohio           | 30%         | Liquor                                  | Private                         | Internal   |
| Oregon         | Unavailable | Liquor                                  | State                           | Stand Alone  |
| Pennsylvania   | 30%         | Liquor and Wine                         | State                           | Stand Alone  |
| Utah           | 86%         | Liquor and Wine                         | State                           | Stand Alone  |
| Vermont        | 65%         | Liquor                                  | State                           | Stand Alone  |
| Virginia       | 64%         | Liquor                                  | State                           | Internal   |
| West Virginia  | 28%         | Liquor                                  | State                           | Internal   |
| Wyoming        | 17.6%       | Liquor and Wine                         | State                           | Internal   |

\*While the North Carolina Alcoholic Beverage Control Commission is housed within the North Carolina Department of Public Safety, it is an independent agency that reports directly to the Office of the Governor.

SOURCE: PEER analysis of information provided by NABCA as of August 2019 and The Program Evaluation Division of the North Carolina General Assembly report entitled *Changing How North Carolina Controls Liquor Sales Has Operational, Regulatory, and Financial Ramifications* (February 11, 2019).

# Technical Appendix: Analysis of Three Privatization Options for Regulation of Alcoholic Beverages in Mississippi

Based on the information obtained about control systems in operation in other states and as a follow-up to PEER Report #473 entitled *The State Tax Commission's Office of Alcoholic Beverage Control: A Management Review and Policy Analysis* (December 7, 2004), PEER evaluated three possible policy options for privatization of Mississippi's wholesale system to determine whether there could be a more efficient opportunity at regulating alcoholic beverage sales than what the state does now. Those options from the previous report that are still worth consideration include:

- fully divest wholesale alcoholic beverage sales, in essence becoming a licensing state;
- privatize wholesale alcoholic beverage operations through contracting out or another similar method, remaining the wholesaler by law, setting wholesale prices and choosing which products to sell; and,
- partial divestment of wholesale operations, essentially becoming a license state for wine.

## Privatization Feasibility Criteria

PEER used the three main criteria established within PEER Report #473 entitled *The State Tax Commission's Office of Alcoholic Beverage Control: A Management Review and Policy Analysis* (December 7, 2004) in order to judge the feasibility of the three privatization options. Those criteria are:

- Each option should give the state at least the same amount, or more, of revenue than it currently receives from the wholesaling of liquor and wine.
- Each option should not cause a significant increase in alcohol consumption in the state or rely on a significant increase in alcohol consumption to meet the first criteria of revenue generation.
- Each option should provide permittees and consumers at least the same level of service through wholesale sales and distribution.

PEER's first criterion is that each option should give at least the same amount of revenue, either through a reduction in operating costs, an increase of revenue collection, or both--was included in order to ensure that any policy changes maintain overall budget neutrality.

PEER's second criterion is regarding neutrality of consumption--was included because of the current state policy of prohibition by default and strict regulation of alcohol in localities that have lifted prohibition. This criterion was also included because of the link between consumption of alcohol and social costs. According to the Centers for Disease Control, excessive alcohol use can lead to increased risk of health problems such as injuries, violence, liver diseases, and cancer.

PEER's third criterion is that at least the same level of service be provided to permittees or consumers--takes into account the probable success of each system in providing wholesale sales and distribution. PEER assumed that the privatization options included in the analysis would not change the state's ability to provide effective law enforcement or quality assurance as applicable.

### Analysis of Option One: Full Divestment

***If Mississippi fully divested itself of wholesale sales of liquor and wine, it would in essence become a license state, licensing wholesalers and allowing vendors direct control over wholesale sales of alcoholic beverages to permittees. If the state converted to a license system, it would need to increase taxes to keep the current level of revenue that ABC brings into the state each year.***

With this option, these wholesalers and vendors would still remit excise tax as a percentage of their sales to the state. If this option were implemented, Mississippi would become a licensing state like thirty-three other states.

### Method of Analysis

In order to determine the feasibility of this option, PEER analyzed Mississippi's revenues and expenditures from FY 2013 through FY 2018 (as noted on pages 12 through 18) to determine a baseline for consumption and what revenue would be needed by the state to meet the feasibility criteria.

PEER also reviewed academic research studies regarding the revenues and consumption of control states in comparison to licensing states.

### Potential Effect on Revenues

In order to meet the criteria PEER developed for feasible privatization, the transition of Mississippi to a licensing state by full divestment would need to produce the same amount of revenue for the state.

