



Virginia Department of Planning and Budget **Economic Impact Analysis**

3 VAC 5-50 Retail Operations
Virginia Alcoholic Beverage Control Authority
Town Hall Action/Stage: 5857 / 9448
November 30, 2021

The Department of Planning and Budget (DPB) has analyzed the economic impact of this proposed regulation in accordance with § 2.2-4007.04 of the Code of Virginia (Code) and Executive Order 14 (as amended, July 16, 2018). The analysis presented below represents DPB's best estimate of these economic impacts.¹

Summary of the Proposed Amendments to Regulation

The Virginia Alcoholic Beverage Control Board of Directors (Board) proposes to allow percentage-based payments to management companies and promoters hired by the licensee to handle operational duties on behalf of the licensee, provided that the management company or promoter receives less than 10 percent of the business income.

Background

Currently, the regulation prohibits percentage-based payments to third parties except for two instances where the percentage-based payment is a franchise fee or a rent payment. The purpose of the general prohibition against the percentage-based payments is to prevent otherwise unqualified individuals from operating a licensed business (e.g., hidden ownership).

The proposed changes would create an additional exemption to the general rule and thereby allow percentage-based payments to a management company or promoter if the payment is less than 10 percent of the business income. According to the Virginia Alcoholic Beverage

¹ Code § 2.2-4007.04 requires that such economic impact analyses determine the public benefits and costs of the proposed amendments. Further the analysis should include but not be limited to: (1) the projected number of businesses or other entities to whom the proposed regulatory action would apply, (2) the identity of any localities and types of businesses or other entities particularly affected, (3) the projected number of persons and employment positions to be affected, (4) the projected costs to affected businesses or entities to implement or comply with the regulation, and (5) the impact on the use and value of private property.

Control Authority (Authority), compensation structures in management agreements based on the percentage of income for a licensed business have been more common in recent years. Examples of such agreements include operation of a restaurant in a hotel or operation of a food-court business in a mall. In such situations, a party may own the location and may wish to reap most of the profits from that location but may not have the business expertise to run it in instances where alcoholic beverages are served. The 10 percent threshold is rooted in the statutory disclosure requirements whereby an ownership percentage above the threshold is subject to background checks.²

Estimated Benefits and Costs

It is not unusual for an entity or an individual to have the capital or real estate needed to start a business that requires an alcoholic beverage license, but to lack the experience needed to run such a business. The proposed regulation would accommodate such entities or businesses by allowing them to hire other individuals or entities with expertise to run such businesses based on a percentage of revenues. Currently, the Authority does not tolerate such compensation structures and once identified the licensees are usually forced to modify their licenses to reflect a status as joint owners, which triggers a need for all owners to comply with the ownership requirements (such as background checks and liability) as is already required for the primary licensee. The joint license requirements currently discourage this type of business model by imposing requirements on an individual or entity who has the expertise to run such a business but may lack the capital or the real estate to operate it.

Other requirements will remain in place which would likely help prevent the abuse of this new exception. These include the 10 percent threshold on percentage-based payments, and the requirement that the Authority be provided a copy of the contract indicating that the management company or promoter is an agent of the licensee for the purposes of exercising the privileges of the license and the licensee is liable for any violations of Title 4.1 (the Alcoholic Beverage and Cannabis Control Act) or of Board regulations that may be committed by the management company or promoter.

² See §§ 4.1-222 & 4.1-225 of the Code of Virginia.

In summary, the proposed amendments would remove a barrier to forging partnerships by allowing capital or real estate resources to work with operational expertise while minimizing the risk of hidden ownerships or violations of laws and regulations.

Businesses and Other Entities Affected

According to the Authority, there are 20,648 licensed businesses in the Commonwealth. Of these, 713 currently utilize management agreements. A subset of the 713 licensees are most likely to take advantage of the newly available percentage based compensation structure. None of the licensees appear to be disproportionately affected.

The Code of Virginia requires DPB to assess whether an adverse impact may result from the proposed regulation.³ An adverse impact is indicated if there is any increase in net cost or reduction in net revenue for any entity, even if the benefits exceed the costs for all entities combined. As noted above, the percentage based payments represents a new business friendly compensation structure option. Thus, no adverse impact is indicated.

Small Businesses⁴ Affected:⁵

The proposed amendments do not appear to adversely affect small businesses.

Localities⁶ Affected⁷

The proposed amendments do not introduce costs for local governments.

³ Pursuant to Code § 2.2-4007.04(D): In the event this economic impact analysis reveals that the proposed regulation would have an adverse economic impact on businesses or would impose a significant adverse economic impact on a locality, business, or entity particularly affected, the Department of Planning and Budget shall advise the Joint Commission on Administrative Rules, the House Committee on Appropriations, and the Senate Committee on Finance. Statute does not define “adverse impact,” state whether only Virginia entities should be considered, nor indicate whether an adverse impact results from regulatory requirements mandated by legislation.

⁴ Pursuant to § 2.2-4007.04 of the Code of Virginia, small business is defined as “a business entity, including its affiliates, that (i) is independently owned and operated and (ii) employs fewer than 500 full-time employees or has gross annual sales of less than \$6 million.”

⁵ If the proposed regulatory action may have an adverse effect on small businesses, Code § 2.2-4007.04 requires that such economic impact analyses include: (1) an identification and estimate of the number of small businesses subject to the proposed regulation, (2) the projected reporting, recordkeeping, and other administrative costs required for small businesses to comply with the proposed regulation, including the type of professional skills necessary for preparing required reports and other documents, (3) a statement of the probable effect of the proposed regulation on affected small businesses, and (4) a description of any less intrusive or less costly alternative methods of achieving the purpose of the proposed regulation. Additionally, pursuant to Code § 2.2-4007.1, if there is a finding that a proposed regulation may have an adverse impact on small business, the Joint Commission on Administrative Rules shall be notified.

⁶ “Locality” can refer to either local governments or the locations in the Commonwealth where the activities relevant to the regulatory change are most likely to occur.

⁷ § 2.2-4007.04 defines “particularly affected” as bearing disproportionate material impact.

Projected Impact on Employment

To the extent the proposed allowance for percentage payments help start new businesses, a positive impact on employment can be expected.

Effects on the Use and Value of Private Property

To the extent the proposed allowance for percentage payments help start new businesses, a positive impact on asset values of parties on both sides of the agreement and on the value of real estate involved may be expected. The proposed amendments do not appear to directly affect the real estate development costs.