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**STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL**

**A PERFORMANCE AUDIT
OF THE**

**DEPARTMENT OF LIQUOR LICENSES
AND CONTROL**

OCTOBER 1983

**A REPORT TO THE
ARIZONA STATE LEGISLATURE**



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AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

October 14, 1983

Members of the Arizona Legislature
The Honorable Bruce Babbitt, Governor
Mr. Lloyd H. Robertson, Superintendent
Department of Liquor Licenses and Control

Transmitted herewith is a report of the Auditor General, A Performance Audit of the Department of Liquor Licenses and Control. This report is in response to the January 18, 1982, resolution of the Joint Legislative Budget Committee.

The blue pages present a summary of the report; a response from the Department of Liquor Licenses and Control is found on the yellow pages preceding the appendices.

My staff and I will be pleased to discuss or clarify items in the report.

Respectfully submitted,

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Enclosure

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OFFICE OF THE AUDITOR GENERAL

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DEPARTMENT OF LIQUOR LICENSES AND CONTROL

A REPORT TO THE
ARIZONA STATE LEGISLATURE

REPORT 83-19

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SUMMARY

The Office of the Auditor General has conducted a performance audit of the Department of Liquor Licenses and Control (DLLC) in response to a January 18, 1982, resolution of the Joint Legislative Oversight Committee. This performance audit was conducted as part of the Sunset Review set forth in Arizona Revised Statutes (A.R.S.) §§41-2351 through 41-2379.

The Department is responsible for 1) licensing alcohol beverage suppliers, wholesalers and retailers; 2) assisting State officials and political subdivisions in collecting liquor-related taxes; 3) investigating compliance with liquor laws and assisting the Department of Public Safety and all local law enforcement agencies in liquor law enforcement; and 4) conducting hearings and imposing sanctions for violations of liquor laws.

The Department Can More Effectively
Utilize Local Police Agencies to
Enforce Liquor Laws (see page 13)

DLLC has not fully utilized local police agencies in the enforcement of liquor laws. DLLC's control over liquor establishments (on-sale all-liquor retailers) is largely limited by the quality of enforcement done by local law enforcement agencies. In many instances DLLC has been unable to take action against licensees because of inadequate investigations and/or reports from local agencies. In some instances reports have not been sent to DLLC, even though required by law. Many other reports do not contain enough information and/or are sent to DLLC so late that solid cases cannot be prepared for administrative action. However, until recently DLLC has taken little action to correct these conditions. More specifically, DLLC has not been following up with local agencies to determine why reports are not being sent or to discuss the inadequacies of reports sent.

Raise civil penalties -

During the audit DLLC began to establish a liaison with each local enforcement agency to improve the reporting of liquor violations. DLLC should give even more emphasis to this liaison role, including a more extensive training program.

Greater emphasis on this liaison role should generate a greater number of actionable reports from local agencies. Therefore, additional staff may be needed to process these reports and handle the resulting disciplinary caseload.

The Legislature should consider reviewing again the enforcement activities of DLLC in approximately two years after the reporting of liquor violations has improved.

Restrictions on the Number of Liquor Licenses Should Be Removed (see page 29)

Restrictions on the number of liquor licenses issued should be eliminated. These restrictions are ineffective in achieving the traditional goals of promoting temperance and aiding enforcement. Due to historical exclusions and exceptions to the quota, restrictions have not limited the number of retail outlets. Arizona ranks fourth in alcohol availability and currently has about one outlet for every 400 persons. Recent research indicates that consumption of alcoholic beverages is based on numerous social and economic factors, and eliminating quotas should not increase consumption. In addition, as the number of retail outlets is not expected to increase significantly, eliminating quotas should not hinder law enforcement. License issuances could then be based on need and convenience rather than artificial barriers to entry that protect the industry.

✓

Revision of License Transfer Statutes Would
Generate Significant Additional Revenues (see page 43)

The State is not realizing sufficient revenues from transfers of licenses. Transfer fees are considerably less than original license fees without apparent justification. The processing work loads for transfers and original licenses are almost identical and transfers afford licensees the same privileges as original licenses. Depending upon the outcome of the recommendations in the Finding concerning quotas, transfers should be either 1) eliminated or 2) restricted to quota licenses and transfer fees increased to equal original license fees. Either change would have produced approximately \$724,000 in additional revenues in 1982.

Luxury Taxes Should
Be Increased (see page 51)

Increased liquor luxury tax rates could produce significant additional revenues. Arizona's tax rates are lower than other states' rates and have not increased in at least nine years. For instance, Arizona's beer tax is 38 percent lower than the 13-cents-per-gallon average of the other western states.

If Arizona's tax rates were comparable to other western states' rates, the State could generate additional revenues of at least \$5.2 million annually. Tax rates comparable to the national average would generate an additional \$14.7 million. An increase of 5 cents per gallon on beer alone--or 3 cents per six-pack--would produce \$4.5 million annually.

Lottery Statutes Do Not Allow
an Equal Opportunity of Obtaining
a License (see page 59)

Although the Department's lottery drawing procedures appear adequately controlled, statutes do not effectively limit the number of applications a person can submit. Our review of written procedures and interviews with Department staff indicate that, in the absence of collusion, controls are sufficient to prevent abuse. However, lottery applicants are able to circumvent the statutory goal of giving all persons an equal opportunity

of obtaining a license. By submitting additional applications under business names and names of family members, a person is able to increase his chances of selection. We identified two persons who used this approach to submit 15 applications in 1980 and 1982. In one instance this number provided almost a 50 percent chance of being selected. According to a Department employee, as many as 25 applications have been submitted by an individual for a single lottery. The Legislature should consider amending the statutes to more effectively restrict the number of applications an individual may submit.

Most Original License
Hearings Are Unnecessary (see page 65)

Most original license hearings held by the Liquor Board and the hearing officer are unnecessary and can be eliminated. Original license hearings for nonprotested, city-approved applications are unnecessary for the following reasons. First, similar licenses issued for transfers are not subject to either Board or hearing officer hearings. Second, local hearings provide for sufficient public input on these applications. Third, hearing officer hearings do not ensure that licensees will comply with statutory requirements. Fourth, numerous other states do not require hearings under similar conditions. In addition, these statutorily required hearings inconvenience license applicants and are an inefficient use of staff time. The Legislature should consider amending the statutes to eliminate mandatory hearings for original licenses, except when a local governing body recommends disapproval or when there are public protests or other problems.

Enforcement Activities Relating to
Sale of Liquor to Minors (see page 71)

Because of legislative interest, we reviewed DLLC activities relating to the sale of liquor to minors. The results of our analysis are presented as "Other Pertinent Information" beginning on page 71.

INTRODUCTION AND BACKGROUND

The Office of the Auditor General has conducted a performance audit of the Department of Liquor Licenses and Control in response to a January 18, 1982, resolution of the Joint Legislative Oversight Committee. This performance audit was conducted as part of the Sunset Review set forth in Arizona Revised Statutes (A.R.S.) §§41-2351 through 41-2379.

Liquor has been taxed or otherwise regulated in Arizona since the late nineteenth century. The 1864 Howell Code, Arizona's first law compilation, provided for license taxes for vendors of wines and distilled spirits. In 1919, the 18th amendment to the United States Constitution created a national Prohibition, eliminating the need for regulation at the state level. Upon repeal of Prohibition in 1933, the authority to license and regulate the manufacture and sale of liquor was placed in the Temperance Enforcement Commission under the State Tax Commission. In 1939, the Legislature established the Department of Liquor Licenses and Control (DLLC) and vested responsibility for administration and enforcement of liquor laws in the superintendent. A three-member State Liquor Board was added in 1967, and in 1979 the number of board members was increased to five.*

Both the superintendent and the Board are appointed by the Governor. The superintendent serves concurrently with the Governor; Board members serve three-year terms. Only one of the five Board members may be engaged in the liquor business. Board members receive compensation on a per diem basis.

* According to DLLC staff, one position on the Board has been vacant a total of nine months between August 1982 and September 1983.

Although the enabling legislation does not explicitly state the Legislature's intent in regulating liquor, several court cases have defined the purpose of regulation.

"The legislature, in creating the department of liquor licenses and control, intended to create and establish state-wide control over the traffic in intoxicating liquors." Mayor and Common Council of City of Prescott v. Randall, 670 Ariz. 369, 196 P.2d 477 (1948)

"The liquor laws are plainly designed to protect welfare, health, peace, temperance, and safety of all the citizens by providing for strict regulation and control of the manufacture, sale, and distribution of alcoholic beverages." Mendelsohn v. Superior Court in and for Maricopa County 76 Ariz. 163, 261 P.2d 983 (1953)

The Department is responsible for 1) licensing alcohol beverage suppliers, wholesalers and retailers; 2) assisting State officials and political subdivisions in collecting liquor-related taxes; 3) investigating compliance with liquor laws and assisting the Department of Public Safety and all local law enforcement agencies in liquor law enforcement; and 4) conducting hearings and imposing sanctions for violations of liquor laws. The types and numbers of licenses issued as of May 1983 are presented in Table 1.

TABLE 1

LIQUOR LICENSES ISSUED AS OF MAY 1983

<u>License Type</u>	<u>Number of Licenses Issued</u>	<u>License Type</u>	<u>Number of Licenses Issued</u>
1. Distiller's License (In-State)	0	12. Railroad Train License	0
2. Brewers License (In-State)	1	13. Airline License	14
3. Vintners License (In-State)	1	14. Private Club License	284
4. Wholesaler, All Liquors	68	15. Hotel/Motel License	104
5. Wholesaler, Wine and Beer	24	16. Restaurant License	868
6. On-Sale Retailer, All Liquors	1,531	17. Distillers License (Out-of-State)	30
7. On-Sale Retailer, Wine and Beer	1,349	18. Brewers License (Out-of-State)	17
8. On-Sale Retailer, Beer	496	19. Vintners License (Out-of-State)	61
9. Off-Sale Retailer, All Liquors	1,400	20. Importers, Exporter or Rectifier	92
10. Off-Sale Retailer, Wine and Beer	1,253	21. Government License	20
11. Off-Sale Retailer, Beer	210	22. Domestic Farm Winery	<u>1</u>
		Total Liquor Licenses Issued	<u>7,824</u>

The Department of Liquor Licenses and Control receives a General Fund appropriation. Revenues are generated from license fees, fines, salesman registrations and other miscellaneous sources. The Department's revenues and expenditures for fiscal years 1979-80 through 1983-84 are shown in Table 2.

TABLE 2

DLLC REVENUES, EXPENDITURES AND FTE POSITIONS
FISCAL YEARS 1979-80 THROUGH 1983-84

	<u>Actual 1979-80</u>	<u>Actual 1980-81</u>	<u>Actual 1981-82</u>	<u>Estimated 1982-83*</u>	<u>Estimated 1983-84</u>
FTEs	16.5	19.5	20.5	24.5	25.5
Revenues	<u>\$2,035,007</u>	<u>\$2,252,300</u>	<u>\$2,355,349</u>	<u>\$2,493,356</u>	<u>\$2,651,341</u>
Expenditures:					
Personal services	224,800	293,000	326,900	295,700	456,200
Employee related	41,400	56,500	65,500	62,100	101,800
Professional and outside services	15,300	3,000	3,400	3,300	1,500
Travel:					
In-State	10,600	14,600	19,100	11,600	28,200
Out-of-State	800	1,600			
Other operating	71,000	92,200	93,800	68,000	65,100
Equipment	5,600	15,200	2,700	9,000	
Sub-total	<u>369,500</u>	<u>476,100</u>	<u>511,400</u>	<u>442,300</u>	<u>652,800</u>
Investigations unit	-0-	-0-	-0-	116,200	-0-
Total	<u>\$ 369,500</u>	<u>\$ 476,100</u>	<u>\$ 511,400</u>	<u>\$ 558,500</u>	<u>\$ 652,800</u>

Sources: State of Arizona Appropriations Reports and DLLC Budget Requests for fiscal years 1981-82 through 1983-84.

* Amount includes \$116,200 appropriated by HB 2420 (Chapter 329, Laws of 1982) to provide a full-time hearing officer and to establish a separate investigations unit to ensure compliance with liquor laws, particularly those pertaining to minors. The bill also appropriated \$36,600 to the Attorney General to provide the services of one full-time attorney to the Department.

Scope of Audit

The scope of our audit included most Department operations and functions. Our major audit objectives were to determine:

1. Whether the current level of regulation is appropriate and in the best interest of the public health, safety and welfare;
2. Whether liquor-related taxes and fees should be increased;
3. If current licensing procedures are effective and efficient; and
4. If current enforcement and disciplinary activities are adequate.

Lynn

We identified several other areas where further audit work may be needed. Due to time and staffing constraints, we were not able to address these areas, which are listed in the Areas for Further Audit Work section (see page 77).

X

The Auditor General and staff express appreciation to the State Liquor Board members, the superintendent and their staff for their cooperation and assistance during the audit.

*300 cases = 91% of cases referred to by police agencies
① Administrative*

Mr. Thompson

SUNSET FACTORS

In accordance with A.R.S. §41-2354, the Legislature should consider the following 11 factors in determining whether the Department of Liquor Licenses and Control should be continued or terminated.

1. Objective and purpose in establishing the agency

Neither the 1933 legislation creating the Temperance Enforcement Commission nor the 1939 legislation establishing the Department of Liquor Licenses and Control explicitly state legislative intent. Authoritative literature, Arizona case law and DLLC's statements of objectives support protection of the public health, safety and welfare as the purpose of liquor regulation. According to the Superintendent, the Department's primary objective is to "regulate the industry through the license control process, collect fees and taxes for the maintenance of government, and enforce statutes in order to maintain the health and welfare of the community."

2. The effectiveness with which the agency has met its objective and purpose and the efficiency with which the agency has operated

DLLC can improve its regulation of the liquor industry by working more aggressively with local law enforcement agencies to obtain the reporting needed for effective disciplinary actions (see Finding I, page 13). The efficiency of DLLC's operation can be improved by eliminating most original license hearings. These hearings are unnecessary for qualified applicants with unopposed, locally approved applications (see Finding VI, page 65).

3. The extent to which the agency has operated within the public interest

DLLC activities serve the public interest by protecting the public's safety and welfare. DLLC screens license applicants to ensure only legitimate and qualified persons operate in the industry and enforces liquor laws which protect the public.

