

**Licensing Subcommittee Report**

**Customer Advisory Committee  
Liquor Control Commission**

**OCTOBER 18, 2005**

## **Authority, Scope of Direction, Organization**

**Section 209(2)** the Liquor Control Code, being MCL 436.1209(2), provides authority for the creation of this subcommittee. Specifically, the section states that of the five members of the Liquor Control Commission, two members “...shall be designated by the chairperson as hearing commissioners to hear violation cases and **to perform such other functions and duties as are assigned to them by the chairperson.**”

Accordingly, Chairperson Nida Samona, in June 2004, made the following appointments to a licensing subcommittee of the Liquor Control Commission’s Customer Advisory Committee. The charge assigned to the subcommittee was to review current licensing operations of the agency and suggest improvements to the efficiency of the liquor licensing process in Michigan<sup>1</sup>.

Appointed to the Subcommittee were Hearing Commissioner Jim Storey, Chair; Attorneys Peter Abbo and John Doyle, both experienced liquor law counselors; Mark Wibel, a veteran restaurant owner-operator and current president of the Michigan Restaurant Association; Mary Dechow, Director of Government and Regulatory Affairs for Spartan Stores, Inc. and active member of both the Michigan Grocers Association and the Associated Food Dealers of Michigan; Randall Epps, Assistant Director of the Commission’s Licensing Division and longtime field investigator; and Mary Anne Donley, former Commission field investigator and current Supervisor in the MLCC Enforcement Division’s Farmington district office.

The subcommittee alternated meeting locations between the Commission’s Farmington and Lansing offices.

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<sup>1</sup> Attachment I – Memorandum creating subcommittee.

In its organizational meeting, the subcommittee quickly decided to first gather information from those who have participated in the licensing process in Michigan and other states, including information from the subcommittee members' own experiences. Once information gathering was complete, the subcommittee would debate and recommend changes, and then seek necessary support to implement the recommended changes.

The subcommittee originally intended to publish its report in March 2005. However, due to weather, illness, and other scheduling difficulties, the meeting schedule was delayed.

### **Goal**

The subcommittee resolved that its primary goal was to recommend changes that will reduce the amount of time required for a liquor license applicant to obtain an agency decision as to whether or not an the applicant would be licensed.

In 2004, the enacting authorities<sup>2</sup> established a requirement that State of Michigan license-granting agencies make such decisions within 90 "tollable" days. An agency that exceeds the 90-day requirement must forgive certain licensing fees during the first year of licensure.

While the subcommittee took notice of this enactment, it also determined that licensing this crucial aspect of the state's hospitality industry -- the sale and service of liquor -- was cumbersome, unnecessarily complicated, unpredictable and more time-consuming than necessary to meet the Liquor Control Commission's constitutional

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<sup>2</sup> The Governor and Legislature

obligation to **“exercise complete control of the alcoholic beverage traffic within the state, including the retail sales thereof.”**<sup>3</sup>

Anecdotal evidence presented to the subcommittee was persuasive that a delay in the agency’s licensing process has discouraged some from investing in the state. In addition, the unpredictability of the licensing process makes it difficult for businesses to plan for the future.

The subcommittee concluded the agency and its staff should commit to ensuring the licensing process be completed well within the 90 days envisioned by the enacting authorities and strive to further reduce that licensing time to 60 days or less, which seems possible from the experience of other states and other Michigan administrative agencies with similarly demanding responsibilities.

### **Information Gathering**

At least two previous efforts have been undertaken in the last 30 years to streamline and reduce the amount of time for an applicant to gain approval of a liquor license.

In 1979, a special committee created by the Legislature made several recommended changes to the licensing process of the time. Some were adopted and did reduce the licensing demands for a period of time, but newer requirements have since been added to the process.

A 1999 largely internal effort by MLCC made recommendations to the executive office, including a revisit to an idea explored by the 1979 committee of granting

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<sup>3</sup> Constitution of Michigan 1963: Article 4, Section 40.

temporary licenses while a full-fledged licensing investigation is underway. Several states employ this licensing method to speedily place retail operations in business.

The agency has consistently rejected the temporary license approach because of the perceived difficulty the Commission faces in removing a licensee from a business once it has been granted.