Academic studies<sup>15</sup> show that control states earn up to 120% higher revenue per capita than license states. The optimal model for control states to receive the highest return per capita is states

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<sup>15</sup> Roland Zullo, "Better to Own or to Regulate? The Case of Alcohol Distribution and Sales," *Administration & Society*, 49, no. 2 (2017): 190-211.



controlling wholesale with a mix of state- and agency-contracted retail stores. The Institute for Research on Labor, Employment, and the Economy (IRLEE) conducted a national economic study<sup>16</sup> measuring the difference, in total net income, derived from alcohol sales between control states and license states. The report concludes that control states earn a total of 82.4% higher alcohol-related net income than license states. This is due to the fact that license states rely mainly on taxes at the retail level for revenue, while control states are able to capture revenue from the actual sale of alcohol at the wholesale and retail level. The same report found that revenue collected from alcohol licenses and alcohol taxes created almost the exact amount of money per capita, leaving the difference in alcohol-related income to whether a state owns and regulates wholesale and retail. Any legislative measures to move away from state control of alcohol wholesaling must be measured against the potentially significant loss of wholesale derived tax revenue.

For FY 2018, the total revenue generated by the ABC wholesale operation was \$114,232,525. When subtracting the FY 2018 expenditures for the ABC warehouse operations (\$5,031,534) and for ABC enforcement (\$2,072,983), the net revenues generated through the current control system was \$107,128,008. If fully divested, one could assume that the cost of the ABC warehouse operations could be seen as a cost savings while also assuming that the current ABC enforcement expenditures would remain constant.

As previously stated, control states may receive revenue from alcohol sales, alcohol taxes, and alcoholic beverage license/permit fees. However, if fully divested, the state would have to obtain revenue solely through alcohol taxes and licensing fees. In FY 2018, ABC collected \$63,858,394 from wholesale alcohol sales and therefore this amount would have to be collected through an increase in taxes equal to this amount in order to meet the criterion of revenue neutrality. The private wholesalers would also have to charge at least some markup to cover their costs and make a profit. A combination of the private wholesaler markup and additional taxes imposed on alcohol by the state could potentially increase prices for the consumer, or would require an increase in alcohol sales volume, or an increase in licensing fees to make up for the lack of wholesale revenue for the state. Most likely, market conditions would not allow for such increases and the state would not collect as much revenue.

### **Potential Effect on Consumption**

As discussed above, either increased tax rates or increases in alcohol sales volume would need to occur for this option to meet the feasibility requirement for revenue. Thus, this option would likely rely on an overall increase in consumption to meet the revenue criterion.

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<sup>16</sup> Zullo, Roland, Bi, Xi; Xiaohan, Yu; Siddiqui, Zehra. *The Fiscal and Social Effects of State Alcohol Control Systems*. Ann Arbor: Institute for Research on Labor, Employment, and the Economy, University of Michigan, 2013.

However, according to the National Institutes of Health<sup>17</sup> (NIH), control states have lower liquor consumption per capita than license states. The NIH study stated:

*There is strong evidence that per-capita liquor consumption is lower in control states. Moreover, moving to privatized sales of certain alcoholic beverage types leads to a median 44% increase in their consumption, with minimal changes in the consumption of beverage types that remain non-privatized. Importantly, there is also evidence that retail monopoly states have significantly lower rates of heavy drinking and alcohol-related fatalities among underage youth.*

### **Potential Effect on Service**

If the state were to fully divest, the state would no longer be involved in the service delivery of wine and spirits. It would be up to the private wholesalers to control product selection, control the availability of stock, and ensure deliveries were made on time to permittees.

The NIH study also found retail sales prices of liquor to be lower in license states compared to control states because the state wholesale markup rate is not included within the price of the product. The NIH study also noted that in addition to increased consumption, as mentioned in the previous section, there is generally an increase in the total number of package stores. Therefore, this usually results in increased competition among retailers and expanded access to alcoholic beverages. The NIH study stated:

*In addition, however, the privatization of alcohol sales is generally associated with a higher number and greater diversity of alcohol outlets, more permissive hours of alcohol sales, increased expenditures on marketing, and possibly reduced adherence to laws forbidding the sale of alcohol to underage or intoxicated persons. All of these additional factors would also contribute to the adverse public health effects associated with privatization of alcohol sales.*

Despite retail prices being slightly lower for license states than control states, the prices to consumers may yet still increase if this option were implemented. This would primarily be attributed to the private wholesalers who would have to impose a markup to operate and the state would have to impose higher tax rates equal to the current markup to make up for lost revenue and meet the revenue criterion for feasibility.

