

**ALASKA LEGISLATURE COMMITTEE FILES 1997-1998 8672**

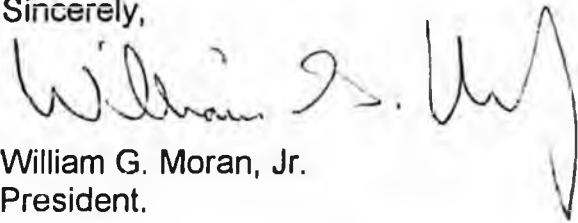
**9624 SENATE LABOR & COMMERCE**

recapture our investment will directly impact the level of investment and the locations where new ATM's are economically feasible.

If the legislature thinks that government interference in the market place is going to improve the quality of financial services available to Alaskan consumers, or help relatively small regional organizations like First Bank compete with giant, statewide or national financial conglomerates it has not studied history very well. The law of unexpected consequences is still very much alive and well. If the proposed legislation is allowed to pass in its present form, surcharges will be a non-issue for many rural Alaskans because the government will have made the decision that they do not need access to a cash machine whether they are willing to pay for it or not.

If you have any questions or need any additional information, please contact me.

Sincerely,

A handwritten signature in cursive script, appearing to read "William G. Moran, Jr.", written in dark ink.

William G. Moran, Jr.  
President.

Cc: Willis Kirkpatrick, Director of Banking

**Alaska Bankers Association**  
Anchorage, Alaska 99510-0500

MAR 09 1998

P.O. Box: 100600

(907) 265-2920

March 9, 1998

Senator Loren Leman, Chairman  
Senate Labor & Commerce Committee  
State Capital, Mail Stop 3100  
Juneau, AK 99801-1182  
Via Fax: (907) 465-3810

RE: SSB212 An Act Banning Automated Teller Machine  
Surcharging

Dear Senator Leman:

As presented in our formal testimony, the Alaska Bankers Association is opposed to SSB212. We do not believe that a Republican-led Alaska State Legislature would want to place price controls on a competitive industry. Were SSB212 to become law, many ATM's set up throughout Alaska for customer convenience would be shut down and almost all new ATM deployment would be curtailed. Many small businesses in Alaska, who have leased these machines to serve their customers, would lose their machine income and be left with expensive lease payments.

As was noted in testimony on SSB212, to date there have been no complaints about either ATM surcharges or ATM safety. Therefore, we believe there is no reason for the government to get involved in placing controls on this industry. As you are also likely aware, the State controlled Alaska "Quest" card, which now makes available electronic benefit transfers to southeast Alaska families receiving general assistance, food stamps, or AFDC makes cash available to recipients with no ATM fees. This EBT Quest program will spread to other areas of Alaska over the next year again with no ATM fees for recipients.

Allowing ATM suppliers to recover their costs has led to more consumer choices each month on where to get cash and at the time the consumer wants it. Greater competition in ATM service has resulted in more machines in more locations with more customer convenience. Free market competition will determine what is a fair and profitable rate for the many convenience stores, gas stations, shopping malls, hotels, restaurants, and, yes, banks who provide this service for consumers.

Senator Loren Leman, Chairman

3-9-98

Page 2

Setting unneeded price controls would only handicap business, reduce customer convenience and limit customer choice. That is why the U.S. Chamber of Commerce and the National Grocers Association have also joined the banking industry in opposing such legislation.

We urge you to vote against SSB212.

Sincerely,



Ron Kukes

President

Alaska Bankers Association

cl

cc: Members of Senate Labor & Commerce Committee  
Willis Kirkpatrick, Director of Banking

## ATM Access Fees – Information Kit

### Foreword

ATMs have revolutionized the way Americans conduct their banking – they allow customers to bank 24 hours a day, seven days a week, across town, and across the world. With this convenience comes a cost – like paying for a taxi versus the bus, using FedEx versus regular mail. In making technology widely available that ensures the security and accuracy of ATM-using customers' accounts, some ATM owners impose access fees, or so-called "surcharges", on customers using ATM machines outside of their own bank's network. Offsetting the high cost of deploying and maintaining the machinery means that customers can have access to their accounts at locations such as hospitals, airports, hotels, and theme parks – places where it was previously too costly to maintain ATMs.

A recent flurry of attention on access fees from the media and consumer advocates has prompted some in Congress to introduce bills that would tighten existing disclosure regulations and even ban ATM access fees altogether. These bills may have an emotional appeal. However, this is an issue that deserves a careful, deliberate hearing. The following enclosures get to the heart of the issue and expose the reality of ATM access fees.

- The Facts About ATM Access Fees: a Q&A piece that clarifies the facts about the nature and benefits of ATMs and access fees.
- Consumers Have Many Choices to Avoid Paying ATM Access Fees: covers the myriad of options consumers have to avoid incurring any access fees, while demonstrating that many consumers *are* willing to pay for the added convenience of ATM availability.
- Price Controls Would Stifle ATM Competition: an in-depth piece that covers the costs of ATM operation, the failure of price controls, and how flexibility in pricing enhances competition, benefiting all consumers.
- Consumers Are Informed of ATM Access Fees: a one-pager outlining the existing rules requiring access fee disclosure.

As with any service, ATM pricing is a matter of competition that should be left to the marketplace to determine.

We hope you find this information helpful.

## FACTS ABOUT ATM ACCESS FEES

Recently, there has been a lot of attention given to ATM access fees (or "surcharges") and with it, much misunderstanding about the nature and benefits of ATMs and access fees. Too often ignored in access fee discussions is how they have enhanced consumer convenience by increasing the number of ATMs. More ATMs now give consumers access to their funds 24 hours a day in locations where cash would otherwise not be available. It is also important to recognize that consumers have many choices if they do not wish to pay for the convenience of using a particular ATM that imposes an access fee.

It is also worth noting that ATM access fees are not new and banks are not making huge profits on ATMs. In addition, ATMs are not a substitute for tellers and have not reduced bank costs as had been expected. The following questions and answers should help clarify key points about ATMs and access fees.

### *What are ATM access fees?*

ATM access fees are fees imposed by the *owner* of an ATM. The owner may be a bank or a non-bank. Bank ATM owners typically do not impose this fee on their own customers. A "foreign transaction fee," in contrast, is a fee imposed by the customers' own bank when they use an ATM not owned by their bank. This fee covers the bank's interchange and other networking costs.

### *Is an ATM access fee a double charge?*

An ATM access fee is not a "double charge" in that a single entity is not charging the customer twice for the same transaction. An access fee is actually an additional fee for an additional service. When using an ATM not owned by the consumer's bank, the consumer's bank often charges for the use of the ATM network (e.g. MOST, PLUS, Cirrus,). On the other hand, the access fee is paid to the ATM *owner* to cover its costs related to the maintenance and operation of the ATM hardware. Consumers pay similarly for other types of service. For example, for a single telephone call, hotel guests often pay a fee to the hotel for use of its phone system as well as separate charges imposed by the telephone company.

### *Are ATM access fees new?*

Access fees first appeared in the late 1980's as a result of a settlement between a regional ATM network and one of its member banks that threatened to sue unless access fees were permitted. In 1990, the Ninth Circuit Court ruled that a Nevada state law permitting access fees was constitutional. Since then, *fifteen* states have passed laws specifically overriding network prohibitions on ATM access fees in order to encourage the installation of more ATMs.

As a consequence of these state actions, effective spring 1996, two national networks, Cirrus (owned by MasterCard) and Plus (owned by VISA), changed their rules to permit their

members to impose access fees. This does not mean that all ATM owners will impose them, only that they *may* impose such fees.

### ***Are banks making huge profits from ATMs?***

Contrary to popular press reports and claims by consumer groups, ATMs are *not* highly profitable. In fact, for the industry as a whole, they lose money. According to the Federal Reserve Board's *Functional Cost Analysis*, on average, *expenses exceed revenues by thousands of dollars per machine per year*. Losses vary tremendously, but average about \$10,000 per machine per year. Consumer groups claim that banks are making a large profit, even though they acknowledge that it actually costs more to provide ATM service than the revenues an ATM generates. They calculate profits based on the difference between what the banks *actually lost* and what they *would have lost* had ATM transactions been teller transactions. Labeling losses as profits on the theory that the losses would have been higher if ATM transactions had been teller transactions is a novel way to calculate profits.

The costs of installing and maintaining an ATM will vary based on individual circumstances. Initial and continuing expenses to provide ATM service include the cost of:

- ATM purchase, installation, and maintenance;
- ATM enclosure and "surrounds";
- rent if not on premises owned by ATM owner;
- signage;
- security;
- cash replenishment and associated security;
- deposit pick-ups and processing;
- network costs; and
- other communication costs.

### ***Why do banks charge for ATM use when ATM transactions cost less than teller service?***

ATMs are not a substitute for teller transactions: rather, they are a *complement* to teller transactions. In fact, to a large degree, ATMs have grown into a separate delivery mechanism for bank services. ATMs were first introduced as an instrument to increase customer convenience and, it was hoped, to reduce bank costs. However, because of competitive pressures and

consumer habits, they have not proved to be a less expensive teller substitute. For example, customers tend to use ATMs more often and withdraw less than they do for teller transactions. Thus, while an individual ATM transaction may cost less than a teller transaction, ATM users make more transactions, increasing overall costs. Furthermore, ATMs have not reduced the number of teller branches. The number of teller branches today is greater than in 1985.

Moreover, ATMs are no longer just machines available at or near banks. They are installed in shopping malls, airports, train and bus stations, hospitals, universities, convention centers, grocery stores, and other areas. Nor are they owned just by banks. In fact, the second largest owner of ATMs is a nonbank.

### *How do access fees benefit consumers?*

ATM access fees have made possible a significant increase in the number of ATMs available to consumers, greatly enhancing consumer convenience. After stalled growth, ATM shipments increased 40% in 1996, with a record 33,406 new terminals shipped, due largely to access fees. Today, about half of the nation's 93,000 convenience stores have ATMs – up from 41% in 1995. And, 63% of supermarkets have ATMs – in contrast to 56% in 1995. Further, states which have permitted ATM access fees for several years have experienced great increases in the number of ATMs deployed.

Consumers have benefited from the convenience. For example, a traveler arriving at the airport late at night who encounters an unexpected and expensive taxi ride is likely to be willing to pay an access fee to use a foreign ATM. Yet, without income from access fees, the ATM owner would probably not otherwise be able to justify deploying an ATM at the airport. Other examples of areas where the cost of installing and maintaining the ATM would be too high to justify without charging fees include hospitals, grocery stores, resorts, national and state parks, train and bus stations, hotels, shopping malls, college campuses, and special events such as fairs and conventions. ATMs are also often less expensive than alternatives such as travelers' checks.

### *Can consumers avoid ATM access fees?*

Consumers have many choices and may easily avoid ATM access fees. They may choose:

- **To use their own banks' machines.** Consumers can pay little or nothing for ATM transactions by simply using their own banks' machines.
- **To use an ATM that doesn't impose an access fee.** There are many ATMs available that do not impose access fees. For example, a New York Bankers Association survey of its members found that 110 out of its 126 members *do not* charge access fees to noncustomers. Out of 5,952 bank-owned ATMs in New York, *no* ATM access fee was charged to noncustomers at 4,831, or 81% of those ATMs. Moreover, the marketplace has responded to access fees with the formation of fee-free "ATM Alliances." Member banks of these alliances agree to provide free ATM access to customers of all alliance members.

- **To use alternative payment systems.** As an alternative to ATMs, consumers may also choose from a long list of other payment mechanisms including: checks; debit cards, including point of sale transactions that give cash back; credit cards; bank tellers; and travelers' checks.

Most customers find that the convenience of using ATMs, even if they must pay a small fee, is worth the price. Just as they pay a little extra for express mail, one-hour photo processing, or items in a convenience store, they are willing to pay for the convenience of using an ATM not owned by their bank.

***Do consumers know when they are being charged an ATM access fee?***

Under industry-drafted ATM network rules, ATM owners must post a notice that a fee will be imposed. Thus, consumers know about the fee even before they insert their card. In addition, after displaying the amount of the charge, the ATM screen must query users whether they wish to continue the transaction. Users may cancel the transaction without charge. ATM receipts also disclose the amount of the access fee pursuant to Regulation E.

***Will permitting access fees put community banks out of business?***

Experience in states such as Utah and Texas which have permitted access fees for several years indicates that small banks are well able to thrive even if large banks that own most of the ATMs impose access fees on noncustomers. Further, the Independent Bankers Association of Texas, an association of over 700 community banks, in its formal position on ATM access fees noted that such fees have provided income to community banks "making it possible for such banks to provide ATMs in otherwise unprofitable situations." In addition, small banks, particularly in rural areas, have said that they are able to deploy ATMs in low volume areas that they would not have, but for the permissibility of ATM access fees. They have also said that the ability to impose ATM access fees ensures banking services in some remote areas where a brick and mortar branch is not economical.

Further, over the last year, the marketplace has responded to ATM access fees by forming "Fee-Free ATM Alliances." Members of alliances agree that customers of any bank in the alliance may use their ATMs for free. For example, banks in California, Oregon, and Washington have to date committed more than 2,600 ATMs to be fee-free to customers of alliance members. Similarly, a consortium of 90 banks in Massachusetts have designated over 700 ATMs as free to members' customers.