The quota licensing system does not appear to serve the public interest, as was intended. Restrictions on the number of liquor licenses issued are not effective in achieving the traditional goals of promoting temperance and aiding enforcement. Instead, these restrictions create artificial barriers to entry which protect the industry and do not allow new outlets where public need is shown (see Finding II, page 29). Furthermore, contrary to statutory intent, the lottery system for distributing quota licenses does not provide an equal opportunity for all applicants to obtain a license (see Finding V, page 59).

4. The extent to which rules and regulations promulgated by the agency are consistent with the legislative mandate

The State Liquor Board and the superintendent have promulgated rules as required by A.R.S. §4-112, Subsections A and B. The rules were reviewed and approved by the Attorney General's Office for consistency with the statutes. During our audit we found no apparent inconsistencies between DLLC regulations and the statutes.

5. The extent to which the agency has encouraged input from the public before promulgating its rules and regulations and the extent to which it has informed the public as to its actions and their expected impact on the public

The Department has complied with Open Meeting Law minimum requirements but should take other steps to notify the public. While DLLC's efforts to solicit input and inform licensees of its actions are adequate, the Department's procedures for notifying the general public are limited.

The Department informs licensees of rules hearings and actively solicits input from licensees before promulgating rules. Industry associations and attorneys practicing in the liquor industry receive copies of proposed rules and are notified of hearings. The associations notify licensees through articles and notices in trade publications.

However, DLLC has not used additional means of notifying the general public. Notices are posted in the Occupational Licensing Building, but the Department uses no other means of notification such as sending notices to the pressroom in the Capitol or notifying public interest groups. Attorney General guidelines regarding the Open Meeting Law encourage agencies to use such other means of notifying the public.

6. The extent to which the agency has been able to investigate and resolve complaints that are within its jurisdiction

DLLC's investigation of complaints appears to be adequate. A.R.S. §4-210, Subsection C charges the superintendent with investigating and resolving complaints of alleged liquor law violations. All complaints are investigated or referred to DPS, including anonymous complaints. According to DLLC records, it received 504 complaints in fiscal year 1981-82. DLLC staff report they received 556 complaints in fiscal year 1982-83. Approximately 277 of these complaints were referred to DPS for investigation. Most complaints investigated by DLLC were resolved in three to four days.

7. The extent to which the Attorney General or any other applicable agency of State government has the authority to prosecute actions under enabling legislation

The Department appears to have adequate enforcement powers. In addition to administrative action against licensees, the statutes allow the superintendent and Board to seek injunctive relief against persons operating without licenses. Further, the statutes provide criminal penalties for violation of State liquor laws. County attorneys or the State Attorney General serve as prosecutors in these cases.

8. The extent to which the agency has addressed deficiencies in the enabling statutes which prevent it from fulfilling its statutory mandate

DLLC has consistently sought statutory changes to enable it to more effectively attain its objectives. Between 1979 and 1983, DLLC supported bills which

- Provided for hearings and appeals,
- Increased disciplinary options by providing for injunctive relief and increasing fines,
- Required DLLC to maintain liaison with law enforcement officials and required law enforcement agencies to report liquor law violations to DLLC,
- Established a separate investigations unit within the Department,
- Required certain licensees to post bonds,
- Restricted corporate stock transfers, and
- Revised the quota system to more accurately reflect population changes.

According to the superintendent, several statutory changes are still needed:

- Statutory language concerning bonding should be clarified and proposed legislation addressing the problem was withdrawn in 1983 when a nonrelated amendment was attached;
- The Department's authority to subpoena records should be broadened; and
- The Department's role in filing liens should be defined.

DLLC plans to request legislation addressing the first two issues during the next session.

9. The extent to which changes are necessary in the laws of the agency to adequately comply with the factors listed in the Sunset Law

As explained in the findings of this report, we recommend the following statutory changes:

- Amend A.R.S. §4-206 to eliminate quota restrictions on type 6,7 and 9 licenses (see page 29);
- Amend the statutes to require bonding of all licensees (see page 39);
- If quotas are eliminated, amend A.R.S. §4-203(F) to eliminate all transfers; and if the quota system is retained, amend A.R.S. §4-209(F) to make transfer license fees equal to original license fees (see page 43);
- Amend A.R.S. §42-1204(A) to provide for higher liquor luxury tax rates (see page 51);

- Amend the statutes to more effectively restrict the number of lottery applications an individual may submit (see page 59); and
- Amend A.R.S. §4-201(E) to eliminate mandatory hearings for original licenses which are locally approved and nonprotested (see page 65).

10. The extent to which the termination of the agency would significantly harm the public health, safety and welfare

Regulation of the liquor industry is necessary for the protection of the public health, safety and welfare. The need for control over the sale of liquor is well established. All 50 states regulate the liquor industry, although regulatory structures vary dramatically. We evaluated the feasibility of transferring DLLC's licensing and enforcement functions to the Department of Revenue or the Department of Public Safety (similar to several other states) but could not identify significant benefits to warrant a consolidation.

11. The extent to which the level of regulation exercised by the agency is appropriate and whether less or more stringent levels of regulation would be appropriate

Licensure appears to be an appropriate level of regulation. Licensing provides a screening mechanism to ensure that negative influences, such as organized crime, do not operate in the industry. The threat of license suspension or revocation also provides incentives for licensees to comply with liquor laws and regulations.

Statutory restrictions on the number of licenses issued, however, should be eliminated. These restrictions do not attain their intended objectives and generally serve the industry rather than the public interest (see page 29).

FINDING I

THE DEPARTMENT CAN MORE EFFECTIVELY UTILIZE LOCAL POLICE AGENCIES TO ENFORCE LIQUOR LAWS.

DLLC has not fully utilized local police agencies in the enforcement of liquor laws. DLLC's control over liquor establishments is largely limited by the quality of enforcement done by local law enforcement agencies. In many instances, DLLC has been unable to take action against licensees because of inadequate or untimely investigative reports from local agencies. Until recently, however, DLLC has taken little action to correct these conditions. To improve the quality of reporting, DLLC should cultivate an ongoing liaison with these agencies and provide more training. More emphasis in these areas would improve liquor law enforcement throughout the State.

Enforcement Responsibilities and Activities

DLLC, DPS and local law enforcement agencies share responsibility for enforcing liquor laws. The statutory duties of each agency are summarized in Table 3.

TABLE 3
 STATUTORY RESPONSIBILITIES FOR
 LIQUOR LAW ENFORCEMENT

<u>Agency</u>	<u>Arizona Revised Statutes Section</u>	<u>Responsibilities and Duties</u>
Department of Liquor Licenses and Control (DLLC)	4-112, (B)(6) 4-112, (C)	Maintain effective liaison with DPS and local law enforcement agencies in enforcing liquor laws Investigate compliance with Title 4 (liquor laws)
	4-210, (C)	Superintendent to receive and investigate complaints of alleged violations
Department of Public Safety, Division of Liquor Control (DPS)	41-1792	Enforce the provisions of Title 4 (liquor laws) to obtain compliance by licensees
	41-1794	Maintain effective liaison with DLLC and local law enforcement agencies; forward investigative reports of licensee violations to DLLC
Local law enforcement agencies	41-1794	Forward investigative reports of licensee violations to DLLC

DLLC Activities - To fulfill its statutory enforcement responsibilities, DLLC has established an investigations section.* Investigators perform these major types of enforcement activities:

- Conduct routine license inspections (RLIs) to determine compliance with Title 4 and DLLC rules and regulations. RLIs are announced visits during which inspectors determine whether the establishment is licensed and review for such items as tax stamps on bottles and propriety of advertising.
- Investigate complaints received from the public and industry.
- Follow up on investigative reports received from DPS and local law enforcement agencies to obtain additional information needed for disciplinary actions.
- Conduct investigations originating from other sources, such as potential ownership problems identified by discrepancies on license applications.
- Perform restaurant audits to determine whether licensees are operating as bona fide restaurants.**

While performing investigations or inspections, DLLC may detect potential tax problems, such as skimming or wholesale sales by retailers. Potential tax problems are referred to DOR for audits to determine the amount of tax liability.

* In 1982 this section consisted of three investigators plus a chief investigator. One of these investigators, however, was acting as office manager over the clerical staff and thus was not performing investigative duties. During 1983 the section increased to six investigators plus the chief.

** A.R.S. §4-205.02., Subsection G requires restaurants to derive at least 40 percent of gross revenues from food sales.

DPS and Local Activities - Most "street" enforcement is performed by DPS and local law enforcement agencies. DPS's Division of Liquor Control has 56 officers whose primary duty is to enforce liquor laws. These officers are dispersed throughout the State. According to a DPS report, in 1981 DPS personnel spent nearly 50,000 man-hours in the following liquor-related activities:

- Liquor Investigations - These include both overt and covert investigations to detect liquor violations. Many investigations are initiated by requests from other State or local agencies (including DLLC) or citizen complaints. A covert operation is aimed at detecting "on view" violations such as serving liquor to minors.
- Routine License Inspections - Similar to RLIs conducted by DLLC. Inspection results are forwarded to DLLC.
- Prelicensure Investigations - DPS screens each liquor license applicant for criminal involvement by checking DPS records (including fingerprint checks) and contacting other State agencies. A DPS agent also visits the proposed location of the establishment to verify that it meets licensing requirements (e.g., adequate distance from schools and churches). Results of both the background check and the location survey are reported to DLLC.

Statewide, there are approximately 5,000 certified peace officers serving with local law enforcement agencies. Although no estimates are available of the time these officers may spend in liquor-related enforcement activities, under the provisions of A.R.S. §41-1794 they constitute a significant resource for the enforcement of liquor laws.

Both criminal prosecution and administrative action can result from investigative work performed by DPS and local law enforcement officers. Administrative action (i.e., action against a liquor license) is initiated by sending an investigative report of potential licensee violations to DLLC. DLLC enforcement staff review the report to determine whether 1) the violations are within DLLC's jurisdiction and 2) the report contains sufficient evidence on which to proceed with a hearing. DLLC disciplinary options include fines and actions against the liquor license (suspension/revocation). The provisions of A.R.S. §41-1794 enacted in 1982* require all DPS and local law enforcement officers to forward investigative reports of potential licensee violations to DLLC. This has increased the number of reports sent to DLLC, as shown in Table 4. During the first half of calendar year 1983 DLLC received 24 percent more reports than during the entire year 1982 and 41 percent more than during 1981.

* House Bill 2420

TABLE 4

REPORTS RECEIVED FROM LAW ENFORCEMENT
AGENCIES DURING 1981, 1982 AND 1983

<u>Jurisdiction</u>	<u>1981</u>	<u>1982</u>	<u>1983 as of June 24</u>
Apache County Sheriff	3	8	2
Apache Junction P.D.	9	16	33
Avondale	3	0	6
Bisbee P.D.	2	0	0
Buckeye P.D.	5	1	0
Casa Grande P.D.	15	16	10
Chandler P.D.	10	2	65
Clifton P.D.	0	1	0
Cochise County Sheriff	4	9	7
Coconino County Sheriff	0	1	3
Coolidge P.D.	4	3	11
Cottonwood P.D.	2	7	5
Douglas P.D.	0	1	0
Eager P.D.	0	0	1
El Mirage P.D.	1	5	2
Eloy P.D.	6	5	18
Flagstaff P.D.	15	45	97
Gila County Sheriff	6	8	0
Gilbert P.D.	7	0	0
Glendale P.D.	15	31	18
Globe P.D.	12	9	0
Guadalupe P.D.	0	1	1
Holbrook P.D.	0	1	28
Huachuca P.D.	1	0	0
Jerome P.D.	0	1	0
Kingman P.D.	33	2	1
Lake Havasu P.D.	7	15	2
Marana P.D.	0	3	6
Maricopa County Sheriff	33	23	13
Mesa P.D.	54	41	46
Mohave County Sheriff	2	32	8
Navajo County Sheriff	4	12	1
Paradise Valley P.D.	0	1	1
Parker P.D.	13	25	8
Payson P.D.	23	2	0
Peoria P.D.	4	4	1

TABLE 4 (Concl'd)

REPORTS RECEIVED FROM LAW ENFORCEMENT
AGENCIES DURING 1981, 1982 AND 1983

<u>Jurisdiction</u>	<u>1981</u>	<u>1982</u>	1983 as of <u>June 24</u>
Phoenix P.D.	111	177	82
Pima County Sheriff	26	50	4
Pinal County Sheriff	0	0	6
Prescott P.D.	18	10	2
Prescott Valley P.D.	0	1	0
San Luis P.D.	0	0	2
Scottsdale P.D.	145	108	78
Show Low P.D.	3	6	0
Superior P.D.	0	2	1
South Tucson P.D.	14	0	360
Surprise P.D.	4	2	0
Tempe P.D.	102	75	31
Tucson P.D.	39	58	219
Wickenburg P.D.	1	0	7
Wilcox P.D.	1	0	0
Winslow P.D.	0	0	105
Yavapai County Sheriff	18	9	11
Yuma P.D.	17	182	30
Yuma County Sheriff	5	3	0
DPS	<u>469</u>	<u>429</u>	<u>458</u>
Total	<u>1,266</u>	<u>1,443</u>	<u>1,790</u>

Due to the number and geographical dispersion of licensed establishments, and considering the small size of its own staff, DLLC can most effectively and efficiently exercise its enforcement authority by relying on DPS and local law enforcement agencies throughout the State. Even now the vast majority of DLLC's administrative actions against licensees are based on investigative work done by these other agencies. In fact, during 1982 only 9 percent of all administrative actions originated with DLLC investigators.

Unable to Take Action
Against Licensees

In many instances DLLC has been unable to take action against licensees because of inadequate investigative reports from local law enforcement agencies. Many reports do not contain enough information and/or are sent to DLLC so late that solid cases cannot be prepared for administrative action.

During the audit, several sources indicated that DLLC was not taking sufficient action against establishments with histories of repeated violence related to liquor consumption. We selected four bars which had reputations as "problem bars" and reviewed DLLC files to determine what potential violations have been reported and what follow-up actions have been taken by DLLC. The history for each bar--particularly relating to violence*--is summarized in Table 5 for calendar year 1982 and part of 1983.

* A.R.S. §4-210 states, in part:

"A. The Board may suspend, revoke, refuse to renew and the superintendent may suspend any license issued pursuant to this chapter for any of the following reasons:

1. There occurs on the licensed premises repeated acts of violence or disorderly conduct."

R4-15-213 states, in part:

"A licensee upon whose licensed premises an act of violence occurs shall make a detailed, written report within 24 hours of such act of violence to the Department of Liquor Licenses and Control."

