IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

ANHEUSER-BUSCH, INC. et al.,	)	
	)	
Plaintiffs,	)	
	)	Case No.: 10-CV-01601
vs.	)	
	)	Hon. Robert M. Dow, Jr.
	)	
STEPHEN B. SCHNORF, et al.,	)	
	)	
Defendants.	)	

AFFIDAVIT OF PAMELA S. ERICKSON

1. My name is Pamela S. Erickson. I make this affidavit based on my personal and professional knowledge of alcohol regulation and research involving alcohol policy. I currently own a small business based in Scottsdale, Arizona. That business, Public Action Management, PLC, involves consulting on alcohol policy issues and providing an educational program called the "Campaign for a Healthy Alcohol Marketplace." From 2003 until 2007, I managed statewide media education and leadership advocacy programs designed to reduce underage drinking for Oregon Partnership, a non-profit dedicated to alcohol and drug abuse prevention. From 1996 to 2003, I was Executive Director of the Oregon Liquor Control Commission. In that capacity, I was responsible for administering and enforcing all statutes of the Liquor Control Act, licensing approximately 10,000 businesses, and managing the state's distilled spirits business with 240 retail outlets and a wholesale operation. I have a B. A.

in political science from Portland State University and a M.A. in Government from Georgetown University in Washington, D.C.

2. **<u>Allowing manufacturers to distribute alcohol will decrease competition and increase the monopolistic practices of a marketplace already dominated by two very large companies. Such domination will likely increase public health and safety problems and costs to the taxpayer.</u>** The United States beer market is dominated by two companies that comprise 80 percent of the US beer market: Anheuser-Busch and the joint venture of SAB Miller/Molson Coors. It has been characterized as a "duopoly" by the Marin Institute in their report, "Big Beer Duopoly, A Primer for Policymakers and Regulators." (See Exhibit A) These companies also dominate the alcohol market in general, as beer is the type of alcohol most frequently consumed by Americans including underage youth and binge drinkers.

In his book, "Paying the Tab, The Economics of Alcohol Policy," Professor Philip J. Cook, notes that while alcohol is no longer widely condemned, "Alcohol abuse is all too prevalent, and an endemic source of harm in the form of injuries, early death, unfulfilled potential, family strife, crime, and violence." (Preface, p. 1) The National Institute on Alcohol Abuse and Alcoholism estimates the economic cost is $185 billion a year in medical costs, lost productivity, crashes, and accidents. An update of that cost for 2005 is much higher: $220 billion for 2005. (See Exhibit B) Our prisons are filled with people who committed their crime under the influence of alcohol. Frequent heavy alcohol consumption harms virtually every organ in the body and is associated with such serious problems as cancer and liver disease. Underage drinking is threatening to dull the potential of our youth as children begin drinking at younger and younger ages. According to the Surgeon General, 5,000 lives are lost per year due to underage drinking. Youth are drinking at younger and younger ages. About 10% of 12 year olds say they have used alcohol. By age 13 that number doubles. By age 15, 50 % have used it. When youth drink, they drink a lot...an average of 5 drinks on occasion. (The Surgeon General's Call to Action To Prevent and Reduce Underage Drinking, 2007, US Department of Health and Human Services). A comprehensive list of alcohol harms compiled by the Marin Institute is included as Exhibit B. As explained below, market domination by large foreign manufacturers will likely increase consumption of both youth and adults as they continue to push for deregulation that will facilitate selling more product.

3. **Allowing manufacturers to distribute beer will pave the way for vertical integration, a monopolistic practice which the alcohol system designers were attempting to avoid.** Vertical integration occurs when the manufacturing, distribution and retail sectors merge either by ownership or financial arrangement. Before Prohibition, alcohol was sold almost exclusively in "saloons" which were primarily owned by large national manufacturers. These manufacturers, motivated by extracting the highest possible profit, pushed the retailer "saloons" to aggressively sell the product, which in turn, created major social problems with public intoxication, violence, and addiction. Problems were so severe that the drastic step of Prohibition was taken. During Prohibition the legitimate alcohol marketplace was completely eliminated.