## **Consumers Are Informed of ATM Access Fees**

Consumers receive timely disclosures about ATM access fees that allow them to make an informed choice. By adopting ATM network disclosure rules, the industry took the initiative to ensure that consumers understand when a fee is being imposed and its amount. Accordingly, legislation is unnecessary. Moreover, statutory responses are inherently inflexible and inevitably fail to anticipate impractical and inappropriate applications or future innovations in technology and the marketplace.

### **ATM Access Fees Are Disclosed at the ATM Before the Transaction Is Completed.**

- Industry drafted ATM network rules require that a sign be posted by the ATM indicating that an access fee will be imposed. Thus, consumers know before they even insert their card that they will be charged an access fee.
- In addition, these ATM network rules require that the amount of the access fee be disclosed on the screen and that the screen query users whether they wish to continue the transaction. Thus, consumers can choose to cancel the transaction if they do not wish to pay the access fee.
- Regulation E (The Electronic Fund Transfer Act) requires that the amount of any access fee either be posted near the ATM or displayed on the screen before the user becomes obligated to complete the transaction.

### **Consumers Receive Records of ATM Access Fees.**

- Regulation E requires that the ATM receipt include the access fee.
- Regulation E also requires that access fees be disclosed on the account periodic statement.

### **The Federal Reserve Board Has the Authority to Require Additional Disclosures.**

- The Electronic Fund Transfer Act gives the Federal Reserve Board the authority to require additional disclosures if necessary to ensure that consumers understand the fees being charged.

## Price Controls Would Stifle ATM Competition

Bills expected to be introduced in the 105<sup>th</sup> Congress would impose price controls on ATM services. As with any price-control measure, these would impede the burgeoning availability of ATMs, reducing customer convenience and limiting customer choice. The government's role in a free-market economy should not be to set prices in a competitive market, and the market for ATM service is certainly a very competitive one.

Moreover, ATM owners who have implemented access fees in order to help recoup their investment and to help cover their ongoing expenses have come under fire recently from consumer interest groups. Allegations have included the notion that service charges are somehow anti-competitive, or that banks are already fully recovering the costs of their ATM investments. Both of these claims are false.

### Flexibility in Pricing Enhances Competition

Greater competition in ATM service has resulted in more machines in more locations and more customer convenience. All segments of the industry – through their trade associations, the American Bankers Association, Independent Bankers Association and Consumer Bankers Association – support open competition and pricing flexibility among banks of all sizes as well as among banks and non-banks.

- Prohibitions on access fees are anti-competitive. ATM owners have successfully made their case to the courts that banning access fees represses the forces of competition and diminishes consumer access to service.
- Access fees have increased competition already. Since last year, ATMs in place have increased at an annual rate of 23 percent (source: *Bank Network News*). Such a boom in a market that already has seen annual growth rates of over 10 percent for several years is clearly an indication that free-market pricing works.

### Service Fees Do Not Cover ATM Costs

Banks historically have used ATM service as a "loss-leader," a service offered at a loss in order to attract customers. Banks have lost money on nearly every ATM they have installed, but have tried to make it up by developing relationships with customers to whom the bank can offer a broad range of related services, including accepting deposits.

- ATM expenses typically have amounted to \$1,500 to \$2,500 per month per machine, including maintenance on the machine, servicing the machine's cash and deposits, depreciation on the machine and related site improvements, and network and other communications costs.
- ATM revenue has averaged only around \$1,100 per month per machine, a figure which can vary widely depending upon location, functionality and marketing strategy.
- The loss associated with particular machines varies over a wide range, from zero to as much as \$20,000 per year. On average, expenses exceeded revenue by about \$10,000 per machine per year according to the Federal Reserve Board's *Functional Cost Analysis* for 1991 through 1996.

### Price Controls Would Eliminate the Fastest-Growing Service Providers

No entity would ever deploy an ATM unless it had the ability to recover its costs by either charging a fee for the service or else providing other, deposit-related services. Therefore, if a price-control prohibition on access fees were enacted, it is unlikely that non-financial firms would offer ATM service. And even depository institutions could only afford to continue ATM service in their own backyards where their existing customers are most concentrated. That would seriously impede the recent boom in competition, considering:

- Most of the explosion in ATM service has come from non-financial institutions that would be unable to recover costs because they have no customer relationship with the users of their ATMs (source: Mentis Corp.).
- Much of the rest of the growth has come from banks extending the reach of their networks to more remote locations, serving growing numbers of users who are not the banks' customers.

### New Access Fees Are Not Likely to Soon Turn Most ATMs Into Profit Centers.

Major ATM networks recently have changed their policies to allow machine owners to charge users – usually users who are not customers of the owner – service fees for using the ATM to gain remote access to their accounts. However, the revenue from these so-called “surcharges” will be limited.

- Customers have a myriad of free options available to them. Indeed, most ATM transactions are free because they are made at customers' own banks.
- Anecdotal evidence suggests that customers are willing and able to choose when the convenience is worth an extra charge and when it is not.

### ATM Service Has Not Been a Substitute for Teller Branch Service

Some consumer interest groups have claimed that banks actually profit by deploying ATMs because ATMs have allowed banks to save money on branches. These interest groups have suggested that profits should be calculated based on the difference between what banks *actually lost* and what they *would have lost* had ATM transactions been teller transactions, which are more expensive. This would certainly be a creative accounting technique. Unfortunately, banks have *not* saved money on teller transactions.

- Since 1985, the number of teller branches in the U.S. is actually up, presenting banks with greater total costs than ever.
- Customers like – and expect – to be able to access their banking services through different channels – some through tellers, some through ATMs, others through telephones or the Internet. With each new technology that comes along, the banking industry has had to invest more in parallel delivery channels without realizing net savings.

### Price Controls Failed in the Past

Banks were precluded from offering market-determined deposit interest rates during the 1970s under Regulation Q (the government's price control mechanism for deposit interest rates). Innovative institutions took to giving away toasters and free services – like enhanced checking account services – to slow the exodus of customers from the banking industry.

- Price controls failed – and non-price-controlled mutual funds flourished – because customers wanted more competitive interest rates rather than products and services for which they didn't ask.
- Customers today benefit from competitive interest rates. This also means, however, that related services – like check writing and ATM access – must be priced explicitly, as such costs can no longer be recovered through reduced deposit interest rates.

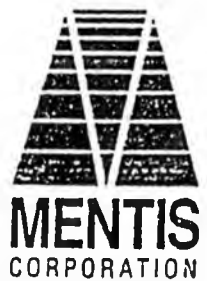
### Conclusion

Price controls have no place in a free-market economy, especially in a market as competitive as ATM service. The recent boom in ATM installations – a result of greater competition among ATM owners – would not be possible under a prohibition on access fees. Stifling such competition with price controls would result in less innovation, less access, and less overall convenience for consumers.

**American Bankers' Association—January 13, 1998**

**ATMS AND SURCHARGING**

*An Executive Presentation by  
Beth Phillips  
Mentis Corporation*



## Agenda

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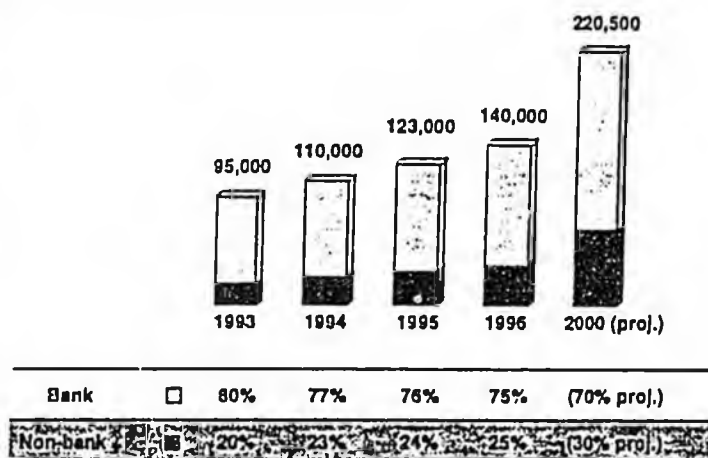
- Methodology
- Installed Base Trends
- Growth In Annual Acquisitions
- Off-premise Placement Strategies
- Surcharging
- Conclusion and Implications

## Mentis Methodology

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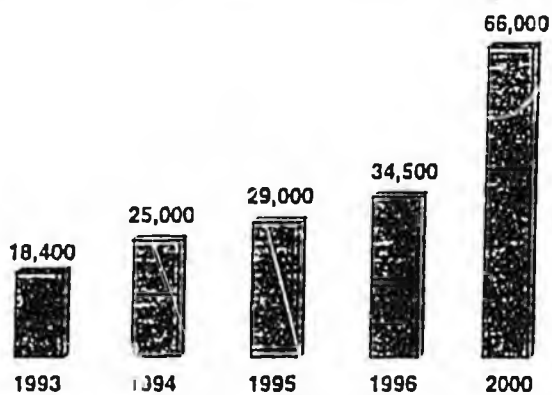
- Survey of over 800 financial institutions, top 50 credit unions, and other ATM-owning credit unions and non-financial organizations
- Extensive vendor interviews
- Survey of more than 2,000 banked consumer households
- Review of secondary materials

## The installed base of self-service terminals grew by 14% in 1996



ATM-01

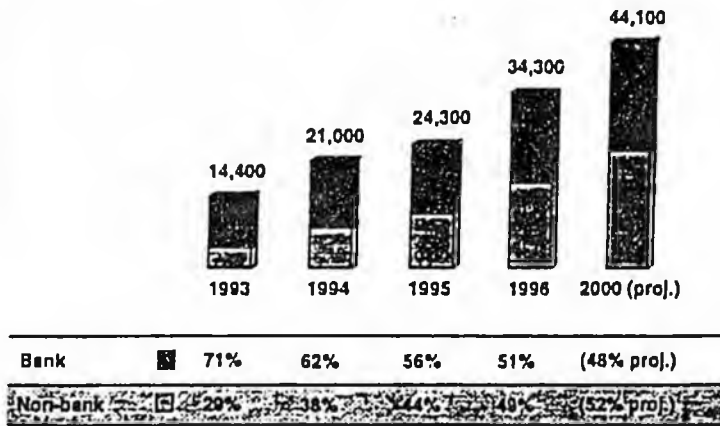
## The non-bank installed base has nearly doubled



Number of Units Owned by Non-banks

ATM-13

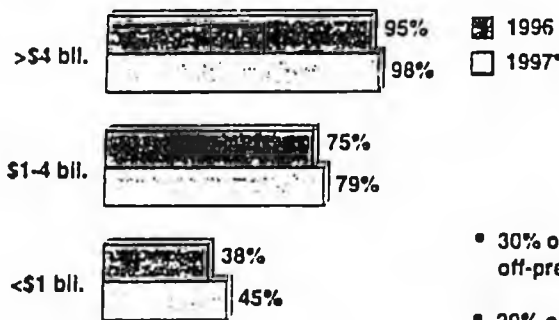
## Annual ATM shipments are increasingly non-bank CDs



Based on vendor-reported shipment information.

ATM-18

## Large banks embrace an off-premise deployment strategy

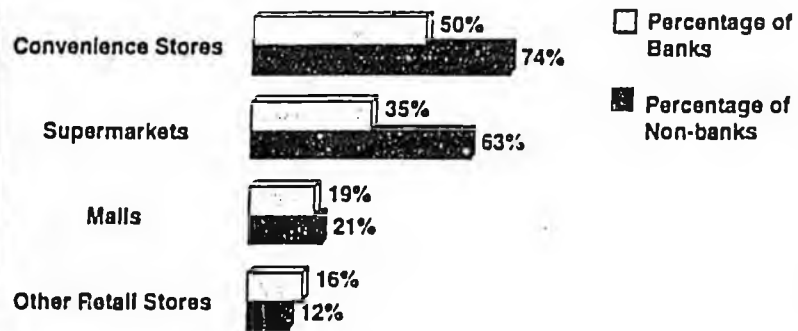


Percentage of Banks With ATM in Off-premise Locations

\*1997 data is based on preliminary findings.

- 30% of units are in off-premise locations
- 20% of off-premise units are CDs
- 70% of >\$4 bl. banks plan to install off-premise terminals in 1998\*

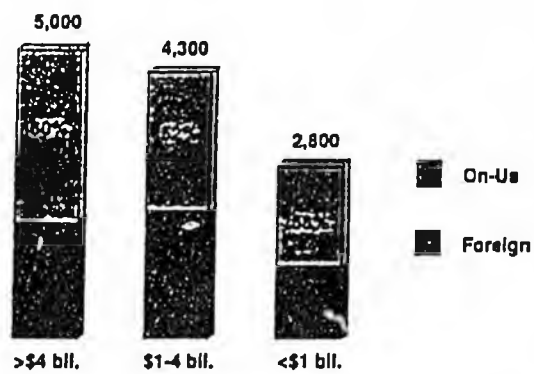
## Retailers are popular off-premise locations



For ATM owners with units in off-premise locations.

