

**MINISTRY OF JUSTICE
LIQUOR DISTRIBUTION BRANCH
BRIEFING NOTE**

PURPOSE: For INFORMATION for the Honourable Suzanne Anton.

ISSUE: Commission paid by the LDB to BC commercial wineries for sales to wholesale customers

SUMMARY:

- BC commercial wineries can currently sell to wholesale customers, hospitality customers and retail customers. For these sales, the LDB pays them a 7 percent commission on their sales to wholesale customers and hospitality customers, and a 30 percent commission on their sales to retail customers.
- Recently, it was discovered that, due to a system error, the LDB has been over-paying commissions to commercial wineries for their sales to wholesale customers i.e. the LDB was paying a 7 percent commission on the retail price instead of the discounted price.
- Going forward, systems will be amended to ensure that commercial wineries receive a 7 percent commission for the value of their sale (the wholesale price) instead of being overcompensated by receiving a 7 percent commission for the higher retail value.
- Due to this, Josie Tyabji requests that the wholesale commission rate be increased from 7 percent to 8.2 percent to account for their reduced commissions that commercial wineries will receive with the amendment.
- However, the reduction in commission payout that they will receive for this is not due to a change in the wholesale commission structure but instead a correction to rectify an error.
- It should be noted that there are concurrent changes in the commission structure as a result of wholesale pricing that further benefit commercial wineries:
 - The 30 percent commission for retail sales is being eliminated and replaced with a 7 percent commission for the winery's sale to their on-site store (wholesale sale) plus a retail mark-up that is retained by the winery that will increase the revenue retained by the wineries.
 - Commercial wineries will now receive commissions for sales to Independent Wine Stores and Special Occasion License (SOL) holders (as well as retain the retail mark-up on SOL sales) which was not provided in the previous model.

BACKGROUND:

- Before April 1, the LDB paid commercial wineries a 7 percent commission on sales made directly to wholesale customers (including private liquor stores, restaurants, bars and pubs) and hospitality customers, and a 30 percent commission on direct sales to retail customers at the winery site.
- The idea behind this commission is that because the commercial winery is selling on behalf of the LDB and the winery incurs the cost of delivering the product, the LDB pays the winery a percentage of the LDB's revenue on the sale to recognize this cost.
- Under the previous pricing model, some wholesale customers received a discount off of the BC Liquor Store retail price. For example, Licensed Retail Stores (LRSs) received a 16 percent discount, Rural Agency Stores (RASs) received a 12 percent discount and Independent Wine Stores (IWSs) received a 30 percent discount. Other customers, including restaurants, bars and pubs, paid the full retail price (i.e. they did not receive a discount).
- Each commercial winery signed a sales agreement with the LDB that states the following:

The LDB will reimburse you for the cost of Product sold and pay you a commission equivalent to seven (7) percent of the **value of sales** to select Wholesale Customers and (30) percent of the value of select Retail Sales. You will receive notice of the commissions as set out in Part 3 of the Reporting Requirements and Procedures.

- Based on the specific reference to commissions being equivalent to 7 percent of the **value of sales**, the commission should have been calculated on the actual price that was paid by the wholesale customer. For LRSs, RASs and IWSs, the commission therefore should have been calculated on the discounted price.
- However, it was discovered that the commission was being calculated on the full retail price (i.e. the price before any discounts were applied).
- This means that over the years, the LDB has been overpaying commercial wineries on their sales to customers who received a discount. The total value of these overpayments is in the seven figure range.
- There was not impact to commission for hospitality sales.

Example of Overpaid Commission

- Under the previous model, the LDB's revenue on a sale from a commercial winery to an LRS, for example, was equal to the retail price less 16 percent; therefore, the commission paid should have been based on this price.

