Testimony on Implementation of Act 39 before House Liquor Control Committee

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Wine Institute is non-profit trade association of nearly 1,000 California wineries. While there are now wineries in every state, CA produces 89% of all domestic wine. Wine constitutes 42% of PLCB revenue - $848 million in FY2015. California wine comprises about 53% of PLCB wine sales by both volume and revenue.

Thank you for an opportunity to comment on implementation of Act 39. This is truly an historic step forward in the way wine is sold to Pennsylvanians.

Wine Institute has taken no position on privatization/modernization, but for years has supported allowing direct shipping of wine to PA consumers, expanded hours and Sunday sales at PLCB stores, and generally increasing the number of off-premise outlets selling wine.

DIRECT WINE SHIPMENTS

PA is the 44th state to allow consumers to buy wine directly from wineries with shipment to home or business addresses. Act 39 is consistent with model shipping legislation: wineries obtain PA permit for $250 per year and may ship up to 36 cases of wine per resident per year for personal use; wineries verify age of buyer and ship via common carrier in a box with appropriate label; wineries collect and remit a PA 6/7% sales tax and a $2.50/gallon ($0.50/750 ml bottle) wine excise tax, and report total sales annually.

PA's program is shaping up to be highly successful, with licenses being issued quickly: 622 wineries with PA licenses in 2 ½ months. To compare: MD has a 5-year old program with 880 licensees shipping wine to 6 million people; NY has allowed direct shipping since 2005 and has 1,600 wineries shipping to its population of 20 million people.

We anticipate annual direct-to-consumer sales of 200,000 cases with an average retail price of $40 generating approximately $8 million per year in new taxes and license fees.

CHALLENGES WITH ACT 39

While Act 39 provides positive change for wine sales, PLCB's implementation of the new law also raise concerns for wineries. In particular, we are closely monitoring implementation of flexible pricing. We are seeing less transparency surrounding the pricing of products, with PLCB limiting the number and variety of wine SKUs available to new off-premise retailers.

Unlike elsewhere, PLCB serves a dual role in operating as both a wine wholesaler and a retailer. Our wineries tell me that PLCB is limiting the SKUs made available to our new retail partners by approving the list of products they can sell. Said another way, a food store's biggest

lower prices. All - winery, wholesaler, retailer - make more money. When asked, PLCB has offered no assurances of reduced retail prices for lower cost of goods.

With flexible pricing, PLCB is paying less for product and imposing a different markup, but can charge the same retail price. There's no question PLCB will be making more money under this pricing model they term "margin optimization".

LOSS OF TRANSPARENCY in PRICING

Nothing in Act 39 eliminates the requirement for transparency surrounding the cost of goods or the application of the markup. Despite the desire to operate like private enterprise, PLCB remains a government-run monopoly whose activities should continue be subject to public scrutiny. Before Act 39, everyone knew the markup and could figure out PLCB's cost of goods.

Of course, all wineries knew the details of their own brands, but more importantly, they could figure out at what prices their competitors were selling wine to PLCB. This was an effective system of commercial checks and balances governing PLCB treatment of suppliers.

Under "flexible pricing" PLCB can change the markup on almost every item, and keep their cost of goods confidential. This may be how a private wholesaler operates, but PLCB is not a private wholesaler. PLCB has changed both their pricing formula and the level of transparency surrounding its activity. Little remains to ensure the accountability we should all expect from a government body. Note that in non-control states, wineries have a choice about which private wholesaler to utilize; there is no such choice in PA.

One example of how things are becoming less transparent: Act 39 requires PLCB to publish on a quarterly basis on its web site "a listing of the wholesale and PA liquor store retail prices." However, when asked where to find such wholesale and retail prices, PLCB directs one to a retail price catalogue with a footnote that wholesale prices are calculated by taking 10% off the retail price. While this 10% discount may represent the wholesale price for licensees, it does not represent the wholesale cost of goods that the Legislature required to be made available to the public. PLCB must follow this statutory requirement in Act 39.

Further evidence of how things are changing at PLCB can be found in the difference between PLCB Board meeting minutes on August 10 and 31. Board minutes from August 10 and before detailed wholesale unit and case, and retail pricing associated with every prices change request. After Act 39 implementation, the 8/31 agenda has no pricing information and uses 15 new codes as reasons for price changes, ranging from "strong market support" to "high dollar profit potential".

Even further, before Act 39, PLCB individually approved each request for a retail price change. Then, on October 5 PLCB delegated power to their Executive Director to approve pricing and one-time buys before official PLC Board approval.

Act 39 also requires an annual written report by April 1 to House and Senate Liquor Committees on the PLCB "method and rationale" for pricing products. Further, PLCB must testify before both Liquor Committees on that report by June 1 each year. We hope this provides sufficient legislative oversight of PLCB pricing activity.