TABLE 5

ANALYSIS OF INCIDENTS REPORTED
AND SUBSEQUENT ACTIONS BY DLLC
FOR FOUR LIQUOR ESTABLISHMENTS

Liquor Establishment	Period Covered by Reports in Auditor's Analysis*	Total Number of Reports	Number Involving Violence**			Disciplinary Action by DLLC	
			Inside Bar	Outside Bar	Total	Number and Nature of Citations/Warnings Issued	Final Disposition
Bar A	Jan. 1982-Jul. 1983	27	13	7	20	1 citation issued 7/8/82 containing 9 charges, including unreported acts of violence, overserving and repeated acts of violence	Licensee consented to \$700 fine for 1 charge of unreported violence; other charges dismissed
						1 citation issued 9/14/82 containing 1 charge of exposure and 2 charges of touching	Licensee consented to \$300 fine for 1 charge of touching; other charges dismissed
						1 warning letter for employee drinking	
Bar B	Jan. 1982-Dec. 1982	46	26	10	36	6 warning letters, mostly for violence	
Bar C	Jan. 1982-Mar. 1983	27	12	11	23	1 warning letter for unreported violence	
						1 citation issued 4/27/83 containing 7 charges, including unreported violence, overserving, locked front doors and repeated acts of violence	Informal conference with licensee pending as of 9/8/83
Bar D	Jan. 1982-Jun. 1983	74	14	11	25***	1 citation issued 4/27/83 containing 24 charges, including 15 for unreported acts of violence and 5 for overserving	Hearing pending as of 9/8/83
						1 warning letter for allowing intoxicated person to remain on premises	

* The periods specified are based upon the dates of the incidents reported by the local agencies. We reviewed only those reports which were in the licensee's permanent files at the time of the analysis. Other more current reports were in different stages of review by DLLC staff and thus were not available for our review.

** Many of these reports involving violence also noted other potential liquor law violations, such as overserving (serving to an intoxicated person) and allowing an intoxicated person to remain on the premises.

*** Of the other 49 reports not involving violence (74-25=49), 11 were drug related, 3 were prostitution related, 7 were arrests for outstanding warrants and 4 were related to pick-pocketing incidents.

Need to update disposition of cases.

We questioned the DLLC Superintendent and Attorney General representative to determine why the Department did not take more action against these licensees. Various reasons were given for inaction. For example, some violence is inevitable and is therefore dismissed if 1) the police report indicates that the licensee's employees responded properly to stop the disturbance or 2) there were no injuries as defined by the regulations.* Oftentimes a fight has ended before the police arrive and no one is willing to testify that the incident occurred or how it started. Frequently fights have moved outside before police arrive, making it more difficult for the officers to establish the fact that the violence began on the "licensed premises."**

According to the Superintendent and Attorney General representative, DLLC could take disciplinary action in more instances if police investigations and reports were more complete. In many instances all the evidence needed for administrative action may have been at hand when the police arrived, but because of inadequate investigations and/or reports DLLC could not prepare solid cases. For example, take a typical situation in which a fight between two intoxicated persons starts in a bar but moves outside before the police arrive. Apparently these persons were overserved in the bar, which is also a violation of the liquor statutes.*** However, when the police arrive the persons are no longer on the "premises" as defined in A.R.S. §4-101. Therefore, in order to document the violence and overserving violations, the officers should take the fighters into the bar and attempt to obtain sufficient testimony that these persons had in fact been served and started fighting in that bar. If the officers fail to do this, then DLLC is faced with the choice of either dismissing the matter or conducting a time-consuming follow-up investigation to gather the evidence needed for administrative action. The latter is often impossible

* R4-15-213 defines violence as ". . . any disturbance in which bodily injuries, fatal or not, are sustained by any person. . . ."

** A.R.S. §4-101(17) defines the "licensed premises" as ". . . the area from which the licensee is authorized to sell, dispense, or serve spirituous liquors under the provision of the license."

*** A.R.S. §4-244(14)

because witnesses are no longer available. The difficulty of obtaining evidence is compounded if the police report is not sent to DLLC until several months after the incident.

One of the four bars reviewed illustrates the importance of sending investigative reports to DLLC in a timely manner. In November 1981 DLLC suspended Bar D's license for 10 days for various violations. This action was based on reports submitted by the local police department. After the suspension ended, no reports were sent to DLLC for approximately 18 months. During this period numerous reports alleging liquor violations by Bar D were written by the local officers, but these were not sent to DLLC because of a misunderstanding within the police department. Finally, a local newspaper story noted the frequent violence occurring at Bar D and criticized DLLC for not taking more action against the licensee. DLLC subsequently contacted the local police department and requested that the past reports be sent, many of which were more than a year old.* Based on these reports, DLLC has issued a citation to the licensee noting 24 potential violations; as of September 8, 1983, a hearing is pending. According to the Attorney General representative many other apparent violations noted on the police reports were dropped because the passage of time since the incidents occurred made it impossible to locate witnesses.

DLLC Should Work More Closely
with Local Enforcement Agencies

DLLC can improve the quality of local reporting--and hence the effectiveness of liquor law enforcement--by working more closely with local law enforcement agencies. To free more resources for this role, DLLC should eliminate restaurant audits.

* Of the 74 reports shown in Table 5 for this establishment, 37 were received by DLLC more than 6 months after the incidents occurred.

Liaison with Other Agencies - As explained earlier, DLLC must rely on DPS and local law enforcement agencies for most "street" enforcement work. These agencies are already generating most of DLLC's disciplinary cases by forwarding reports involving liquor law violations. However, these agencies apparently have the potential to provide much better enforcement than is now occurring. To achieve this potential DLLC should strengthen its liaison role, including more emphasis in the training area. By this means DLLC can help local law enforcement officers improve the quality of investigations and reports involving liquor establishments.

Until recently DLLC has done relatively little to improve the quality of liquor enforcement by local agencies. According to the DLLC chief investigator, if an agency's reports were consistently late or inadequate, no one contacted the agency to determine why or to explain how the reports could be improved. Our contacts with the local agencies in whose jurisdiction the four "problem bars" are located confirm this statement. One agency said it was unaware DLLC considered its reports to be inadequate. A second agency, lacking specific feedback from DLLC regarding its reports, maintained that its reports are adequate for DLLC to act on. Another agency, not related to the bars mentioned above, said that DLLC had recently commented on a lack of documentation in its reports; but when it questioned DLLC, it was not given guidelines for correcting the problem.

In addition, as illustrated by the earlier example (Bar D), no one was reviewing the DLLC report log to identify agencies with unusually low numbers of reports. This simple analytical task could help DLLC identify local agencies which might not be fulfilling the reporting requirement of A.R.S. §41-1794. For example, Table 4 (page 18) shows the number of reports from each local enforcement agency in 1981, 1982 and part of 1983. The fluctuations for several agencies could indicate a reporting problem. In particular, Kingman sent 33 reports in 1981 but only 2 in 1982 and only 1 in 1983 (as of June 24). Payson sent 23 reports in 1981 but only 2 in 1982 and none in 1983 (as of June 24). By contacting these two agencies we were told Payson was unaware that a mandatory reporting

requirement existed. The Kingman official told us he was unaware that his department had not been sending reports and that there must have been an administrative mistake.

During the audit, DLLC began a program to establish a liaison with each local agency. In June 1983 the superintendent began assigning his investigators to separate areas of the State. The investigators are to periodically contact each local police agency and inspect each licensee within their districts. The superintendent estimates that each enforcement agency should be contacted about every two months. According to the chief investigator, once initial contacts have been made, then his staff will take a problem-solving approach in later contacts such as a discussion of reporting problems.

DLLC has provided some training to local agencies, but potentially could provide much more. For example, in a recent 18-month period DLLC staff were involved in training only 38 days. Half of those sessions involved law enforcement agencies and half involved liquor retailers. According to the chief investigator, DLLC's training program is being explained to each local agency during the initial contacts described above.

Eliminate Restaurant Audits - DLLC could devote more staff time to this liaison and training role by eliminating restaurant audits, which are costly and unnecessary. According to the superintendent, one DLLC investigator had been assigned nearly full-time to these audits in the past. (Prior to this year, this represented 25 percent of the enforcement staff.) However, these audits do not appear to deter noncompliance because few licensees are subject to audit. The 45 audits done in 1982 represent only 5 percent of all licensed restaurants. The fact that 17 of those audited (38 percent) were not in compliance with the food requirement suggests that the minimal coverage has little deterrent effect on the other licensees.

If quotas are eliminated, as recommended in Finding II, then there will be no need for the 40 percent food requirement* and thus no need for restaurant audits. If quotas are continued, DLLC should consider an alternative method for encouraging compliance. One solution might be a certification program. A restaurant licensee could be required to submit evidence, certified by a CPA, attesting to the breakdown of sales between food and alcoholic drinks. DLLC could adopt regulations specifying the procedures the CPA should follow to verify that the requirement is met. Thus, with a minimal amount of staff time and follow-up, DLLC could expand its monitoring effort to include all restaurant licensees.

More Staff May Be Needed - DLLC may need more staff to handle the increasing number of reports from law enforcement agencies. Additional emphasis on training combined with the effect of the 1982 law is likely to continue, increasing the number of investigative reports forwarded to DLLC. Thus, DLLC may need additional enforcement staff to review and follow up on these reports and additional clerical staff to prepare citations and handle the paperwork resulting from administrative hearings.**

CONCLUSION

DLLC's ability to regulate type 6 licensees (i.e., on-sale all-liquor retailers) depends largely on the quality of investigations and reporting by local law enforcement personnel. Better and more timely reports from the local agencies would enable DLLC to take disciplinary action in more cases. DLLC can help these agencies improve their reporting by placing more emphasis on its liaison and training roles.

* Apparently the rationale for the 40 percent food requirement is that it prevents a person from opening a restaurant to circumvent the current restrictions on the number of on-sale all-liquor licenses.

** The number of administrative citations has already increased substantially in the past year. DLLC issued 164 administrative citations in 1981, 207 in 1982 and 213 as of September 12, 1983.

RECOMMENDATIONS *H1*

1. To improve the quality of reporting by local law enforcement agencies, DLLC should give more emphasis to its liaison role by a) contacting each agency on a regular, frequent basis and b) increasing its training efforts.
2. To provide greater resources for more critical enforcement activities, DLLC should eliminate restaurant audits and consider alternative methods of encouraging compliance with the statutory food requirement. One solution might be to require licensees to submit certification attested by a CPA.
3. The Legislature should consider providing DLLC additional staff to process the increased number of reports from law enforcement agencies.
4. The Legislature should consider reviewing again the enforcement activities of DLLC in approximately two years to evaluate DLLC's effectiveness once the reporting of liquor violations is improved.

*3 goals of liquorable - goals 1, 2, 3
→ Promoting temperance
→ Preventing liquor industry*

FINDING II

RESTRICTIONS ON LIQUOR LICENSE ISSUANCES SHOULD BE REMOVED BECAUSE THEY ARE INEFFECTIVE AND CREATE ARTIFICIAL BARRIERS TO ENTRY.

Restrictions on the number of liquor licenses issued should be eliminated. These restrictions are ineffective in achieving the traditional goals of promoting temperance and aiding enforcement. Restrictions have not decreased the number of retail outlets. Research indicates that eliminating quotas should not increase consumption or place an additional burden on enforcement. License issuances could then be based on public need and convenience rather than artificial barriers to entry that protect the industry.

Background

A.R.S. §4-206 restricts, based on county population, the number of retail liquor establishments which are permitted to sell all spiritous liquors. Neither the total number of on-sale (type 6) licenses nor the total number of off-sale* (type 9) licenses within a single county are permitted to exceed:

* A.R.S. §4-101, Subsections 14 and 15 define off-sale and on-sale retailers as follows:

"14. "Off-sale retailer" means any person operating a bona fide regularly established retail liquor store selling spiritous liquors, wines and beer, and any established retail store selling commodities other than spirituous liquors and engaged in the sale of spirituous liquors only in the original package, to be taken away from the premises of the retailer and to be consumed off the premises.

"15. "On-sale retailer" means any person operating an establishment where spirituous liquors are sold in the original container for consumption on or off the premises and in individual portions for consumption on the premises."

- "1. One license for each one thousand inhabitants for the first twenty-four thousand inhabitants within the county, and in addition
2. One license for each two thousand inhabitants for the population within the county from twenty-five thousand through one hundred thousand inhabitants, and in addition
3. One license for each two thousand five hundred inhabitants for the population within the county from one hundred thousand inhabitants"

In addition, on-sale wine and beer licenses (type 7) are restricted to one license for each 500 inhabitants. Type 6 licenses are included in the count for determining availability of type 7's because type 6 licenses also permit the sale of wine and beer.

Because licenses which allow the sale of all alcoholic beverages, both on- and off-sale, have the highest demand, these licenses have reached their statutory limits in most counties. Therefore, only county population increases allow issuances of new type 6 and 9 licenses. Because the number of applicants for new 6 and 9 licenses is greater than the number of available licenses, the Department of Liquor Licenses and Control (DLLC) instituted an annual lottery in 1975. The lottery drawing process determines which applicants will be considered for the type 6 and 9 licenses created by population growth.* In 1982, original type 6 licenses were issued in only two counties and original type 9 licenses were issued in only four counties.**

* Finding V describes lottery drawing procedures.

** Although type 7 licenses are restricted, they have not reached quota limits and are therefore not included in the lottery.

Restrictions Are Ineffective
in Attaining Goals

License issuance restrictions are not effective in attaining the traditional goals of promoting temperance, protecting the liquor industry and aiding enforcement. Due to current exclusions and historical statutory exemptions from quotas, the total number of retail outlets is not limited. Arizona has high alcoholic beverage availability, the number of outlets to be policed is large and quotas have failed to protect businesses from financial distress.

Goals - Although the statutes do not specifically state the intent of creating quotas, authoritative sources indicate that such restrictions were originally placed on licenses to 1) promote temperance, 2) protect the liquor industry, and 3) aid law enforcement. An Arizona court case cites temperance as a reason for restricting licenses. A 1938 Tax Commission* report requested limits on license issuances to protect the liquor industry and to aid law enforcement. According to a 1973 report by the Joint Committee of the States to Study Alcoholic Beverage Laws, states limit licenses to aid enforcement by ensuring licensees a certain financial security. The report states in part:

". . . Most states attempt to keep the number of licensed outlets within such limits that operating licensees are not in perennial financial distress because of extensive competition, since this could lead to the social evils that the liquor laws seek to eliminate."**

* DLLC's predecessor, the Temperance Enforcement Commission, was part of the Tax Commission.