- The following is an example of the commission over-payment on a bottle of wine with a retail price of \$12.99, sold direct to an LRS:

Commission paid in error: $\$12.99 \times 7 \text{ percent commission} = \0.91

If commission was paid correctly: $\$12.99 - (12.99 \times 16\% \text{ discount for LRSs}) \times 7 \text{ percent commission} = \0.76

- In the above example, there is a \$0.15 (20 percent) over-payment of commission made to the winery.
- Because the commission paid is based on a percentage rate, as the retail price of a product increased, so too would the amount of over-paid commission.

Ms. Tyabji's Request (see Appendix A)

- Going forward, LDB's commercial winery agreement has been replaced, due to the new wholesale pricing implementation, and sent to all parties. The replacement agreement has revised wording that clearly indicates that the 7 percent commission is on the wholesale price and systems have been amended accordingly.
- Ms. Tyabji requests that the wholesale commission rate be increased from 7 percent to 8.2 percent. She argues that an increase in the rate of commission paid is necessary to account for the reduced commissions that commercial wineries will receive going forward.
- The LDB explained to Ms. Tyabji that she cannot use the historical commission payments as the standard because those payments were significantly inflated due to the error.
- In addition, the reduction in commission payout that wineries will receive is not due to a change in the wholesale commission structure, but instead a correction to rectify an error.
- Furthermore, there are concurrent changes in the commission structure as a result of wholesale pricing that benefit commercial wineries:
 - Commercial wineries will continue to receive a 7 percent commission on sales to wholesale customers, while the 30 percent commission on retail sales is being replaced with a 7 percent commission for the winery's sale to their on-site store (wholesale sale), plus a retail mark-up that is retained by the winery. This is anticipated to actually increase each winery's revenue.
 - Also, commercial wineries will now receive commissions for sales to IWSs and Special Occasion License holders (as well as retain the retail mark-up on SOL sales), which was not provided previously.

- Based on the above, current commission figures for BC commercial wineries should not be used in any discussions regarding their financial status pre- and post-wholesale pricing implementation. These figures are inaccurate and significantly inflated due to error.
- LDB has denied and continues to deny Josie Tyabji's request.

Prepared by:

Vince Cournoyer
Senior Policy Analyst
Liquor Distribution Branch
604 252-2874

Approved by:

Audrey Wong
A/Director Policy and Communications
Liquor Distribution Branch
604 252-3035

Attachment(s)

Appendix A: Email from Josie Tyabji

Appendix A

Email from Josie Tyabji

From: Josie Tyabji [mailto:Josie.Tyabji@cbrands.com]
Sent: Wednesday, March 25, 2015 9:38 AM
To: Bissoondatt, Roger LDB:EX
Cc: dwilson@missionhillwinery.com; greg.berti@andrewpeller.com; Lalonde, Jarett JAG:EX; Lawson, R. Blain LDB:EX
Subject: Commissions on Direct delivered manufactured in BC products

Hi Roger – as you know we are looking for confirmation that the integrity of the value of our direct delivery commissions will be protected in the move to a wholesale price. There has been some previous discussion around this and I would like to clarify our understanding:

- Wineries have been responsible for establishing their retail prices in the past which formed a consistent number for establishing commissions.
- From this retail price (the sales price) **a full mark up**, and taxes has been established and paid to the BCLDB and government. The mark up was not calculated on any other number other than this retail price. a
- We have always received 7% of the retail price for customers who are licensed retailers to pay for the price of the delivery. The retail price is the sales price. If the sales price was the lesser 16%, than the mark up would have to have been adjusted to the lower number.
- You have paid 16% to the LRS out of the full 110% mark up you collected from us, to compensate the retailer for the fact that they are retailing the product. This shows up on the form as a “discount” in the transaction, to shorten the process for them and essentially deliver their commission to them directly, on your behalf. This is not a reduction in our selling price.
- This is not a money making venture for us, we pay significant dollars to deliver this product on behalf of the BCLDB, order desks, administrative processing, trucking and warehousing and we cannot take a hit on this part of our business. You are receiving significant mark up on this part of the industry through us, and we are taking care of all costs associated with processing, handling and delivering it, and the private retailers are selling it.

