MINUTES

SENATE STATE AFFAIRS COMMITTEE

DATE:	Wednesday, March 12, 2014
TIME:	8:00 A.M.
PLACE:	Room WW55
MEMBERS PRESENT:	Chairman McKenzie, Senators Davis, Fulcher, Hill, Winder, Lodge, Siddoway, Stennett and Werk
ABSENT/ EXCUSED:	None
NOTE:	The sign-in sheet, testimonies and other related materials will be retained with the minutes in the committee's office until the end of the session and will then be located on file with the minutes in the Legislative Services Library.
CONVENED:	**Chairman McKenzie** called the Senate State Affairs Committee (Committee) to order at 8:08 a.m. with a quorum present.
VOTE ON GUBERNATORIAL APPOINTMENTS:	**Senator Siddoway** moved to send the gubernatorial appointment of **Jackie R. Flowers** to the Idaho Energy Resources Authority to the floor with the recommendation that she be confirmed by the Senate. **Senator Lodge** seconded the motion. The motion carried by **voice vote**.
	Senator Lodge moved to send the gubernatorial reappointments of **Dennis P. Duehren** and **Wendy W. C. Diessner** to the Bingo-Raffle Advisory Board to the floor with the recommendation that they be confirmed by the Senate. **Senator Siddoway** seconded the motion. The motion carried by **voice vote**.
RS 23112	A Unanimous Consent Request from the Education Committee for a Concurrent Resolution Rejecting **Docket No. 08-0202-1306**; presented by Senator Goedde.
MOTION:	**Senator Winder** moved to send **RS 23112** to print. **Senator Siddoway** seconded the motion. The motion carried by **voice vote**.
HJR 2	Proposing an Amendment to the Constitution to Empower the Legislature to Delegate Rulemaking Authority to Executive Agencies and to Approve or Reject the Administrative Rules Issued by those Agencies; presented by Representative Loertscher.
	Representative Loertscher explained that **HJR 2** is a constitutional amendment to provide that the Legislature has the ability to reject, in part or in whole, agency rules. **Representative Loertscher** said this was put in Idaho statute in 1965 and it has operated for many years. Meade v Arnell was a case brought by an agency against the Legislature that said it doesn't have that authority under the Idaho Constitution. The Legislature won that case and continues to operate under a three to two decision. If that rule process comes under attack in the future, the Legislature would have to make their case all over again. This will ensure that the Legislature has the ability to reject rules set in the Idaho Constitution.
MOTION:	**Senator Davis** moved to send **HJR 2** to the floor with a **do pass** recommendation. **Senator Winder** seconded the motion.
	Senator Werk asked for an explanation of the last sentence on lines 17-19 and noted that Section X, Article IV is about veto power. **Representative Loertscher** responded that line 27 states the exact meaning: it "shall not require the approval of the governor."
VOTE:	The motion carried by **voice vote**

H 540 Relating to the Administrative Rules to Remove Language Relating to Statements in the Administrative Procedure Act that violates the Principle of Separation of Powers between the Executive and the Legislative Branches; presented by Representative Loertscher.

Representative Loertscher said that **H 540** removes the language from the Administrative Procedures Act (APA) that the Legislature can amend or modify a rule. The Legislature was able to amend or modify rules up until 1995 when the then Legislative Services Director pointed out that it could be a problem. Since that time, they have not modified or amended rules. This removes the cloud in the APA so that when the electorate goes to vote on **HJR 2**, that question will not be in their minds.

Senator Hill stated his concern about the wording in the constitutional amendment that says a rule can be rejected "in whole or in part." By rejecting part of a rule, which is done now, under this provision, would it be considered a modification? **Representative Loertscher** answered that the Constitution would prevail.

MOTION: **Senator Davis** moved to send **H 540** to the floor with a **do pass** recommendation. **Senator Siddoway** seconded the motion. The motion carried by **voice vote**.

Chairman McKenzie moved **S 1395** before **H 524** in case we lose some of the Committee members. This bill had to be addressed.

S 1395 Relating to Salaries of State Elected Officers to Revise Salaries of State Elective Officers Except for the Attorney General; presented by Senator Davis.

