



COMMONWEALTH of VIRGINIA

Department of Alcoholic Beverage Control

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October 30, 2015

The Honorable Frank W. Wagner, Chair
Committee on Rehabilitation and Social Services
Senate of Virginia
General Assembly Building
Richmond, Virginia 23219

The Honorable William R. DeSteph, Jr.,
Patron of HB 1814
House of Delegates
General Assembly Building
Richmond, Virginia 23219

CC: Susan Clarke Schaar, Clerk of the Senate

RE: Mixed Beverage Food to Beverage Ratio

Dear Senator Wagner and Delegate DeSteph:

Pursuant to Rule 20 (o) of the Rules of the Senate, the Senate Committee on Rehabilitation and Social Services referred the subject matter of HB 1814 to the Virginia Department of Alcoholic Beverage Control for study. The Virginia Alcoholic Beverage Control Board hereby submits the requested report.

Background

Liquor by the drink was approved by the General Assembly in 1968. Initially, mixed beverage licensees were required to sell more food than alcoholic beverages, including wine and beer. Gradually this requirement has been modified through the years resulting in the current requirement that food sales must be at least 45 percent of the combined gross receipts from the sale of mixed beverages and food. Wine and beer sales are no longer considered when determining the ratio. Section 4.1-114 of the Code of Virginia compels the Board to annually review the ratio of food and mixed beverage sales of each mixed beverage licensee. The Board requires each mixed beverage licensee to annually file a Mixed Beverage

Annual Review Report (MBAR) form. A copy of the form is attached as Appendix 1. Licensees are audited when there is reason to suspect the report does not accurately represent the actual sales, or in the course of reviewing the performance of a new licensee which has been issued a temporary license under the provisions of §4.1-211.

During the 2013 General Assembly session, the second enactment clause of Chapter 661 of the 2013 Acts of Assembly (SB 1349) directed:

2. That the Virginia Alcoholic Beverage Control Board shall meet with interested parties, including licensees and trade associations representing the same, to develop guidelines for appropriate sanctions including license revocation, for violations of alcoholic beverage control laws and regulations governing (i) the food-to-beverage ratio for mixed beverage licensees and (ii) the submission of the annual report by such licensees, including instances where the Alcoholic Beverage Control Board finds that a licensee has submitted a fraudulent report. The guidelines developed by the Alcoholic Beverage Control Board after meeting with the interested parties can be found in Appendix 2.

Regulatory Perspective

The MBAR process has both benefits and challenges from a regulatory perspective. The Mixed Beverage Annual Review report filed by mixed beverage licensees is largely constructed by the licensee and is a self-reporting process in which the licensee may highlight their business practices through complete and accurate reporting. We have found that the overwhelming majority of our licensees are reporting accurately and we are able to utilize that data to gain a picture of compliance or non-compliance by the licensed businesses. There are many examples in which the licensees self-report non-compliance and do not submit fraudulent reports. The department welcomes this reporting as it provides an opportunity for the department to work with the licensee to get the business into compliance. However, fraudulent information has also been submitted to the department in this process. In many cases, when fraudulent figures are discovered, there are significant resources dedicated to the investigation of such activities due to the extensive forensic auditing that must be done in order to substantiate the activity.

More often than fraudulent activity, the department finds that there are a number of licensees that have difficulty making the required ratio of 45% food to 55% mixed beverage sales and food sales figures of \$4,000.00 per month in food sales. The inability to comply with the ratio or minimum food sales often resides in business practices employed by the licensee. In some instances, accounting errors are discovered and training of the licensee is able to rectify the issue. In the balance of cases, the establishment sells far more alcohol than food due to the fact that the business model is viewed as more of an entertainment venue than a restaurant by patrons.

Currently, there are just slightly less than 4,900 mixed beverage restaurant licensees in the Commonwealth of Virginia. According to §4.1-100, these restaurants are "...an established place of business (i) where meals with substantial entrees are regularly sold and (ii) which has adequate facilities and sufficient employees for cooking, preparing, and serving such meals for consumption at tables in dining areas on the premises, and includes establishments specializing in full course meals with a single substantial entrée." Annually, less than 2% of these licensees will face disciplinary charges pertaining to qualifications to retain the license because of food ratio concerns or for insufficient food sales. Table 1 below indicates the number of audits conducted in the past two fiscal years.