In order to continue with a consistent compensation for this delivery cost – maintaining the manufacturer program as committed, and to pay us the same amount of \$ moving forward, the 7% of retail needs to change to 8.2% of wholesale, as there is no longer a fixed retail price.

We would appreciate confirmation that this will be modified moving forward to adjust from a retail system to a wholesale system. I have reviewed this with our industry counterparts and they are aligned in this position.

Thanks very much!

Josie

(on behalf of the wineries who are captured under this scenario.)

**MINISTRY OF JUSTICE
LIQUOR DISTRIBUTION BRANCH
BRIEFING NOTE**

PURPOSE: For INFORMATION for the Honourable Suzanne Anton, Minister

ISSUE: April 1st changes to the BC liquor industry

SUMMARY:

- The LDB has made significant changes affecting the BC liquor industry. These changes came into effect on April 1, 2015.
- Numerous efforts were taken to smooth the transition prior to April 1st. These efforts include numerous forms of industry engagement with external stakeholders, internal systems changes to align existing IT systems, business practices and processes with the LDB's business objectives, and extensive training for LDB staff at BC Liquor Stores, the Wholesale Customer Centre and Head Office.

BACKGROUND:

- On April 1st, significant changes to BC's liquor industry came into effect. These changes were made in line with the 2013 BC Liquor Policy Review and aim to increase transparency and modernize the beverage alcohol industry in BC.
- These changes were the culmination of 7 months of hard work and many major business decisions were made with the objective of leveling the playing field for all liquor retailers in BC.
- Some of these changes include:
 - a complete overhaul of the pricing model to a new common wholesale pricing system for all liquor retailers in BC, eliminating the complex model that was previously in place;
 - extensive changes that will increase convenience to consumers, such as installing refrigeration, amending labour hours to accommodate extended store hours, and the introduction of liquor in grocery stores with the accompanying systems updates to set up grocery stores as a new LDB customer type;
 - separation of LDB lines of business into retail and wholesale divisions, along with necessary IT systems changes and changes to the way wholesale sales are reported to the LDB;
 - transition to an entirely online system for Special Occasion License applications; and

- transition to tax-excluded-pricing in BC Liquor Stores.
- In order to implement these changes, large-scale systems changes were necessary to update the LDB's business processes and systems. These systems changes will streamline the way the LDB does business with industry partners.
- As part of the transition, over 300 wholesale customers were transitioned to the Wholesale Customer Centre (WCC).
 - Over 135 online webinars were conducted for individual wholesale customers to provide a hands-on tutorial of WebStore, the LDB's electronic ordering system.
 - Delivery and distribution schedules were set up for each of the 300+ new customers to ensure that each customer continued to be able to pick up their orders in a convenient and accessible manner.
- Numerous efforts were made to prepare BC Liquor Store staff for these changes.
 - Various webinars were held where a total of 222 Store Managers attended to prepare for training frontline sales associates.
 - Sales Associates were fully briefed via a detailed training package to anticipate and respond appropriately to customer questions/concerns about the changes.

Industry Engagement

- Since the beginning of 2014, the LDB'S General Manager has attended approximately **40 meetings** with stakeholders to ensure they are up-to-date with the ongoing changes.
- There have been numerous briefings and meetings hosted by the LDB, including:
 - **In-person information sessions** held at LDB headquarters for stakeholders.
 - **7 webinar info sessions** for manufacturers, private distributors and wholesale customers since the beginning of the year, with more to follow.
 - **An in-person March 23 presentation and Q&A session** for industry groups by the LDB's CEO and General Manager Blain Lawson and the Liquor Control and Licensing Branch's General Manager Doug Scott. This presentation was attended by approximately 350 people.
 - Countless meetings, letters and telephone calls with stakeholders to discuss systems changes.
- The LDB also established **a dedicated email address** to field questions from industry and other stakeholders – thus far, **over 1,500 emails** have been answered.

- Various communications were sent to each stakeholder group to prepare them for the new changes that would specifically affect their group.