The subcommittee members spent considerable time soliciting comments from the Michigan liquor retail industry regarding suggestions for improving the licensing process. This outreach included participation in annual meetings of major retail trade groups<sup>4</sup>, a survey of licensees granted licenses within the previous 12 months, written and oral suggestions from approximately 40 attorneys who regularly represent potential licensees, and a limited number of interviews with agency staff members.

Among the licensees surveyed, the time required to gain a license ranged from 3 to 13 months. In addition, the subcommittee developed the attached flow chart to document the various steps in the current licensing process.

One attorney made a most telling observation: though the Commission presently requires a very detailed pre-license investigation, it rarely outright denies a license applicant. The attorney commented that with a high percentage of license applicants ultimately gaining approval, the result of unnecessary delay is lost alcohol sales, lost business and employment opportunities, and ultimately lost tax receipts for the state.

The subcommittee also interviewed an Ohio attorney who frequently represents entities seeking licenses in that state. The Ohio system, while in many ways different from the process in Michigan, did share an important characteristic: though the state

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<sup>4</sup>Associated Food Dealers, Michigan Grocers Association, Michigan Licensed Beverage Association and Michigan Restaurant Association.

government reserved for itself the ultimate authority to grant liquor licenses, each state provides distinct and specific opportunity for action by the affected local government.

The survey of licensees, minutes of the subcommittee meetings, communications from the attorneys, and the information gleaned from the industry meetings are attached to this report. The suggestions and findings will not be repeated in the report itself, rather, taken as body of industry suggestions, they formed the data basis for the subcommittee's recommendations.

### **Licensing Philosophy**

As mentioned earlier, Commission staff emphasis, as it presently conducts its pre-license investigations, is heavily weighted toward winnowing-out those applicants assessed unlikely to gain Commission approval.

While this process provides the Commission and the larger state government with abundant information about potential licensees, it requires the major accumulation of documents by both the applicant and Commission staff. Further, it requires the agency to devote days of staff hours toward reviewing, understanding, and evaluating the information contained in the documents.

Commission rules already empower the Commission to penalize through license revocation or suspension those licensees who obtain licenses through deceit, fabrication or the falsification of documents.

The stringent requirements for certainty of a potential licensee's qualifications were apparently developed as a result of the Commission's historic reluctance to revoke or suspend the licenses of poorly performing licensees. As a result, license applicants

who may have excellent credentials are unnecessarily delayed weeks or months in receiving licenses.

In the interest of accelerating the licensing process, the Commission should give thoughtful and urgent consideration to changing the existing paradigm that “front-loads” proof of all applicants’ suitability to hold a license.

By asserting its constitutional mandate to “exercise complete control” of Michigan’s alcohol beverage traffic, the Commission has the responsibility and authority to revoke fraudulently obtained licenses.

In an intensive and increasingly competitive retail environment where consumers have more choices, legal and otherwise, to obtain liquor products, it’s in the state’s best financial interest to license in a prudent and expeditious manner those who act as revenue- generators for the Michigan Treasury.

This is especially important in those areas close along interstate-borders, in which three of the four nearby states are so-called “free states”. As Michigan alcohol prices tend to be higher in all categories than three<sup>5</sup> of the four border states, it is especially important that customers have convenient access to businesses that sell alcohol when product price is currently not Michigan’s strength.

The subcommittee submits the following recommendations that will help the Commission keep up with the speed at which business is conducted in the early 21<sup>st</sup> Century. As is painfully evident, businesses, like the individual consumer, have choices when *selecting* states in which to operate. The Governor and other state agencies have recognized that Michigan’s efforts to end unnecessary and counterproductive licensing

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<sup>5</sup> Indiana, Illinois, Wisconsin

delays, while still protecting public health and safety, will attract new business investment and preserve existing businesses in Michigan.

## **Major Licensing Change Recommendations**

**1. Revise financial background investigation requirements to end unnecessary fruitless searches to confirm the legality of funds.** The crux of this issue is the use of the word “verifiable” in Commission Rule 436.1105 (b)<sup>6</sup>. This Rule as presently applied in pre-licensing investigations requires that licensees prove or verify that business funds are legitimate through a long and sometimes unpredictable list of documents. Individuals experienced in Michigan liquor licensing situations have cited the qualification for this rule to be the single greatest issue in meeting Commission staff requirements. This causes applicants, who may ultimately be approved, weeks of delay in receiving their license.