Table 1: Number of Audits

<i>Audit Type</i>	<i>FY14</i>	<i>FY15</i>	<i>Total</i>
Number of Audits Conducted	31	31	62

Mixed Beverage Annual Review Violations

Most violations are first offenses. Most late-filing violations are corrected as soon as the matter is called to the attention of the licensee. Table 2 shows the numbers of mixed beverage food requirement cases disposed of by written warning for the most recent fiscal years.

More serious, uncorrected, or repeat cases are usually disposed of with formal disciplinary hearings. Data from the last two fiscal years was examined and it was determined that there were 279 violations related to either the mixed beverage licensee food-to-beverage ratio, insufficient food sales or the annual MBAR report (late filing, failure to submit, inaccurate submission) substantiated by board orders. These 279 violations stemmed from 227 cases which were heard and had board orders rendered during Fiscal Years 2014 and 2015. This data is contained in Table 3.

Of the violators in Fiscal Year 2014, 52 were repeat offenders. In Fiscal Year 2015 there were 38 repeat offenders.

For the purposes of reporting this information, a charge must receive a disposition before it can be counted as substantiated. The disposition date was used to determine in which fiscal year the charge was counted.

Table 2: Number of Written Warnings

<i>Infraction</i>	<i>FY14</i>	<i>FY15</i>	<i>Total</i>
Total Mixed Beverage Annual Review Written Warnings	845	914	1759
<i>Infraction</i>			
<i>Late filing</i>	745	864	1609
<i>Failure to Submit</i>	21	11	32
<i>Ratio Infraction</i>	79	39	118

Table 3: Substantiated Violation Counts

<i>Violation</i>	<i>FY14</i>	<i>FY15</i>	<i>Total</i>
Food-to-Beverage Ratio/Insufficient Food Sales	56	62	118
Mixed Beverage Annual Report (MBAR) Violations	79	82	161
<i>Late filing</i>	52	53	105
<i>Failure to Submit</i>	15	17	32
<i>Inaccurate</i>	12	12	24

Of the 279 substantiated violations during FY14 and FY15, 15 licenses were revoked over the last two fiscal years. Other mixed beverage licensees received suspensions of up to 30 days and/or civil penalties up to \$5,000. This data does not account for those licenses surrendered while charges were pending.

Table 4: Penalties Imposed

<i>Penalty</i>	<i>FY14</i>	<i>FY15</i>	<i>Total</i>
Suspension Days Assessed	353	715	1,068
Civic Penalties Inflicted	\$36,300.00	\$79,500.00	\$115,800.00
Mandatory Suspension Day (w/ Civil penalty)	110	150	260
Probation Months Assessed	0	4	4
Licenses Revoked	9	6	15

Three Mixed Beverage licenses were revoked for substantiated defrauding and/or deceiving the Board or any other governmental entity charges during the last two fiscal years pertaining to the filing of MBAR reports.

The statistics reflect that a very small fraction of mixed beverage licensees, fewer than three percent per year, incur substantiated violations related to Mixed Beverage Annual Review requirements.

Mixed Beverage Annual Review Calculations

Under current ratio requirements, the food ratio is calculated by dividing total food and non-alcoholic beverage sales by the total of mixed beverage sales and food and non-alcohol beverage sales with the result multiplied by 100 to provide the percentage. Under the proposed formula in HB 1814, the percentage of food sold would be calculated by dividing total food by total mixed beverage sales with the result multiplied by 100 to provide the percentage. The fundamental difference between the two calculations is that under current law there must be 81 cents of food sales for every dollar of mixed beverage sales, whereas under the formula proposed in HB 1814, the ratio is lowered to 75 cents of food sales for every dollar in mixed beverage sales. Examples of both methods of calculation are demonstrated below. The first example reflects a licensee who qualifies under both formulas. The second example demonstrates a licensee who would not meet qualifications under the current formula but would qualify under the proposed formula. The third example demonstrates a licensee who fails to qualify under either formula.