Senator Davis acknowledged that there was a robust conversation on this bill when the RS was before the Committee. At that time, a spreadsheet was provided showing the changes in salaries. There are three parts to the bill:
- There is a two and one-half percent increase for the Governor, the Lt. Governor, and the constitutional officers except for the Attorney General.
- The Attorney General will be tied to the district court judge position.
- The Attorney General will plateau for the four year term.

MOTION: **Senator Hill** moved to send **S 1395** to the floor with a **do pass** recommendation. **Senator Stennett** seconded the motion. The motion carried by **voice vote**.

H 524 Relating to Beer to provide that it shall be Unlawful for a Brewer to have any Financial Interest in the Business of a Licensed Dealer or Wholesaler of Beer; presented by Jeremy Pisca, Attorney for Risch Pisca Law Firm, and representing the Idaho Beer and Wine Distributors Association (IBWDA).

Mr. Pisca focused his first remarks on what all the concerned parties agree upon:
- They agree that Idaho does have a three-tier system.
- The system has been in place for years and has worked effectively.
- The idea behind the three-tier system was to separate financially, the three tiers so that any one of those tiers wouldn't have the ability to control any one of the other two tiers.
- There are no brewery owned branches in Idaho today.

They are asking for a codification of what the status quo is today in the State of Idaho. The bill closes a loophole. The question is: Why are we bringing this bill? We believe there is a threat. Other states that have not closed this loophole have seen breweries come in and purchase distributorships. We believe now is the time to act while there are no brewery owned branches in Idaho because the consequences could be devastating.

The products being dealt with here are unique. The beverages contain alcohol and those beverages can have social consequences. They are not like other consumer products. They require regulation, and they are the only product that has been the subject of two constitutional amendments. **Mr. Pisca** reviewed information about how the system works and showed a U.S. map that highlighted the distribution of brewery owned branches indicating that the majority of America has already acted to ban branch ownership.

Mr. Pisca explained each part of the bill. Lines 13-18 ban the financial interest between a brewer and a distributor. Lines 19-21 exempt out small brewers; those that brew 30,000 barrels or less annually. Lines 22-34 discuss the five year period where a brewer may service a branch by supporting brand distribution and a financial interest. Lines 35-39 cover a situation where a distributor voluntarily wants out of his contract, a brewery can step in and, for a period of five years, support and provide financial aid. Line 40 states a distributor cannot have a financial interest in a brewery. There is a provision exempting a de minimus interest and there is an emergency clause. This bill does not change contracts. There are no known amendments and, if there are, they would be considered hostile.

Senator Davis stated his understanding that a brewer would have the right to own a distributorship for the limited period of five years if: 1) they can't service the designated sales area; 2) termination, cancellation or discontinuance; 3) failure to renew the distribution agreement; or 4) any reason set forth in § 23-1105. Subpart (1) in § 23-1105 states that it could be: 1) suspension of license; 2) distributor isn't solvent within the definition of the bankruptcy code; 3) a stockholder or partner who owns 10 percent or more of the stock has been convicted of a felony; 4) there has been a transfer of the business without written consent; 5) covers fraud; 6) unpaid bills; 7) transfer infractions; and 8) selling products outside of their territory.

Senator Davis recalled his question from the bill last year and stated that he didn't see the answer in this bill. **Mr. Pisca** referred to line 32 that states, for a period not to exceed five years, they are able to have an unlimited financial interest. Typically, in the case of a failing distributorship, a brewery will appoint their distributor from a neighboring territory to assume responsibility for that distributorship. **Senator Davis** said he wants to see the basis in which they could acquire it. Where does it say that there can be a foreclosure of a lienholder position?