The rule’s<sup>7</sup> defenders argue that it prevents those whose source of funds is of questionable legitimacy from gaining licenses. However, it cannot be disputed that, in the case of new licenses, this portion of pre-licensing investigation delays sales of alcohol and collection of associated taxes.

- A. The subcommittee recommends the rule be modified to either delete the word verifiable or, at the least, define for staff and license applicants what is acceptable as verification of finances. In this instance, the willingness of Commissions to revoke or suspend the licenses of those licensees who,

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<sup>6</sup> “An applicant for a license shall provide evidence in the application of, or demonstrate at a hearing, all of the following . . . (b) The existence of adequate legitimate and verifiable financial resources for the establishment . . .”

<sup>7</sup> *This rule dates to the era when the nation emerged from prohibition and Michigan sought to prevent the transfer of gangster-generated funds into the legitimate liquor business operations.*

in post-licensing investigations, are shown to have deceived the Commission in asserting legitimate funds, would assuage senior staff uneasiness regarding a lessening of this requirement.

- B. License applicants who, through reports to other state or federal agencies, document that more than 50% of ownership is held by a publicly-traded corporation, should be deemed to have fulfilled the financial requirement. The remaining 50% or less ownership's finances shall be documented by affidavits with supporting documents.

Entities whose ownership of 50% or less is held by a public corporation may provide an affidavit asserting fund legitimacy, provided they are accompanied by supporting documents.

- C. The subcommittee recommends that private, non-public entities be licensed if both of the following criteria are met:

- (1). They provide a sworn affidavit attesting funds are of a legitimate source, and attach documentation of the sources, such as bank statements and loan documents. Further, for good and verifiable cause, the Commission may require verification of fund sources prior to licensing. In implementing this change to current investigation practices, the subcommittee also recommends the Commission consistently demand licensee applicants truthfully report the source of funds or surrender any licenses granted as a result of incorrect, misleading or fraudulent information. Furthermore, upon adoption of this recommendation, the

subcommittee also recommends the MLCC Enforcement Division undertake IRS-like random audits of recently licensed entities to ensure compliance with the truthful financial reporting requirements of all license applicants.

(2.) Applicant funds derived from “cash-on-hand” are limited to a maximum of \$20,000 per applicant entity or one-third of the total project cost, whichever amount is smaller. This cash limitation should be indexed to the rise in the consumer price index.

D. The subcommittee also recommends the Commission eliminate the requirement for verification of funds used in the construction of additions to currently licensed establishments.

The subcommittee estimates implementing this rule change will reduce licensing time by up to two weeks in the case of a transfer, which is the bulk of the Commission’s licensing activity.

**2. Limit the scope and time permitted local governments for their review of applications.** Other than the financial documentation, the most often-cited delay in granting license applications is the review required by local governments, especially for Class C licenses. The subcommittee recommends that unless a local government acts within 30 calendar days of receipt of the application, the Commission consider the application to have met local approval. The subcommittee also believes the local government should, upon its written request, be granted 15 additional calendar days to complete its review and recommendation process. The subcommittee further believes the

local governments' objection to an application should be limited to these situations: 1) non-payment of local taxes by the applicant; 2) character and fitness of the applicant, applicant's stockholders, members, and principal officers, and the principal manager of the business.

The subcommittee further recommends deleting the current procedure that requires local police approval of a licensee's request for an additional bar permit. The subcommittee estimates this change would reduce issuance time of the permit by two to six months.

Local governments shall retain the authority to ensure adherence to building, safety and zoning codes prior to the actual issuance of the license. However, the local governments would not be permitted to delay the Commission decision on a license solely to implement those local requirements.