ATM-43

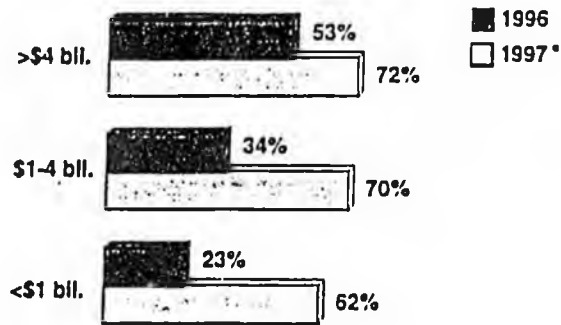
## Foreign transactions account for almost one-half of banks' volume



Average Distribution of Monthly Transaction Volume Per ATM

ATM-44

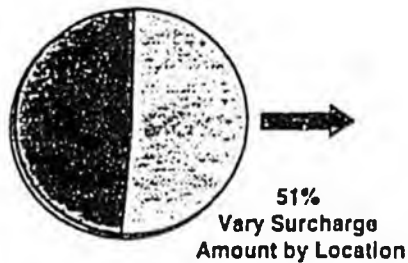
## Support of surcharging is growing rapidly



Percentage of Bank ATM Owners That Surcharge

\*1997 data is based on preliminary findings.

## Most large banks vary surcharges by location



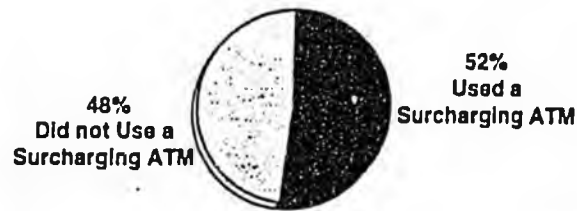
Percentage of >\$4 bil. Banks That Surcharge

- Tourist Venue: 50%
- Entertainment Outlet: 28%
- Transportation Locale: 11%

Percentage of >\$4 bil. Banks Citing the Location of Their ATMs With the Highest Surcharge

Data is based on preliminary findings.

## Nearly one-half of ATM users have avoided surcharging ATMs



	<i>Generation X</i>	<i>Baby Boomers</i>	<i>Depression Era</i>
Used Surcharging ATMs	60%	54%	29%
Maximum Average Surcharge	\$1.47	\$1.55	\$1.63

Percentage of Banked Households That Use Their ATM Cards  
(Based on the Last Ten ATM Transactions)

97 Ceres-23/97 Ceres 25-T

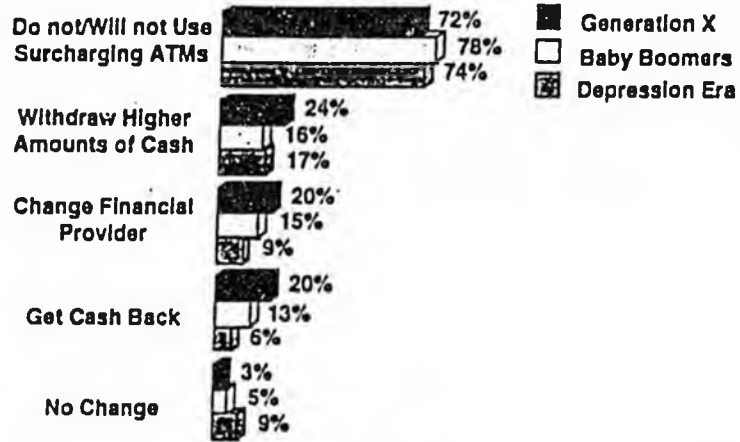
## Consumers prefer ATMs located at branch locations

	<i>Generation X</i>		<i>Baby Boomers</i>		<i>Depression Era</i>	
	1993	1997	1993	1997	1993	1997
On-premise, branch location	81%	78%	82%	83%	86%	89%
Off-premise, non-branch location	19%	22%	18%	17%	14%	11%

Percentage of Banked Households Citing the Location  
of the ATM That is Used Most Often

97 Ceres-23-T

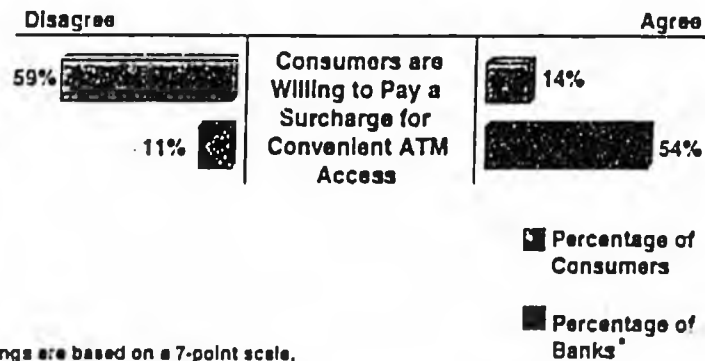
## Consumer reaction to surcharging is avoidance



Percentage of Banked Households That Use Their ATM Card

FF Com-04

## Consumers and banks differ on the importance of convenience



Ratings are based on a 7-point scale, with "1" being strongly disagree and "7" being strongly agree.

\*Data is based on preliminary findings.



**SB**

**232**

# FISCAL NOTE

**STATE OF ALASKA**  
**1998 LEGISLATIVE SESSION**

**BILL NO. SB 232** | \_\_\_\_\_

Revision Date (Note if correction) \_\_\_\_\_ Dept. Affected All state agencies  
 Title An Act relating to electronic records and BRU \_\_\_\_\_  
 signatures. \_\_\_\_\_ Component \_\_\_\_\_  
 Sponsor Sen. Parnell \_\_\_\_\_  
 Requester Sen. Labor and Commerce Component Serial No. \_\_\_\_\_

**Expenditures/Revenues** (Thousands of Dollars)

OPERATING EXPENDITURES	FY 99	FY 00	FY 01	FY 02	FY 03	FY 04
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
<b>TOTAL OPERATING</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

<b>CAPITAL EXPENDITURES</b>						
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<b>CHANGE IN REVENUES ( )</b>						
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**FUND SOURCE** (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type)						
<b>TOTAL</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

Estimate of any current year (FY98) cost: \_\_\_\_\_

**POSITIONS**

Full-time						
Part-time						
Temporary						

**ANALYSIS:** (Attach a separate page if necessary)

This bill would not have a significant fiscal impact on any state agency.

Prepared by Jack Kreinheder *[Signature]* Phone 465-4676  
 Division Office of Management and Budget Date 3/27/98  
 Approved by Commissioner Jim Ayers, Chief of Staff *[Signature]* Date \_\_\_\_\_  
 Agency Office of the Governor

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# SENATE COMMITTEE REPORT

## First Committee of Referral

DATE: 1/14/98

FURTHER: Judiciary

Date of 5-Day Notice: 3-26-98  
(in accordance with Uniform Rule 23)

DATE TURNED  
IN TO OFFICE: 3-31-98

Labor and Commerce Committee considered SENATE BILL NO. 232

"An Act relating to electronic signatures, electronic records, requirements for records, and the reproduction of public records."

and recommends:

be replaced with \_\_\_\_\_ CS \_\_\_\_\_ (\_\_\_\_\_)

adopt previous \_\_\_\_\_ CS \_\_\_\_\_ (\_\_\_\_\_)

attached amendment(s)

adopt Letter of Intent by \_\_\_\_\_ Committee

further referral to the \_\_\_\_\_ Committee

**Senate Bill:**

same title  
 new title

**House Bill:**

same title  
 technical title  
 new: SCR# \_\_\_\_\_

SIGNING DO PASS	DP	OTHER RECOMMENDATIONS	NR	DNP	AM
<i>T. Kelly</i>	<input checked="" type="checkbox"/>	<i>Mike Miller, D/</i>	<input checked="" type="checkbox"/>		
		<i>Sign Hoffman</i>	<input checked="" type="checkbox"/>		
CHAIR: <i>Don J. Rubin</i>	<input checked="" type="checkbox"/>	CHAIR:			

**NEW FISCAL NOTE(S):**

Department      Date      Zero      Fiscal

<i>At a glance</i>	<i>3/27/98</i>	<input checked="" type="checkbox"/>	

**PREVIOUS FISCAL NOTE(S):\***

Department      Date      Zero      Fiscal


APPROPRIATION -- no fiscal note

\*include fiscal notes accompanying Governor's bill

# Alaska State Legislature

## SENATE DISTRICT I

Bayshore	Alvott Loop
Campbell	Bear Valley
Dimond	Girdwood
Independence Park	Glen Alps
Klat	Hillside
Old Seward	Huffman O'Malley
Southport	Indian
Taku	Portage
	Rabbit Creek



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WATER STREET  
STATE CAPITOL  
JUNEAU, ALASKA 99801-1182  
(907) 463-2885 (907) 463-2883

SENATOR SEAN PARNELL

## Sponsor Statement SB 232

"An Act relating to electronic signatures, electronic records, requirements for records, and the production of public records."

At the request of the Lieutenant Governor, Chair of the Telecommunications Information Council, I have introduced SB 232 to allow both the public and private sectors of Alaska to operate quickly, securely and efficiently in the electronic age. Electronic signatures are increasingly used as this new technology is quickly adapted into the ever-changing world of electronic commerce. Currently two states, Utah and Washington, have adopted statutes to standardize the practice of electronic signatures and legislation is pending in most other states. SB 232 will help continue Alaska's interstate, intrastate and global economic growth, by providing legal framework for use of electronic signatures commerce.

Specifically, SB 232 establishes electronic signatures as a legal practice with the same standing as a standard signature. This act allows the Lt. Governors office or other state agencies to develop regulations for using electronic signatures by private or public entities and establishes criteria for electronic signature regulations. Lastly, this act repeals some state agencies' selected notarization requirements to better utilize the efficiencies of electronic signatures.

SB 232 is an important component in keeping Alaska competitive and efficient in both public and private business practices. I appreciate your support of this act.

**SB 232**  
**Bill Summary/Sectional Analysis**

**Bill Summary:**

This bill makes electronic signatures legal in our state. It will help bring the state of Alaska and the businesses that operate here into the electronic age - allowing business and government to conduct business electronically with counterparts in Alaska, other states and other countries.

The various sections accomplish the following:

1. Declare that the use of electronic signatures in Alaska between consenting parties is legal. Electronic signatures would have the same legal standing as a standard signature from an individual.
2. Allow state agencies to promulgate regulations for using electronic signatures in their interactions with the public.
3. Define various terms relating to electronic signatures.
4. Repeals for some state agencies selected notarization requirements that could hinder an agency's ability to implement the use of electronic signatures.

By making electronic signatures legal, the bill provides an opportunity for state agencies to better serve the public "online." State government will be able to serve citizens participating in the new world of electronic commerce.

This bill has the support of the Telecommunications Information Council. It is modeled on the Georgia State Act, which is considered one of the foremost electronic signature laws in the United States.

**Sectional Analysis**

**Section 1:** Removes the requirement that reports filed by banks with the Department of Commerce and Economic Development be verified by a notary and replaces it with a requirement for signature under penalty of unsworn falsification.

**Section 2:** Specifies that information in state records that would compromise the security of an electronic signature is an "exception" from the state public records statute.

**Section 3:** Accomplishes the following:

1. Articulates the purposes of electronic signatures, such as facilitating government business and private commerce and promoting electronic government and commerce.

2. Establishes that the use of electronic signatures between consenting parties is legal in Alaska. An electronic signature would have the same legal standing as a handwritten signature.

3. Specifies that the Lt. Governor's Office or other state agencies can adopt regulations for the use of electronic signatures in conducting state business or for use of electronic signatures by businesses and individuals.

4. Defines electronic signatures and records.

**Sections 5 – 44:** Open the door for the state Department of Commerce and Economic Development to allow businesses and corporations to file reports electronically and verifying them with electronic signatures. These sections revise statutes in the corporations and partnership codes to remove notary requirements on various documents filed with the DCED.

**Sections 45 - 48:** Revise statutes in AS 34.45 to remove the requirement that signatures on reports or other forms filed with the state regarding unclaimed property be notarized and replace it with the requirement that signatures be made under penalty of unsworn falsification.

**Sections 49 - 50:** Revise statutes relating to the state archives system to allow the archives to accept electronic records.

**Sections 51 – 55:** Revise various statutes in AS 45.50 relating to regulation of trademarks to remove the requirement that signatures on certain forms filed with the state be notarized.

## Frequently Asked Questions Regarding Digital Signatures

### What are Digital Signatures?

A reliable electronic means of signing electronic documents that provides sender authentication, message integrity and non-repudiation. A digital signature is a convenient, time-saving, and secure way of signing electronic documents.

### What is an electronic document?

An electronic document is any document that is generated or stored on a computer, such as a letter, a contract, or a will. In addition, an electronic document can be an image, such as a blueprint, a survey plat, a drawing, or even a photograph. A digital signature can be used to sign all these documents

### What does a digital signature look like?

A signature looks like a random series of numbers, letters and symbols. Each signature is unique and by using the appropriate public key, each signature can be linked back to the sender of the message.

-----BEGIN SIGNATURE-----

ivblawubmvs1a5qycUmFGnyJAQFAKgL/ZkbfbeNESbthba4BlrcnjaqbckgNv+a5kr4537y8  
Rcd+RDv56yYh5ttieufjlk4kjlj3ojljkjljkj67NSjliuoj6AAcjawuJLKdk21Vkm+qymC2hRbh+Rb2h5WI

-----END SIGNATURE-----

### How do they work?

In simplest terms, the digital signature software does all the work for you. The software will prompt you to follow the commands and will automatically generate a key pair for you. Once your key pair is generated you simply identify the electronic document you want digitally signed and you simply hit the sign prompt. The new file that is created is the digitally signed electronic document that you can then send to anyone. The receiver of the electronic document then can verify your signature using interoperable digital signature software. If the electronic document was altered in any manner in transmission, it will not verify.