Senator Werk asked for an equivalent of 30,000 barrels. **Mr. Pisca** said all of Idaho's craft brewers combined would not be 30,000 barrels. Idaho's largest brewer is 12,000 barrels a year. That number was picked back in 1994 and has remained the same. **Senator Werk** asked how Subparts (1) and (2) interact together. Subpart (1) has an exemption that does not seem to be in Subpart (2). **Mr. Pisca** explained that in 1994 an exemption from the three-tier system was granted to small brewers. They are able to be their own distributor, they can brew their own beer, and they can have a brew pub or an on or off site retail location. The second part explains how to maintain the three-tier system and bans a financial interest between them, then a distributor can't own a majority interest in a small brewery. If they do, they are no longer independent because they are financially tied to one of the other tiers.

Senator Winder noted that there are principles in this bill that are important. But by maintaining the position on the three-tier system, we must ask about free enterprise. Do distributors feel this is a disadvantage to them for selling and achieving the most value for their businesses? **Mr. Pisca** answered that the IBWDA does not feel that it is unfair. It believes it gives them some security and a higher market value. Knowing that the brewery is not going to be a partner from a financial standpoint gives that business the freedom and independence that it needs to thrive. **Senator Winder** asked what, if other distributors are likely buyers, kind of conditions would exist to prevent a distributor from selling to another distributor. **Mr. Pisca** responded that in certain instances, a brewer may have a contract with a distributor that grants the brewer the right of first refusal. That could result in the devaluation of the business. The brewer always has the ability to approve the buyer of a distributor. There are various strict requirements in place when a distributorship is sold.

Senator Davis said he is looking at this from an Article IX point of view and discussed his viewpoint with the if and then scenarios. The bill last year only focused on the remedy side, or the "then" side. This bill has the "if" side and they are appropriate. However, something is missing. **Senator Davis** said if a brewer advances the money and is the primary financier, is it granted a secured lienholder position and can that position be foreclosed upon. That is not spelled out in the language on lines 25-26. **Mr. Pisca** yielded to Mr. Hayden to answer the question.

Dodds Hayden, Owner and Operator of Hayden Beverage Company, explained that a brewery controls the distribution rights, which are the driving piece of equity in the business. Distribution rights are the heart of the transaction in the sale of a distributorship. **Senator Davis** emphasized that he is talking about the hard money financing to make a sale happen when a brewery takes an Article IX lien hold position in all the tangible and intangible assets of the company, including a lien hold interest in the distribution agreement. Now the brewery forecloses on that security position. He is not seeing the secured transaction right, the Article IX right, to trigger an ownership interest. **Mr. Hayden** said that if the distributor doesn't pay its bill, the brewery can terminate the distribution rights and now has that asset. They can then take that asset and sell it to another distributor to make them whole.

Ken McClure, Attorney with Givens Pursley on behalf of Anheuser-Busch (AB), spoke in opposition of **H 524**. **Mr. McClure** stated that the concerns they had for the bill last year haven't changed, although the bill has changed. AB is concerned about the action to take away from a brewer a legal right it currently has in Idaho. AB has contracts with its distributors that have been negotiated, they are agreements that have significant benefits to both sides, people are depending on the validity of those agreements and there is an investment of substantial sums of money. AB has negotiated away to the distributor, the right to a perpetual contract: It does not renew; it is terminable only under very limited circumstances; and other than those circumstances, it is not terminable. **Mr. McClure itemized** the details of the contract for both the distributor and the brewer. There is a limitation on how to sell beer. As a consequence, AB is very focused on the success of their distributors. They are denied by statute, the right to transfer from one distributor to another. They bargained that away with the acknowledgement that they retained the right of first refusal and also retained the right to own and operate if they wanted to do so. **Mr. McClure** elaborated on the AB corporate policy to own as much of the middle tier as possible; that is categorically untrue. They do operate a global enterprise and in virtually all nations, there are no statutory requirements to sell only through the three-tier system. In those places, they sell the way that makes sense. In he U.S., if they need to, they want the right to step in and protect their brand, market and sales. There have been three transactions in Idaho in the last five years. In each of those cases, AB

approved the transfer with the purchaser. AB has 500 distributors in the U.S.; they own 17 of those distributors. **Mr. McClure** explained why they owned various distributorships, especially in Oregon. **Mr. McClure** talked about the "muscling" by large brewers and said their distributors have no such fears. He went on to debate other arguments set forth by Mr. Pisca.