After Prohibition the alcohol market had to be reestablished. Since states were given the responsibility to regulate alcohol, each state had to design a new marketplace. With little expertise in such matters, most states relied on the recommendations of a study financed by John D. Rockefeller, a prominent entrepreneur who originally favored Prohibition, but changed his mind once he saw its poor results. The study, Toward Liquor Control, was written by R.B. Fosdick and A.L. Scott, after investigating alcohol regulatory systems around the world. An extensive discussion of the history and original purpose for design of the alcohol regulatory systems can be found in *Wendell J. Manuel dba Jungle Lounge & Restaurant, et al v. State of Louisiana, Office of alcohol and Tobacco Control, et al* . Fosdick and Scott were concerned that a market without checks on the profit motive would encourage private businesses to sell more alcohol; buy political influence and lax enforcement; and, violate laws. While they favored a state owned monopoly system, most states adopted a "license system." The *Manuel* case quotes Fosdick's and Scott's recommendations about how a licensing system can eliminate or curtail the profit motive by extending the price control provision to the wholesale tier. (See p. 4, paragraph 4.) All states adopted some version of the "Three-tiered System." The *Manuel* case explains the importance of such a system, "Without the three-tier system, the natural tendency historically has been for the supplier tier to integrate vertically. With vertical integration, the supplier takes control of the manufacture, distribution and retailing of alcohol beverages from top to bottom. The result is that individual retail establishments become tied to a particular supplier. When so tied, the retailer takes its orders from the supplier who controls it, including naturally the supplier's mandate to maximize sales." (See p.9-10, paragraph 9) "The three-tier system was implemented to counteract all these tendencies. Under the three-tier system, the industry is divided into three tiers, each with its own service focus. No one tier controls another. Further, individual firms do not grow so powerful in practice that they can out-muscle regulators." (See p. 10, paragraph 9)

Today's marketplace is somewhat different than the former "saloon system", but equally threatening as will be demonstrated in the United Kingdom example below. There is good reason to believe that elimination of the middle tier is a long-term economic goal of Anheuser-Busch as it seeks to further monopolize the US beer market. In an article for <u>Beverage World</u>, Heather Landi noted that AB InBev was "studying the possibility of streamlining its network of independent US beer distributors, with the idea of someday selling up to as much as 50 percent of the US beer volume directly to retailers through its own distributors." (<u>Beverage World</u>, August 15, 2009).

As the Marin Institute report states, "The distribution tier is a vital component of the three-tier system. Distributors help act as a buffer between potentially overzealous producers and retailers. Publicly traded alcohol producers and increasingly, big box retailers, care more about turning a profit than placing limits on the sale of a potentially dangerous product."

<u>4. Alcohol is a different product in the sense that standard business practices can produce harmful results. Therefore, special regulations are warranted to preserve public health and safety.</u> A quick illustration will clarify the need to restrain alcohol sales practices. Imagine you decide to purchase a floral business. You would first develop a business plan. Very likely, you would seek to identify your "best customers", i.e. those people who are frequent buyers of flowers. Your goal would be to strengthen and increase that "frequent buyer" customer base. You would do that by advertising, promotions, coupons, discounts and other standards techniques. You would also advertise and promote the product to young people as they are your next generation of customers. These are standard, legitimate business practices taught in all business schools. But, if you substitute alcohol for flowers, you can see the problem. The "best customer" category includes underage drinkers, alcoholics and heavy/abusive drinkers. The "underage market" has been estimated between 11-19% (Philip Cook, Paying the Tab, Chapter 12, Footnote 2) and those in the heavy drinker category purchase a very large amount of alcohol. Clearly, we do not want these markets to get larger.