### How are they used?

Digital signatures are used for any electronic document that requires sender authenticity, message integrity, and non-repudiation (can't say you never sent the document or its contents). It is a secure form of transacting. Contracts, images, letters, etc., may be digitally signed and sent electronically in seconds. Examples of specific applications in Utah: Court Filings, Corporate Filings, UCC Filings, Procurement, Grant Applications, Motor Vehicle Titling, Real Estate Transactions, and etc.

### Where do I get one? How do I register with a Certifying Authority?

You can purchase digital signature software at your local computer and software retailer. Once you have generated your key pairs via your digital signature software, you need to link your corresponding key pairs with your identity. To do this you need to contact a licensed certification authority who will verify your corresponding key pairs and your identity. Thereafter, certification authority will issue you a certificate certifying that you are who you say you are and that the correspond key pairs belong to you. This certificate will then be published at the certification authorities on-line repository for relying parties to verify your digital signature.

The approved Certifying Authorities are:

# CORRECTION

THE FOLLOWING DOCUMENT(S)  
HAVE BEEN REFILMED TO  
ASSURE LEGIBILITY OR PAGINATION



Rev. 6/98

Central Microfilm Services  
Department of Education  
State of Alaska

2. Establishes that the use of electronic signatures between consenting parties is legal in Alaska. An electronic signature would have the same legal standing as a handwritten signature.

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Hendrix: PIN #s; digital image

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-----BEGIN SIGNATURE-----

ivb1aWubmvsIa5qycUmFGnyJAQFAKgL/ZkBfbcNEsbthba4BlrcnjaqbckgNv+a5kr4537y8  
Rcd+RDv56yYh5ttieufjlk4kjlj3ojljkjljkj67NSjliujoj6AAcjawuJLKdk21Vkm+qymC2hRbh+Rb2h5Wl

-----END SIGNATURE-----

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The approved Certifying Authorities are:

Utah Digital Signature Trust. One So. Main. Salt Lake City. Utah 84111 (801) 524-8671

### **How am I identified as the signer?**

When you use your digital signature software, you create a matched pair of keys. One is the private key, which is used only by you and is required during the signing process.

The second key is the public key, which is available for use by anyone wanting to authenticate the electronic documents you sign. The public key will read the digital signature created by the private key and verify the authenticity of the electronic documents created with it.

### **What will this cost me?**

Depending on what type of digital signature software you decide to purchase, it will cost approximately \$150. However, if an individual chooses not to purchase the digital signature software to generate their own key pairs, then your local licensed certification authority can provide that service at a nominal fee ranging anywhere from \$10-\$30. To obtain a certificate from a certification authority will also be a nominal fee ranging anywhere from \$20-\$50. Normally, the certificate will be valid for a period of one year. Thereafter, an individual could use their digitally signature to sign an infinite number of electronic documents during the validity period of the certificate.

### **Do I have to register with a CA?**

No. However, it is recommended. In Utah, in order for your digital signature to be self-authenticating and obtain the benefits of the Utah Digital Signature Act, a digital signature must be verified through a valid certificate issued by a Utah licensed certification authority. However, this does not preclude a digital signature that has not been verified through a valid certificate issued by a Utah licensed certification authority, from satisfying the signature requirement. In those circumstances, the burden of proof in a court of law is very similar to that required for a handwritten signature. Consequently, a digital signature verified through a valid certificate issued by a Utah licensed certification authority will be self-authenticating and much easier to prove in a court of law.

# Digital Signature Tutorial

The authentication of computer-based business information interrelates both technology and the law, and calls for cooperation between people of different professional backgrounds and areas of expertise. Each field of expertise brings to the topic of authentication a different repertoire of concepts. Often the concepts from the information security field correspond only loosely to concepts from the legal field, even though both fields apply the same term to their differing concepts.

This interdisciplinary contrast exists even for basic, central concepts such as "authentication" or "digital signature". From a technical point of view, "digital signature" means the result of applying to specific information the technical processes described below. From a legal point of view, handwriting one's name on paper has been the principal means of signature for centuries. In addition, the legal concept of signature recognizes, in many cases, not only a handwritten name but any mark made with the intention of authenticating the marked document.<sup>fn.1</sup> In an electronic setting, today's broad legal concept of "signature" may well include markings such as digitized images of paper signatures, typed notations such as "s/John Smith", or even addressing notations such as letterheads, electronic mail origination headers, and the like. From an information security viewpoint, these simple electronic signatures are entirely different from the "digital signatures" described in this tutorial and in technical documents, although "digital signature" is sometimes used colloquially or in some legal writing to mean another or any form of computer-based signature. To avoid confusion, this publication uses "digital signature" only in the sense in which the term is used in information security terminology, as meaning the result of applying the technical processes described in this tutorial.

The differences between digital signatures and other electronic signatures are significant, not only in terms of process and result, but also because those differences make digital signatures more serviceable for legal purposes. However, some electronic signatures, though perhaps legally recognizable as signatures, may not be as secure as digital signatures, and may lead to uncertainty and disputes.

To understand why digital signatures serve well in legal applications, this tutorial begins with an overview of the significance of signatures in legal transactions. It then explains digital signature technology in simple terms, and examines how, with some legal and institutional infrastructure, digital signature technology can be applied as a computer-based alternative to traditional signatures.

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## Signatures and the Law

A signature is not part of the substance of a transaction, but rather of its representation or form. Parties often represent their transactions in signed writings. Signing writings and other formalistic legal processes or customs serve the following general purposes: <sup>fn.2</sup>

- **Evidence:** A signature identifies the signer with the signed document; by signing, the signer marks the text in her own unique way and makes it attributable to her. <sup>fn.3</sup>
- **Ceremony:** Signing calls to the signer's attention the legal significance of his act, and thereby helps prevent "inconsiderate engagements". <sup>fn.4</sup> The act of signing may satisfy a human desire to mark an event. <sup>fn.5</sup>
- **Approval:** In certain contexts defined by law or custom, a signature expresses the signer's approval or authorization of the writing, or the signer's intention that it have legal effect. <sup>fn.6</sup>
- **Efficiency and logistics:** A signature on a written memorandum often imparts a sense of clarity and finality to the transaction, especially if the signature is used to indicate approval or authorization. Because of this apparent clarity and finality, signatures may lessen the need to inquire beyond the face of a document, <sup>fn.7</sup> and, at face value, a document may be processed more efficiently and with less risk than a document beneath which traps for the unwary may lie. Negotiable instruments, for example, attain their ability to change hands with ease, rapidity, and minimal interruption through legal rules triggered by compliance with certain formal requirements including a signature. <sup>fn.8</sup> Furthermore, the finality of signing makes it useful as a decisive point

in staging how a transaction takes effect.

Although achieving these purposes is salutary, legal systems vary, both among themselves and over time, in the degree to which a particular form, including one or more signatures, is required for a legal transaction. If a particular form is required, legal systems also vary in prescribing consequences for failure to cast the transaction in the required form. The statute of frauds of the common law tradition, for example, requires a signature, but does not render a transaction invalid for lack of one. Rather, it makes it unenforceable in court, fn.9 and the persistent notion that the underlying transaction remained valid led case law to greatly limit the practical application of the statute.

In general, the trend in most legal systems for at least this century has been toward reducing formal requirements in law, fn.10 or toward minimizing the consequences of failure to satisfy formal requirements. Nevertheless, sound practice remains to formalize a transaction in a manner that best assures the parties of its validity and enforceability, fn.11 In current practice, that formalization usually entails documenting the transaction and signing or authenticating the documentation.

However, the centuries-old means of documenting transactions and creating signatures are changing fundamentally. Documents continue to be written on paper, but sometimes merely to satisfy the need for a legally recognized form. In many instances, the information exchanged to effect a transaction never takes paper form. It also no longer moves as paper does; it is not physically carried from place to place but rather streams along digital conduits at a speed impossible for paper. The computer-based information is also utilized differently than its paper counterpart. Paper documents can be read efficiently only by human eyes, but computers can also read digital information and take programmable actions based on the information.

The law has only begun to adapt to the new technological forms. The basic nature of the transaction has not changed; however, the transaction's form, the means by which it is represented and effected, is changing. Formal requirements in law need to be updated accordingly. The legal and business communities need to develop and adopt rules and practices which recognize in the new, computer-based technology the effects achieved or desired from the paper forms.

To achieve the basic purposes of signatures outlined above, the following effects are needed: fn.12

- **Signer authentication:** To provide good evidence of who participated in a transaction, a signature should indicate by whom a document or message is signed and be difficult for any other person to produce without authorization.
- **Document authentication:** To provide good evidence of the substance of the transaction, a signature should identify what is signed, fn.13 and make it impracticable to falsify or alter, without detection, either the signed matter or the signature, fn.14
- **Affirmative act:** To serve the ceremonial and approval functions of a signature, a person should be able to create a signature to mark an event, indicate approval and authorization, and establish the sense of having legally consummated a transaction.
- **Efficiency:** Optimally, a signature and its creation and verification processes should provide the greatest possible assurance of authenticity and validity with the least possible expenditure of resources.

The concepts of signer authentication and document authentication comprise what is often called "nonrepudiation service" in technical documents. The nonrepudiation service of information security "provides proof of the origin or delivery of data in order to protect the sender against false denial by the recipient that the data has been received, or to protect the recipient against false denial by the sender that the data has been sent." fn.15 In other words, a nonrepudiation service provides evidence, fn.16 to prevent a person from unilaterally modifying or terminating her legal obligations arising out of a transaction effected by computer-based means.

Digital signature technology generally surpasses paper technology in yielding these desired effects, fn.17 To understand why, one must first understand how digital signature technology works.

## How Digital Signature Technology Works

Digital signatures are created and verified by means of cryptography, the branch of applied mathematics that concerns itself with transforming messages into seemingly unintelligible forms and back again. For digital signatures, two different keys are generally used, one for creating a digital signature or transforming data into a seemingly unintelligible form, and another key for verifying a digital signature or returning the message to its original form. fn.18 Computer equipment and software utilizing two such keys is often termed an "asymmetric cryptosystem".

The keys of an asymmetric cryptosystem for digital signatures are termed the **private key**, which is known only to the signer fn.19 and used to create the digital signature, and the **public key**, which is ordinarily more widely known and is used to verify the digital signature. A recipient must have the corresponding public key in order to verify that a digital signature is the signer's. If many people need to verify the signer's digital signatures, the public key must be distributed to all of them, perhaps by publication in an on-line repository or directory where they can easily obtain it.

Although the keys fn.20 of the pair are mathematically related, it is XE "Computational infeasibility: deriving private key from public" computationally infeasible fn.21 to derive one key from the other, if the asymmetric cryptosystem has been designed and implemented securely for digital signatures. fn.22 Although many people will know the public key of a given signer and use it to verify that signer's signatures, they cannot discover that signer's private key and use it to forge digital signatures.

Use of digital signatures is comprised of two processes, one performed by the signer and the other by the receiver of the digital signature:

- **Digital signature creation** is the process of computing a code derived from and unique to both the signed message and a given private key. For that code or digital signature to be secure, there must be at most only a negligible chance that the same digital signature could be created by any other message or private key. fn.23
- **Digital signature verification** is the process of checking the digital signature by reference to the original message and a public key, and thereby determining whether the digital signature was created for that same message using the private key that corresponds to the referenced public key.

A more fundamental process, termed a "**hash function**" fn.24 in computer jargon, is used in both creating and verifying a digital signature. A hash function creates in effect a digital freeze frame of the message, a code usually much smaller than the message but nevertheless unique to it. fn.25 If the message changes, the hash result of the message will invariably fn.26 be different. Hash functions enable the software for creating digital signatures to operate on smaller and predictable amounts of data, while still providing a strong evidentiary correlation to the original message content.

As illustrated in figure 1, to sign a document or any other item of information, the signer first delimits precisely what is to be signed. The delimited information to be signed is termed the "**message**" in the ABA Guidelines and Utah Act. Then a hash function in the signer's software computes a hash result, a code unique to the message. The signer's software then transforms the hash result into a digital signature by reference to the signer's private key. This transformation is sometimes described as "encryption". The resulting digital signature is thus unique to both the message and the private key used to create it.

Typically, a digital signature is attached to its message and stored or transmitted with its message. However, it may also be sent or stored as a separate data element, so long as it maintains a reliable association with its message. Since a digital signature is unique to its message, it is useless if wholly dissociated from its message.

Verification of a digital signature, as illustrated in Figure 2, is accomplished by computing a new hash result of the original message by means of the same hash function used in creating the digital signature.

Then, using the public key, the verifier checks whether the digital signature was created using the corresponding private key, and whether the newly computed hash result matches the hash result derived from the digital signature. If the signer's private key was used and the hash results are identical, then the digital signature is verified. Verification thus indicates (1) that the digital signature was created using the signer's private key, because only the signer's public key will verify a digital signature created with the signer's private key, fn.27 and (2) that the message was not altered since it was signed, because the hash result computed in verification matches the hash result from the digital signature, which was computed when the message was digitally signed.

Various asymmetric cryptosystems create and verify digital signatures using different mathematical formulas and procedures, but all share this overall operational pattern.

