

COMMONWEALTH OF PENNSYLVANIA
HOUSE OF REPRESENTATIVES

HOUSE LIQUOR CONTROL COMMITTEE
SENATE LAW AND JUSTICE COMMITTEE
PUBLIC HEARING

NORTH OFFICE BUILDING
HEARING ROOM 1
HARRISBURG, PENNSYLVANIA

MONDAY, JUNE 3, 2019
11:00 A.M.

PRESENTATION ON THE
LIQUOR CONTROL BOARD'S IMPLEMENTATION OF FLEXIBLE PRICING
AS MANDATED BY ACT 39 OF 2016

BEFORE:

HONORABLE PATRICK STEFANO, SENATE MAJORITY CHAIRMAN
HONORABLE JAMES BREWSTER, SENATE MINORITY CHAIRMAN
HONORABLE JEFF PYLE, HOUSE MAJORITY CHAIRMAN
HONORABLE DANIEL J. DEASY, HOUSE MINORITY CHAIRMAN
HONORABLE MATTHEW DOWLING
HONORABLE VALERIE GAYDOS
HONORABLE BARRY JOZWIAK
HONORABLE JOSHUA KAIL
HONORABLE THOMAS KILLION
HONORABLE ANDREW LEWIS
HONORABLE NATALIE MIHALEK-STUCK
HONORABLE TIM O'NEIL
HONORABLE GREG ROTHMAN
HONORABLE MICHAEL REGAN
HONORABLE FRANCIS RYAN
HONORABLE CRAIG STAATS
HONORABLE JESSE TOPPER
HONORABLE JUDITH WARD
HONORABLE DAVID M. DELLOSO
HONORABLE MARIA P. DONATUCCI
HONORABLE MARYLOUISE ISAACSON
HONORABLE STEVEN RICHARD MALAGARI
HONORABLE ADAM RAVENSTAHL
HONORABLE PETER G. SCHWEYER
HONORABLE CHRISTINA TARTAGLIONE
HONORABLE ANTHONY WILLIAMS

COMMITTEE STAFF PRESENT:

MICHAEL BIACCHI

MAJORITY EXECUTIVE DIRECTOR

ERICA GODSEY

MAJORITY LEGISLATIVE ADMINISTRATIVE ASSISTANT

ABBY KRUEGER

PUBLIC RELATIONS CONTACT TO CHAIRMAN PYLE

LYNN BENKA-DAVIES

DEMOCRATIC EXECUTIVE DIRECTOR

BRITTNEY RODAS

DEMOCRATIC RESEARCH ANALYST

* * * * *

*Pennsylvania House Of Representatives
Commonwealth of Pennsylvania*

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SUBMITTED WRITTEN TESTIMONY

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P R O C E E D I N G S

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SENATE MAJORITY CHAIRMAN STEFANO: Good morning.
Chair calls this joint hearing of the Senate Law and
Justice Committee and the House Liquor Control Hearing to
order.

Act 39 of 2016 requires an annual report on the
subject of flexible pricing at this joint hearing. This
year in addition to hearing from the Liquor Control Board
about the implementation of Act 39, we will also hear from
representatives of the wine and spirit industry about their
views on the implementation. I am grateful to the
representatives of their industry for their testimony
today. Flexible pricing fundamentally changed the manner
in which alcohol is delivered in Pennsylvania and to our
constituents. The purpose of this hearing is to understand
exactly how it has changed and to whose benefit. The
public policy process works best when the legislature
passes a policy, the executive branch or agency implements
it, and that policy is implemented correctly and without
unintended consequences and makes any changes that are
necessary. It is that oversight function that we embark on
today and, that I believe, in the next coming months.

Chairman Pyle, would you like to make any opening
comments?

1 HOUSE MAJORITY CHAIRMAN PYLE: Thank you,
2 Chairman. We very much appreciate the LCB's time sitting
3 before us today and as the Senator pointed out, this is a
4 requirement under Act 39. I look forward to what's said
5 today and maybe learn some new things.

6 SENATE MAJORITY CHAIRMAN STEFANO: Thank you,
7 Chairman. Chairman Deasy, would you like to make any
8 opening comments?

9 HOUSE MINORITY CHAIRMAN DEASY: Briefly, thank
10 you. It's great to be here. It's great to see the LCB
11 here and we are excited to see both panels. As a new
12 member and new chairman to the committee, I'm curious to
13 hear the positives of Act 39 and where we need to go in the
14 future, so thank you all for being here and look forward to
15 it. Thank you.