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<sup>17</sup> Michael Siegel, William DeJong, Alison B. Albers, Timothy S. Naimi, David H. Jernigan, "Differences in Liquor Prices Between Control State-Operated and License-State Retail Outlets in the United States," *Addiction*, 108, no. 2 (2013): 339-347.

## Potential One-Time Revenue and Cost Savings

If the state were no longer the wholesaler of wine and spirits, the state could receive one-time revenue from the sale of the ABC warehouse. The ABC building has approximately 227,937 square feet of warehouse and office space and applicable land acres. Also, the additional warehouse authorized in the 2019 Regular Session that DOR executives are in the process of purchasing could be seen as a cost savings should the state be able to sell it back at or close to the purchase price.

The state could also save some general fund dollars annually for the ABC warehouse operating costs. As noted previously in the report, in FY 2018, general funds provided about \$5,031,534 toward ABC's wholesale operations. However, this would likely be offset by the reduction in state revenue from the sale of wine and spirits.

## Licensing States' Experience with Private Wholesale Distribution

Since the 2004 PEER report, one state has moved from the control system to a licensing system (Washington). In addition, two other states (Pennsylvania and Virginia) have considered moving to a licensing system.

In November 2011, voters in Washington state approved Initiative 1183 (I-1183), which ended the government monopoly on distilled spirits sales. In June 2012, Washington transitioned from a control state to a license state. According to the Washington Office of Financial Management, as a result of transitioning from a control state to a license state, the number of retail package stores increased 327% after privatization. However, the administration cost for the Washington Liquor Control Board reduced by 77% from \$244 million to \$56 million.

A study<sup>18</sup> published in July 2016, four years after the citizens of Washington voted against state control over alcoholic beverages, showed that if citizens were to vote again at the time the study was completed, the ballot measure to eliminate state control over alcohol would not have passed. The study further discussed that even though the number of retail outlets had increased dramatically, the price of liquor at the retail level also increased between five and fifteen percent.

Using the same statistics that Washington provided when their state converted to a license state from a control state, an increase in package stores at 327% would yield approximately 2,621 package stores in Mississippi, up from 614. Mississippi's total operational cost, if it reduced by 77% based on FY 2018 ABC warehouse expenditures, could be \$1,157,253.

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<sup>18</sup> Meenakshi S. Subbaraman, William C. Kerr, "Opinions on the Privatization of Distilled-Spirits Sales in Washington State: Did Voters Change Their Minds?" *Journal of Studies on Alcohol and Drugs*, 77, no. 4 (2016): 568-576.

## Conclusion Regarding the Full Divestment Option

Converting to a license system of controlling alcohol would likely not be a good option for Mississippi. The state would have to increase taxes to keep the current level of revenue that ABC brings into the state each year. As a control state, Mississippi levies taxes at both the wholesale and retail sale of alcoholic beverages in the state. If the state were to consider ending its control over the wholesaling of alcohol, revenue would need to be generated in other areas to recoup the 27.5% markup and excise taxes collected during the wholesale of alcohol products from the ABC warehouse to the permittee. Of the seventeen control states, Mississippi has the second lowest markup<sup>19</sup> rate.

As stated previously in the report, the state's policy is prohibition by default, but to require strict regulation of alcohol where it is allowed. The current local option system affords each county the opportunity to vote whether they want to be under the law of prohibition. The ABC enforcement patrols the entire state enforcing local option laws to ensure prohibition in dry areas. Mississippi would also need to consider that transitioning to a license state could also increase per capita consumption of alcoholic beverages. As noted by both the research and more recently in the state of Washington, the number of package stores increased significantly when it moved from a control state to a license state system.

Amendment of relevant state laws would be necessary to implement this policy option.

## Analysis of Option Two: Contracting Out Warehouse Operations

***If Mississippi contracted out its wholesale operations, the state would collect the markup and taxes from contractors that would house inventory, take orders, and process and deliver the orders. While there would be a greater possibility for revenue neutrality than for Option One, it is likely that any increased costs from the private wholesaler's cost per case would be passed along to the permittees and ultimately the consumer.***

In this option, the state would contract out wholesale operations including warehousing, ordering, and purchasing but would remain the wholesaler by law, would set prices, and would still receive the sales revenue. Revenue collection and service delivery requirements would be set in the state's contracts with the private contractors. The state would likely pay a contractor a per-case fee for order processing, warehousing, and distribution.