The processes of creating a digital signature and verifying it accomplish the essential effects desired of a signature:

- **Signer authentication:** If a public and private key pair is associated with an identified signer as described below, a digital signature by the private key effectively identifies the signer with the message. The digital signature cannot be forged by a person other than the proper signer, unless the proper signer loses control of the private key, such as by divulging it or losing a computer-readable card and its associated personal identification number (PIN) or pass phrase. fn.28
- **Message authentication:** The process of digitally signing also identifies the matter to be signed, typically with far greater certainty and precision than paper signatures. Verification also reveals any tampering with the message, since processing the hash results (one made at signing and the other made at verifying) discloses whether the message is the same as when signed.
- **Affirmative act:** Creating a digital signature requires the signer to provide her private key and invoke a software function to create a digital signature. This act can be the basis of a ceremony and can be used in staging the completion of a transaction. fn.29
- **Efficiency:** The processes of creating and verifying a digital signature provide a high level of assurance that the digital signature is genuinely the signer's and are almost entirely automated or capable of automation. They can be set up to run with great speed and accuracy, with human interaction only for non-routine processing decisions. Compared to paper methods such as checking bank signature cards, methods so impracticable that they are rarely actually used, digital signatures yield a high degree of assurance without adding greatly to the resources required for processing.

The core of the programs used for digital signatures have undergone thorough peer review, and an extensive scientific and technical literature underlies them. Digital signatures have been accepted in several national and international standards developed in cooperation with and accepted by many corporations, banks, and government agencies. The likelihood of malfunction or a security problem in a digital signature cryptosystem designed and implemented as prescribed in the industry standards is extremely remote, and far less than the risk of undetected forgery or alteration on paper or of using other less secure electronic signature techniques.

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## Public Key Certificates

To verify a digital signature, the verifier must obtain a public key and have assurance that that public key corresponds to the signer's private key. However, a public and private key pair has no intrinsic association with any person; it is simply a pair of numbers. The association between a particular person and key pair must be made by people using the fact-finding capabilities of their senses.

In a transaction involving two parties, for example, the parties could bilaterally identify each other with the key pair each party will use, but making such an identification is no small task, especially when the parties are geographically distant from each other, communicate over an open, insecure information

network, are not natural persons but rather corporations or similar artificial entities, and act through agents whose authority must be ascertained. Since reliably identifying a remote party involves considerable effort, establishing a remote party's digital signature capability specially for each of many transactions is inefficient. Instead, a prospective digital signer will often wish to identify itself with a key pair and reuse that identification in multiple transactions over a period of time.

To that end, a prospective signer could issue a statement such as: "Signatures verifiable by the following public key are mine". However, others doing business with the signer may well be unwilling to take the signer's own purported word for its identification with the key pair. Especially for electronic transactions made over worldwide information networks rather than face to face, a party would run a great risk of dealing with a phantom or an impostor, or of facing a disavowal of a digital signature by claiming it to be the work of an impostor, particularly if a transaction proves disadvantageous for the purported signer. To assure that each party is indeed identified with a particular key pair, one or more third parties trusted by both of the others must associate an identified person on one end of the transaction with the key pair creating the digital signature received at the other end, and vice versa. That trusted third party is termed a "**certification authority**" in the ABA Guidelines, the Utah Act, and most technical standards.

To associate a key pair with a prospective signer, a certification authority issues a certificate, an electronic record that sets forth a public key and represents that the prospective signer identified in the certificate holds the corresponding private key. That prospective signer is termed the "subscriber". Thus, a certificate's principal function is to identify a key pair with a subscriber, so that a person verifying a digital signature by the public key listed in the certificate can have assurance that the corresponding private key is held by the subscriber also listed in the certificate.

To assure the authenticity and inviolability of the certificate, the certification authority digitally signs it. The issuing certification authority's digital signature on the certificate can be verified using the public key listed in another certificate, and that other certificate can be verified by the public key listed in yet another certificate, and so on, until the person relying on the digital signature is adequately assured of its genuineness.

To make a public key and its identification with a specific subscriber readily available for use in verification, the certificate may be published in a repository. Repositories are on-line databases of certificates available for retrieval and use in verifying digital signatures. Often, retrieval is accomplished automatically by having the verification program inquire of the repository to obtain certificates as needed.

Once issued, a certificate may prove to be unreliable, such as in situations where the subscriber misrepresents his identity to the certification authority. In other situations, a certificate may be reliable enough when issued but come to be unreliable sometime thereafter. For example, if the subscriber loses control of the private key, the certificate becomes unreliable, since digital signatures created by the lost private key would appear to be the subscriber's according to the certificate. In such situations where the certificate has become unreliable, the certification authority, perhaps at the subscriber's request, may suspend (temporarily invalidate) or revoke (permanently invalidate) the certificate. Immediately upon suspending or revoking a certificate, the certification authority must publish notice of the revocation or suspension, or at least notify persons who inquire or who are known to have received a digital signature verifiable by reference to the unreliable certificate.

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## Challenges and Opportunities

The prospect of fully implementing digital signatures in general commerce presents both advantages and disadvantages, or benefits and costs. The costs or disadvantages consist mainly of:

- **Institutional overhead:** The cost of establishing and utilizing certification authorities, repositories, and other important services, as well as assuring quality in the performance of their

functions through means such as professional accreditation, oversight by another, superior certification authority, fn.30 licensing and governmental regulation, periodic auditing, or legal and financial responsibility for errors and omissions.

- **Product cost:** A digital signer will require software that may well be more expensive than a simple pen, and may probably also have to pay a certification authority to issue a certificate. Equipment to secure one's private key may also be advisable. Recipients of digital signatures will incur expenses for verification software and perhaps for access to certificates in a repository.

On the plus side, the principal advantage to be gained is more reliable authentication of messages. Digital signatures, if properly implemented and utilized:

- **Impostors:** Minimize the risk of dealing with impostors or persons who can escape responsibility by claiming to have been impersonated.
- **Message corruption:** Minimize the risk of tampering with messages, altering the terms of a transaction and covering up the traces of the alteration, or false claims that a message was altered after it was sent.
- **Formal legal requirements:** Strengthen the support for concluding that legal requirements of form, such as writing, signature, and an original document, are satisfied, since digital signatures are functionally on a par with or superior to paper forms.
- **Open systems:** Retain a high degree of information security, even for information sent over open, insecure, but inexpensive and widely used communication channels.

Considering the alternatives, such as paper signatures, computerized images of handwritten signatures, or typed signatures such as "s/John Smith", the benefits of digital signatures outweigh their burdens. The ABA Guidelines and Utah Act are intended to advance legal recognition of digital signatures and establish an institutional infrastructure to support digital authentication.

## Notes

### Note 1

See, e.g., Uniform Commercial Code § 1-201(39) (1992).

### Note 2

This list is not exhaustive. For example, Restatement (Second) of Contracts notes another function, termed the "deterrent function", which seeks to "discourage transactions of doubtful utility. Restatement (Second) of Contracts § 72 comment c (1981). Professor Perillo also notes, in an especially comprehensive list, earmarking of intent, clarification, managerial efficiency, publicity, education, as well as taxation and regulation as functions as served by the statute of frauds. Joseph M. Perillo, *The Statute of Frauds in the Light of the Functions and Dysfunctions of Form*, 43 *Fordham L. Rev.* 39, 48-64 (1974) (hereinafter "Perillo").

### Note 3

Restatement (Second) of Contracts, statutory note preceding § 110 (1982) (purpose of the statute of frauds, which includes a signature requirement); Lon L. Fuller, *Consideration and Form*, 41 *Colum. L. Rev.* 799, 800 (1941) (hereinafter "Fuller"); Jeremy Bentham, *The Works of Jeremy Bentham* 508-85 (Bowring ed. 1839) (Bentham called forms serving evidentiary functions "preappointed [i.e., made in advance] evidence"). A handwritten signature creates probative evidence in part because of the chemical properties of ink that make it adhere to paper, and because handwriting style is quite unique to the signer; Perillo at 64-69.

### Note 4

2 John Austin, *Lectures on Jurisprudence* 939-44 (4th ed. 1873); Restatement (Second) of Contracts § 72 comment c (1982) and statutory note preceding § 110 (1982) (what is here termed a "ceremonial" function is termed a "cautionary" function in the Restatement); Perillo at 53-56; Fuller at 800; Rudolf von Jhering, *Geist des römischen Rechts* § 45 at 494-98 (8th ed. 1883) (hereinafter "Jhering").

### Note 5

**S B**

**2 3 3**

Revision Date: \_\_\_\_\_ Dept. Affected: \_\_\_\_\_ Revenue \_\_\_\_\_  
 Title: Alcohol Beverage Control Board BRU: Alcoholic Beverage Control Board  
 Component: Alcoholic Beverage Control Board  
 Sponsor: Senate Labor & Commerce Committee  
 Requestor: Senate Labor & Commerce Committee COMPONENT SERIAL NO. 100

Expenditures/Revenues: (Thousands of Dollars)

OPERATING EXPENDITURES	FY 99	FY 00	FY 01	FY 02	FY 03	FY 04
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
<b>TOTAL OPERATING</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

CAPITAL EXPENDITURES						
----------------------	--	--	--	--	--	--

CHANGE IN REVENUES ( )						
------------------------	--	--	--	--	--	--

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other						
<b>TOTAL</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

Estimate of any current year (FY96) cost \$ 0

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

No expenditure of funds is necessary to extend the life of the ABC Board for another four (4) years.

As a functioning regulatory board, the ABC Board is funded as part of the operating budget for the Department of Revenue. All funding for the ABC Board is derived from program receipts for liquor license, permit fees and miscellaneous payments.

Prepared by: Douglas B. Griffin  
 Division: Alcoholic Beverage Control Board  
 Approved by Commissioner: Wilson L. Condon  
 Agency: Department of Revenue

Phone: 907-277-8638  
 Date: March 18, 1998  
 Date: March 18, 1998

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**SENATE COMMITTEE RE RT**  
**First Committee of Referral**

DATE: 1/14/98

FURTHER: Finance

Date of 5-Day Notice: 2-19-98  
 (in accordance with Uniform Rule 23)

DATE TURNED  
 IN TO OFFICE: 3-18-98

Labor and Commerce Committee considered SENATE BILL NO. 233

"An Act extending the termination date of the Alcoholic Beverage Control Board."

and recommends:

be replaced with \_\_\_\_\_ CS \_\_\_\_\_ (\_\_\_\_\_)

adopt previous \_\_\_\_\_ CS \_\_\_\_\_ (\_\_\_\_\_)

attached amendment(s)

adopt Letter of Intent by \_\_\_\_\_ Committee

further referral to the \_\_\_\_\_ Committee

**Senate Bill:**

- same title
- new title
- House Bill:**
- same title
- technical title
- new: SCR# \_\_\_\_\_

SIGNING DO PASS		DP	OTHER RECOMMENDATIONS	NR	DNP	AM
<i>[Signature]</i>		✓				
<i>[Signature]</i>						
<i>[Signature]</i>		✗				
<i>[Signature]</i>						
CHAIR: <i>[Signature]</i>		✓	CHAIR:			

**NEW FISCAL NOTE(S):**

Department	Date	Zero	Fiscal
Revenue	3/18	✓	

**PREVIOUS FISCAL NOTE(S):\***

Department	Date	Zero	Fiscal

APPROPRIATION -- no fiscal note

\*include fiscal notes accompanying Governor's bill

CLEMM'S OFFICE

APPROVED

Date: 2-24-98

Submitted by: Assemblymember CLEMENTSON,  
Abney, Begich, Bell, Carlson, Kendall, Meyer, Murdy,  
Von Gemmingen, Wohlforth, Wuerch  
Prepared by: Assembly Office  
For reading: February 24, 1998

ANCHORAGE, ALASKA

AR NO. 98- 64

A RESOLUTION OF THE ANCHORAGE MUNICIPAL ASSEMBLY SUPPORTING  
SENATE BILL 233, EXTENDING THE TERMINATION DATE OF THE ALCOHOLIC  
BEVERAGE CONTROL BOARD

---

WHEREAS, by State statute, the Alcoholic Beverage Control (ABC) Board is scheduled to be sunset as of June 30, 1998; and

WHEREAS, SB 233 has been introduced before the Alaska State Legislature to amend this State statute, specifically to extend the termination date of the ABC Board to June 30, 2002; and

WHEREAS, the Anchorage Assembly believes the ABC Board and its oversight and enforcement responsibilities has played a critical role in ensuring the public safety and health of our community; and

WHEREAS, the ABC Board has worked hand-in-hand with our local government - especially the Assembly - in making sure that State statutes governing the sale of alcoholic beverages are adhered to by local Anchorage businesses.

NOW, THEREFORE, the Anchorage Municipal Assembly resolves:

Section 1. That the Assembly supports SB 233, extending the termination date of the ABC Board to June 30, 2002.

Section 2. That the Assembly looks forward to a continued working relationship with the ABC Board.

Section 3. That, upon approval, the Municipal Clerk provide copies of the resolution to the State Legislature..

PASSED AND APPROVED by the Anchorage Municipal Assembly this  
3rd day of March, 1998.

# Alaska State Legislature

## Senate



Official Business

State Capitol  
Juneau, AK. 99801-1182

### Senate Labor & Commerce Committee

#### Sponsor Statement SB 233: ALCOHOL BEVERAGE CONTROL BOARD

The Board was established by Title 4 in 1959. SB 233 extends the Council another 4 years to June 30, 2002.

The Board's tasks include the following duties:

- control the manufacture, barter, possession, and sale of alcoholic beverages in the state
- review all applications for licenses
- may order the director to issue, renew, revoke, transfer or suspend licenses or permits
- may reduce the licensed area when Board deems it necessary to ensure control over the sale and consumption of alcoholic beverages.

The Legislative Auditor continues to be concerned about the liquor license fee sharing program's compliance with AS 04.11.610.