** Joint Committee of the States to Study Alcoholic Beverage Laws, Alcoholic Beverage Control, 1973, page 21.

Exclusions and Exceptions - Due to exclusions and historical exceptions to the quota, the total number of retail outlets is not limited. Numerous license types are not restricted and issuances exceed quota limits as a result of various legislative actions.

Not all licenses are subject to population restrictions. As shown in Table 6, quotas are placed on only three of eight retail license types. Hotel/motel licenses were kept under quota from 1939 until 1950, at which time the restriction was removed. Restaurants were restricted as an on-sale establishment until the early 1960s when they were made a separate unrestricted license type. Unrestricted licenses now account for about 40 percent of all retail licenses and may serve to circumvent quota restrictions. For example, A.R.S. §4-205.2(G) requires restaurants to derive at least 40 percent of their gross revenues from food sales. In 1982 DLLC audited 45 selected restaurants and found 38 percent failed to meet the food sales requirement.*

Historically, statutory exceptions to the quota have also contributed to the system's ineffectiveness in reducing the number of outlets. When quotas were established for hotels and on-premise all-beverage licenses in 1939, existing licenses were grandfathered and allowed to continue operation. In 1941, grandfathering also occurred when off-premise all-beverage (type 9) licenses were placed under quota. The grandfathered licenses were counted in determining licenses available for issuance.

The 1961 lease-replacement bill which prohibited leasing liquor licenses to third parties further compounded the problem. Both lessors and original licensees were allowed to keep their licenses. Until 1980, these lease replacements were excluded from the counts for determining license availability.

* Prior to July 1982 §4-205.2(G) required restaurants to derive at least 25 percent of their gross revenues from food sales, rather than the current 40 percent requirement.

Table 6

A COMPARISON OF RESTRICTED
AND UNRESTRICTED RETAIL LICENSES
AS OF MAY 1983

<u>Restricted Licenses</u>				<u>Unrestricted Licenses</u>			
<u>License Type</u>	<u>Consumption On/Off Premises</u>	<u>Types of Liquor Sold</u>	<u>Number of Licenses</u>	<u>License Type</u>	<u>Consumption On/Off Premises</u>	<u>Types of Liquor Sold</u>	<u>Number of Licenses</u>
Type 6	On/Off	All	1531	Type 16 (Restaurant)	On	All	868
Type 7	On/Off	Beer & wine only	1349	Type 15 (Hotel/Motel)	On	All	104
Type 9	Off	All	1400	Type 8	On/Off	Beer only	496
				Type 10	Off	Beer & wine only	1253
				Type 11	Off	Beer only	210

Handwritten note:
 1531 + 1349 + 1400 = 4280
 868 + 104 + 496 + 1253 + 210 = 2931

Due to these exclusions and exceptions to quota restrictions, many counties exceeded quota limits when quotas were established and continue to exceed limits for restricted license types. As of May 1983, type 6 licenses exceeded quota limits in 11 of 15 counties, while type 9 were overissued in 5 of 15 counties, as shown in Table 7.

TABLE 7
RESTRICTED LICENSE ISSUANCES AS OF MAY 1983

<u>County</u>	<u>Number of Licenses Permitted*</u>	<u>Type 6 Issuances</u>	<u>Percent Over Amount Permitted</u>	<u>Type 9 Issuances</u>	<u>Percent Over Amount Permitted</u>
Apache	39	34		32	
Cochise	56	83	48%	56	
Coconino	53	55	4	55	4%
Gila	31	55	77	34	10
Graham	23	26	13	23	
Greenlee	13	15	15	14	7
LaPaz**	13	18	38	17	31
Maricopa	662	655		660	
Mohave	40	41	3	40	
Navajo	47	47		47	
Pima	248	259	4	248	
Pinal	59	88	49	64	8
Santa Cruz	22	23	5	20	
Yavapai	48	81	69	48	
Yuma	52	51		42	

* Counties are permitted the same number of licenses for both Type 6 and Type 9 licenses.

** LaPaz County was a portion of Yuma County until January 1983. LaPaz license issuances exceed the number permitted as a result of dividing the county.

Availability - Arizona ranks high in alcoholic beverage availability. A study reported in the Journal of Studies on Alcohol compared all 50 states and the District of Columbia using 8 availability factors, including limitations on on-premise and off-premise sales. The study results showed that Arizona ranks fourth in the U.S. for alcohol availability. Arizona has about 1 retail outlet for every 400 persons.

Financial Security Not Assured - Quotas have not effectively protected liquor businesses from financial distress. As discussed earlier, the number of retail outlets has not been severely restricted. Further, the industry is highly competitive, as evidenced by a high turnover in retail outlets. According to the DLLC superintendent, about 30 percent of the outlets turn over annually. In addition, an official in a private lending institution stated that liquor establishments are high-risk businesses.

No Negative Impact from
Removing Quotas

Eliminating quota restrictions should not increase consumption or adversely impact enforcement. According to recent research, consumption does not appear to be a function of availability; therefore, an increase in the number of outlets will not increase consumption. In addition, the number of outlets is also not likely to increase in the long run because demand is a relatively constant factor and the market is already highly competitive. Therefore, the impact on law enforcement should be minimal.

Availability and Consumption - Eliminating quota restrictions should not increase demand since alcohol consumption does not appear to be a function of availability. According to several studies, the major determinants of alcohol use are product price, personal income, degree of urbanism, religious and socio-cultural background, youthfulness and interstate travel. These studies also indicate that control policies, in general, have little or no effect on consumption.

Arizona should not have a large increase in the number of outlets if quota restrictions were removed. According to a 1982 study* the average number of per capita licenses in states with or without these restrictions does not differ significantly. Of 31 license states surveyed by our Office, 14 states stated that they had no limit on the number of retail license issuances.

* Smith, Janet Kithom, "An Analysis of State Regulations Governing Liquor Store Licenses," Journal of Law and Economics, Vol. XXV, October 1982.

Impact on Enforcement - As the number of retail outlets is not expected to increase significantly, eliminating quotas should not hinder law enforcement. To maintain a large, permanent increase in outlets, consumption must rise to a level which would support more outlets. However, as explained earlier, research suggests that consumption may not be a function of availability. Further, the current retail outlet turnover rate of 30 percent suggests the market may already be saturated. A short-run outlet increase is possible, as reflected in the number of lottery applicants each year.* However, this possible increase will be short-lived, as alcohol demand will set a natural market equilibrium. In addition, any short-run rise in outlets will bring in additional revenues from license fees that could be used to support any necessary additional enforcement.

Licensing Should Be Based on
Public Need and Convenience

Licenses should be issued based on public need and convenience rather than on a quota system which acts as an artificial barrier to entry that protects the industry. Although quotas have not provided complete financial protection for existing licensees, they protect the industry to some extent against new entrants who may shift business away from existing licensees. Although restrictions create an artificial paper value which further restricts entry, the State can remove these limits. Further, the quota system does not always allow new outlets where public need is shown.

* Numerous persons apply for the lottery each year. However, we were unable to determine the number of applicants, as individuals may submit more than one application. Additional information on the lottery is contained in Finding V.

Industry Favors Quotas - Quotas are supported by the liquor industry for several reasons including limiting competition. During the liquor reform movement in the 1960s, the industry lobbied against repeal of the quota law. According to a newspaper article published at the time:

"Their chief argument seems to be that without quotas, irresponsible persons will open bars by the dozens and ruin the economic status of present bar owners."*

In 1983, both the Arizona Licensed Beverage Association and the Wholesale Beer and Liquor Association continue to oppose the repeal of the quota. The Wholesale Beer and Liquor Association favors quotas and believes removal of quota restrictions on type 6 and 9 liquor licenses would 1) spread the retail market too thin and cause more businesses to fail, 2) possibly cause wholesalers to receive more bad checks from retailers, and 3) cause delivery costs to increase due to a possible increase in the number of retail liquor outlets.

The Arizona Licensed Beverage Association feels quotas are necessary because 1) the value of the license ensures that licensees run their businesses in a proper manner, 2) the value of one license deters nonpayment of taxes, and 3) quotas provide licensees an opportunity to make a living by ensuring that there is not "a liquor store on every corner."

Liquor

* Cooper, Jim, "Everyone Tried to Get Into Liquor License Act," Tucson Daily Citizen, April 18, 1961.

Paper Value - Quotas present additional barriers to entry by creating artificial paper values on licenses. Although this paper value creates a property right between the licensee and third parties, the State can remove these limits since a liquor license is a privilege granted by the State. Bonding could be implemented for all licenses to prevent tax losses to the State.

Quota restrictions create an artificial paper value on type 6 and 9 licenses which is much higher than the DLLC license issuance fee. License fees for types 6 and 9 licenses are \$1,500 and \$1,000, respectively. Currently, types 6 and 9 licenses have a market value as high as \$25,000 to \$35,000. This artificial value is caused by quota restrictions since prospective licensees must generally buy licenses from existing owners.

Although elimination of quotas would diminish the artificial value of licenses, the State can take such action. A liquor license is a privilege to engage in business subject to regulation of the State. However, it is a property right between a licensee and a third party. According to a July 1, 1983, Legislative Council memorandum,* the State has the authority to eliminate quotas and such elimination would not deprive a licensee of property without just compensation. The memorandum states in part:

State
1,000 - 1,500

Paper Value
25,000 - 35,000

* Appendix I contains the memorandum text.

". . . it appears that eliminating quotas in the issuance of liquor licensees by repealing A.R.S. §4-206 would fall within the broad power of the state to regulate the sale of intoxicating liquors and would not constitutionally deprive a liquor licensee of property without just compensation. Such action by the legislature would not be an actual taking of property itself since the licensee would still retain the actual use of the license but would only decrease the value of the license, a value that has been artificially increased by previous legislative action."

If quotas are eliminated, all licensees could be bonded to protect the State against losses from tax delinquencies. Due to the artificial paper values of type 6 and 9 licenses, licensees are careful about payment of taxes to avoid license revocation. If licenses are revoked due to delinquent taxes, the Department of Revenue (DOR) can auction the licenses. Unrestricted licenses have an increased likelihood of tax delinquency because licensees lack the incentive of the artificial paper value. However, restaurant and hotel/motel licenses once had a high incidence of sales tax loss. Legislation was recently enacted requiring restaurant hotel/motel licensees to be bonded to ensure tax payment. A similar requirement could be implemented for all retail license types.

Public Need and Convenience - Although A.R.S. §4-203 currently provides for consideration of need and convenience, the quota system can prevent the establishment of new outlets in areas showing public need. By eliminating quota restrictions, all licenses could be issued based on need and convenience, thus better ensuring that the public interest is served.

A.R.S. §4-203, Subsection A requires that applicants prove that licensure is in the best interests of the community:

"The board shall issue a spirituous liquor license only after satisfactory showing of the capability, qualifications and reliability of the applicant and, with the exception of club licensees, that the public convenience requires and that the best interest of the community will be substantially served by the issuance."

The quota system can prevent the establishment of outlets in areas showing public need. Maricopa County illustrates this point. Maricopa County is experiencing population growth in many communities. As new licenses are only available through annual quota drawings, individuals cannot obtain restricted licenses except through a transfer. Even when licenses are available, the lottery selection does not ensure that licenses are issued to the growing areas where there is need.

The public can control outlet number through the local and State protest and hearing process. Although market saturation cannot be quantified, the need and convenience clause and natural market forces are sufficient controls to better ensure the public interest is served.

CONCLUSION

Restrictions should be removed on the number of liquor licenses issued, because these restrictions are ineffective in promoting temperance and aiding liquor law enforcement. Removing these restrictions will not increase problems associated with alcohol consumption or enforcement. Licenses should be available on the basis of public need and convenience--removing artificial barriers to entry into the liquor industry.

RECOMMENDATIONS

The Legislature should consider:

1. Amending A.R.S. §4-206 to eliminate quota restrictions on type 6, 7 and 9 licenses. ✱

2. Amending the statutes to require bonding all licenses. ✓

FINDING III

THE STATE CAN REALIZE SIGNIFICANT ADDITIONAL REVENUE BY REVISING LICENSE TRANSFER STATUTES.

The State is not realizing sufficient revenues from transfer of licenses. Transfer fees are considerably less than original license fees without apparent justification. The processing work loads for transfers and original licenses are almost identical and transfers afford licensees the same privileges as original licenses. Depending upon the outcome of the recommendations in Finding II concerning quotas, transfers should be either 1) eliminated or 2) restricted to quota licenses and transfer fees increased to equal original license fees. Either change would have produced approximately \$724,000 additional revenues in 1982.

Arizona Revised Statutes (A.R.S.) §4-203, Subsection F provides for the transfer of all licenses except club, hotel/motel, restaurant, government and domestic farm winery licenses. When a business with a transferable license is sold, the new owner may apply for a transfer and receive an interim permit allowing the business to continue operating until the transfer is approved.* When a business with a nontransferable license is sold, the new owner must apply for an original license. As in the case of a transfer, the new owner may operate under an interim permit until the new license is approved.

Low Transfer Fees Are Not Justified

License transfer fees are considerably lower than original license fees without apparent justification. These differences are not based on variances in processing costs or in the privileges granted under each licensing scheme.

* Interim permits are not permitted if the license is being transferred to a new location which has not been previously approved.

Higher Fees - Original license fees can be as much as \$1,400 higher than transfer fees. Applicants for original licenses must pay an issuance fee, an annual fee and a \$100 application fee when they apply for licenses. Transfer applicants pay a transfer fee and the \$100 application fee but do not pay the annual fee. However, the issuance fee for an original license is as much as 10 times higher than the transfer fee. Total costs for original issuance and transfers are shown in Table 8.