OTHER MINISTRIES IMPACTED/CONSULTED:

- N/A

Prepared by:

Melissa Tang
Senior Policy Analyst
Liquor Distribution Branch
604 252-3159

Approved by:

Audrey Wong
A/Director, Policy and Communications
Liquor Distribution Branch
604 252-3035

**MINISTRY OF JUSTICE
LIQUOR DISTRIBUTION BRANCH
BRIEFING NOTE**

PURPOSE: For INFORMATION for the Honourable Naomi Yamamoto and the Honourable Terry Lake

ISSUE: Meeting with the BC Craft Brewers Guild

SUMMARY:

- The BC Craft Brewers Guild currently has 40 members, all of which are small production, local breweries.
- The Guild is concerned the introduction of the wholesale pricing structure by the Liquor Distribution Branch (LDB) will have a significant negative impact on their members' revenues.
- The LDB's position is that small-production breweries in BC are supported by a significant reduction in the mark-up applied to their products relative to large breweries.
- Further, the liquor wholesale/retail landscape has changed significantly with the introduction of the wholesale pricing structure that requires manufacturers across all product categories and retailers to adjust – it is premature to suggest small breweries will necessarily experience an appreciable decline in revenue.
- For the majority of cases, the retail price for small-production breweries packaged beer sold through BC Liquor Store and private retailers has increased as part of the transition to the new wholesale pricing model, while the price for small-production breweries draught products has decreased – assuming supplier costs remain the same.

BACKGROUND:

- The LDB has three tiers of mark-up on beer. Companies that produce 15,000 hectolitres (hl) or less have the lowest mark-up applied, companies that produce between 15,000 – 350,000 hl have the next lowest mark-up applied that is graduated and companies producing more than 350,000 hl have the highest mark-up applied. A hectoliter is 100 litres, or about 25 dozen beer. The LDB's mark-up rates for beer, based on annual brewery production, are shown in Appendix A.
- The purpose of this mark-up structure is to support small brewing companies that do not have the economies of scale of large companies and therefore have higher production costs. In order to direct the lower mark-up benefit to small companies, beer production is based on the total amount of beer produced by all facilities owned by the same company (e.g. a small brewery owned by a large brewery would not qualify).

- There has been a large increase in the number of small production breweries (the LDB does not designate breweries as 'craft') in BC over the last number of years, following the trend in the US and the increasing consumer demand.
- The tiered mark-up structure has been successful in supporting this growth. There are currently 82 breweries in the first tier, 10 in the middle tier and 13 in the last tier. This compares to 40, 7 and 3 respectively in 2012.
- The Guild's member breweries are predominantly in the first mark-up tier (< 15,000 hl).
- The Guild's consultant Craig Jangula has had a considerable amount of contact with the LDB regarding the introduction of the wholesale pricing structure and what impact those changes may have on the small-production beer industry in BC.

Wholesale Pricing Model – impact on small breweries:

Positive:

- The price for draught beer purchased by the hospitality industry (restaurants, bars, pubs) will decrease if the brewery does not raise its price of product because the LDB is not adding a retail margin to the wholesale price that must be paid by hospitality customers – previously the price paid by hospitality customers included a LDB retail margin. This may encourage sales growth of draught beer to the hospitality market. If the price the hospitality industry pays for a draught product is kept the same, that would mean the brewery would generate additional revenue.
- The mark-up applied to packaged product is now the same as the mark-up applied to draught beer (significantly reduced), therefore the revenue generated from the sale of packaged product at the brewery site will increase if the brewery chooses to maintain the same retail price.
- The LDB mark-up schedule was revised to align with the wholesale pricing structure and the opportunity was taken to eliminate the 'fiscal cliffs' that previously existed as a brewery moved from the first tier to the second tier and from the second tier into the third tier, as annual production volume grew. The second tier has been expanded from a production volume of 160,000 hl to up to 350,000 hl, and a graduated increase in the mark-up within that tier has been introduced.