Scenario #1

Food/Non-Alcoholic Beverage Sales = \$1,175,221

Mixed Beverage Sales = \$200,201

Current Formula:

$$1,175,221 / (1,175,221 + 200,201) = x$$

$$x = 1,175,221 / 1,375,422$$

$$x = 0.85 * 100 = 85\%$$

Proposed HB 1814 Formula:

$$1,175,221 / 200,201 = x$$

$$x = 5.87$$

$$x = 5.87 * 100 = 587\%$$

Scenario #2

Food/Non-Alcoholic Beverage Sales = \$369,930

Mixed Beverage Sales = \$466,370

Current Formula:

$$369,930 / (369,930 + 466,370) = x$$

$$X = 369,930 / 836,300$$

$$X = 0.44 * 100 = 44\%$$

Proposed HB 1814 Formula:

$$369,930 / 466,370 = x$$

$$x = 0.79$$

$$x = 0.79 * 100 = 79\%$$

Scenario #3

Food/Non-Alcoholic Beverage Sales = \$65,937

Mixed Beverage Sales = \$203,478

Current Formula:

$$65,937 / (65,937 + 203,478) = x$$

$$x = 65,937 / 269,415$$

$$x = 0.24 * 100 = 24\%$$

Proposed HB 1814 Formula:

$$65,937 / 203,478 = x$$

$$x = 0.32$$

$$x = 0.32 * 100 = 32\%$$

An Alternative View

In order to ascertain the general impact of the proposed formula in HB 1814, it is beneficial to achieve a like kind comparison between the current formula and the proposed formula. As mentioned earlier, the proposed formula is viewed from the very basic perspective that for every dollar of mixed beverages sold, a licensee must sell 75 cents of food. The current formula requires licensees to sell 81 cents of food for every dollar of mixed beverage sold.

With this amount of change, the mixed beverage licensees that are well qualified would remain well qualified and those extremely under qualified would remain as such. The group of licensees impacted are those whose food sales are marginally or just below the qualifying 45%. As is demonstrated in the second calculation example, the licensee's food ratio is 44% and thus just below qualifying under the current formula. However when calculated under the proposed formula, the licensee's food sales are 79% of their mixed beverage sales and would thus be qualified.

Regulated Community Feedback

Throughout the years, the Alcoholic Beverage Control Board has received a number of suggested remedies from our regulated partners to deal with the current ratio requirements. These suggestions run from doing away with the mixed beverage ratio altogether to enforcing the current provisions more strenuously. The examples below are not endorsed by the Alcoholic Beverage Control Board, but are provided as illustrations of the diversity of opinion within the industry surrounding this issue.

- 1) Strictly enforce the current laws with no changes. Some members of the restaurant industry feel the current ratio requirements are practical and effective and see no need for further change. As has been pointed out in previous testimony before various General Assembly committees, some current restaurant owners question the fairness of lessening the current requirements. Diminishing the current requirements would allow new operators to enter the mixed beverage restaurant

- business with less of a focus on the food side of the business, leading to less investment in restaurant equipment and fixtures, placing existing owners at a competitive disadvantage.
- 2) Establish a minimum dollar amount for food sales (example, \$25,000 per month) that would relieve the licensee from maintaining a ratio of food to spirits sales. Food sales of \$300,000 per year certainly establishes that the facility is fully engaged in the restaurant business. Currently, over 70% of our mixed beverage restaurants sell more than \$300,000 of food annually.
 - 3) Restructure the current ratio. Some restaurant owners point out that current demand from diners frequently puts them at odds with complying with the ratio. Modern day diners may wish to have their meal at one establishment and drinks at another. Alternatively, patrons may only consume smaller plated meals rather than a large, traditional meal. Demand is also strong for expensive specialty drinks that contain top-shelf spirits products that can cost as much as a meal. Some restaurant owners argue that lessening the current food/spirits ratio would allow them to focus on serving the customer's demands and less on devising gimmicks to meet the ratio.
 - 4) Completely eliminate the ratio for establishments that desire to operate as entertainment venues. Some restaurant owners feel that entertainment venues should be licensed and monitored in a different fashion than traditional restaurants. This tiered licensing structure with appropriately higher license fees would allow entertainment venues to be relieved of the food/spirits ratio, but require that food be available at all times that alcohol is served.