### Method of Analysis

PEER utilized the feasibility criteria from the prior report, PEER Report #473 entitled *The State Tax Commission's Office of Alcoholic Beverage Control: A Management Review and Policy Analysis*

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<sup>19</sup> Markup information for Idaho, Maine, and Oregon was not used in this comparison.

(December 4, 2014) stating that the ABC warehouse privatization costs would need to be 10% less than what the state currently pays to operate the ABC warehouse for there to be any benefit to the state.

PEER also reviewed a 2017 DOR request for information (RFI) for contracting out wholesale operations of the state ABC warehouse. The RFI requested information on cost for a warehouse operator that would be responsible only for receiving trucks, unloading product, stocking product, fulfilling orders, and delivering product. The request for information asked vendors how they would handle situations and operate the warehouse based on the current operations of the warehouse including minimum order amount for shipment, per case operating fees, and frequency of delivery to permittees. This request for information received five responses. Of the five responses, only two answered questions regarding cost per case operating fee and flat annual operating fees.

#### **Potential Effect on Revenue**

If the state contracted out wholesale operations, it could potentially structure its contract to receive the same amount of revenue as the current ABC operations. The state would still set the prices of wine and spirits. Thus, the state would still have the markup from wine and spirits sales, excise taxes, sales tax, and alcohol abuse taxes. Therefore, revenue estimates could be assumed to be budget neutral.

#### **Potential Effect on Consumption**

In this privatization option, the state would still be the wholesaler by law, regulating and directly controlling wine and spirits distribution even though the wholesale operations are contracted out. Therefore, consumption would likely not change if this option were implemented.

#### **Potential Effect on Service**

The contracts designed to implement this option could specify service delivery requirements, as is done currently in ABC's two shipping delivery contracts. Mississippi currently allows retailers to place orders for product online through TAP daily and provides next-day delivery up to four days per week based on days the ABC warehouse operates. The state would still be responsible for product selection and would provide quality assurance to contractors in service delivery areas.

Despite mirroring the current service delivery requirements within the potential contracts, based on the two responses regarding the DOR 2017 RFI, it is likely that any increased cost per case the private retailer would charge the state would be passed along to the consumer (see the discussion on page 54 for more detail). This would result in higher retail prices for permittees and consumers.

#### **Potential One-Time Revenue and Cost Savings**

If the state were no longer the wholesaler of wine and spirits, the state could receive a potential one-time revenue from the sale of the current ABC warehouse and grounds. Instead of selling the

building, the state could choose to lease the building to the contractor or allow use of the building as part of the contract.

If the contracting option were implemented, the state could also save some general fund dollars annually for the ABC warehouse operating costs. As noted previously in the report, in FY 2018, general funds provided about \$5,031,534 toward ABC's wholesale operations. However, this amount would have to be reduced somewhat because the potential cost savings would not include administration costs. Administration costs would still be necessary to manage the contractors for quality assurance.

Despite a savings in annual operating costs savings, these would likely be mostly, if not completely, offset by the fees paid to the private contractors based on the two responses to the DOR 2017 request for information. These two responses noted that they would charge the state \$1.50 per case and \$5 per case as the fee to operate the wholesale of liquor and wine in the state. In Calendar Year 2018, the ABC warehouse shipped 3,316,643 cases of alcoholic beverages. For FY 2018, the ABC warehouse cost per case shipped was \$1.56. Using the two responses collected from the 2017 RFI, it could be reasonable to assume that a private warehouse contractor would charge the state at a minimum \$4,974,964 to \$16,583,215 to operate the ABC warehouse. In comparison to the FY 2018 ABC warehouse expenditures of \$5,031,534, at face value this would be \$56,569 less expensive based on the lower proposal cost and more expensive by \$11,551,681 than the higher proposal cost for running only the ABC warehouse operations.

### **Conclusion Regarding the Warehouse Privatization Option**

Privatizing the ABC warehouse operations would likely not save the state a minimum of 10% compared to current operational costs. While there would be a greater possibility for overall revenue neutrality to the state, it is likely that any increased costs as a result of the private wholesaler's cost per case would be passed along to the permittees and ultimately the consumer. The increase in overall retail prices of product could potentially result in less revenue to the state.

While the Department of Revenue believes that it has statutory authority to privatize warehouse operations, it would be prudent for the DOR to seek legislative guidance prior to departing from the state's current system for managing alcohol distribution.