16 SENATE MAJORITY CHAIRMAN STEFANO: Thank you,
17 Chairman.

18 At this time, I call forward our first panel,
19 already seated, which is the Liquor Control Board. Joining
20 us today are Chairman Tim Holden, Board Member Mike Negra,
21 Executive Director Charlie Mooney, and Dale Horst, Director
22 of Sales and Marketing. Gentlemen, the floor is yours.

23 TIM HOLDEN: Thank you Mr. Chairman and members
24 of both committees, and we are very pleased to be here
25 today as required by Act 39 to report on pricing. In

1 consultation with the chairmen and with their staffs, we
2 have decided that the best way that we should proceed,
3 before we take questions maybe, is to have Dale Horst who
4 is the director of our marketing and merchandising explain
5 the process of what we have done for the last almost three
6 years and how we implemented things and how we are trying
7 to move forward. And Dale brings to us 10 years of
8 experience at the Pennsylvania Liquor Control Board plus 38
9 years at Weis Markets, a great deal of knowledge in retail.
10 So at this time I guess I get to be Ed McMahon and say,
11 here's Dale.

12 DALE HORST: Thank you, Chairman. Chairmen, it's
13 good to see you this morning, and members of both
14 committees.

15 Prior to Act 39, the retail prices on all
16 products had to be proportional with the product
17 acquisition cost paid by the board to its suppliers. As a
18 result, whatever mark-up structure was applied to a
19 product, the same mark-up structure had to be applied
20 consistently across all the products that the board sold.
21 Proportional pricing limited the ability of the agency to
22 use its economies of scale. And being one of the largest
23 purchasers in the world of liquor and wine, we now can
24 negotiate product acquisition costs differently.
25 Proportional pricing did not allow us to do that.

1 I would like to talk a little bit about
2 methodology and rationale on how we go about it and then
3 talk a little bit about how we evaluate products.

4 The LCB strives to promote a wide selection of
5 products that deliver value, variety and quality to our
6 customers.

7 Secondly, PLCB seeks to maximize the revenue for
8 the state. This is accomplished through our pricing
9 methodology and rationale applying key business metrics and
10 retail best practices to the process of purchasing
11 decisions and pricing of our products. The PLCB is
12 committed to fairness and partnership with our suppliers in
13 setting our retail prices and the methodology involved in
14 the analysis of the pricing decisions.

15 The current retail pricing of all products is
16 available on finewineandgoodspirits.com and on the LCB
17 website. A quarterly retail price list can also be found
18 on PLCB website and dating back to 2016 for historical
19 looks.

20 The PLCB purchases products to be included in the
21 listed portfolios that are warehoused in the three
22 distribution centers with constant availability. The PLCB
23 also purchases products on a one-time basis for Fine Wine &
24 Good Spirits stores and for licensees. The PLCB fosters an
25 open dialogue with each supplier in review of each of their

1 products in their listed portfolio of wine and spirits on
2 an ongoing basis. All suppliers' brokers set each products
3 cost to the LCB at all times. All supplier's sales
4 discounts are passed through to the retail shelf, price and
5 to the consumer. With one-time buy products, cost is
6 negotiated along with margin and a retail price being set
7 with each buy.

8 I'll talk a little bit about how we evaluate each
9 product and its pricing. Each listed product's cost, gross
10 margin dollars, gross margin percentage, and retail price
11 is evaluated to optimize the sales performance and revenue.
12 Gross margin is calculated prior to the 18 percent liquor
13 tax, so we're looking for our LCB gross margin on each
14 product.

15 Product selection analyzes each product's retail
16 price in relation to the manufacturer's suggested price,
17 competitive-like products, surrounding states' prices,
18 gross margin percentage to the category averages of like
19 products, retail price at the winery or distillery if they
20 sell it themselves, and to the sales trend of the item
21 historically and current. This analysis assures our
22 customers are paying a fair price for the listed products
23 sold at Fine Wine & Good Spirits stores and on ecommerce
24 and then to all licensees.

25 Once a listed product is selected as an

1 opportunity to enhance the gross margin due to analysis,
2 the supplier is notified with a request to discuss the
3 product within the next 30 days. Cost margin,
4 manufacturer's suggested retail price, and the present
5 retail price of the item is discussed. A decision follows
6 to either adjust the retail price or maintain the product
7 at its present retail price. The wholesale department then
8 notifies licensees if there's going to be a retail price
9 change, somewhere between 75 and 90 days before it goes
10 into effect. This whole process covers a period of about
11 120 days from when we notify the supplier that we would
12 like to discuss a product and until a decision is made and
13 everyone's been notified, the supplier and the licensees
14 that purchase the product, until the retail price goes into
15 effect.