TABLE 8

TOTAL COSTS FOR ORIGINAL ISSUANCES ADD TRANSFERS

License Type	Original License Fee				Person-to-Person Transfer Fee			Difference Between Total Original and Total Transfer Fees
	Issuance Fee	Annual Fee*	Application Fee	Total	Transfer Fee	Application Fee	Total	
1. Distiller's License (In-State)	\$1,500.00	\$350.00	\$100.00	\$1,950.00	\$500.00	\$100.00	\$600.00	\$1,350.00
2. Brewers License (In-State)	1,500.00	350.00	100.00	1,950.00	500.00	100.00	600.00	1,350.00
3. Vintners License (In-State)	1,500.00	150.00	100.00	1,750.00	300.00	100.00	400.00	1,350.00
4. Wholesaler, All Liquors	1,500.00	250.00	100.00	1,850.00	500.00	100.00	600.00	1,250.00
5. Wholesaler, Wine and Beer	1,500.00	100.00	100.00	1,700.00	200.00	100.00	300.00	1,400.00
6. On-Sale Retailer, All Liquors	1,500.00	150.00	100.00	1,750.00	300.00	100.00	400.00	1,350.00
7. On-Sale Retailer, Wine and Beer	300.00	75.00	100.00	475.00	150.00	100.00	250.00	225.00
8. On-Sale Retailer, Beer	200.00	25.00	100.00	325.00	50.00	100.00	150.00	175.00
9. Off-Sale Retailer, All Liquors	1,000.00	50.00	100.00	1,150.00	100.00	100.00	200.00	950.00
10. Off-Sale Retailer, Wine and Beer	300.00	50.00	100.00	450.00	100.00	100.00	200.00	250.00
11. Off-Sale Retailer, Beer	200.00	25.00	100.00	325.00	50.00	100.00	150.00	175.00
12. Railroad Train License	1,500.00	225.00	100.00	1,825.00	450.00	100.00	550.00	1,275.00
13. Airline License	1,500.00	225.00	100.00	1,825.00	450.00	100.00	550.00	1,275.00
14. Private Club License	1,000.00	150.00	100.00	1,250.00	**			
15. Hotel/Motel License	1,500.00	500.00	100.00	2,100.00	**			
16. Restaurant License	1,500.00	500.00	100.00	2,100.00	**			
17. Distillers License (Out-of-State)	200.00	50.00	100.00	350.00	100.00	100.00	200.00	150.00
18. Brewers License (Out-of-State)	200.00	50.00	100.00	350.00	100.00	100.00	200.00	150.00
19. Vintners License (Out-of-State)	200.00	50.00	100.00	350.00	100.00	100.00	200.00	150.00
20. Importers, Exporter or Rectifier	200.00	50.00	100.00	350.00	100.00	100.00	200.00	150.00
21. Government License	100.00	100.00	100.00	300.00	**			
22. Domestic Farm Winery	100.00	100.00	100.00	300.00	**			

* If application is issued on or after July 1, the annual fee is one-half the annual fee shown.

** No transfers are allowed for these licenses.

3/4 mill

Processing Cost Differences Are Negligible - The slight work load differences between original and transfer application processing do not create cost differentials which would account for the large disparity in license fees. License transfers require almost identical processing as original licenses. The major difference between transfers and originals is that original licenses require a location inspection and a formal hearing. If the license transfer involves a new location, the Department of Public Safety's liquor enforcement personnel inspect the site at no cost to the DLLC.* If the license transfer is being issued to a previously licensed establishment, no location check is required. Further, the cost of hearings is small compared to the difference in fees.** Application processing requirements are summarized in Table 9.

TABLE 9

TRANSFER VS NEW LICENSE PROCESSING

<u>Process</u>	<u>Required for Transfers?</u>	<u>Required for Originals?</u>
Application accepted	Yes	Yes
DPS background and fingerprint check	Yes	Yes
Location inspection	New location only	Yes
Posting of application for 20 days	Yes	Yes
City recommendation of approval or disapproval	Yes	Yes
File review by designated representative	Yes	Yes
Formal hearing	No(1)	Yes

(1) A hearing may be held if the transfer is protested, city disapproved or has other disqualifying factors.

* The inspection determines if 1) a building exists or is under construction, 2) there is a kitchen for a restaurant or a Hotel/Motel license (series 15 and 16), 3) the structure is generally appropriate for business, and 4) the building is the proper distance from a church or school.

** Hearings for unprotested, locally approved applications are unnecessary. If hearings were eliminated (page 65), administrative costs for processing originals and transfers should be identical.

Privileges Are Identical - Since holders of licenses issued as transfers or originals enjoy the same privilege of selling liquor, low transfer fees are not justified and are inequitable. For example, the new owner of an existing beer-only bar can obtain a license for \$150 by transferring the license held by the previous owner. However, the new owner of a beer-only bar at a new location must pay \$325 for an original license.*

Transfers Can Be Eliminated
or Restricted to Quota Licenses

The extent to which transfers can be eliminated depends upon whether the quota system is eliminated.** If the current quota system is continued, transfers will be necessary for restricted license types; however, the transfer fee should be increased. Unrestricted license transfers can be eliminated. If the quota system is removed, no transfers are needed.

Restricted Licenses Require Transfers - If quotas continue, restricted licenses should be allowed to transfer to aid the sale of a business. Current demand for type 6 and 9 licenses creates a shortage of these license types because licenses must be obtained from an existing licensee or through the lottery selection process. Transferring these licenses ensures the purchaser of a previously licensed establishment that he will be able to operate the business during the time he is awaiting Board approval of his license. However, the transfer fee should equal the original license issuance and annual fees to promote equitability and raise State revenue.

* The transfer applicant pays the \$50 transfer fee and a \$100 application fee. The original license applicant pays a \$200 license fee, a \$25 annual fee and a \$100 application fee, totaling \$325 for a new license.

** Under the current quota system, DLLC may issue only a limited number of licenses in these categories: on-sale retailer, all liquor (series 6), on-sale retailer, beer and wine (series 7) and off-sale retailer, all liquor (series 9). There are no restrictions on other license types. Eliminating the quota system is recommended in Finding II (see page 29).

Unrestricted License Transfers Can Be Eliminated - There is no valid reason to allow unrestricted licenses to transfer. According to a DLLC official, licenses are transferrable to allow new owners to operate the business as an on-going concern. Applicants for transfers may be issued an interim permit allowing them to operate until the license transfer is approved. However, restaurants and hotel/motels, which must obtain original licenses, are also allowed to operate on interim permits as on-going concerns. Eliminating transfer of unrestricted licenses would increase State revenues as the licenses would be issued as an original license at a higher fee.

Transfers Are Not Needed if Quotas Are Eliminated - If the quota system is eliminated, all license types would be unrestricted. Under these circumstances, the transfer option would not be needed to ensure the sale of an on-going concern.

Changes Would Generate
Additional Revenue

The State could realize significant additional revenues if license transfers were eliminated or transfer fees were increased. By eliminating transfers, all licenses would be considered original licenses and applicants would pay the higher original license fee. If some licenses remain transferrable (types 6, 7 and 9), then the fees on the license transfer should be increased to that of the original license issuance and annual fees. Either change would have generated approximately \$724,000 additional revenues in 1982. This potential additional revenue (based on 1982 transfer data) is summarized in Table 10.

TABLE 10

POTENTIAL ADDITIONAL ANNUAL REVENUES FORGONE IN
1982 DUE TO LOW LICENSE TRANSFER FEES

<u>License Types</u>	<u>Potential Additional Revenue per Transfer</u>	<u>Number of Transfers</u>	<u>Total Potential Revenue</u>
Restricted licenses			
6-On-sale retailer, all liquors	\$1,312.50	374	\$490,875.00
7-On-sale retailer, wine & beer	206.25	215	44,343.75
9-Off-sale retailer, all liquors	937.50	147	137,812.50
Subtotal, restricted licenses			<u>673,031.25</u>
Unrestricted licenses*			
4-Wholesaler, all liquors	1,187.50	9	10,687.50
8-On-sale retailer, beer	168.75	48	8,100.00
10-Off-sale retailer, wine & beer	237.50	116	27,550.00
11-Off-sale retailer, beer	168.75	24	4,050.00
20-Importer, exporter or rectifier	137.50	2	275.00
Subtotal, unrestricted licenses			<u>50,662.50</u>
Total potential additional revenue			<u>\$723,693.75</u>

* During 1982, there were no transfers of other unrestricted license types.

CONCLUSION

The State could realize significant additional revenues if license transfers were eliminated or transfer fees were increased. These transfers require almost identical work loads as original licenses and endow licensees with the same privileges, yet transfer licenses have much lower fees. Transfers can either be eliminated or restricted to quota licenses. By making transfer and original license fees more equitable, the State could have realized an additional \$724,000 in 1982.

RECOMMENDATIONS

1. If quotas are eliminated, the Legislature should consider amending A.R.S. §4-203, Subsection F to eliminate all transfers.

2. If the quota system is maintained, the Legislature should consider amending a) A.R.S. §4-203, Subsection F to eliminate the transfer of all unrestricted licenses and b) A.R.S. §4-209, Subsection F to increase transfer fees for restricted licenses (types 6, 7 and 9) to equal the original issuance and annual license fees.

FINDING IV

LUXURY TAX RATES SHOULD BE INCREASED.

Increased liquor luxury tax rates could produce significant additional revenues. Arizona's tax rates are lower than other states' rates and have not increased in at least nine years. If Arizona's tax rates were comparable to other states, the State could generate additional revenues of at least \$5.2 million annually.

Arizona's Tax Rates Are
Lower than Other States' Rates

Arizona Revised Statutes (A.R.S.) §42-1204, subsection A prescribes the following liquor luxury taxes:

- \$2.50 per gallon for distilled spirits,
- 8 cents per gallon for beer,
- 42 cents per gallon for wine containing 24 percent alcohol or less, and
- \$2 per gallon for wine containing more than 24 percent alcohol.

These rates are lower than both the national average and the average rate assessed by other western license states.* For example, Arizona's beer tax is 38 percent lower than the 13-cents-per-gallon average of the other western license states. Only the tax on table wine** is comparable to the other western license states; however, that rate is 21 percent lower than the national average. A comparison of Arizona's rates to the national average and other western states' averages is shown in Table 11.

* Western license states include all license states west of the Mississippi River. In license states, alcohol beverages are sold by private retailers licensed by the state.

** Wine containing less than 14 percent alcohol.

TABLE 11

COMPARISON OF ARIZONA'S LUXURY TAX RATES TO THE NATIONAL AVERAGE
AND OTHER WESTERN LICENSE STATES' AVERAGE LUXURY TAX RATES

	Arizona's Tax Rate*	National Average*	Arizona's Rate Is:	Other Western** License States' Averages*	Arizona's Rate Is:
Distilled spirits	\$2.50	\$2.78	- 10%	\$2.65	- 6%
Beer	.08	.22	- 64%	.13	- 38%
Wine***					
Less than 14% alcohol	.42	.53	- 21%	.41	+ 2%
14-21% alcohol	.42	.68	- 38%	.65	- 35%
Champagne, sparkling wine	.42	.78	- 46%	.75	- 44%

* Per gallon

** Arkansas, California, Colorado, Kansas, Minnesota, Missouri, Nebraska, Nevada, New Mexico, North Dakota, Oklahoma, South Dakota and Texas.

*** 23 states differentiate tax rates for types of wine. For example, 8 states assess one rate for table wine, a higher rate for vermouth and dessert wine (14-21% alcohol) and the highest rate for champagne and sparkling wine. Other states' tax rates for wine with alcohol content over 24% are not available.

Source: Public Revenues From Alcohol Beverages, 1980/1981, Distilled Spirits Council of the United States

Tax Rate Has Not Changed
in Recent Years

Because Arizona taxes liquor at a flat rate and rates have not increased in recent years, revenues have not kept pace with price changes. Prices have increased significantly and inflation has reduced the value of liquor tax dollars.

The distilled spirits tax has not changed in nine years although liquor prices have increased at least 20 percent during the past four years alone. Due to inflation, the \$2.50 distilled spirits tax assessed in 1974 is worth only \$1.24 in today's dollars. The last increase in 1974 was only the fourth such change since Prohibition was repealed 50 years ago.

Beer and wine tax rates have remained unchanged for even longer. The taxes on beer and wine with less than 24 percent alcohol have not increased in 21 years. The tax rate for wine containing more than 24 percent alcohol was last increased 16 years ago in 1967. Several recent efforts to increase luxury taxes have been unsuccessful. Four bills introduced in 1980, 1981 and 1983 failed.

Increased Tax Rates Would
Produce Additional Revenue

The State could realize significant additional revenues from increased tax rates. Such increases are unlikely to reduce consumption.

Additional Revenues - Increasing Arizona's luxury tax rates to a level comparable to other western states would generate at least \$5.2 million in additional revenues annually. Such a change would increase the tax on distilled spirits 15 cents per gallon and the tax on beer 5 cents per gallon. Wine taxes, already comparable to other western states, would not change.* Other alternatives, including increasing taxes to the national average, are presented in Table 12.

* The tax on table wine, which constitutes the largest segment of wine sales, is comparable to other western states. Differences in the tax on dessert wine and champagne and sparkling wine are not considered because these items represent only a small amount of total sales.

TABLE 12

POTENTIAL ADDITIONAL REVENUES RESULTING FROM THREE ALTERNATIVE LUXURY TAX INCREASES

	Alternative I			Alternative II			Alternative III		
	Less than Other Western States	Comparable to Other Western States	Comparable to National Average	Less than Other Western States	Comparable to Other Western States	Comparable to National Average	Less than Other Western States	Comparable to Other Western States	Comparable to National Average
Current Rate (Per Gallon)	Proposed Rate	Additional Cost Per Unit*	Additional Revenues**	Proposed Rate	Additional Cost Per Unit*	Additional Revenues**	Proposed Rate	Additional Cost Per Unit*	Additional Revenues**
Distilled spirits	\$2.50	\$2.60	\$ 421,578	\$2.65	\$.03	\$ 703,580	\$2.78	\$.06	\$ 1,436,783
Beer	.08	.10	1,798,060	.13	.03	4,495,150	.22	.08	12,586,420
Wine	.42	.42	-0-	.42	-0-	-0-	.53	.02	734,366
			<u>\$2,219,638</u>			<u>\$5,198,730</u>			<u>\$14,757,569</u>

* Per fifth for distilled spirits, per six-pack for beer and per 750 ml. bottle for wine

** Based on 1982 consumption. Calculation for distilled spirits assumes a 1 percent consumption decline in all alternatives and calculation for wine assumes a 1 percent consumption decline in Alternative III.

No Adverse Impact on Demand - An increase in luxury tax should not affect demand for alcoholic beverages. Luxury tax increase opponents have argued that raising taxes will reduce revenues by reducing consumption. Our review indicates that consumption and revenues are unlikely to be affected in this manner. First, demand for some alcoholic beverages is not responsive to price changes. Second, for other beverages which are somewhat sensitive to price changes, tax increases should not raise price enough to discourage consumption to the point of decreasing revenues. Last, experiences in other states indicate that an increased tax rate can support consumption similar to or greater than Arizona's.