### **Analysis of Option Three: Partial Divestment of Wholesale Operations**

*The ABC could consider a partial divestment of wholesale operations and limit its control solely to liquor, essentially becoming a license state for wine. Under partial divestment, overall revenues would likely decrease and the state would need to generate revenues from other means in order to retain budget neutrality. Although ABC would likely not have a significant reduction in the overall warehouse expenditures, it could expand its liquor storage capacity within the existing warehouse and might not need to purchase an additional warehouse for bulk storage.*

Similar to the option of full divestment of wholesale operations, Mississippi could consider partial divestment of its wholesale alcoholic beverage operations to limit control solely to liquor. This would allow Mississippi to remain a control state for liquor, but essentially be a licensing state for wine. Currently, Mississippi is one of only five control states that regulates wine in the same manner as liquor.

### **Method of Analysis**

In order to determine the feasibility of this option, PEER analyzed Mississippi's revenues and expenditures from FY 2013 through FY 2018 (see pages 12 through 18).

### **Potential Effect on Revenue**

Under partial divestment, the state would provide licenses to wholesalers and allow vendors direct control over the wholesale of wine to permittees throughout the state. These wholesalers and vendors would still remit excise tax as a percentage of their sales to the state.

As noted previously, license states typically earn less revenue in comparison to control states. License states rely mainly on taxes at the retail level for revenue, while control states are able to capture revenue from the actual sale of wine at the wholesale and retail level. Therefore, it would be safe to assume that should Mississippi divest itself of the wholesale operations of wine, overall revenues would likely decrease and the state would need to generate revenues from other means in order to retain budget neutrality. According to the FY 2018 DOR Annual Report, the total number of cases shipped through the ABC warehouse in calendar year 2017 was 3,237,021. Of this number, wine represented approximately 39% of total cases shipped, or 1,262,438 cases. Applying this percentage of cases shipped to the FY 2018 total ABC revenue generated of \$114,232,525, then the wholesale of wine in Calendar Year 2017 could be estimated to have generated approximately \$44,550,685 in revenues.

### **Potential Effect on Service**

Because this option involves only partial divestment of its wholesale operations, ABC would likely not have a significant reduction in the overall ABC warehouse expenditures. The DOR would maintain the current ABC warehouse solely for the storage and wholesale of liquor. Similar to the full divestment option, private wine wholesalers would also have to charge at least some markup to cover their costs and make a profit. A combination of the private wholesaler markup and additional taxes imposed on wine by the state could potentially increase wine prices for the consumer or might require an increase in wine sales volume or in licensing fees to make up for the reduction of wine wholesale revenue for the state.

### **Potential One-Time Revenue and Cost Savings**

As noted on page 26 of this report, the DOR has commissioned multiple capacity studies of the current ABC warehouse and is in the process of purchasing an additional warehouse for the bulk storage of product. According to ABC staff, over half of its warehouse space is taken up with wine in stock. Divestment of wine warehousing responsibilities would essentially privatize the wholesale of wine and therefore could allow ABC to expand its liquor storage capacity. Ultimately, this could negate the need for purchasing an additional warehouse for bulk storage.

### **Conclusion Regarding the Partial Divestment Option**

Under partial divestment, overall revenues would likely decrease and the state would need to generate revenues from other means in order to retain budget neutrality. Although ABC would likely not have a significant reduction in the overall warehouse expenditures, it could expand its liquor storage capacity within the existing warehouse and might not need to purchase an additional warehouse for bulk storage.

Amendment of relevant state laws would be necessary to implement this policy option.



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# Agency Response



— DEPARTMENT OF —  
**REVENUE**  
STATE OF MISSISSIPPI

OFFICE OF THE COMMISSIONER

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September 27, 2019

James A. Barber, Executive Director  
Joint Legislative Committee on Performance Evaluation and Expenditure Review  
501 North West Street  
Woolfolk Third Floor  
Jackson, Mississippi

Dear Mr. Barber:

My staff and I have received the draft report “Alcoholic Beverage Control in Mississippi: Warehouse Operations and Policy Considerations for Regulation” and our staff has reviewed the draft. We appreciate the work put into this report and believe that we both have an interest in improving the operations of the state’s Alcoholic Beverage Control System and its warehouse operations. We have responded to the conclusions in the draft as follows:

**1 – The ABC Warehouse does not have a comprehensive management system for its warehouse equipment that includes tracking conveyor system breaks, and implementing a preventative maintenance system plan. Thus, the ABC Warehouse may often experience more down time and lost productivity than necessary, as well as lost revenue opportunities. Lack of a comprehensive equipment management system also hampers ABC’s ability to make accurate budget projections and funding request to the Legislature. Recommendations are that the ABC warehouse managers should track instances in which equipment becomes inoperable and repair parts must be procured and develop a preventative maintenance plan to extend equipment life and minimize downtime.**

While the ABC does not have a schedule for routine maintenance or replacement of the conveyor system, the night shift maintenance person walks the warehouse nightly looking for any issues with the conveyor system. This allows the ABC to make any necessary repairs before a breakdown may occur.

The ABC agrees that we need to implement a plan for replacing equipment. We have developed a 5-year equipment replacement time line that we will work to implement as funds allow. We have also developed a work order system for maintenance personnel to track repairs and the costs associated with each repair. This was put in place September 24, 2019. We are also developing a preventative maintenance schedule for the conveyor and material-handling equipment. This should be in place no later than middle of October.

**2 – The ABC Warehouse lacks written safety and operating procedures for its employees. This could result in workplace injuries at the warehouse that might otherwise have been avoided. Recommendations are that the Commissioner should direct ABC managers to develop standard operating procedures for warehouse operations with specific emphasis on warehouse safety.**

We agree that warehouse safety is a top priority and we are committed to improving the safety of our warehouse team. The ABC has been working with our claims administrator, CCMSI, to address safety concerns at the warehouse. We implemented safety harnesses and lanyards on July 23. We have established a Safety Committee and have appointed a Safety Captain. The Committee has created a Safety Checklist for use in a monthly walkthrough of the facility. Monthly warehouse inspections will occur and findings will be recorded and addressed. The Committee will meet monthly with ABC management to discuss its findings and established a plan to address. The ABC is working with our legal department and our TPA to implement post-accident drug screening. We are also working to revamp our agency safety program to address procedures and policies relative to employee safety. We anticipate having the necessary revisions completed by year-end.

Additionally, you have indicated that 40% of the ABC Warehouse's workplace-related injuries were incurred by staff who had less than three years of experience. It should be noted that 42 of the current 67 filled Property Officer Positions have three years or less experience, which is 62.6% of the total filled PINS. It should also be noted that comparing the rate of workers' compensation claims with the rest of the DOR is misleading since the rest of the DOR employees work in an office environment or in the field and do not work with or around conveyors, racking, forklifts and stock pickers. In addition, comparison with Mississippi Industries for the Blind may not be accurate as no comparison to size of the organization or equipment use was included.

The DOR received an award for the Outstanding Employee Safety Program for Large Agencies for 2012 and 2013 from the MS State Agencies Self-Insured Workers' Compensation Trust. This included all claims made for the agency, including ABC.

**3 – The ABC Warehouse does not require each of its vendors to keep minimum amounts of alcoholic beverage stock on hand in the warehouse. This practice does not assure that ABC utilizes its warehouse space as efficiently as possible or that sufficient amount of each product is available for purchase, thus maximizing potential revenues to the state.** *Recommendations are that the DOR should determine an equitable storage level for all bailment products in order to maximize the efficient use of the warehouse space and that the ABC warehouse should consider creating a minimum stock level policy for all bailment items.*

While we do not set minimum inventory levels, the ABC believes that its current procedures do ensure maximization of our warehouse space and work to ensure that any product outage that occurs is not due to actions of the ABC.

Unlike many control states, the Mississippi ABC does not operate retail markets. This is the primary way that a state has the ability to affect consumer purchases using the same marketing and display practices used by most retailers. The Mississippi ABC, as the states wholesaler of alcoholic beverages, has to ensure availability of products to our retailers. We accomplish this through ensuring that we have proper inventory and ensuring that the inventory we carry is heavily weighted toward the best-selling products. A warehouse full of slow moving or poor selling products does no good to the state or its retailers. We work to ensure a proper balance of all products in the floor space we have. The ABC does not require our vendors to keep a minimum inventory level due to the nature of the business and the products carried by the ABC. The brokers and vendors review their inventory levels and maintain the appropriate levels of inventory for their bailment products.