The Senate Labor and Commerce Committee introduced the bill to ensure the extension could be considered by the Legislature.

# Audit Report



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DEPARTMENT OF REVENUE  
ALCOHOLIC BEVERAGE CONTROL BOARD

December 3, 1993

---



Audit Control Number:

04-1414-94

Division of Legislative Audit  
P.O. Box 113300, Juneau, Alaska 99811-3300

# LEGISLATIVE BUDGET AND AUDIT COMMITTEE

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## DIVISION OF LEGISLATIVE AUDIT

The Legislative Budget and Audit Committee is a permanent interim committee of the Alaska Legislature. The committee is made up of five senators and five representatives, with one alternate from each legislative chamber. The chairmanship of the committee alternates between the two chambers every legislature.

The committee is responsible for providing the legislature with audits of state government agencies. The programs and activities of state government now cost more than \$5 billion a year. As legislators and administrators try increasingly to allocate state revenues effectively and make government work more efficiently, they need information to evaluate the work of governmental agencies. The audit work performed by the Division of Legislative Audit helps provide that information.

As a guide to all their work, the Division of Legislative Audit complies with generally accepted auditing standards established by the American Institute of Certified Public Accountants and with government auditing standards established by the U.S. General Accounting Office.

Audits are performed at the direction of the Legislative Budget and Audit Committee. Individual legislators or committees can submit requests for audits of specific programs or agencies to the committee for consideration. Copies of all completed audits are available from the Division of Legislative Audit's offices in either Anchorage or Juneau.

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Senator Al Adams  
Senator Steve Frank  
Senator Steve Rieger  
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Senator Jay Kerttula (alternate)

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Representative John Davies  
Representative Mark Hanley  
Representative Ron Larson  
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Representative Sean Parnell (alternate)

### DIVISION OF LEGISLATIVE AUDIT

Randy S. Welker, CPA  
Legislative Auditor  
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Deputy Legislative Auditor

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(907) 561-1445, Anchorage  
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# ALASKA STATE LEGISLATURE

## LEGISLATIVE BUDGET AND AUDIT COMMITTEE

Division of Legislative Audit



P. O. Box 113300  
Juneau, AK 99811-3300  
(907) 465-3830  
FAX (907) 465-2347

December 3, 1993

Members of the Legislative Budget  
and Audit Committee:

In accordance with the provisions of Title 24 of the Alaska Statutes, the attached report is submitted for your review.

### DEPARTMENT OF REVENUE ALCOHOLIC BEVERAGE CONTROL BOARD

December 3, 1993

Audit Control Number

04-1414-94

As discussed in the Objectives, Scope, and Methodology section of this report, this review examines the activities of the Alcoholic Beverage Control Board (ABC Board) to determine if there is a demonstrated public need for its continued existence and if it has been operating in an efficient and effective manner. Alaska Statute 44.66.010 specifies that the ABC Board will terminate on June 30, 1994 and provides it with one year to conclude its affairs. We recommend that the legislature extend the ABC Board's termination date until June 30, 2001. Alternatively, the legislature should consider removing the ABC Board from the sunset review process altogether.

The audit was conducted in accordance with generally accepted government auditing standards. Fieldwork procedures utilized in the course of developing the findings and discussion presented in this report are outlined in the Objectives, Scope, and Methodology section. Audit results may be found in the Report Conclusions, Findings and Recommendations, and Analysis of Public Need sections of the report.

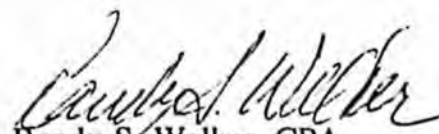
  
Randy S. Welker, CPA  
Legislative Auditor

TABLE OF CONTENTS

	<u>Page</u>
Objectives, Scope, and Methodology .....	1
Organization and Function .....	3
Report Conclusions .....	5
Findings and Recommendations .....	7
Analysis of Public Need .....	11
Appendices:	
A. Summary of Revenues and Expenditures .....	17
B. Number of Licenses by Category .....	19
C. Number of Permits Issued by Category .....	21
D. Licenses, Permits, and Fees .....	23
E. Summary of Questionnaires Sent to Municipalities .....	25
F. Summary of Questionnaires Sent to Law Enforcement Agencies ..	29
G. Summary of Questionnaires Sent to Licensees .....	35
Agency Responses:	
Alcoholic Beverage Control Board .....	39
Department of Revenue .....	43

## OBJECTIVES, SCOPE, AND METHODOLOGY

In accordance with Titles 24 and 44 of the Alaska Statutes (sunset legislation), we have reviewed the activities of the Alcoholic Beverage Control Board (ABC Board or the Board) to determine if there is a demonstrated public need for its continued existence and if it has been operating in an efficient and effective manner.

As required by legislative intent, this report shall be considered during the legislative oversight process in determining whether the ABC Board should be reestablished. The law currently specifies that the Board will terminate on June 30, 1994. At that time, it will be given one year to conclude its affairs unless its termination date is extended.

### Objectives

The ABC Board was created to regulate the manufacture, sale, barter, and possession of alcoholic beverages in order to protect the public health, safety, and welfare of citizens in the State. To this end, our primary objective in this audit was to determine whether there is a public need for the Board and if it should continue to exist.

The secondary objective was to review the Board's major functions of licensing, inspections, and investigations for effectiveness in meeting public need and for efficiency of operation.

Our report conclusions, findings and recommendations, and analysis of public need have been summarized in the appropriate sections of this report.

### Scope

We reviewed ABC Board activity that occurred subsequently to the last sunset audit which was performed in 1989. The activity was evaluated to determine whether or not it has been in the public interest. We also reviewed the proceedings of the Board to ensure that it complies with Alaska statutes and regulations.

### Methodology

We reviewed and evaluated the following during the course of our examination:

- Title 4 and other applicable Alaska Statutes.
- Title 15, Chapter 104 of the Alaska Administrative Code.
- ABC Board licensing files.
- ABC Board reading files.

- ABC Board operating budgets.
- Questionnaires sent out by us to municipalities, law enforcement agencies, and licensees.

In addition we attended Board meetings, interviewed ABC Board staff, and contacted the State Ombudsman, the Attorney General's office, the Division of Equal Employment Opportunity, and the Human Rights Commission.

## ORGANIZATION AND FUNCTION

The Alcoholic Beverage Control Board (ABC Board or the Board) was established in 1959 by Title 4 of the Alaska Statutes as a quasi-judicial agency. For administrative purposes the ABC Board is assigned to the Department of Revenue. The purpose of the Board is to regulate the manufacture, barter, possession, and sale of alcoholic beverages in the State. Control is exercised through Board review and consideration of liquor license applications for original issuance, renewal, and transfer; and through revocation and suspension of licenses. The Board also has the power to propose and adopt regulations and to hear appeals concerning actions of ABC Board personnel.

The Board is composed of five members appointed by the governor and confirmed by the legislature. Traditionally, appointed members represent all geographic areas of the State. Two of the members are required by statute to be representatives of the alcoholic beverage industry while the other three are public members. Board members are appointed for overlapping three-year terms. A director, appointed by the governor, serves as the executive officer and is responsible for enforcing Title 4 and regulations adopted by the Board.

Title 4 specifies the type of licenses, licensing fees, and the activities allowed under each class of license issued by the Board. Title 4 also establishes procedures for the issuance of new and renewal licenses.

ABC Board employees are charged with ensuring compliance with alcoholic beverage statutes by over 1,800 licensees. Employees provide three functions that include administration, licensing, and enforcement. These services are briefly described below.

Administration: The ABC Board director has a wide variety of administrative duties which provide support for the Board. Responsibilities include oversight of staff, preparation of budget documents, and direction of special enforcement investigations and public hearings. The director and a secretary comprise the administrative staff.

Licensing: The three-member licensing staff is responsible for processing license applications, maintaining licensing records and files, collecting licensing fees, and answering licensing questions asked by the public.

---

### Alcoholic Beverage Control Board Members

Bill Bishop, Chairman  
Kodiak  
Industry Member  
Term expires January 31, 1996

Brad Bradley  
Anchorage  
Public Member  
Term expires January 31, 1995

Ben Elkins  
Ketchikan  
Industry Member  
Term expires January 31, 1994

Jim McNamee  
Fairbanks  
Public Member  
Term expires January 31, 1994

Jane Perkins  
Nome  
Public Member  
Term expires January 31, 1996

---

Enforcement: The ABC Board currently has three investigators, an increase of one from FY 93. All three investigators are based in Anchorage. Investigators perform various duties that include inspecting licensed premises, investigating complaints of suspected licensing violations, and responding to questions from licensees and the public. Investigators also give lectures relating to alcoholic beverage laws and regulations on behalf of the Board.

The ABC Board office is located in Anchorage. In FY 93, the Board had an operating budget of \$507,000 for Board activities and the seven staff positions.

## REPORT CONCLUSIONS

### Status of Prior Audit Recommendations

The previous sunset audit, dated June 30, 1989, made two recommendations to the Department of Revenue and the Alcoholic Beverage Control Board (ABC Board or the Board). In order to operate in a more efficient and effective manner, the department and the Board incorporated administrative procedures to partially implement one recommendation. Current Recommendation No. 1 addresses the remaining problems with this issue.

The second recommendation has not been implemented as the Board disagreed with it. The members of the Board felt that the finding addressed a discretionary issue and that the Board acted properly at the time. This issue was not considered significant during the current audit period.

### Report Conclusions

In our opinion, the Alcoholic Beverage Control Board is operating in an efficient and effective manner and should continue to regulate the manufacture, sale, barter, and possession of alcoholic beverages in Alaska in order to protect the public's health, safety, and welfare. Protection is provided by the Board through issuance, renewal, revocation, and suspension of licenses as determined appropriate and through active investigation of suspected licensing violations and enforcement of the State's alcoholic beverage control laws and regulations.

As indicated in the Analysis of Public Need section of this report, in our opinion the ABC Board has met the various statutory sunset criteria. With the exceptions noted in Recommendation Nos. 1 and 2, we believe that the Board is effectively meeting its statutory responsibilities.

We have reviewed the activities of the ABC Board since the last sunset review and, in our view, it is operating in the public interest. We recommend that Alaska Statute 44.66.010(a)(1) be amended to extend the life of the ABC Board to June 30, 2001. This recommendation is consistent with one made in our audit report titled *A Special Report on Selected Boards and Commissions Issues, October 30, 1992*. In that report, we recommended that the ABC Board be extended to the year 2001 as part of a comprehensive restructuring of the State's sunset review process.

Alternatively, the legislature should consider removing the ABC Board from the sunset process altogether. The Board has consistently met the public need. We do recognize, however, that performance issues arise periodically. In such instances, the Division of Legislative Audit, at the request of the Legislative Budget and Audit Committee, can address those issues through a special audit.

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## FINDINGS AND RECOMMENDATIONS

### Recommendation No. 1

The Department of Revenue (DOR) and the Alcoholic Beverage Control Board (ABC Board or the Board) should review the liquor license fee sharing program to ensure that it complies with Alaska Statute 04.11.610.

The concept of sharing liquor license fees with municipalities was established when Alaska was a territory. When statehood was granted, the territorial laws relating to the refund of liquor license fees were adopted by the State. In 1980, the entire statutory title concerning the regulation of alcoholic beverages was rewritten. The only changes made to the territorial law relating to refunds were to change the words "territorial" to "state," "territorial treasurer" to "commissioner of revenue," "incorporated cities" to "municipalities," and "intoxicating liquors" to "alcoholic beverages." The substance of the statute remained the same.

The rewritten statute, Alaska Statute 04.11.610, *Refund to municipalities*, states:

*(a) Annual license fees, excluding annual wholesale license fees, collected within a municipality shall be refunded semiannually to the municipality.*

*(b) If the officers of a municipality fail to actively enforce local ordinances, laws of the United States and the state, and the regulations relating to the manufacture and sale of alcoholic beverages in the state, the commissioner of revenue may deny the refund provided for under (a) of this section until the board finds the enforcement of the ordinances, laws and regulations is resumed.*

*(c) The Department of Revenue shall recover any amounts erroneously refunded under (a) of this section.*

Senate Journal Supplement No. 23, dated April 1, 1980, accompanied the bill and contained a section analysis of the proposed rewritten statute. It stated that the purpose of the refunds was

*to provide an incentive to municipalities to actively enforce liquor laws and the authority to grant, deny and recover refunds of license fees is intended to further that purpose.*

The term "Municipality" was defined as an incorporated city, an organized borough, or a unified municipality established under Alaska statute.

Since 1989, DOR has issued refunds totaling \$119,900 to ten municipalities that do not maintain a local police force.

In order for a municipality to be eligible for refunds of the license fees paid by operators of licenses within their jurisdiction, the municipality must supply local enforcement of liquor laws. Ten municipalities whose only protection is provided by Village Public Safety Officers (VPSO) and/or State Troopers received refunds of liquor license fees. Both the VPSO program and the State Trooper positions are completely funded by the State of Alaska.

DOR has interpreted "officers of a municipality" to include "police or VPSO protection." We believe that municipalities with only VPSO or State Trooper protection do not qualify for the shared fees. The purpose of the shared fees is to offset the costs of maintaining an enforcement unit. Since these ten municipalities have not responded to the "incentive" feature of the refund by maintaining a local police force, the State is essentially paying twice for law enforcement in those communities.

DOR should reconsider its definition of "officers of a municipality" and determine if any liquor license fees previously refunded should be recovered.