The demand for beer, which provides almost half of Arizona's liquor luxury tax revenue, is unlikely to decline due to price increases. According to recent research, the primary determinant of demand is youthfulness, not price.* Demand is price-inelastic, or relatively unresponsive to price changes. When demand is price-inelastic, a price increase produces a less-than-proportionate demand decline and total revenues increase.

Although price increases for distilled spirits will generate equivalent demand declines because demand has unitary price elasticity,** higher taxes should increase total revenues. A given percent tax increase will not produce a similar percent price increase or consumption decline. The price increase will be much smaller. Price increases resulting from a 10 percent tax increase are illustrated in Table 13.

* Stanley I. Ornstein and Dominique M. Hanssens, "Alcohol Control Laws, Consumer Welfare and the Demand for Distilled Spirits and Beer," U.C.L.A. Working Paper Series, Center for Marketing Studies, Paper No. 102, March 1981. The study was supported by a grant from the California Department of Alcohol and Drug Abuse with additional support from the Research Program in Competition and Business Policy, Graduate School of Management, U.C.L.A.

** Ibid.

TABLE 13

PRICE INCREASES RESULTING FROM A 10 PERCENT
TAX INCREASE FOR DISTILLED SPIRITS

	<u>Brand A</u>	<u>Brand B</u>	<u>Brand C</u>	<u>Brand D</u>	<u>Brand E</u>
Cost Per Gallon*	\$17.98	\$18.96	\$20.78	\$21.54	\$27.93
Tax per gallon	<u>2.50</u>	<u>2.50</u>	<u>2.50</u>	<u>2.50</u>	<u>2.50</u>
Cost at current tax rate	<u>20.48</u>	<u>21.46</u>	<u>23.28</u>	<u>24.04</u>	<u>30.43</u>
Additional tax at a 10 percent increase to \$2.75 gallon	<u>.25</u>	<u>.25</u>	<u>.25</u>	<u>.25</u>	<u>.25</u>
Cost with 10 percent tax increase	<u>\$20.73</u>	<u>\$21.71</u>	<u>\$23.53</u>	<u>\$24.29</u>	<u>\$30.68</u>
Cost increase as a percentage of cost under current rate	1.2%	1.2%	1.1%	1.0%	.8%

* Actual manufacturers' prices to wholesalers as of June 1, 1983.

A 10 percent tax increase to \$2.75 per gallon, accompanied by a 1 percent consumption decline, would generate almost \$1.3 million in additional revenue annually, as shown in Table 14.

TABLE 14

ADDITIONAL REVENUE RESULTING FROM A 10 PERCENT TAX
INCREASE AND A 1 PERCENT CONSUMPTION DECLINE

1982 consumption with 1 percent decline (gallons)	5,640,030	
x Tax at 10 percent increase (per gallon)	<u>\$ 2.75</u>	
Projected total distilled spirits tax revenues		<u>\$15,510,083</u>
1982 consumption (gallons)	5,697,000	
x Current tax rate (per gallon)	<u>\$ 2.50</u>	
1982 distilled spirits tax revenue		<u>\$14,242,500</u>
Additional distilled spirits tax		<u>\$ 1,267,583</u>

The specific factors affecting the demand for wine are unknown. However, even if wine were assumed to have unitary price elasticity (as with distilled spirits) an increase in luxury taxes to the national average would result in less than a 1 percent increase in price.

Other states' experiences indicate that similar or greater consumption can be maintained with higher tax rates. Ten of the fourteen other states assessing higher taxes on distilled spirits have per capita consumption rates at least as great as Arizona's. For example, Florida charges \$4.75 per gallon, compared to Arizona's \$2.50 per gallon rate, and ranks 5th in consumption compared to Arizona's 27th ranking. Thirty-four other states assess higher taxes on beer; five of these have similar or greater consumption. Of the 23 states charging higher taxes on wine, 6 support consumption similar to or greater than Arizona.

CONCLUSION

Increasing liquor luxury taxes to a level comparable to other western license states would generate at least \$5.2 million annually in additional revenues.

RECOMMENDATION

The Legislature should consider amending A.R.S. §42-1204, subsection A to provide for increased liquor luxury tax rates.

FINDING V

LOTTERY STATUTES DO NOT ALLOW APPLICANTS AN EQUAL OPPORTUNITY OF OBTAINING A LICENSE.

Although the Department's lottery drawing procedures appear adequately controlled, statutes do not effectively limit the number of applications a person can submit. Our review of written procedures and interviews with Department staff indicate that, in the absence of collusion, controls are sufficient to prevent abuse. However, lottery applicants are able to circumvent the statutory goal of giving all applicants an equal opportunity of obtaining a license. By submitting additional applications under business names and names of family members, applicants are able to increase their chances of selection. At least two other states have more effective controls over the number of applications submitted per person.

State law and Department regulations provide for random selection when the number of applicants exceeds available licenses.* Separate lottery drawings are held by county and license type. In 1982, six drawings were held--two for type 6 licenses and four for type 9. A.R.S. §4-203 requires DLLC to use a random selection procedure which provides all applicants an equal opportunity to obtain a license. Subsection B states:

". . . the board shall, if there are more applicants than the number of available spirituous liquor licenses, provide a method of random selection within a county to determine which applicant or applicants shall be considered for issuance of a license. The random selection method shall allow each applicant within the county an equal opportunity of obtaining the available license or licenses."

* A.R.S. §4-206, Subsections A, B and C limits the number of on-sale all liquor (type 6), on-sale beer and wine (type 7) and off-sale all liquor (type 9) licenses which DLLC may issue in each county. None of the counties have reached the maximum allowable number of type 7 licenses. Finding II contains additional information concerning the quota system (see page 29).

Administrative Rule R4-15-109 establishes a lottery drawing which matches randomly selected names and numbers. These numbers correspond to the number of available licenses plus an equal number of alternates and indicate the order in which DLLC will consider applications. Selection grants only the right to be considered for licensure. Successful lottery applicants are subject to background checks and the local hearing process and thus may be denied licenses.

Lottery Drawings Appear
Adequately Controlled

The Department appears to have adequate controls over the lottery drawings. DLLC uses standard entry forms placed in a transparent container. The names are read aloud before entries are put in the container and applicants may inspect their forms and drop them in the container themselves. Two clerical employees from a temporary employment agency simultaneously draw a name and a number. The selected name and number are then read aloud and verified and recorded by Department employees. The drawing is open to the public and media and is tape-recorded by the Department.

Although drawing procedures appear adequately controlled, questions have been raised as to why certain applicants are selected* in successive lotteries or twice in the same lottery. At least 12 such events have occurred during the past 3 years. For example, the wife of a man selected in 1980, 1981 and 1982 was also selected twice in 1981. One grocery store chain was selected for two licenses in 1980, two licenses in 1981 and three licenses in 1982.

* "Selected" applicants refers to both winners and alternates. Alternates are selected to be considered for licensure if a winner either chooses not be considered or is disqualified.

Applicants Do Not Have
an Equal Opportunity

Applicants are able to circumvent the statutory goal of giving all applicants an equal opportunity of obtaining a license. Statutes do not prevent a person from applying under business names and names of family members. In reality, those applicants who 1) are aware of this "loophole" and 2) can afford to pay for additional applications (\$100 each) can greatly increase their chances of winning.

Statutes Allow Additional Applications - Some lottery applicants have increased their odds of selection by submitting additional applications under business or family names. A.R.S. §4-203, Subsection C permits a person to make as many applications as there are licenses available, to a maximum of five:*

"C. If there are more applicants than the number of available spirituous liquor licenses within a county, the following limitations shall apply:

1. No person shall make more applications than the number of spirituous liquor licenses available.
2. If there are more than five spirituous liquor licenses to be issued, notwithstanding the provisions of paragraph 1 of this subsection, no person shall make more than five applications." (emphasis added)

A person may submit more than five applications, however, by submitting additional applications under business names. This is legal because of the way "person" is defined in A.R.S. §4-101, paragraph 16:

"'Person' includes partnership, association, company or corporation, as well as a natural person."

* An applicant must pay a \$100 fee for each application.

There is also no restriction against submitting additional applications under the name of a spouse, son or daughter. Thus, in addition to submitting five applications as an individual, a person can submit another five applications for each business name he wishes to use, five applications under his spouse's name, etc. We identified 2 persons who used this approach to submit 15 applications in 1980 and 1982. According to a Department employee, as many as 25 applications have been submitted by an individual for a single lottery.

Additional Applications Increase Chances - Additional applications can greatly increase a person's chances of selection. A statistician from Arizona State University analyzed the probabilities of selection for several applicants in the 1980, 1981 or 1982 lotteries. According to his analysis, although several of these applicants won in successive years, these wins were not unusual based on the probabilities associated with the multiple applications.* The effect of additional applications on the probabilities of winning is shown in the following example. The 1980 Maricopa County drawing for type 6 licenses had 860 applications with 27 winners and 8 alternates:

1. An applicant with one application had a 4 percent chance of selection.
2. An applicant with five applications had a 19 percent chance of selection.
3. An applicant with 15 applications had a 46 percent chance of selection.**

Other States Have More Effective Control

At least two other states have more effective controls over the number of applications per person. We contacted several other states to learn how they distribute restricted licenses. Some states do not use a lottery system at all but instead allow the counties or cities to decide how the

* See Appendix II for the statistician's full report.

** At least one applicant submitted 15 applications for this drawing and was subsequently drawn.

licenses will be distributed. California and Florida hold drawings by county but have tighter restrictions than Arizona on the number of applications per person. In California, the number of restricted licenses issued is based on a county's population. An individual may submit only one application per lottery; he may not also apply under a business name, nor can his spouse apply. In Florida, an individual can have interest in only one application per lottery. Thus, if a person submits an application under his own name, he cannot also have an interest in any other application. Florida uses computer analysis to detect applicants with multiple interests.

CONCLUSION

The Department's lottery drawing procedures appear adequately controlled, however, statutes do not effectively limit the number of applications a person can submit. Lottery applicants are able to circumvent the statutory goal of giving all applicants an equal opportunity of obtaining a license.

RECOMMENDATION

The Legislature should consider amending statutes to more effectively restrict the number of lottery applications an individual may submit.

FINDING VI

THE DEPARTMENT'S LICENSING PROCESS CAN BE IMPROVED BY ELIMINATING MOST ORIGINAL LICENSE HEARINGS.

Most original license hearings held by the Liquor Board and the hearing officer are unnecessary and can be eliminated. These statutorily required hearings inconvenience license applicants and are an inefficient use of staff time.

License Procedures

Arizona Revised Statutes (A.R.S.) §4-201, subsection E requires the Liquor Board to hear and approve all original license applications. The Board issues numerous types of original licenses. Including:

1. Nontransferable original licenses are issued to clubs, hotel/motels, restaurants and governmental bodies.
2. Original licenses may also be issued for restricted license types* which have not yet reached the statutory limits or if new licenses are available due to population growth. These licenses may be transferred to new licensees.
3. Unrestricted, transferable licenses are issued to producers, wholesalers, off- and on-sale beer-only outlets, off-sale beer and wine outlets, railroads and airlines. These may be either original licenses or transfers. Additional information on original and transfer licenses is contained in Finding III (see page 43).

* The number of on-sale all liquor, on-sale beer and wine and off-sale all liquor licenses which DLLC may issue is statutorily restricted, based on county population. Additional information concerning the quota system is contained in Finding II (see page 29).

The application processing procedure follows several steps. Applicants for a liquor license supply DLLC with a completed application and questionnaire and a set of fingerprints. Once submitted, DLLC has 105 days to approve or disapprove the application. Next, DLLC forwards a copy of the application to the city in which the applicant seeks licensure. The city clerk posts the application on the proposed premises for 20 days at which time written arguments in favor of or opposed to license issuance may be filed with the clerk. After the 20-day posting, the governing body of the city or town recommends approval or disapproval of the application and forwards the recommendations to DLLC. In the meantime, DPS processes fingerprints to determine if the applicant has prior convictions and inspects the proposed location. Once all qualifying information is obtained, the application is set for hearing for either the Board or the hearing officer* who acts as the Board's designated representative.

Currently, the Board delegates most original license hearings (nonprotested, city-approved applications) to the hearing officer. Applications which may be denied due to city disapproval, citizen protests** or other problems generally are heard by the Board.

The hearing officer conducts formal hearings with the applicant usually present. The hearing officer 1) reviews the applicant's file for completeness, 2) briefly questions the applicant, and 3) recommends either approval or disapproval. After the hearing the Board is informed of the recommendation and approves or disapproves the application.

* The hearing officer for original license hearings is the Assistant Superintendent of the Liquor Department.

** Applications are subject to local hearings prior to Board approval. Citizens may protest the application at the local hearing. Local governments are required to approve or disapprove the application. While citizen protests and local government disapprovals are not binding on the Board, the Board must consider them in its decision.

Hearings Are Unnecessary

Original license hearings for nonprotested, city-approved applications are unnecessary. First, licenses issued for transfers are not subject to either Board or hearing officer hearings. Second, local hearings provide for sufficient public input on these applications. Third, hearing officer hearings do not ensure that licenses will comply with statutory requirements. Further, numerous other states do not require hearings.

Hearings Not Required for Transfer Applications - Most licenses issued through transfers are approved by the hearing officer without a hearing. Hearings are held only when a local governing body disapproves an application, the transfer is protested or other problems exist. These transfers are essentially identical to original licenses in that they grant the same privileges as original licenses. In addition, both transfer and original licenses are issued to new and previously licensed premises, as transfers can be issued for location changes.

Local Government Hearings Provide for Sufficient Public Input - The public has an opportunity to protest license issuances at local government hearings. These hearings appear adequate for uncontested applications. According to the Superintendent, few applications are protested at a DLLC hearing which were unprotested at the local level. Further, the Department's Assistant Attorney General suggests greater opportunity could be given for public input at local government hearings by lengthening the posting period prior to the hearings.

Hearings Do Not Ensure Restaurant License Compliance - Although the hearing officer feels that hearings are needed to determine if restaurant applicants intend to operate as bona fide* restaurants, hearings are not an effective or efficient means of determining or ensuring compliance. The hearing does not provide new information. The hearing officer's questions simply reiterate the questions on the application. Further all necessary information is contained on the license application reviewed by

* A bona fide restaurant must derive at least 40 percent of its gross revenue from food sales.

the designated representative before the hearing. The sworn application provides information on gross sales representing purchase of meals and floor-space footage designed for dining and includes a copy of the menu. In addition, investigators could during routine license inspections, check the premises to ensure it is a bona fide restaurant.