Potential Negative:

- Under the previous discount-off-of-display wholesale price system for private retailers, the LDB would actually incur a loss on many small brewery packaged beer products when a private retailer bought those products because the private retailer discount was more than the LDB revenue from the mark-up and the retail margin. This was an unintended consequence of the discount-off-of-display model and the increasing discount that was provided to private retailers over the years.
- In other words, the LDB was subsidizing the shelf price of BC small brewers' packaged products sold through the private retail channel.

- The wholesale pricing model eliminates this unintended consequence, but may result in the retail margin offered to retailers becoming very small if the shelf price is kept the same and the brewery keeps its supplier price the same – thus becoming a disincentive for retailers to carry small brewers' products.
- It remains to be seen how this will work itself out in the marketplace. Small brewers may decide to reduce their revenue from the sale of packaged product in the wholesale channel so retailers are able to realize a better retail margin selling the product at current prices. This could be counter-balanced with the additional revenue provided by draught sales and the sale of packaged product at their on-site store.
- If the brewery keeps their wholesale pricing stable, retailers may decide to increase the shelf price in order to increase their retail margin, however given consumer demand for beer from local, small producers, sales may not be significantly affected.
- LDB sales data indicates that draught beer sales are the mainstay of most small-production breweries in BC, and as such, most breweries should be in a net positive position with respect to revenue if their overall operation is considered.

The Guild's Request:

s.13

LDB's Position:

s.13

OTHER MINISTRIES IMPACTED/CONSULTED:

- N/A

Prepared by:

Vince Cournoyer
Senior Policy Analyst
Liquor Distribution Branch
604 252-2874

Approved by:

Audrey Wong
A/ Director Policy and Communications
Liquor Distribution Branch
604 252-3035

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**MINISTRY OF JUSTICE
LIQUOR DISTRIBUTION BRANCH
BRIEFING NOTE**

PURPOSE: For INFORMATION for the Honourable Suzanne Anton and LDB CEO Blain Lawson.

ISSUE: IVSA meeting with Minister Anton and LDB CEO Blain Lawson on May 5, 2015.

SUMMARY:

- The IVSA is advocating for a flat tax mark-up structure similar to Alberta's.
- They are also advocating for import wine to be sold on grocery store shelves.
- Finally, the IVSA maintains that alcohol is over-regulated and over-taxed in BC when compared to 'nearly every other North American market'.

BACKGROUND:

The IVSA is meeting with the Minister and the CEO of the LDB on May 5, 2015, to discuss concerns they have with some of the liquor policy changes that have recently been implemented – namely the mark-up structure, the requirement that wine sold on the grocery store shelf must be from 100 percent BC grape, and they voice their concern about what they characterize as the over-taxation and over-regulation of liquor in the province.

The IVSA distributed a briefing note explaining their concerns and offering solutions. Below are their three concerns and a response to them.

1) Wholesale Price Model

- Insufficient private industry consultation in the formation of wholesale price model
- Resultant baseline wholesale pricing is too high and results in higher retail prices
- Tight margins are squeezing all resellers – from BC Liquor Stores, to private retailers
- Manufacturers are publicly denouncing BC as a prohibitive market in which to do business; more inclined to invest elsewhere
- Higher prices encourage high-income British Columbians to shop out of province

Why was a flat tax model, similar to the Alberta model not considered? This model is successful in nurturing a strong business environment and provides exceptional tax revenue to the Alberta government and is extraordinarily straight forward. It requires much less administration and provides extreme clarity for all stake holders. Many IVSA members also operate in Alberta and make significantly more sales and revenue in that market, along with the hospitality and private retail channels.

IVSA Solution:

Convene an industry brain-trust to review current wholesale pricing model and provide recommendations on how to modify it to create a more stimulating, more beneficial and less punitive pricing model. Involve BCLDB, BCLS, private retailers, agents, and other industry stakeholders. Industry can provide a report to government for review and amendments to be introduced April 1, 2016.