No standards have been established for the use of the liquor license fee refunds by the municipalities.

The purpose behind liquor license fee refunds to municipalities is to provide an incentive for them to actively enforce ordinances, laws, and regulations relating to the manufacture and sale of alcoholic beverages. Therefore, it follows that the refunds should be used for this enforcement.

The results of a survey performed by the Division of Legislative Audit during this review showed that most of the refunds are deposited into general fund accounts and used as a source of funding for all municipal operations. Only three of the 34 municipal respondents to the survey indicated that the refunds were used to fund police enforcement activities. DOR does not require any documentation indicating how the refunds are used by the recipients.

We believe that, by specifying that these funds only be used for liquor law enforcement, the overall alcoholic beverage control program will be strengthened. DOR should consider whether they have the authority to establish standards for the municipal use of the liquor license fee refunds. If the department determines that they lack this authority, they should consider the potential benefits to the program and request the necessary legislative changes. The refunds should be designated to fund the local enforcement of the alcoholic beverage laws.

The liquor license fee sharing program lacks sufficient controls to ensure that the correct amounts of liquor license fees are refunded to eligible municipalities.

ABC Board personnel maintain the data base used to determine the amount of license fees refunded to municipalities. Twice a year a license fee revenue report is sent to DOR's Income and Excise (I&E) Audit division. I&E is responsible for issuing the refunds. Warrants are sent to municipalities who responded to an I&E inquiry in 1991 as to whether or not they had police protection. The recipients of the refunds are based on the response to that inquiry.

ABC Board employees do not reconcile payments made by I&E to the amount that the Board requested them to make. Although the Board director has asked for information on the warrant distribution, I&E has only provided it via its *Shared Taxes and Fees Annual Report* issued five months after the end of the fiscal year. When errors are made in the amount or destination of the refunds, they may not be identified in a timely manner, if ever. For example, in FY 92, because of an error by I&E in reading the license fee revenue report, a municipality received only \$1,250 instead of the \$6,300 it was owed.

ABC Board personnel should obtain information on the warrant distribution after the warrants are issued, use it to determine that the proper distributions were made, and make any necessary corrections.

#### Recommendation No. 2

The Alcoholic Beverage Control Board should establish and implement procedures to comply with the Alaska Administrative Code (AAC) requirement that licensees applying for tourism license renewals prove that issuance of their licenses encouraged tourism.

Original applicants for tourism licenses must show that issuance of the license in conjunction with the construction or improvement of an airport terminal or a hotel, motel, resort, or similar business with dining facilities will encourage tourism. Applicants must also show that tourist business will comprise a substantial portion of their business.

According to 15 AAC 104.325, renewal applicants for tourism licenses must demonstrate:

*that issuance of the license encouraged tourism, that the facility was constructed or improved in accordance with the application, and that the facility continues to be operated by the licensee. If the licensee does not make the showings required by this subsection, the renewal will be denied.*

The ABC Board does not require licensees who hold tourism licenses to show upon renewal that their licenses actually encourage tourism. The form currently used by the ABC Board for license renewals does not request any of the information required by regulation.

By not requiring evidence that the liquor licenses promote tourism, the ABC Board may improperly renew them. Tourism licenses are issued without regard to statutory limits based on population, which establish the number of licenses allowed in an area. Improper renewal may inadvertently allow for circumvention of those limitations.

The ABC Board should establish what documentation is necessary to meet the requirements of 15 AAC 104.325 and implement procedures to obtain such documentation from licensees seeking to renew their tourism licenses.

## ANALYSIS OF PUBLIC NEED

### Limited Analysis

The following analyses of the Alcoholic Beverage Control Board's (ABC Board or the Board) activities relate to the public need factors defined in the "sunset" law, Alaska Statute 44.66.050. These analyses are not intended to be comprehensive, but address those areas we were able to cover within the scope of our review.

*The extent to which the board, commission, or program has operated in the public interest.*

The Board operates in the public interest and protects the public's health, safety and welfare through limits on the number of licenses authorized, careful review of license applicants, license regulation and enforcement, investigation of complaints, and license revocation, and suspension. The ABC Board provides consistent interpretation and application of alcohol law statewide for the public, law enforcement, and liquor industry.

In addition ABC Board employees present training lectures to alcohol servers, club licensees, various alcohol and drug abuse conferences, and to the Alaska State Troopers and Village Public Safety Officers. Personnel have also assisted the Anchorage Municipal Assembly in developing local liquor ordinances.

*The extent to which the operation of the board, commission, or agency program has been impeded or enhanced by existing statutes, procedures, and practices that it has adopted, and any other matter, including budgetary, resource, and personnel matters.*

We found no statutes that were obsolete, vague, or unduly restrictive except those relating to the refund of license fees to municipalities. The Department of Revenue and the Board should review the liquor license fee sharing program to ensure that it complies with Alaska statute. (See Recommendation No. 1.)

Alaska statutes allow for communities to decide to restrict the sale, importation, or possession of alcohol within their boundaries. As of October 1993, 111 communities have taken advantage of that opportunity. The ABC Board's work load has been substantially reduced because of the availability of local option.

The ABC Board's FY 93 budget was reduced from \$723,200 to \$507,000. Enforcement personnel were cut in FY 93 by 70 percent which seriously limited the Board's effectiveness in enforcing the State's liquor laws and regulations. In 1993, the Board had 550 (44%) more licenses than it did in 1977 and three (60%) less investigators. During FY 93, as compared to FY 92,

Number of Communities With Local Option Restrictions	
Ban Sale	9
Community License Only	5
Ban Sale & Importation	73
Ban Possession	22
Package Store License Only	2

the number of premise inspections dropped by 35%, the number of advisory notices<sup>1</sup> issued dropped by 50%, and the number of notices of violation<sup>2</sup> dropped by 60%. The change to biennial license renewal in 1994 should help alleviate work load problems.

The Division of Legislative Audit sent out questionnaires to municipalities, law enforcement agencies, and licensees which covered a number of issues. (See the Questionnaire Summaries in Appendices E, F, and G.) Many of the law enforcement respondents indicated the need for more enforcement staff with comments such as:

“There is a great need for more ABC enforcement staff.”

“You need more agents. There are many bush violations that are being passed up.”

“You need more field enforcement to be effective.”

*The extent to which the board, commission, or agency has recommended statutory changes that are generally of benefit to the public interest.*

Several pieces of legislation have been passed since the last audit was performed on the Board in 1989 that are of general benefit to the public interest. One new law required that signs warning of the possible danger from drinking during pregnancy also warn of possible danger from smoking cigarettes during pregnancy.

In 1993, legislation was passed that required alcoholic beverage licensees and employees who sell or serve alcoholic beverages to complete an alcohol server education course. A second law changed the form of the Alaska driver's license to include a holograph symbol and identification of drivers who are under 21 years old and provided for driver's license revocation for using false identification to illegally obtain alcohol.

The final legislative modification to Title 4 in 1993 changed all alcohol-related licenses from annual to biennial renewal. This amendment will reduce the amount of paperwork handled by the licensees and by the ABC Board staff by half.

*The extent to which the board, commission, or agency has encouraged interested persons to report to it concerning the effect of its regulations and decisions on the effectiveness of service, economy of service, and availability of service that it has provided.*

---

<sup>1</sup> An advisory notice may be issued when an incident occurs that may result in a violation of a statute, regulation, or municipal ordinance.

<sup>2</sup> A notice of violation is an informal communication given to a licensee that a violation of statute, regulation, or municipal ordinance might have occurred or might be occurring on the licensed premises.

Public participation is encouraged at each Board meeting. Title 4 requires that the Board meet in each of the four judicial districts of the State at least once each year. In both 1992 and 1993, the Board met eight times. Each meeting is advertised in local newspapers and is open to the public. Meeting announcements are published in newspapers prior to the meeting.

*The extent to which the board, commission, or agency has encouraged public participation in the making of its regulations and decisions.*

As required by statute, when new regulations are being adopted notices are mailed to all known interested parties. Public hearings are held in a further effort to receive public input. As noted above, all Board meetings are noticed and open to the public.

*The efficiency with which public inquiries or complaints regarding the activities of the board, commission, or agency filed with it, with the department to which a board or commission is administratively assigned, or with the Office of the Ombudsman have been processed and resolved.*

The Office of the Ombudsman received 13 complaints about the ABC Board during the time period of June 1, 1989 through October 7, 1993. Generally, the Ombudsman responded to these complaints in a timely manner. Most of the perceived problems were created because the complainant did not have sufficient information on a particular issue. As soon as the Ombudsman was able to provide accurate information, the complaints were resolved.

*The extent to which a board or commission which regulates entry into an occupation or profession has presented qualified applicants to serve the public.*

The Board reviews liquor license applications to determine if the applicants meet certain statutory qualifications. If a license is available and if the applicant meets the requirements, the Board issues the license. Our review of applicants' files disclosed no violations of those requirements. The Board may also suspend or revoke licenses or permits previously authorized if it finds that it would be in the best interests of the public.

*The extent to which state personnel practices, including affirmative action requirements, have been complied with by the board, commission, or agency to its own activities and the area of activity or interest.*

We found no evidence of hiring practices or Board appointments that are contrary to state personnel practices. No complaints have been filed with either the Division of Equal Employment Opportunity or the Human Rights Commission.

*The extent to which statutory, regulatory, budgeting, or other changes are necessary to enable the agency, board, or commission to better serve the interests of the public and to comply with the factors enumerated in this subsection.*

Please refer to the Findings and Recommendations section of this report.

APPENDICES

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APPENDIX A

Department of Revenue  
Alcoholic Beverage Control Board  
Summary of Revenues and Expenditures  
Fiscal Years 1990 through 1993

	<u>FY 90</u>	<u>FY 91</u>	<u>FY 92</u>	<u>FY 93</u>
<u>Revenue</u> (From Schedule 1 below)	\$1,728,230	\$1,823,250	\$1,685,485	\$1,772,595
Less: Transfers to Municipalities (Note 1)	<u>880,025</u>	<u>869,525</u>	<u>868,950</u>	<u>884,475</u>
<u>Net Revenue</u>	848,205	953,725	816,535	888,120
Less: Expenditures (Note 2)	<u>647,365</u>	<u>699,785</u>	<u>729,265</u>	<u>504,650</u>
<u>Excess of Revenue Over Expenditures</u>	<u>\$ 200,840</u>	<u>\$ 253,940</u>	<u>\$ 87,270</u>	<u>\$ 383,470</u>

Schedule 1 - Revenue

Liquor License Application Fees	\$ 201,550	\$ 262,200	\$ 209,805	\$ 231,300
Pub Licenses	400	400	400	400
Brewery Licenses	1,000	2,000	0	1,500
Distillery Licenses	500	500	500	500
Beverage Dispensary Licenses	817,275	812,500	803,750	818,700
Club Licenses	51,900	38,600	39,900	51,625
Common Carrier Licenses	47,600	53,900	58,400	63,275
Restaurant Licenses	93,575	93,900	83,700	95,250
Retail Store Licenses	334,500	332,925	294,375	324,375
Wholesale Licenses	127,800	127,600	134,600	131,400
Miscellaneous (Note 3)	52,130	78,725	59,605	54,270
Clerical Fees	<u>0</u>	<u>0</u>	<u>450</u>	<u>0</u>
<u>Total Revenues</u>	<u>\$1,728,230</u>	<u>\$1,823,250</u>	<u>\$1,685,485</u>	<u>\$1,772,595</u>

(Note 1) In accordance with AS 04.11.610, refunds of annual license fees, excluding annual wholesale license fees, collected within a municipality are to be given to the municipality semiannually. The total of these refunds is the "Transfers to Municipalities" amount.

(Note 2) Expenditures do not include encumbrances.

(Note 3) The miscellaneous revenue account includes fees from various low-volume licenses (theater, recreational sites, and municipal golf courses) and permits (caterer, special events, restaurant caterer, club license caterer, and restaurant designation).

Source of Information: The Alaska State Accounting System

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APPENDIX B

Department of Revenue  
 Alcoholic Beverage Control Board  
Number of Licenses by Category  
 Calendar Years 1989 through 1993 (Note 1)

<u>License Categories</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>
Pub	1	1	1	1	1
Brewery	2	3	3	3	3
Distillery	1	1	1	1	1
Beverage Dispensary	684	679	687	685	690
Club	89	81	83	85	86
Common Carrier	162	175	186	207	212
Restaurant	320	314	313	320	324
Theater	1	1	1	1	1
Retail Store	465	457	456	451	446
Wholesale	21	21	24	23	22
Recreational Site	20	19	19	20	23
Municipal Golf Course	<u>0</u>	<u>0</u>	<u>0</u>	<u>1</u>	<u>1</u>
<u>Total Licenses</u>	<u>1,766</u>	<u>1,752</u>	<u>1,774</u>	<u>1,798</u>	<u>1,810</u>

(Note 1) Calendar year 1993 is January 1<sup>st</sup> through October 8<sup>th</sup>

Source of Information: Alcoholic Beverage Control Board files

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APPENDIX C

Department of Revenue  
 Alcoholic Beverage Control Board  
Number of Permits Issued by Category  
 Calendar Years 1989 through 1993 (Note 1)

<u>Permit Categories</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>
Special Events Permit (AS 04.22.230)	89	88	88	67
Restaurant Caterer's Permit (15 AAC 104.680)	5	3	24	21
Club License Caterer's Permit (15 AAC 104.690)	6	5	2	7
Caterer's Permit (AS 04.11.230)	<u>629</u>	<u>643</u>	<u>669</u>	<u>487</u>
<u>Total Number of Permits Issued per Year</u>	<u>729</u>	<u>739</u>	<u>783</u>	<u>582</u>
Restaurant Designation Permits (15 AAC 104.715 - .795) (Note 2)				<u>1,988</u>

(Note 1) Calendar year 1993 is January 1<sup>st</sup> through October 8<sup>th</sup>.