Mr. McClure stated his desire to have been included in the development of this legislation. Miller Coors was involved and given the opportunity to help shape the legislation. AB made the request but were denied the opportunity. They would prefer that the market be allowed to function and that the bill would be held in Committee. The amendment that they would have presented is not a great deal different than this bill. AB does finance the transition of its distributorships as time and financial circumstances dictate. Most of these operations are small, family owned businesses. When those businesses change owners, AB helps to capitalize that transition. They finance it and take a security interest or, more commonly, a minority ownership interest and can even take a majority ownership which, in any case, will amortize over time. This bill does not permit that. They would have asked for a longer period of time, from five years to eight years. They would have also asked for the ability to have a minority ownership thereafter. It takes longer than five years to amortize out. AB would like the ability to continue as a minority non-controlling partner beyond the expiration of the years in the legislation. It is not clear what public policy reasoning makes that unacceptable. **Mr. McClure** asked that the legislation either be held in Committee or sent to the Amending Order. **Mr. McClure** gave a brief overview of a letter of opposition from Daniel Levine, Chairman, K&L Distributors, Inc. and submitted it to be recorded in the minutes (see attachment a).

Senator Davis referred to the language of termination, cancellation and discontinuance; how do you read this in view of Article IX, and would this language preclude an effective foreclosure of a collateral lien hold position? **Mr. McClure** responded that his understanding is that it would preclude a foreclosure on a security interest through which a brewer that had loaned money for an acquisition would retain its security interest. This allows a brewer to step in: 1) if those provisions have been met for insolvency, fraud, etc. and, 2) if the distributor wants to sell. There is no ability in this legislation for a brewer to foreclose upon an interest without the consent of the distributor. That only deals with the debt. It doesn't deal with the other means of financing, which is equity financing. That is not in the legislation at all. That is a concern. This prevents a brewer from protecting its financial interest either through a debt or equity circumstance.

Senator Hill said that they haven't been operating in the free market under the three-tier system. The arguments you have made could be made against the whole three tier system. Does the three-tier system have value? **Mr. McClure** said that AB is a strong supporter of the three-ier system. It has a great deal of value. It gets quality product serviced to the marketplace, it gets a uniform and efficient distribution system, it provides for a central location for the collection of taxes and it provides an assurance that there will not be a proliferation of illegal distribution. AB has recently spent a lot of money protecting the three-tier system by opposing initiatives in the State of Washington and those pending in the State of Oregon. You are right, this is not a free market system but we are dealing with an alcoholic product. This legislation adds further restrictions to an already limited system. There should be a good reason for doing that, and the proponents of the legislation have not given such a reason.

Senator Hill recalled that AB owned 17 distributorships. How many have been acquired in the last five years? **Mr. McClure** responded that there have been 67 transactions across the U.S. and of those, 25 were in areas where AB had the legal right to acquire; AB acquired 5.

Skip Smyser, Attorney and Consultant for Lobby Idaho, appeared on behalf of Miller Coors. He stated that he did not participate in the Senate last year regarding a similar piece of legislation but became involved once it reached the House and was instrumental in defeating that legislation. The message they heard was to work with the distributors and find a way to resolve their differences. Miller Coors is a strong proponent of the three-tier system and also a strong proponent of their distributors in Idaho. They have worked with the IBWDA and they came together with the compromises contained in **H 524**. Miller Coors believes that five years allows them to take an ownership interest in cases where that may be appropriate. Mr. McClure identified many instances where that is appropriate. Five years to "right the ship" and find a purchaser is an adequate amount of time, and so they support the legislation that is before the Committee.

ADJOURNED: **Chairman McKenzie** said that there are others who have signed up to testify. Some leadership members must leave by 9:30, and Senator Lodge had to leave for another meeting. The Committee will not be asked to vote on this bill until the full Committee is present and those still wishing to testify have the opportunity to do so. This hearing will be resumed at the next meeting on Friday. There being no further business, **Chairman McKenzie** adjourned the meeting at 9:30 a.m.

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Senator McKenzie
Chair

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Twyla Melton
Secretary