There is a variety of reasons that requiring a minimum level of inventory is not feasible. Some of the reasons include:

- Seasonal items
- Allocated items
- Supplier issues
- Availability of the product

The report states that ABC's primary method of controlling stock and maximizing space allocation is the limitation of a vendor's six-week supply of available product. This is not accurate. The ABC Warehouse has limited space and we do not need a minimum level for slower moving products. What we have found to be more beneficial is to work on keeping the appropriate mix of products. Our primary method of controlling stock and maximizing space allocation is not predicated on having a specific quantity of each of our bailment items but in having our available space being used by the products that are the best-selling products. We have a category manager that works with our data to give us information on what products are the best performers. We use a twice a year de-listing process to remove slow movers out of bailment. We list new products every other month, which allows us to keep the newest products introduced to the market. De-listed products are still available through the special order process.

The report indicates that twelve of the control states require vendors to stock minimum quantities or product and that some states charge fees when vendors do not maintain the minimum amount of product. We previously looked at implementing a fee for out of stocks but we do not have a statutory authority to charge such fee.

**4 – During the 2019 Regular Session, the Legislature appropriated an amount of up to \$4 million for purchasing an additional warehouse for ABC operations. Although the DOR has begun the process of purchasing an additional warehouse, it does not have a formal, written plan for the logistics of incorporating the additional warehouse into the operations of the existing warehouse. Lack of such a plan could reduce efficiency of warehouse operations or reduce revenue potential for the state. Recommendations are that the Commissioner require ABC managers to develop a written facility usage and logistics plan prior to purchasing such warehouse space and that the plan should address how any additional warehouse space will be incorporated into the existing warehouse operations and at what costs.**

While the ABC does not have a formal plan, we have had meetings to work on the logistics and timeline for incorporating the potential new warehouse. We are working on the IT needs, programming needs for our MARS system, equipment needs, and product logistics. The following are the steps that we are working with in regards to the potential new building. The ABC Director James Eubanks drafted these following steps on May 29, 2019.

*The following are the steps that will be used to convert the warehouse picking operation from conveyor pick to voice pick to pallet.*

- 1) *Get the new warehouse. Set up bulk location in the system and make location signs for high volume items in the new warehouse, and develop the process to which will be used to determine if pallets need to be transferred to the new warehouse or to the existing warehouse. (A report will need to be created for this purpose). Order a forklift and 2 batteries for the new warehouse (estimated \$35,000).*
- 2) *Transfer the overstock to the new warehouse and order racking for the open areas created by moving the product to the new warehouse. Install racking (estimated \$200,000.00 plus labor), label racks and create the locations in MARS for pick locations and bulk locations. Using the upper racks for storage in preparation for step 3. A study will need to be done to determine the items placement in the warehouse for shipping (MSU CAV should be able to determine this. (a report from MARS will be needed for this process) Shop for a Pick to pallet system and start the process of getting in place.*
- 3) *Use the new racking lower levels as future pick locations in preparations of moving away from the conveyor system. Verify the number of pick locations needed, build the locations in the system, label the racks. Test the voice picking system and once this is done, schedule a go live date and pick a weekend to move items from conveyor system to new pick locations. Schedule the removal of the conveyor system and extend-o-vayors. (Use the receiving doors for shipping until the extend-o-vayors are removed. Order racking to fill the empty space created from removing the conveyor system. (Estimated \$300,000.00 plus labor).*

We have also been working on getting quotes for the new equipment and racking we will be using to retrofit the existing warehouse to a pallet pick system. At this time, these activities are on hold since we have not been able to reach an agreement with the owner of the potential warehouse on the purchase of the warehouse.

**5 – Although the ABC Warehouse has written customer service procedures in place, it does not ensure that employees follow these procedures and track customer service calls, complaints and comments. Thus ABC loses potential opportunity to correct weaknesses in its service to permittees.** *Recommendations are that the ABC managers should analyze current methods for receiving and responding to customer service contacts and that this information should be systematically analyzed in order to modify or improve operational practices.*

We are working with our ITS Department and our software vendor to determine if we can pull a report from the comments section of our taxpayer/permittee accounts that will allow us to track the status or resolution of calls. In the interim, we are tracking calls through an excel spreadsheet.

The report also details several policy considerations for the regulation of alcoholic beverages in Mississippi and PEER's recommendations for how these recommendations should be reviewed and evaluated. The options outlined include:

- Consider modifying Mississippi's control model;
- Consider privatizing warehousing operations;
- Consider capping the number of retail permits issued; or,
- Consider allowing direct sales of wine to consumers.

We agree that these are all valid policy considerations and the DOR has previously looked into both privatizing wine and privatizing the warehousing operations.