Conclusions

Annual evaluation and monitoring of approximately 4900 mixed beverage licensed establishments for compliance with the ratio (and other) provision(s) relating to the Mixed Beverage Annual Review is a complicated proposition with many benefits and challenges. While data is self-reported by licensees, most elect to report accurately permitting ABC to gain a valid picture of compliance or non-compliance by licensed businesses. Many MBAR related violations are minor and quickly corrected by licensees, while others are more complex, requiring the dedication of extensive resources to conduct forensic auditing of the licensed business.

The regulated community has provided input on the ratio requirement over a number years. Opinions are very diverse and span from completely doing away with the provision to more stringent enforcement of current requirements. Changing the ratio calculation formula to that proposed in HB 1814 would result in a positive impact for a segment of the mixed beverage licensee community, but would not come without implementation challenges for ABC. However, given appropriate resources and time, modifications and updates could be made to critical systems to accommodate a change.

Regardless of whether calculations and formulas are modified, stay the same or cease to exist, ABC simply needs a clear law to enforce and that licensees can understand and voluntarily comply.

Please let me know if you have any other questions.

Sincerely,



Jeffrey L. Painter
Chairman

Appendix 1

Mixed Beverage Annual Review (MBAR) Form

MBAR

**VIRGINIA DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL (ABC)
MIXED BEVERAGE ANNUAL REVIEW**

SALES					
1 Month & Year for Sales	2 Food & Nonalcoholic Beverage Sales	3 Mixed Beverage Sales	4 Wine & Beer Sales	5 Miscellaneous Sales	6 MONTHLY SALES
	.00	.00	.00	.00	.00
	.00	.00	.00	.00	.00
	.00	.00	.00	.00	.00
	.00	.00	.00	.00	.00
	.00	.00	.00	.00	.00
	.00	.00	.00	.00	.00
	.00	.00	.00	.00	.00
	.00	.00	.00	.00	.00
	.00	.00	.00	.00	.00
	.00	.00	.00	.00	.00
	.00	.00	.00	.00	.00
	.00	.00	.00	.00	.00
7 TOTAL SALES	.00	.00	.00	.00	8 GROSS SALES .00

PURCHASES					
9 TOTAL PURCHASES	Food & Nonalcoholic Beverage Purchases	Mixed Beverage Purchases	Wine & Beer Purchases	Miscellaneous Purchases	10 GRAND TOTAL PURCHASES
.00	.00	.00	.00	.00	.00

"I certify that this report and the accompanying inventories have been examined by me and to the best of my knowledge and belief are complete, true and accurate."

Signature _____

Print Title _____

Date _____

Print Name _____

REMINDER: A physical inventory of all alcoholic beverages must be attached to this Mixed Beverage Annual Review. (See the instruction booklet for Inventory Report forms.)

VA Sales Tax Number _____

Telephone
() - _____

Total Seating at Tables & Counters _____

Appendix 2

Mixed Beverage Annual Review Guidelines Developed Pursuant to 2013 General Assembly Direction

On January 1, 2014, the ABC Board initiated the following standardized range or penalties for violations of the ratio provision relating to the Mixed Beverage Annual Review (MBAR).

- 1) For a ratio of 44% or higher (up to 45%): Written Warning
- 2) For a ratio of greater than 30%, but less than 44%
 - a) 1st offense: 30 day suspension lifted at the end of 15 days upon payment of \$1,000
 - b) 2nd offense: 60 day suspension lifted at the end of 30 days upon payment of \$2,500
 - c) 3rd offense: Revocation of license
- 3) For a ratio of 30% or less: Revocation of License
- 4) Fraudulent MBAR reports: Revocation of license

*Any substantiated violation penalty short of revocation will require a CPA-audited report of food and mixed beverage sales for the following MBAR period.