Numerous restaurants are not acting as bona fide restaurants. In 1982, DLLC investigator performed restaurant audits to determine compliance with the required food to liquor ratio. About 38 percent were found to be noncompliant. The high violation rate indicates that prelicensure hearings are not an effective compliance tool.

Other States Do Not Require Hearings - Numerous other license states do not require hearings for unopposed applications. Fourteen of the thirty-one license states surveyed by our Office provide for automatic issuance of such licenses.

The DLLC superintendent agrees that prelicensure hearings for unopposed, locally approved applications are inefficient. However, the superintendent feels that a decision made by the Board, consisting of five individuals, is less likely to receive public criticism than a decision made by one individual.

Hearings Cause Inconvenience to Applicants

Original license hearings for nonopposed, city-approved applications cause inconvenience to applicants through unnecessary travel. The Department expects each applicant to attend a hearing. If the applicant or a representative is not present at the scheduled hearing either the hearing is rescheduled or the license is granted in his absence.

Hearings for problem-free applications are an imposition on some applicants. The individual hearings last only about three minutes and consist of a review of items already in the applicant's file. For applicants in outlying areas, travel to the hearing is both time consuming and costly.

For example, at one hearing attended by a member of the Auditor General staff, an individual drove from Flagstaff in extreme weather conditions to attend a short hearing for a problem-free file.

Inefficient Use of Staff

Original license hearings for problem-free applications are an inefficient use of staff resources. Original license hearings require time from the Board, its secretary, the hearing officer and his secretary. The combined time spent on unprotested, city-approved original license hearings constitutes approximately one third FTE annually. Further, as the number of licenses issued continues to grow, the number of original license hearings and staff time spent on the hearings will increase.

The hearing officer's secretary's time, which is most affected, could be used more effectively. The secretary spends approximately 30 percent of available time, notifying applicants of hearings, scheduling agendas, taping hearings and preparing Board orders. Eliminating mandatory original license hearings would allow the secretary to assist in preparing tax and administrative citations, processing and filing license applications and other duties. In addition, if transfers are eliminated as suggested in Finding III, then all licenses would be issued as "original" licenses.

CONCLUSION

Original license hearings should be held only in cases where the license application may be denied due to possible disqualifying factors, such as city/town disapproval or public protests. The majority of original license hearings are unnecessary. Although required by statute, these hearings inconvenience applicants and are an inefficient use of staff time.

RECOMMENDATION

The Legislature should consider amending A.R.S. §4-201, subsection E to eliminate mandatory hearings for original licenses, except when a local governing body recommends disapproval or when there are public protests or other problems.

OTHER PERTINENT INFORMATION

Enforcement of Statutes Prohibiting
Sale of Liquor to Minors

Legislative actions in recent years indicate a heightened interest in the enforcement of statutes prohibiting the sale of liquor to underaged persons. Because of this interest, we reviewed DLLC activities in this area. According to our analysis, 1) the number of enforcement actions has increased in recent years, and 2) the superintendent has more discretion when determining penalties than his counterparts in some other states.

Recent Legislative Actions - In 1982 the Legislature amended A.R.S. §4-112 to place additional emphasis on the enforcement of statutes prohibiting the sale of liquor to minors. This statute states, in part:

"B. Except as provided in subsection A of this section, the superintendent shall administer the provisions of this title, including:

. . .

6. Taking such steps as are necessary to maintain effective liaison with the department of public safety and all local law enforcement agencies in the enforcement of this title including the laws of this state against the consumption of spirituous liquor by persons under the age of nineteen years.

C. The superintendent shall establish within the department a separate investigations unit which has as its sole responsibility the investigation of compliance with this title including the investigation of licensees alleged to have sold or distributed spirituous liquor in any form to persons under nineteen years of age." (emphasis added)

DLLC Enforcement Activities - The number of DLLC enforcement actions in this area (i.e., sale to minors) has increased in recent years. Most violations of this type are investigated and reported to DLLC by DPS and

local law enforcement agencies. Public complaints are the source of many investigations. In 1982 DLLC received 88 complaints regarding underage drinking; 85 of these were referred to DPS for investigation.

Prior to 1981, DLLC's most common response to a reported violation involving a sale to a minor was to send a warning letter. For example, Table 15 shows that in 1980 DLLC issued 160 warning letters involving sales to minors but only 33 citations. According to DLLC staff, this practice changed sometime in 1981. Thereafter the superintendent's normal response was to issue an administrative citation unless the police report was too vague or incomplete for a solid disciplinary case. Table 15 indicates this change in practice. In 1982 DLLC issued 93 citations involving sales to minors but only 22 warning letters. As of September 12, 1983, DLLC had already issued 100 citations, exceeding the 1982 total. Nearly another 100 cases--all received in 1983--are being held by DLLC pending advice by its Assistant Attorney General.*

The total number of penalties imposed for sales to minors also appears to be increasing. Table 16 summarizes the penalties imposed for cases involving only sales to minors. Some DLLC citations involved one or more other violations in addition to sales to minors, but the outcome of these citations are not included in Table 16. Note that the number of penalties imposed in 1982 increased over 1981. Although many citations issued in 1983 were still pending as of August, it appears that the trend is still upward.

* These cases involve police officers prearranging for underaged persons to buy liquor.

TABLE 15

DLLC WARNINGS AND CITATIONS
INVOLVING SALES TO MINORS

	Calendar Year				1983 as of Sept. 12
	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	
Warnings Involving Sales to Minors*	130	160	78	22	N/A
Citations Involving Sales to Minors*	N/A	33	61	93	100

* Some of these warnings and citations involved other violations in addition to sales to minors.

*Board →
Low income people
income?*

TABLE 16

PENALTIES IMPOSED FOR SELLING TO MINORS*

Sale to Minor --Single Charge	Nature of Action Taken by DLLC	Number of Times Action Applies		
		1981	1982	For Citations Issued as of May 31 1983
	\$100 fine	13	6	3
	\$150 fine	5	17	3
	\$200 fine	8	20	10
	\$300 fine	1	7	5
	\$500 fine	1	2	
	Surrendered license	-0-	2	
	Suspended license	2	-0-	
	Revoked license	1	-0-	
	Total	<u>31</u>	<u>54</u>	<u>21**</u>
Sale to Minor --Multiple Charges				
	\$50 fine	-0-	1	
	\$100 fine	1	-0-	
	\$150 fine	1	-0-	
	\$200 fine	1	1	1
	\$300 fine	2	-0-	1
	\$400 fine	2	1	
	\$500 fine	1	-0-	1
	\$600 fine	1	1	
	\$700 fine	-0-	1	
	\$1200 fine	-0-	1	
	Surrendered license	-0-	-0-	
	Suspended license	1	1	
	Suspended license plus \$500 fine	1	-0-	
	Revoked license	-0-	-0-	
	Total	<u>11</u>	<u>7</u>	<u>3***</u>

* This analysis is restricted to those citations which involved only sale to minors. Citations involving other types of violations in addition to sale to minors are not included in this table. Therefore, the total number of citations in this table cannot be reconciled to the totals in Table 15.

** An additional 28 cases were pending as of August 2, 1983.

*** An additional 3 cases were pending as of August 2, 1983.

100.00

Superintendent Has Much Discretion - Within the broad limits set by statute, the superintendent has much discretion when determining the appropriate penalty to impose in each case. In contrast, we identified several states which have adopted more specific guidelines for determining appropriate penalties.

DLLC has a range of statutory penalties to use against licensees who sell liquor to minors. The superintendent may suspend the license. If he feels it is warranted, he may refer the case to the Board which has the additional option of revoking the license. In lieu of or in addition to a suspension, the superintendent may impose a civil penalty (fine) of not less than \$100 nor more than \$1,500 for each violation.* The licensee is entitled to appeal the superintendent's decision to the Board. The Board may then uphold or modify the superintendent's decision, including increasing the civil penalty (up to \$1,500 per violation).

The superintendent has the discretion to apply whatever penalty he feels is appropriate within the limits described above. Neither the statutes nor regulations specify differing penalties (or ranges) for various types of violations, nor has the superintendent adopted formal guidelines for determining what an appropriate penalty would be. According to the superintendent, however, a first-time offender for selling to a minor will normally receive at least a \$300 fine if the case is solid; he imposes a lesser fine if evidence is not so strong.** Upon a second offense of selling to minors the case is generally referred to the Board. Upon the first offense, if the minor is under 17 years old, the case is either referred to the Board or the superintendent imposes a fine of at least \$500.

* Prior to July 1982 the superintendent was authorized to fine licensees between \$100 and \$300 per violation, and the Board was authorized to fine licensees up to \$500 per violation.

** Table 16 shows that the most common penalty in 1983 for a sale to a minor (single charge) was a \$200 fine.

Several states have established more specific guidelines--either in regulations or agency policy--for taking disciplinary action against licensees. In some cases the minimum penalty for sale to minors is higher than the most common penalties applied in Arizona.

The Texas Alcoholic Beverage Commission uses a "Standardized Penalty Chart" to determine the appropriate penalty. The chart lists suspension ranges for each of 40 different violations. These ranges escalate for subsequent offenses. For example, the first offense of selling to a minor will receive a 5- to 10-day suspension; the second offense would result in an 11- to 15-day suspension. A licensee has the choice of converting the suspension to a fine at the rate of \$150 per each day of suspension. Thus, a 5-day minimum suspension for the first offense would convert to a \$750 fine.

In Tennessee the liquor agency's rules and regulations specify ranges of fines for various types of violations. The first offense of selling to a minor would result in a \$300 to \$1,000 fine. The licensee has the option of converting the fine to a suspension, usually at the rate of one day for each \$100.

AREAS FOR FURTHER AUDIT WORK

During the audit we identified several potential problems requiring further audit work. Due to time and staffing constraints, we were unable to review these areas:

1. Should local governments have greater input in the license approval process?
2. Should limitations on alcoholic beverage availability, such as hours and days of sale, be reduced?
3. Should some restrictions on licensees, such as the credit sales prohibition and advertising restrictions, be eliminated?
4. Are license fees equitable and adequate?
5. Would automatic revocation for license nonrenewal improve efficiency?
6. Is subpoena-serving an efficient use of enforcement staff resources?
7. If quotas are not eliminated, should license types be consolidated?
8. Should DLLC be responsible for filing liens?



State of Arizona
Department of Liquor Licenses and Control

1645 W. Jefferson

Phoenix, Arizona 85007

October 12, 1983

BRUCE BABBITT
GOVERNOR



Mr. Douglas Norton
Auditor General
State of Arizona
111 West Monroe, Suite 600
Phoenix, AZ 85003

Dear Mr. Norton:

This will acknowledge receipt of a revised copy of the preliminary draft of this Department's performance audit which was discussed at length with your office on September 30.

Before presenting a response in three areas, I wish to express my feelings concerning the members of your staff assigned to conduct the audit and their professional approach. Without exception, they displayed professional competency, thorough and well thought out inquiry, availed themselves for in-depth discussion of inquiry points, were thorough and fair, and to my knowledge, left no stone unturned.

I wish to comment on Findings I and VI.

Finding I alleges that until recently the Department has done relatively little to improve the quality of liquor enforcement by local agencies.

The Department of Liquor Licenses and Control is a reactive agency as far as administrative hearings are concerned. The Department cannot implement the administrative hearing process until a law enforcement agency conducts an investigation involving liquor laws and submits a report of its investigation to the Department. Such report must include sufficient evidence and narrative to justify the issuance of a complaint notifying a licensee that an administrative hearing will be conducted before the Superintendent or the Board. In late 1978, the Superintendent was thoroughly aware that in order to exercise a greater degree of control over industry licensees, investigations of alleged liquor law violations needed to be more thorough, and reports of investigations needed to be forwarded to the Department in a timely manner.

Until the latter part of 1978, any improvement in reporting was a direct result of the Superintendent's or his administrative Assistant's personal efforts with the various agencies of the State. In early 1979, two administrative

Mr. Douglas Norton
October 12, 1983
Page Two

investigators had been trained and were assigned myriad duties. One of their responsibilities was to make contact with law enforcement agencies and to offer whatever assistance they could.

In 1981, the Department began logging all investigation reports received in order to determine the total number of reports received from individual agencies. This system has been in effect for three years now and indicates a steady increase in the volume of reporting and the number of agencies reporting.

The processing of administrative complaints during the past five years has risen from 50 per year in 1978 to approximately 1,000 for tax complaints and 300 administrative citations processed for the calendar year 1983. Continued concerted effort should show a steady increase in the number of administrative citations being processed due to more and better reporting by policing agencies.

To the best of my knowledge, all policing agencies in the state have been contacted and every reasonable opportunity has been taken to offer assistance and provide training to promote a better understanding of Title 4 and the investigation and reporting of violations which will result in the successful prosecution and imposition of sanctions for administrative violations and the establishment of better control in the liquor industry.

Your report makes a recommendation to eliminate restaurant audits. The restaurant and hotel licenses have been a problem to the Department for a long time, and it is true that considerable time has been devoted by our very limited investigation staff to the resolution of a "bona fide" restaurant problem. Of the 900 plus restaurants in the state, at least half of them probably fail to meet the statutory requirements of a restaurant. Considerable effort has been expended in getting some of these restaurants into compliance or out of the liquor business. The reason our effort in this area appears miniscule is because we only have one person who devotes a substantial part of his working day to restaurant problems. A considerable amount of our limited manpower was devoted to establishing that we had a substantial problem with restaurant and hotel licensees not operating as bona fide restaurants and thereby operating as all spirits bars. This subterfuge negates the statutorily prescribed limitation on all spirits on-sale liquor (Series 6 quota) licenses.

The recommendation to eliminate our efforts in this inspection process would encourage greater violations. We would be derelict in our duties if we ignored our present statutory responsibilities. The Department does agree that it is not making as great an impact as it would like and that alternative supplemental procedures should be sought to help resolve the problem with the limited resources we have.

Finding VI recommends the elimination of the requirement that uncontested original applications be approved by the Board. This recommendation suggests that uncontested applications for original licenses could be approved by a person specified by statute.

The primary reason for the recommendation not requiring Board action on uncontested applications is the savings of time on behalf of hearing officers,

Mr. Douglas Norton
October 12, 1983
Page Three

secretaries, applicants and Board. It is absolutely correct that the implementation of this recommendation would save considerable time for all parties involved.

As Superintendent of the Department, I wish to disagree philosophically with this recommendation. It is a comforting feeling to know that only the Board can issue a new license and only the Board can revoke it!