5. The United Kingdom is an example of how "deregulation" has reduced competition, increased marketplace domination of large companies and created a virtual alcohol epidemic. The United Kingdom once had an alcohol regulatory system that served as a model for the US. That is no longer the case as they slowly deregulated over many decades to the point where alcohol is available 24 hours a day, seven days a week. (See Exhibit C., Pamela S. Erickson, The Danger of Alcohol Deregulation: The United Kingdom Experience.) As the British Medical Association Board of Science notes, "Since the Second World War, there has been considerable deregulation and liberalization of alcohol control policies in the UK. This has been accompanied by an increase in consumption levels and alcohol-related problems." Today, the UK has one of the highest drinking rates in the world and their underage drinking rates are almost twice that of the US. Liver cirrhosis rates have doubled in over a decade; town centers are plagued with intoxication, public nuisance crimes and violence.

As regulations fell, the UK alcohol marketplace changed. The grocery market became extremely powerful as four large chains came to capture 75% of the market. These chains typically do not use distributors, but have direct financial arrangements with suppliers. They have become vertically integrated. This practice allows them to use their quantity buying power to obtain large amounts of product from suppliers at very favorable rates. This enables them to offer alcohol at cheap prices, regularly use alcohol as a loss leader, and promote products very heavily. According to the UK's Institute of Alcohol Studies, "The Competition Commission have found that the five leading grocery retailers sold 38.6 million pounds (about $57 million) worth of alcohol at below-cost during the 2006 World Cup. Supermarkets know full well that drinks promotions linked to such events entice consumer to buy more alcohol and to drink more alcohol." Alcohol became 70% more affordable from 1980 to 2007 with increased consumption and public health and safety problems following in the wake.

The UK's solution was to institute a large tax increase. Ironically, the UK already had one of the highest alcohol tax rates in the European Union; and, the additional tax did very little to change things. The large grocery chains are so economically powerful that they can compel the suppliers to absorb tax increases. They also can adjust prices of other products to make up a loss for alcohol as cheap alcohol is considered a critical tool to lure shoppers to one chain's store versus another.

Grocery chains in the UK and the US make extensive use of mass merchandising techniques whereby they make money on volume not mark-up. As explained by the Food Marketing Institute, "Low markup to stimulate high volume is the fundamental principle of mass merchandising." (See "Competition and Profit" Food Marketing Institute, website document.) A dependency on high volume sales for alcohol increases the pressure to promote the product very heavily even to vulnerable populations.

6. Research on effective alcohol policy emphasizes the importance of a systematic approach with multiple methods of controlling price, availability and promotion. An extremely important consideration in this case is the value of a comprehensive system designed to maintain a marketplace that prevents excessive promotion, balances price, fosters fairness and accommodates businesses of all types: large, small, in-state and out-of-state. An overarching goal of an alcohol regulatory system is to prevent large quantities of heavily promoted cheap alcohol from flooding the marketplace. The US regulatory systems do that by controlling price, availability and promotion with multiple methods. This approach follows recommendations of the World Health Organization. The WHO has reviewed research from around the world and produced a report entitled, "What are the most effective and cost-effective interventions in alcohol control?" (WHO, February 2004) They warn that there is no silver bullet for alcohol control—which the UK has tried via a large tax increase. They advise that multiple policies be implemented in a systematic way. Such policies should address price, availability, promotion, age restrictions and drunk driving measures.

Of particular importance is price. It is a well established principle of economics that when prices go up, some people buy less of the product. It is called the elasticity factor. Alcohol is elastic which means that when prices are cheap, more people buy more product. As the WHO notes, "There is substantial evidence showing that an increase in alcohol prices reduces consumption and the level of alcohol related problems (WHO, p. 4)." Their review of research has also revealed that price impacts all classes of drinkers—even heavy drinkers—and is especially impactful on youthful drinkers. (WHO, p.7)

The Three-tiered system acts to moderate price. By requiring the product to be sold through an independent distributor, the retailer and supplier cannot readily execute large favorable price agreements. While this does occur in some states, such favorable prices must be offered by distributors to <u>all</u> retail customers, thus discouraging extreme competition on price which would drive up consumption.   Some states also ban volume discounts and other methods designed to offer extremely low prices.