16 It is important to note that some retail price
17 adjustments are executed at the request of suppliers as
18 their costs change or are part of their competitive
19 marketing strategies for a particular brand. The success
20 of suppliers and LCB is intertwined. The agency is
21 cognizant of its role as a state-run enterprise, and it's
22 committed to collaboration and fairness in expressing our
23 flexible pricing authority. We remain focused on
24 maximizing revenue in partnership with suppliers by
25 increasing sales and continuing to provide value and

1 quality to our customers.

2 The LCB contracts with AC Nielsen Corp. to
3 conduct retail price surveys of wines and spirits, shelf
4 and promotional pricing in liquor, drug and mass merchants
5 in states surrounding Pennsylvania. Price surveys have
6 been conducted each year since 2015. Retail prices in
7 Maryland, Delaware, New Jersey, New York, Ohio, Virginia
8 and West Virginia are surveyed. These retail pricing
9 comparisons are analyzed to maintain a competitive retail
10 price for our customers in Pennsylvania.

11 That's how we go about evaluating prices.

12 TIM HOLDEN: Mr. Chairman, we certainly welcome
13 any questions.

14 SENATE MAJORITY CHAIRMAN STEFANO: Thank you and
15 thank you for your testimony. I have a couple questions
16 and then we'll refer to the members.

17 When you are talking about the changes in retail
18 pricing, do you know in a sense of a percentage what number
19 of your products will increase versus decrease?

20 DALE HORST: I have the figures for 2018. Cost
21 increased on 455 items and decreased on 307. That is the
22 cost that the suppliers submitted to us. Retail prices
23 increased on 575 items and decreased on 167. Our total
24 listed portfolio as of December 31, 2018 was 4,692 items,
25 and 3,950 stayed the same. Eighty-four percent of the

1 items did not have a retail price change, and only fifteen
2 percent did.

3 SENATE MAJORITY CHAIRMAN STEFANO: All right.
4 Thank you. Along those lines if you would compare your
5 flexible pricing model to before when you had your standard
6 markup, what would be the physical impact if you would run
7 that model now? Have you ever done that analysis to know
8 where we would have been without flexible pricing?

9 TIM HOLDEN: Well, Mr. Chairman, well you need to
10 see on our revenue transfer, and we were transferring
11 anywhere between \$80 and \$100 million and now we are
12 transferring \$185 million. Once we transferred \$217
13 million but we had to go into our reserves for that. But
14 we have contributed \$185 million for the last two fiscal
15 years, or three fiscal years, and we have told the
16 Governor's office we can do that for next year as well. So
17 the difference is 80 to 100 million versus 85 million.

18 MIKE NEGRA: In addition I'd add that our margin
19 is up 90 basis points, okay, and that's taking to account
20 special orders had a big change in Act 39 as well. We went
21 from a net 20 percent markup to 10 percent markup. And
22 that's \$100 million business basically with licensees. So
23 we took a margin hit there out of Act 39, and we've
24 obviously had the increase in wine sales throughout what
25 almost 1,000 different WEPSS that are out there doing what

1 \$126 million at the last date, you know, and we're taking a
2 10 percent hit there as an additional licensee, so to come
3 out of all of that with a 90 basis point increase has
4 really been the effect of Act 39 when it comes to flexible
5 pricing.

6 SENATE MAJORITY CHAIRMAN STEFANO: I was just
7 looking to see if you have a figure so you could compare
8 the two, if you ever run that model of what it would have
9 been, excluding the wine expanded permits of course.

10 That was just a question, if you've ever compared
11 the two. No.

12 MIKE NEGRA: No, not really.

13 SENATE MAJORITY CHAIRMAN STEFANO: Can you, now
14 that we're into our third year, ending our third year, can
15 you describe your relationship with the suppliers as the
16 initial role out of flexible pricing and how it's evolved
17 into today.

18 TIM HOLDEN: Well, I'll let Dale elaborate on
19 this, Chairman, but obviously it was a change. I mean the
20 rules were the same for 70 years and the industry
21 controlled the price, and the difference is now we control
22 the retail price. So it was a learning curve. It was
23 certainly a learning curve for us. Our buyers were not
24 used to negotiating. I think there was initial -- I would
25 not use the word shock -- but there was initial deer in the

1 headlights a little bit that, you know, the rules have
2 changed like this and we have to learn and there were
3 hiccups. I'd say there are hiccups by us, hiccups by the
4 industry, but I think everyone understands now that this is
5 the law. These are the rules and we're not shutting
6 anybody out. We are not strong arming anybody. We make a
7 proposal. We are certainly prepared to take counter
8 proposals. And we try to do negotiations that are
9 perpetual. And I think the industry understands that.
10 Dale, do you want to elaborate?