Consideration of privatizing warehousing operations looks at three options: 1) Full Divestment of Wholesale Sales of Liquor and Wine, 2) Contracting Out Wholesale Operations and 3) Partial Divestment of Wholesale Operations. In the analysis of the option to contract out the wholesale operations of the warehouse, the report states "Amendment of relevant state laws would be necessary to implement this policy." We do not agree. Our legal staff reviewed this at the time the agency issued its RFI to gauge interest and costs associated with outsourcing. We believe the statute requires the state to act as the wholesaler for alcoholic beverages but the Commissioner of Revenue has the authority to decide whether to operate such wholesale activities directly or whether to outsource such operations.

In the analysis of the option for partial divestment of wholesale operations, the report considers that "the state would provide licenses to wholesalers and allow vendors direct control over the wholesale of wine to permittees throughout the state." We believe that the state should sell the rights to wholesale wine and that the cost for the right be based on geographical territory and market share of the products carried by each vendor. The vendor should then be required to pay for an annual permit. The sale of the right would help offset some of the cost to the state and could be set to recover a time certain period of the loss in revenues related to the partial divestment.

Some additional policy considerations should include:

- Increase in permit fees
- Allowing wine sales in grocery stores
- Repealing prohibition at the state level
- Converting the ABC to a government owned corporation

Permit fees have not increased since the 1966 when the state adopted its current local option model for the sale of alcoholic beverages. We believe an increase in permit fees for on-premise and off-premise retailers is needed to 1) cover the actual cost of issuing such permits and 2) to help limit the number of permits issued.

Allowing wine sales in grocery stores could potentially increase the sales of wine in Mississippi and would therefore increase the revenue the state receives. However, this increase in sales would also result in the need for additional warehouse employees and ABC Enforcement Agents. Any potential increase in revenue would be offset to some degree by the increased costs.

The current local option laws date back to 1966. The state is a patchwork of wet and dry counties, wet cities in dry counties and qualified resort areas in otherwise dry counties. This patchwork is also an impediment to allowing direct sales of wine to consumers as each seller must ensure that sales are made only in area where sales of alcoholic beverages are legal. This patchwork also makes it more difficult to enforce our liquor laws.

Many of the issues surrounding the ABC warehousing operations are the result of the lack of a dedicated funding source to keep current with the best practices in warehousing operations and to be able to replace antiquated equipment with current, more efficient equipment, such as automated storage retrieval systems and voice picking software. Our warehouse employees are covered under the State Personnel Board and as such, we are limited in the pay we can provide and the structure of employee compensation. We believe industry best practices will show that performance based pay will improve the quality and efficiency of our warehouse work and can potentially lead to overall cost savings to the state. Converting the ABC to a government owned corporation can preserve the level of funding the ABC provides to the state and its projected growth while also allowing the ABC the flexibility it needs to operate in the most effective and efficient manner.

The Department believes each of these options has merit; however, we believe any movement toward adopting any or all of these options is solely a policy consideration for the Legislature. Should the Legislature consider any of the options the Department and the ABC will work to provide the Legislature with any assistance needed to adequately evaluate any potential changes and ensure that the ABC can administer the changes effectively.

In closing, I would like to point out that since the construction of the current warehouse in 1983, the number of items in bailment has increased from just over 1,400 items to an average of 4,000 items today. Our warehouse peak operational capacity is 375,000 cases and our current average inventory is 400,000 cases with a peak of around 450,000 during peak holiday season. We order over 8,000 different products through special order. Our ABC sales increased 26% over the last 10 years, case sales have grown 20% over the last 10 years and transfers to the General Fund have increased 23% percent over the last 10 years. In contrast, the operating budget for ABC has decreased 16% over the last 10 years.

We have also made some staffing changes that I believe will be extremely beneficial to the function of the ABC. We have recently hired a new night manager for the warehouse and new deputy director for the ABC. Our night manager comes to us with significant safety experience and he will be instrumental as we make improvements to address employee safety. Our new deputy director comes with project management experience and will be very beneficial to us as we look to forward to potentially replacing our current warehouse conveyor system with more state of the art fulfillment systems. We also have completed a realignment of all ABC and warehouse personnel. The increase in the warehouse salaries has allowed us to hire a better caliber of employee. All these things show our commitment to the highest quality service to our customers and the overall investment we are making in our staff.

We appreciate the work of the PEER Committee and thank you for giving us the opportunity to respond to these recommendations.

Sincerely,



Herb Frierson



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