### **3. Amend MLCC Rule 436.1041 (Obtaining a license for use or benefit of another).**

The current rule, R436.1041, states:

- (1) A licensee or an applicant for a license shall not obtain or attempt to obtain a license for the use or benefit of another person whose name does not appear on the license. In addition, a licensee shall not allow a person whose name does not appear on the license to use or benefit from the license.*
- (2) The provisions of subrule (1) of this rule do not apply to a participating agreement where the commission approves the participating agreement after a showing of good cause by the on-premise licensee or where a person not licensed by the commission receives 10% or less of the gross sales of the licensed business.*
- (3) The provisions of subrule (1) of this rule do not apply to persons approved by the commission and named on a*

*participation permit issued to the licensee. Upon written request of the licensee, the commission may issue a participation permit to a licensee who meets all of the following qualifications:*

*(a) The non-licensed person who receives use or benefit from the licensee's license or who receives gross or net profits from a licensed business shall meet the same qualification as a licensee as prescribed by R436.1101.*

*(b) The licensee makes application and either cancels an existing participation permit or receives a new participation permit before adding or deleting any participating non-licensed person...*

- A. Changes in the existing rules regarding the sharing of profits. Currently anyone who receives any compensation based on gross sales of the licensed business must be approved by the commission and named on a participation permit. The common and often preferred practice within all industries today is to reward employees with compensation, including bonuses, based on performance. However, as the rules are currently written, any employee of a licensed corporation who is compensated in such a way – even if that compensation amounts to less than 1% of the licensee holder's gross or net profits -- must be approved through a participation agreement which requires many steps including fingerprinting.

The Subcommittee suggests the addition of the following new rule to reflect the realities of management compensation in today's work world:

*“The provisions of sub rule (1) of this rule do not apply to employees of the licensee who receive a portion of*

*their wages based on profits of the business, wherein, that portion of wages does not exceed 10% of the gross sales of the licensed business.”*

B. Management Agreement rule should be substantially altered to permit the following:

(1) New type of management agreement entitled “*Management Agreement Pending Transfer (MAPT)*” that is submitted with license application; no licensee shall be permitted more than two “MAPTs” in a lifetime.

(a) This type of agreement should be limited to a duration of six months, with one possible six month extension for good and quantifiable cause.

(b) Profits may flow to the manager while the licensee of record retains liability until the license transfers to the manager/applicant.

**4. Self-reporting and implementing changes in licensed establishments.** Current practices require pre-inspections for existing licensees who want to expand their businesses. This requires the licensee to send a written request to MLCC-Lansing and wait for an inspection to be assigned to an investigator. Following a visit to the site, the investigator must submit a written report with recommendations. This report must then be reviewed by a supervisor and returned to MLCC-Lansing for approval. This routine is a disincentive to those businesses that are expanding, which in turn deters the proceeds from sale increases reaching the state treasury, thereby impeding job and economic

expansion. The subcommittee recommends the following changes:

- A. Additions and deletions of space at licensed SDM locations should be approved upon payment of the fee along with submission of the application and new diagram of licensed establishment. SDD and on-premises license investigations for added/dropped space shall be dramatically reduced in scope to simply verify compliance with MLCC permits, Rules 436.1133 (SDD “half mile rule”) and 436.1503 (church/school within 500’)
- B. The Commission should again give consideration to eliminating the so-called SDD “half-mile” rule (R436.1133).
- C. Additions of customer serving bars at on-premises locations should be approved upon the payment of fee without prior investigation.

These changes would more efficiently utilize the time of field investigators by eliminating some inspections and allowing them to perform inspections at a convenient time after approval has been granted.

**5. Maintain current ownership information in an efficient manner.** Improve efficiency by eliminating the requirement for the form LC-50-2 (change in ownership interest) and instead require a form similar to the LC-52 (report ownership interest, officers, and authorized signers) along with the licensing renewal form. **Licenses will not be renewed without submission of the LC-52-type form, thereby guaranteeing an annual up-to-date ownership record.** Current Commission requirements for notification of changes in ownership interest do not currently address Limited Liability Company members and are filed separately from license renewal on July 1 each year.

This oftentimes necessitates two separate transactions by the agency and the affected licensee within two months of each other in a particular year.

The subcommittee recommends moving the date for filing officer and stockholder forms to coincide with licensee renewals, thus saving the expense and staff time in handling two separate transactions within months of each other. Information veracity can be verified on a random basis after submission.

Changing this notification will update the Commission's ownership records on an annual basis and will eliminate many future violations and transfer-of-license delays due to unreported ownership changes on the part of the licensee.