While the US has problems with alcohol, it has been remarkably successful in achieving the social goal of moderation in consumption. A report from the Centers for Disease Control and Prevention, using 2005-2007 data from their National Health Interview Survey, found that of American adults 39% do not drink at all, 12 % drink rarely (1-11 drinks per year), 29% are light drinkers (3 or less per week) and 5% are moderate drinkers (3-14 per week for a male and 3-7 for a female). Only 5 % were classified as heavy drinkers.

After Prohibition, there was a widespread belief that alcohol could not be effectively controlled. But, as one author observed, "…alcohol control has quietly and effectively organized and managed the production, distribution and sale of alcohol, as well as much of the social life associate with drinking." (See Harry Levine and Craig Reinarman, Establishing an Alcohol Control System, www.drugtext.org/library/articles.)

The danger now is that the alcohol control systems' effectiveness is taken for granted and we have forgotten many of the reasons for our comprehensive system. In addition, piecemeal deregulation threatens to weaken our comprehensive system as one regulation at a time is eliminated. This is exactly what happened to the United Kingdom over four decades. We should take that lesson to heart.

7. Importance of local ability to curb alcohol problems in local communities —Illinois' interest in curbing problems while maintaining a vibrant, competitive alcohol market. The alcohol system designers were keenly aware of the need for local control over alcohol problems. According to Fosdick and Scott, the tied-house system had all the vices of absentee ownership: "The manufacturer knew nothing and cared nothing about the community. All he wanted was increased sales. He saw none of the abuses, and, as a nonresident, he was beyond local influence." (Fosdick and Scott, p. 43) No matter how benevolent a company might be, they still are primarily beholden to shareholders; and, foreign companies should not be expected to empathize with local communities to the point that they will limit their profit-making ability.

When problems with alcohol occur, they are invariably local problems: the bars that serve intoxicated people who then drive drunk, the youth that obtain alcohol far too easily, and the addicts that ratchet up costs for the health care systems. As a former regulator, I can attest to the fact that local companies are more responsive to local concerns and issues. They are impacted by local publicity and pressure to follow regulations. Moreover, a regulatory agency can require their presence at a hearing or a meeting with an investigator. That is exceptionally difficult with an out of state licensee; and even more difficult for a company that takes its orders from the owner in a foreign country. Even reaching someone with authority to address an alleged violation can be difficult. While a state regulator can cite an out-of-state licensee, it is very difficult to carry out. Unless the company chooses not to contest the matter, an expensive course of litigation is the usual result. Most regulatory agencies don't have large legal budgets and their justice departments have other priorities. Large companies are well aware of these facts and recognize that just threatening a lawsuit can result in no action on the matter. Usually, things just get dropped.

In many states, the alcohol control system embodies the value of local business presence in terms of regulatory effectiveness. Some states restrict corporations from owning multiple liquor stores. Other states require some level of local ownership. This should not necessarily be viewed as favoritism or protectionism. Apparently, Illinois has allowed two very small brewers to "self-distribute". Several states also allow small manufacturers to do a limited amount of distribution in order to get their product to market. In some cases, this may have food safety implications as unpasteurized beer is perishable and must be purchased by the customer within a short window of time. As an alcohol regulator in Oregon, I witnessed the exceptional growth and vibrancy of a small winery and craft brewery market as exceptions were made for very small operations. However, if it should be determined that allowing these small operations to distribute is unlawful; I would anticipate that lawmakers will correct the law to preserve the Three-tiered System. Not doing so would destabilize the market, disadvantage small operators and allow for further monopolization of Illinois' beer market. In the long run, consumption would likely rise with its inevitable social problems.

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Pamela S. Erickson

Sworn to before me this _______ day of
May, 2010

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Notary Public