Additionally, the right to appeal to the State Liquor Board any administrative hearing decision of the Superintendent, Hearing Officer, or the designated Representative instills security and integrity in the licensing control system and the administrative hearing process.

Anyone who has been in state government for a period of time can recall the scandals of the early '60's which resulted in the abolition of the Department over a several years' time frame. Not only was the Liquor Department embarrassed and abolished, but members of the legislature were subjected to public criticism.

In my judgment, the current legislative safeguards should not be removed. The philosopher George Santayana made the statement, "Those who cannot remember the past are doomed to repeat it." The Arizona State Liquor Board shares the Superintendent's position that we spend the extra time required in the issuance of uncontested licenses to insure integrity in the system and not to "forget the past."

Sincerely,


L. H. Robertson
Superintendent

LHR:vct

ARIZONA LEGISLATIVE COUNCIL

MEMO

July 1, 1983

TO: Douglas R. Norton
Auditor General

FROM: Arizona Legislative Council

RE: Request for Research and Statutory Interpretation (0-83-11)

This is in response to a formal request submitted on your behalf by William Thomson in a memo dated June 9, 1983.

FACT SITUATION

Arizona Revised Statutes (A.R.S.) section 4-206, subsections A, B and C limit the number of on-sale and off-sale retail liquor licenses which may be issued on the basis of population.

4-206. Licenses; number permitted; exception

A. The total number of spirituous liquor licenses issued within a single county for on-sale retailer's licenses providing for consumption on the premises of all spirituous liquors shall not exceed:

1. One license for each one thousand inhabitants for the first twenty-four thousand inhabitants within the county, and in addition

2. One license for each two thousand inhabitants for the population within the county from twenty-five thousand through one hundred thousand inhabitants, and in addition

3. One license for each two thousand five hundred inhabitants for the population within the county from one hundred one thousand inhabitants.

B. The total number of spirituous liquor licenses issued within a single county for on-sale retailers' licenses providing for consumption on the premises of beer and wine shall not exceed one license for each five hundred inhabitants, including licenses permitting the sale of beer and wine as provided in subsection A.

C. The total number of spirituous liquor licenses issued within a single county for off-sale retailers' licenses providing for the sale of spirituous liquors, wines and beer only in the original packages to be taken from and consumed off the premises shall not exceed:

1. One license for each one thousand inhabitants for the first twenty-four thousand inhabitants within the county, and in addition

2. One license for each two thousand inhabitants for the population within the county from twenty-five thousand through one hundred thousand inhabitants, and in addition

3. One license for each two thousand five hundred inhabitants for the population within the county from one hundred one thousand inhabitants.

D. Club licenses, hotel, motel or restaurant licenses issued pursuant to this title shall not be considered in determining the legal number of licenses permitted in any county.

E. The population of a county shall be deemed to be the official population estimate as last determined by the department of economic security.

These limitations have prevented the issuance of new, all-liquor, on-sale licenses in twelve counties and all-liquor, off-sale licenses in ten counties (1982 figures). Small numbers of these licenses were available in the remaining counties through the lottery system of applicant selection. Those individuals desiring an on-sale or off-sale liquor license in counties that have reached or exceeded their quotas and those not chosen for a license during the lottery must purchase a license from an existing licensee on the open market. Market prices can range from ten to twenty times the cost of an original issuance.

A 1980 Montana Legislative Council study concerning eliminating quotas on liquor licenses found that:

Statutes, custom, and case law have all seemed to invest retail licenses with the status of personal property rather than a privilege granted by the state. As personal property, licenses can be mortgaged or sold for prices far in excess of the state's issuance price.

* * *

QUESTIONS PRESENTED:

1. Is a liquor license a privilege or a property right?
2. Would the removal of the statutory restrictions provided in A.R.S. section 4-206, subsections A, B and C constitute (a) destruction or deprivation of private property for current licensees without due process or (b) taking of private property for public use, requiring "just compensation" by the state?

DISCUSSION:

A license for the sale of liquor is not a contract between the state and the person to whom it is issued but rather it is a mere permit issued in the exercise of the police power of the state. Ghera v. State, 16 Ariz. 344, 146 P. 498 (1915).

The Arizona Supreme Court has recognized an important distinction concerning the rights of the liquor licensee in relation to third persons and in relation to the state. As between the licensee and third persons, a liquor license is a property right with unique

value. Siler v. Superior Ct. in and for Coconino County, 83 Ariz. 49, 316 P.2d 296 (1957); Duncan v. Truman, 74 Ariz. 328, 248 P.2d 879 (1952). But as between the licensee and the state, a liquor license is merely a privilege subject to the police power of the state, it is not a property right or a contract in the legal or constitutional sense of the term. Hooper v. Duncan, 95 Ariz. 305, 389 P.2d 706 (1964).

Hooper involved the validity of a 1961 amendment to the liquor code terminating the leasing of liquor licenses in Arizona. The appellant, who had such a leasing arrangement, sought to declare such legislation invalid on the ground that the amendment constituted an unreasonable exercise of the police power which impaired the obligation of contract. In rejecting this argument, the Hooper court recognized the broad power of the state to regulate liquor licenses, which regulation would not necessarily deprive a liquor licensee of property without just compensation.

Recently, the Arizona Supreme Court has stated that a liquor license is a privilege to engage in a business subject to the regulation of the state. Arizona State Liquor Board v. Poulos, 112 Ariz. 119, 538 P.2d 393 (1975). In Poulos, the court upheld a state statute which provided that a license which is not used by the licensee for a period in excess of six months reverts to the state. In upholding this statute the court acknowledged the broad sweep of the twenty-first amendment of the United States Constitution as conferring something more than the normal state authority over public health, welfare and morals.

Therefore, it appears that eliminating quotas in the issuance of liquor licenses by repealing A.R.S. section 4-206 would fall within the broad power of the state to regulate the sale of intoxicating liquors and would not constitutionally deprive a liquor licensee of property without just compensation. Such action by the legislature would not be an actual taking of property itself since the licensee would still retain the actual use of the license but would only decrease the value of the license, a value that has been artificially increased by previous legislative action.

CONCLUSION:

As between a licensee and a third party a liquor license is a property right. As between a licensee and the state a liquor license is not a property right or contract, it is a privilege to engage in a business subject to the regulation of the state. Therefore, removing the statutory restrictions provided in A.R.S. section 4-206, subsections A, B and C would not constitute destruction or deprivation of property without due process of law or taking of property for public use without just compensation.

cc: William Thomson, Manager
Performance Audit Division

¹ Laws 1961, 1st S. S., Ch. 2, section 5

APPENDIX II

CONSULTANT'S REVIEW OF THE PROBABILITIES OF
SELECTION IN THE LIQUOR LICENSE LOTTERY

ARIZONA STATE
UNIVERSITY

TEMPE, ARIZONA 85281

CENTER FOR URBAN STUDIES
DIVISION OF POLICY ANALYSIS AND EVALUATION (602) 965-3926

August 2, 1983

Mr. William Thomson
Office of the Auditor General
Suite 600
111 West Monroe
Phoenix, Arizona 85003

Dear Mr. Thomson:

I have finally completed all of the computations required to answer the questions that you have raised and have put the results in typewritten format. As I mentioned last week, dealing with thirteen different applicants, three years, seven counties, and two different types of licenses ended up with more computations than I had anticipated.

The first question, "How do you calculate the probability of winning when there is one application," is relatively straightforward and the equations are presented on page one of the attachments.

The more interesting question has to do with the probability of winning when there are more than one applications from a specific individual. For this purpose, the binomial expansion is the appropriate method for the calculation of probabilities. The binomial expansion for five applications (the most frequent form of multiple applications) would be:

$$(P + Q)^5 = P^5 + 5P^4Q + 10P^3Q^2 + 10P^2Q^3 + 5PQ^4 + Q^5$$

where: P = the probability of winning with a single application.
Q = the probability of losing with a single application.

The first term of the equation (P^5) is the probability of winning five times with five applications; the second term is the probability of winning four times with five applications; and so on. The final term of the equation (Q^5) is the probability of losing five times with five applications.

The binomial expansion can be used with any of applications, one must only be concerned with the proper calculation of the binomial coefficients as most tabled values do not go beyond 10. Various multiple application probabilities are presented on pages 2, 3, and 4.

In addressing the issue of whether or not individuals were winning in greater proportion than would be expected (limiting the analysis to these data), I computed a one-sample X^2 (chi square) in which I addressed the

significance of difference between expected and observed probabilities of losing. [NOTE: Analysis could have easily been done with the probabilities of winning but, for ease of interpretation, the alternative probabilities have been used.] For this analysis, the binomial expansion has been used to establish expected probabilities. Actual proportion of winning applications for an individual have been used to determine the observed values. The differences between these two values for a specific applicant are squared and divided by the expected probability. To calculate the one-sample X^2 , these latter values are simply summed. With 8 degrees of freedom, the Type #6 X^2 is not significant. With 21 degrees of freedom, the Type #9 X^2 is not significant, either.

I should note that, because we are assuming independence in our observations over time, I have collapsed all Type #6 and then Type #9 for purposes of the analysis of expected and observed probabilities.

Finally, it is obvious that applicants can increase the likelihood of winning a license (or being placed in the alternate category) by increasing the number of their applications. It is amusing to note, however, that the major outliers (in terms of the difference between expected and observed values) is found for those who made fifteen applications. In both instances, these applicants won but one license.

I hope that this analysis satisfies your interest in the questions that you raised. I would be most happy to sit down with you or one of your staff to go over the actual calculations that led to the numbers I have reported in the various tables.

I found this an intriguing problem to wrestle with. I did need more time than I anticipated to actually run through the required calculations. Consequently, I must report that I did exhaust the full four hours of time you had agreed to. I will chalk up the additional time to my own education and entertainment.

Sincerely,



L.A. Wilson II
Director and
Associate Professor
Center for Public Affairs

attachments

PROBABILITY THAT ANY ONE APPLICATION WILL BE CHOSEN

COUNTY	LICENSE TYPE #6			LICENSE TYPE #9		
	1980	1981	1982	1980	1981	1982
Maricopa	.0406	.0125	.0387	.0776	.0621	.0492
Navajo	.1282			.6666		
Cochise				.1666	.1136	
Pima				.1538		.0485
Mohave				.1075	.0361	
Santa Cruz				1.0000		
Yavapai					.1395	

The probabilities noted above are calculated on the basis of $\frac{1}{N}$ which is appropriate for sampling without replacement. For instance,

$$\text{FIRST DRAW: } \frac{1}{N}$$

$$\text{SECOND DRAW: } \frac{1}{N-1} \times \frac{N-1}{N} = \frac{1}{N}$$

$$\text{THIRD DRAW: } \frac{1}{N-2} \times \frac{N-2}{N} = \frac{1}{N}$$

The first portion of the equation accounts for the reduced population size while the second portion of the equation accounts for the probability of having been chosen on the prior draws.

PROBABILITIES THAT MULTIPLE APPLICATIONS WILL BE CHOSEN
Maricopa County

FIVE APPLICATIONS
License Type #6

NUMBER WINNING	1980	1981	1982
5	.0000001	.0000000003	.00000008
4	.00001	.0000001	.00001
3	.0006	.00001	.0005
2	.0146	.0015	.0133
1	.1719	.0594	.1652
0	.8128	.9390	.8209

FIVE APPLICATIONS
License Type #9

NUMBER WINNING	1980	1981	1982
5	.000002	.0000009	.0000002
4	.0001	.00007	.00003
3	.0039	.0021	.0011
2	.0472	.0318	.0208
1	.2808	.2402	.2010
0	.6677	.7254	.7770

FOUR APPLICATIONS
License Type #9

NUMBER WINNING 1982

4	.00003
3	.0018
2	.0310
1	.2445
0	.7226

TEN APPLICATIONS
License Type #9

NUMBER WINNING 1981

10	.00000000000008
9	.0000000001
8	.000000008
7	.0000003
6	.000009
5	.0002
4	.0021
3	.0183
2	.1039
1	.3487
0	.5267

FIFTEEN APPLICATIONS

NUMBER WINNING	License Type #6 1980	License Type #9 1982
15	.000000000000000000000001	.000000000000000000000002
14	.000000000000000000000004	.000000000000000000000006
13	.000000000000000000000007	.000000000000000000000009
12	.000000000000000000000008	.000000000000000000000007
11	.000000000000000000000006	.000000000000000000000004
10	.000000000000000000000003	.000000000000000000000001
9	.000000000000000000000001	.000000000000000000000006
8	.00000004	.00000001
7	.00000008	.00000003
6	.000001	.000004
5	.0002	.0005
4	.0023	.0046
3	.0190	.0296
2	.1050	.1319
1	.3405	.3642
0	.5370	.4692

TWO APPLICATIONS

NUMBER WINNING	License Type #6 1980
2	.0022
1	.0780
0	.9204

EXPECTED AND OBSERVED FREQUENCY OF LOSING: TYPE #6

APPLICANT NUMBER	1980			1981			1982					
	APP	WON	EXP	OBS	APP	WON	EXP	OBS	APP	WON	EXP	OBS
1	5	1	.8128	.8000	0	0	0	0	0	0	.9379	1.0000
2	5	1	.8128	.8000	5	0	.9390	1.0000	0	0		
3	5	1	.8128	.8000	5	0	.9390	1.0000	0	0		
4	2	1	.9204	.5000	0	0			1	0		
5	15	1	.5370	.9333	5	0	.9390	1.0000	0	0		

$$X^2 = .377$$

II-7

EXPECTED AND OBSERVED FREQUENCY OF LOSING: TYPE #9

APPLICANT NUMBER	1980			1981			1982					
	APP	WON	EXP	OBS	APP	WON	EXP	OBS	APP	WON	EXP	OBS
1	5	0	.6677	1.0000	5	2	.7254	.6000	5	0	.7770	1.0000
2	5	0	.6677	1.0000	5	0	.7254	1.0000	5	2	.7770	.6000
3	5	1	.6677	.8000	0	0			0	0		
4	5	0	.6677	1.0000	5	0	.7254	1.0000	15	1	.4692	.9333
5	5	1	.6677	.8000	0	0			5	0	.7770	1.0000
6	0	0			0	0			5	2	.7770	.6000
7	4	0	.8173	1.0000	5	0	.7254	1.0000	4	1	.7226	.7500
8	5	0	.6677	1.0000	5	1	.7254	.8000	5	1	.7770	.8000
9	5	1	.6677	.8000	10	3	.5267	.7000	6	1	.7388	.8333

$$X^2 = 1.768$$