11 DALE HORST: As our chairman said, when Act 39
12 first went into effect we had a lot of adjustments to do
13 and a lot of learning curve. There were meetings held with
14 every listed supplier, both in the wine and the spirits
15 side. And the Board met with upwards of 20 suppliers.
16 Some suppliers were reluctant at first to come to the table
17 and adjust any of their costs, but we certainly gave them
18 the opportunity to do that.

19 Throughout the last three years, we continue to
20 get cost adjustments from suppliers periodically. We have
21 an open-door policy, both myself and our executive
22 director. We will meet with any supplier at any time and
23 talk about any product or their whole portfolio. We do
24 work with and analyze the products, as I said, looking for
25 opportunities where products may not be priced compared to

1 the rest of their like products in their category. We look
2 at categories and then, of course, we look at our
3 competition around the states around us, so to make sure we
4 offer fair pricing. If I would have to judge it today,
5 it's a business-like atmosphere between the suppliers and
6 the liquor board, but any topic is open for discussion. We
7 have two meetings this week with two major suppliers
8 scheduled at their request to go over their portfolios.

9 CHARLIE MOONEY: Here's the thought I would add.
10 I would echo what Dale said. We've kept a very open
11 transparent door for any discussion basically at any time.
12 We've worked really hard with the trade groups. We're
13 meeting with the wholesalers and the spirits and wines
14 councils and basically any time anybody wants a
15 conversation about pricing, about products, about the
16 methodology that we're using, their SKUs, their products.
17 The door is open and we'll take the meeting.

18 SENATE MAJORITY CHAIRMAN STEFANO: Well thank
19 you. Based on that -- I understand how complex the
20 analysis is -- based on that and all the different levels
21 and you talk about transparency, but it's very hard to be
22 as transparent as possible. What kind of assurances do we
23 have here as a legislature that there aren't any supplier
24 favorites being picked? How do we know that you can keep
25 fairness across the board?

1 MIKE NEGRA: Well, from our point of view, we've
2 got buyers, okay. We've got a pricing coordinator, Libby.
3 We've got Tom Bowman who is Dale's assistant. We have
4 Dale. We have Charlie. And we have the board. All of us
5 look at those on a -- every board meeting we get a list of
6 pricing changes, SPAs, delisting, listing. You know, all
7 of the information that's relevant to Dale's department is
8 looked at by many different levels on a very detailed
9 basis. So if there's a problem that we see, we'll bring it
10 up. There's a lot of vetting that goes on before it gets
11 to our level. And I can't speak for that, but I'm sure
12 Dale can. But I can tell you that it goes all the way up
13 the chain and we're very concerned about all of that in
14 terms of playing favorites, all right, or somebody in a --
15 I guess not in a good position -- and obviously, you know,
16 in this business there are a couple of main players to say
17 the least. And I'm sure that you could hear from a lot of
18 the small players who say, you know, the big guys get all
19 of the deals and all of the shelf placement and so forth.
20 But that's a result of sales, and again, I don't want to
21 get in the middle of that, so I'll turn it over to Dale in
22 terms of from his perspective before it gets to the
23 chairman and myself, of what occurs.

24 SENATE MAJORITY CHAIRMAN STEFANO: Thank you.

25 DALE HORST: So the challenge is to offer the

1 best variety that we sell in the stores to the customers of
2 Pennsylvania. And as I said our listed portfolio is about
3 4,700 products, and our one-time buys is about 8,200
4 products. Along with that we get requests from licensees
5 that they want to sell certain products that we don't offer
6 in our Fine Wine & Good Spirits stores or on ecommerce that
7 they just want to have for their restaurant or for the
8 casinos or whatever. So trying to manage that, we'll get
9 submissions of upwards of 10 to 20,000 products a year. So
10 trying to compare the present products with new ones
11 submitted and do all that analysis is the real challenge,
12 and to try to offer a great selection to our consumers and
13 service the licensees. We can't take every product.
14 There's not enough room in the warehouses or in the stores,
15 so we try to be fair. If a supplier doesn't think we're
16 fair, they are quick to call it to our attention and we
17 take a look at it. And then the consumer is the ultimate
18 factor. They'll stop buying a product if they think it's
19 priced too high, if they don't think it delivers value.
20 And as Mike mentioned, our delist criteria goes strictly on
21 sales trends and so if a product can't perform anymore,
22 we'll take a look at it. We work with the suppliers if
23 they think a price adjustment needs to be made on a product
24 to lower the price to give it a little bit of a kick, but
25 we work with the suppliers on that.