**6. Institute a two-year pilot program that decentralizes the license application process in a designated LCC Enforcement District Office, bringing the process closer to the licensee.** One of the more startling statistics the subcommittee learned was that **65 percent** of initial license applications surveyed in one test period were submitted incorrectly. This delays the licensing process at its earliest stages, while the agency sends a "Notice of Deficiency" through USPS mail and awaits a reply. The agency is working a redesign of the licensing application to reduce the incidence of simple errors, such as not submitting the correct application fee. However, the practice of sending all applications to Lansing and then having each application "authorized for investigation" and sent back to a district for investigation is an invitation to unnecessary processing delay. Each time an application is sent back and forth from Lansing, a minimum delay of a week or more is encountered. This delay in either putting a new license into operation

or transferring a license to a motivated licensee not only frustrates the applicant licensee, but also reduces tax and wholesale fee collections.

The subcommittee recommends that for a period of two years, the agency select one of its three non-Lansing based enforcement districts to pilot a program whereby all applications are originated at the district office. Under this program, the applicant licensee would apply to the district staff who would work with the applicant to ensure all portions of the license application are completed, local investigations undertaken and appropriate fees submitted when the application is filed at agency headquarters. Primary responsibility for accuracy and completeness prior to submission to agency headquarters would rest with the district supervisor and the district staff. Further, such a system would introduce an element of that business motivator, competition, into the operations of a government agency: which system produces the most quickly assembled yet complete application for Commission consideration, with the fewest errors. All districts are headed by supervisors with several years experience who, if given the requirements, instruction, staff support, and equipment necessary to produce applications suitable for Commission review, can draw upon that experience to deliver complete applications in a timely fashion.

The subcommittee recognizes this recommendation is counter-cultural in that it devolves control and responsibility from the traditional power at the centralized seat of government. Yet, since ultimate license approval remains with the Commission itself, the power remains in the headquarters while the selected field organization is freed to be responsive to fluid local situations at a far faster response rate than can the headquarters.

**7. Increase sales opportunities for in-state sale of spirits by allowing intra-county transfer of SDD licenses.** The number of SDD (packaged spirits) licenses is limited by both quota and a host of other requirements, including whether an SDD licensee already exists within a half-mile of the proposed licensed location. While this situation does not

necessarily hinder consumer convenience in the state's urban areas, it can sharply limit availability in rural, particularly resort, areas, where the permanent population swells substantially every summer. The current Commission Rule and Code severely limit the transfer of SDD licenses outside of a *local* governmental unit. In resort areas, this makes it more difficult for out-of-state visitors to purchase packaged spirits within the state, and encourages illegal smuggling. The subcommittee recommends the existing SDD rules be modified to allow intra-county transfer of packaged spirit licenses. This parallels the change enacted a decade ago that allowed intra-county transfer of Class C licenses.

**8. Conduct an agency staffing evaluation to determine the optimum number, best positioning, number of staff and equipment needed to accelerate the licensing process.**

**9. Pursuant to increased costs for application processing, increase MLCC inspection fee to \$250 for any license application, regardless of number of licenses at the location. (Current inspection fee is \$70 per license)**

**10. Increase the maximum fine to \$500 for non-Section 801(2) (sale of alcohol to minor) violations. The current maximum \$300 fine has not been adjusted in decades and is much lower than many other states.**

### **SUMMARY and CONCLUSIONS**

Y The subcommittee discovered, as has previous similarly convened panels, a

number of cumbersome code provisions and rules that are non-conducive to the hospitality business in the 21<sup>st</sup> century. Michigan needs to continually revisit its liquor regulations to ensure the basic requirement to protect public health and safety is realized without imposing regulations that have little or no effect advancing that goal. ADOPTING THESE RECOMMENDATIONS IS A START, but it should truly be a continuous review. Many states, especially those which cater to the hospitality industry; have licensing periods as short as 60 days. The Subcommittee recommends the Commission commit itself to that goal and not rest until it is achieved.

- Y Since its formation the subcommittee met on a monthly basis for minimum half-day sessions. Individuals also participated outside of these meetings with trade groups, attorneys and others.
  
- Y At the start of the subcommittee's journey each member pledged to bring an open mind and ears to the table. There were a number of very vigorous debates among the subcommittee members, sometimes over the same issue at repeated meetings.
  
- Y Recommendations in this report are listed in their order of importance as determined by the Subcommittee.

Signature Page for Licensing Subcommittee Report  
Customer Advisory Committee  
Liquor Control Commission

As set forth this 18<sup>th</sup> day of October, 2005:

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