(Note 2) Total number of Restaurant Designation Permits issued since October 24, 1987. This permit allows for dining by persons under the age of 21 and for the employment of persons between the ages of 16 and 19 within the licensed premises of a hotel, restaurant, or eating place.

Source of Information: Alcoholic Beverage Control Board files

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## APPENDIX D

### Department of Revenue Alcoholic Beverage Control Board Licenses, Permits, and Fees

TYPES OF LICENSES	ANNUAL FEE
Application Filing Fee	\$ 100.00
Beverage Dispensary License - Half Year	625.00
Beverage Dispensary License - Tourism - Half Year	625.00
Beverage Dispensary License	1,250.00
Beverage Dispensary License - Duplicate	1,250.00
Beverage Dispensary License - Tourism	1,250.00
Beverage Dispensary License - Tourism - Duplicate	1,250.00
Beverage Dispensary License - Public Convenience	1,250.00
Beverage Dispensary License - Community License	1,250.00
Bottling Works License	250.00
Brewery License	500.00
Brewpub License	250.00
Club License	600.00
Club License - Half Year	300.00
Club License - Public Convenience	600.00
Common Carrier License	350.00
Common Carrier License - Half Year	175.00
Distillery License	500.00
Package Store License	750.00
Package Store License - Half Year	375.00
Package Store License - Tourism	750.00
Package Store License - Public Convenience	750.00
Package Store License - Community License	750.00
Pub License (University)	400.00
Recreational Site License	400.00
Recreational Site License - Half Year	200.00
Restaurant/Eating Place (Beer & Wine only)	300.00
Restaurant/Eating Place (Beer & Wine only) - Half Year	150.00
Restaurant/Eating Place (Beer & Wine only) - Tourism	300.00
Restaurant/Eating Place (Beer & Wine only) - Public Conv.	300.00
Retail Stock Sale License	100.00
Theater License	300.00
Wholesale License - General (Basic Fee)	1,000.00
Wholesale License - Malt Beverage & Wine	200.00
Winery	250.00
Caterer's Permit	50.00
Club License Caterer's Permit	100.00
Restaurant Caterer's Permit	50.00
Special Events Permit	50.00
Restaurant Designation Permit	50.00

Source of Information: Alcoholic Beverage Control Board

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APPENDIX E

Department of Revenue  
Alcoholic Beverage Control Board  
Summary of Questionnaires Sent to Municipalities

Questionnaires were sent to fifty-nine cities and municipalities. Thirty-four (58%) responded.

1. Is your city or borough given adequate notice by the Alcoholic Beverage Control (ABC) Board of proposed issuances of new licenses and/or transfers of existing licenses?

Number of Responses:

30 Yes  
2 No  
2 No response

2. Since 1989, has your city or borough protested the issuance of a new license, renewal of a license, or the transfer of a license?

Number of Responses:

12 Yes  
21 No  
1 No response

If yes, what criteria has the city or borough used to protest a license?

Typical Comments:

*Protests result from the following: non-payment of utility bills, sales tax and property tax; proximity to schools and churches; and, public opposition to the location of the licensed premise.*

3. Have protests lodged by the city or borough resulted in a hearing by the ABC Board or by a hearing officer appointed by the Governor?

Number of Responses:

7 Yes  
13 No  
6 No response  
8 Not applicable

APPENDIX E (cont.)

Department of Revenue  
Alcoholic Beverage Control Board  
Summary of Questionnaires Sent to Municipalities

4. Does the current system of notification/protest/hearing enable local government's opinions to be heard during the licensing process?

Number of Responses:

23 Yes  
4 No  
7 No response

If no, should local governing bodies be:

5<sup>3</sup> More involved in the licensing process?  
0 Less involved in the licensing process?

One respondent commented, as follows:

*Governing bodies should be more involved in the licensing process. This is particularly true as to the transfer of licenses to new locations. I suggest that the decision as to the transfer of a license to a new premises should be a local decision with no involvement by the ABC Board except to amend its records to reflect the local governing body's decision. The location of a tavern, in contrast to its ownership is more closely a matter of city planning, zoning and law enforcement than it is a matter of alcohol regulation.*

5. Are there existing alcoholic beverage control laws or regulations that are obsolete, vague, unduly restrictive and/or inadequate?

Number of Responses:

2 Yes  
17 No  
15 No response

If yes, please cite the law or regulation and why you believe it is obsolete, vague, unduly restrictive and/or inadequate.

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<sup>3</sup> One respondent answered "yes" to this question.

APPENDIX E (cont.)

Department of Revenue  
Alcoholic Beverage Control Board  
Summary of Questionnaires Sent to Municipalities

Typical Comments:

*There should be a way to deny license renewals for licensees that are repeatedly late in paying sales tax or other monies due to local government.*

*Certain licensing actions such as transfers of licenses and new licensees require public notice. The public notice period should be extended in order to allow local government a better opportunity to hold public hearings if necessary.*

6. What changes in the ABC Board's policies or alcoholic beverage control laws and regulations could be made that would enable your local governing body to better serve the public?

Typical Comments:

*The ABC Board should educate bar operators on statutory requirements regarding bar closure on election days.*

*The community could benefit by increased enforcement visits from the ABC Board.*

*There is a need to deny license renewals for licensees that are repeatedly delinquent in paying municipal taxes.*

One city manager commented, as follows:

*AS 4.21.010(c) should either be deleted or clarified in order to give municipalities clear direction as to their ability to impose additional sales taxes on liquor. . . .*

*The entire Title 4 is awkwardly organized. It is difficult to track. Frequently one must refer to several articles or chapters in order to fully understand the issue.*

*The procedures and standards for issuance of new licenses, transfers of existing licenses from one owner to another, renewals, and transfers of licenses to a new premises should be set out separately rather than combined in a single section or article. Different rights and interests*

APPENDIX E (cont.)

Department of Revenue  
Alcoholic Beverage Control Board  
Summary of Questionnaires Sent to Municipalities

*are involved in each of these matters.*

7. What do you use the alcoholic beverage license fees refunded to your city or borough by the ABC Board for?

Comments:

Nineteen responses stated that license fee refunds go to the general fund.

Three responses reported that they are used for police or public safety.

One response indicated "education."

One response stated City Budget for Public Works.

Ten were non-responsive.

8. Do you have any other comments you would like to make?

Typical Comments:

*ABC employees are helpful, cooperative, and knowledgeable about alcohol laws and regulations.*

*The ABC Board should be retained.*

*The Board provides needed information to small communities lacking expertise and the funds necessary to properly process new alcohol license or renewal applications.*

## APPENDIX F

Department of Revenue  
Alcoholic Beverage Control Board  
Summary of Questionnaires Sent to Law Enforcement Agencies

Forty-five questionnaires were sent to law enforcement agencies. There were twenty-eight (62%) responses.

1. Are you aware of the existence of the Alcoholic Beverage Control (ABC) Board, its operation, and its role in the enforcement of ABC laws and regulations?

Number of Responses:

24 Yes  
2 Enforcement role is not well known  
2 Aware of Board but have never seen any enforcement  
0 Not aware of its role in enforcement

2. Do you feel the enforcement staff of the ABC Board complements, duplicates, or conflicts with the efforts of your law enforcement personnel?

Number of Responses:

22 Complements  
1 Duplicates  
1 Conflicts  
4 None of the above

Typical Comments:

*The ABC Board doesn't have adequate staff to enforce liquor laws in our area.*

*The ABC Board does not have enough field enforcement staff.*

*We frequently cooperate with the ABC Board in both criminal and civil cases.*

*The ABC Board has filled a void for enforcement of liquor laws in our area.*

*Local communities need more help from the ABC Board for the enforcement of alcoholic beverage regulations.*

APPENDIX F (cont.)

Department of Revenue  
Alcoholic Beverage Control Board  
Summary of Questionnaires Sent to Law Enforcement Agencies

3. Do you share investigative information with the ABC Board's enforcement staff and notify them of arrests made on licensed premises?

Number of Responses:

17 Yes, always share information  
3 No, never share information  
7 Occasionally ABC is sent copies of liquor related arrests and reports  
1 No response provided

4. Are there any existing alcoholic beverage control laws or regulations that you feel are obsolete, vague, unduly restrictive and/or inadequate?

Number of Responses:

5 Yes  
19 No  
4 No response provided

If yes, please cite the law or regulation and why you believe it is obsolete, vague, unduly restrictive and/or inadequate.

Typical Comments:

*AS 04.16.051 makes it too easy for a minor to drink if the parent is not opposed to the child drinking.*

*It is difficult to control the sales of alcohol in small communities because there are too many exceptions for license quotas.*

*AS 04.16.030 related to serving intoxicated persons needs to be revised because it is too difficult to prove criminal negligence. The term "criminal negligence" should be revised to "recklessness."*

*The State should make possession of alcohol by a minor an infraction. This would enable a police officer to issue the minor a citation and allow the courts to deal immediately with the problem. As it is now, many juveniles in my area have been arrested numerous times for minor consuming. The Juvenile Probation Department either refuses*

APPENDIX F (cont.)

Department of Revenue  
Alcoholic Beverage Control Board  
Summary of Questionnaires Sent to Law Enforcement Agencies

*or is unable to deal with "status" offenses.<sup>4</sup>*

*Certain words in Title 4, such as the term "drunken" in AS 04.16.040, should be changed to allow for easier legal interpretation and enforceability. The term "criminal negligence" as used in AS 04.16.030 needs to be changed. AS 04.16.030 also uses the term "drunken person." These words are difficult or impossible to enforce. As written, this wording offers too much protection from prosecution to bar tenders and owners that serve intoxicated individuals.*

5. Have the ABC investigators provided training sessions to your local police officers?

Number of Responses:

6     Yes  
22    No

If yes, were the sessions informative and worthwhile?

Five questionnaires said that training was worthwhile. Another respondent stated that the training was worthwhile, but took place several years ago.

If no, have you requested training? .

Fifteen of the respondents stated that they have not requested training.

Other comments include the following.

*We did not know that training was available. We would like to have it.*

*We have not received training from the ABC Board, but they always answer our questions on the phone.*

*With only two agents, the ABC Board is spread too thin.*

6. What do you use the alcoholic beverage license fees refunded to your city or borough

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<sup>4</sup> Status offense means that the offense would not be a crime if the offender were age 21 or older.

APPENDIX F (cont.)

Department of Revenue  
Alcoholic Beverage Control Board  
Summary of Questionnaires Sent to Law Enforcement Agencies

by the ABC Board for?

Comments:

Seventeen of the respondents stated that refunded license fees are put into the general fund.

Eight of the questionnaires were either left blank for this question or were answered by a "don't know" type of response.

Three of the questionnaires stated that the refunds were used for some type of law enforcement activity.

7. Are there any additional comments you would like to make?

Typical Comments:

*There is a definite need for more ABC Board enforcement personnel.*

*ABC staff should be increased so they can do an effective job of enforcement. Because alcohol is the # 1 social problem in this state, it would be a mistake to eliminate the ABC investigators.*

*The ABC Board needs to provide more enforcement to be effective.*

*ABC needs more agents in the bush. There are too many violations that are not enforced. Please get more field investigators.*

*The ABC Board and staff do a fine job.*

*Further cuts in ABC Board personnel will dramatically reduce enforcement capabilities. This is especially true in areas outside local enforcement jurisdictions.*

*ABC Board enforcement is too well controlled by the liquor industry. Political forces from the liquor lobby makes it difficult to apply even-handed enforcement.*

*The ABC Board needs more investigators.*

APPENDIX F (cont.)

Department of Revenue  
Alcoholic Beverage Control Board  
Summary of Questionnaires Sent to Law Enforcement Agencies

*The State should either eliminate the ABC Board effective June 30, 1994 or get serious about the Board's mission and provide adequate funding to the Board. Also, the Board should remove the appearance of economic and political favoritism.*

*The State should consider eliminating the ABC Board and transferring their mission to the Alaska State Troopers.*

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APPENDIX G

Department of Revenue  
Alcoholic Beverage Control Board  
Summary of Questionnaires Sent to Licensees

Questionnaires were sent to thirty-nine licensees. Thirteen (33%) responded.

1. When you deal with the Alcoholic Beverage Control (ABC) Board staff, do you find them to be:

	<u>Yes</u>	<u>No</u>	<u>No Response</u>
Pleasant	10	0	3
Knowledgeable	10	0	3
Responsive	9	0	4

2. Has your facility received an inspection by an ABC Board investigator?

Number of Responses:

12 Yes  
0 No  
1 Respondent Unsure

Approximate number of inspections by year:

<u>Year</u>	<u>Inspections performed</u>	<u>Inspection not performed<sup>5</sup></u>	<u>No response</u>
1993	7	1	5
1992	9	1	3
1991	11	0	2
1990	9	0	4

3. Do you feel ABC enforcement procedures are effective and are applied equitably to all licensees?

Number of Responses:

9 Yes  
1 No  
3 No response

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<sup>5</sup> Respondent wrote "0" for number of inspections for the year.