Response:

- The development of a wholesale pricing structure addresses **the retail sector's longstanding request** to divorce their cost of goods from their competitor's (BC Liquor Stores) pricing and to place all retailers on an equal footing with respect to the cost of goods – this has been accomplished.
- Wholesale pricing was never about the mark-up structure in BC – the mark-up structure itself has remained the same. The mark-up rates had to be scaled down to align with wholesale pricing and keep government revenue stable (not increase).
- Regarding transitioning to a flat tax for all product categories like Alberta's, that is something that would have far-reaching implications and was considered, but rejected at the outset of developing a wholesale pricing structure.
- While there may be some perceived benefits offered by this type of mark-up structure there are also plenty of downsides – this is evidenced by Alberta being the only jurisdiction in Canada to have adopted this structure; their fully privatized system plays a significant part in why they went this route.

2) 100% BC Wine Only on Grocery Store Shelves

- Public did not ask for exclusively 100% BC wine on grocery store shelves.
- In the name of convenience, consumers should be offered imported wine alongside BC Wine in grocery stores.
- Store within a store model is not practical if LRS licenses must be sold and moved while a questionable number of dormant licenses exist for BC Wine on shelf.
- In the interests of a fair and level playing field, lower prices for consumers and government removing itself from interfering with business, the policy prohibiting imported wine on grocery store shelves is counter-intuitive.
- Excluding imported wine on grocery store shelves is a great concern to the international community and risks challenges to trade agreements at a great cost to tax-payers and the domestic industry.
- Current example in Ontario has LCBO taking a cautious approach with beverage alcohol in grocery stores, with respect to international trade agreements.

IVSA Solution:

The IVSA recommends the dormant license types be modified to allow imported wine to be sold on grocery store shelves alongside 100% BC Wine. This would provide the convenience, the selection and the lower prices that consumers are seeking in the Liquor Policy Review recommendations. This would also show the BC Government is sincere in wanting to create a fair and level playing field for all retailers and suppliers, and encourage free enterprise.

Response:

- The government's intent is to allow the sale of all liquor products in the "store in store" model but also to have a model that promotes the quality local products that are made and bottled in British Columbia.
- International trade agreements recognize that products should be treated equally and fairly, but we believe we can support local products while keeping the number of British Columbia wine licences consistent with those allowed under existing trade law.

3) Alcohol Prices in BC and government involvement:

- The wine and food-loving public is acutely aware of international liquor prices, wine quality abroad, restaurant prices abroad, and the contrasts and burdens here at home.
- Manufacturers, suppliers and importers want to do more business in British Columbia but are suffocated by over-taxation and over-regulation – more so than nearly every other North American market.
- British Columbia has an opportunity to introduce a world-leading, innovative and profitable beverage alcohol tax and resale system by consulting with industry stakeholders prior to implementation of the Wholesale Price Model and 100% BC Wine in grocery stores. If less government interference or intervention was the goal, then reduce restrictions on selection and let the consumer decide.

Response:

- Different jurisdictions around the world take different approaches to the provision of public services and to the funding of those services that are offered to their citizens. It is therefore not surprising that liquor prices will vary between international jurisdictions.
- In BC, and across Canada, citizens have access to a wide array of quality, publicly-funded services which require public funds to support. The sale of liquor provides an important source of revenue in every Canadian jurisdiction.
- Given that alcohol is a product that can have serious negative consequences for individuals and for communities, significant government regulation is warranted and is supported by most citizens.

- Having said that, we realized that some of the regulation may not be necessary and that's why we launched the Liquor Policy Review and consulted widely. As a result, we have introduced sweeping changes to modernize the rules.

OTHER MINISTRIES IMPACTED/CONSULTED:

- LCLB drafted bullets for point 2.

Prepared by:

Vince Cournoyer
Senior Policy Analyst
Liquor Distribution Branch
604 252-2874

Approved by:

Blain Lawson
General Manager and CEO
Liquor Distribution Branch
604 252-3021