1 MAJORITY CHAIRMAN STEFANO: All right. Thank you
2 for that. Any other questions?

3 HOUSE MAJORITY CHAIRMAN PYLE: Yes.

4 MAJORITY CHAIRMAN STEFANO: Chairman.

5 HOUSE MAJORITY CHAIRMAN PYLE: Thank you very
6 much, Chairman. I'm already learning a lot. Thank you. I
7 have an initial question. Let's go back to the pre-Act 39
8 days. Wine sales, okay? We're seeing that wine sales is
9 coming out around 42, 44 percent for you guys. Is that
10 pretty close?

11 DALE HORST: Yes.

12 HOUSE MAJORITY CHAIRMAN PYLE: What was it before
13 Act 39? As a percentage of your sales?

14 DALE HORST: So, it was similar. I won't say it
15 was exact because a lot has changed in the market now.
16 With all of the wine expansion permit licensees, about five
17 percent of our business has shifted out of the Fine Wine &
18 Good Spirits stores into the WEPs.

19 HOUSE MAJORITY CHAIRMAN PYLE: Uh, hmm.

20 DALE HORST: Along with that convenience of
21 offering those products in convenience and grocery stores,
22 wine sales have actually picked up. Now on the other hand,
23 you have overall trends in the market that spirit sales are
24 up, especially in the licensees. And the whole trend of
25 the consumer moving to premium and ultra-premium brands

1 across certain categories. All that over the last three
2 years has worked to continue to grow the overall business
3 but has affected just tenths of a point in that comparison
4 of wine and spirits sales.

5 HOUSE MAJORITY CHAIRMAN PYLE: Okay. I believe
6 it was Dale earlier said something very interesting. Last
7 year you had 500 products approximately that went up in
8 price. You had 300 that came down in price. I'm
9 ballparking my numbers. It's 500 and 300 something. You
10 noted out of that 300 items that you were able to bring
11 down the price for 156 of them. Where's the other 151?

12 DALE HORST: We may not have adjusted the retail
13 price down for a number of reasons.

14 HOUSE MAJORITY CHAIRMAN PYLE: Such as?

15 DALE HORST: Well there could be, so it could
16 have been that the profit margin on a given product, we
17 worked with the supplier to enhance that profit margin.
18 Maybe we weren't making quite the same amount on that as
19 one of their competitor's products. And we, in calling
20 that to their attention, they agreed to lower the cost, but
21 yet the retail price was where it should be compared to the
22 competitor's product. So I will say what was unusual when
23 we first made this switch three years ago that everything
24 was marked up 30 percent. But when we looked at the gross
25 margin on every product, it was not straight 30 percent.

1 There were products we were making 23 percent off of.
2 There were products we were making 32 percent off of. So
3 through the discussions with the suppliers and the analysis
4 of all these products since Act 39, we've been able to
5 bring products into line and work with suppliers on
6 adjusting their costs.

7 HOUSE MAJORITY CHAIRMAN PYLE: Thank you. I'll
8 hold for later. Thank you.

9 MAJORITY CHAIRMAN STEFANO: Thank you, Chairman.
10 Senator Williams.

11 SENATOR WILLIAMS: Thank you, Mr. Chairman. I've
12 got about five or six points to be made.

13 One, let's start with the most obvious one. For
14 the record, the Commonwealth is making out better as a
15 result of this change. The numbers bear that out. It's
16 almost two to one in terms of revenue to our bottom line,
17 especially in a state which is strapped with revenue
18 shortages as it is. So for those of us who are trying to
19 figure this out, you know, analysis this, reducing prices
20 that, the bottom line for the benefit of the Commonwealth
21 is that this system is working for the benefit of taxpayers
22 in ways that we may have expected or not expected. Is that
23 a fair representation?

24 TIM HOLDEN: Yes, Senator. It is.

25 SENATOR WILLIAMS: Two, fair. When people use

1 that word, I always get kind of yellow flagish because fair
2 is always in the eye of the beholder. So specifically on
3 the suppliers, is there a Pennsyl ... What percentage of
4 the suppliers are Pennsylvania entities? And is there a
5 preference when it comes to picking them. As Mr. Horst
6 represented, there's not enough space in the warehouse to
7 pick everybody. So if you're from Pennsylvania, is there a
8 preference, or what percentage of folks are Pennsylvanians?

9 DALE HORST: So Pennsylvania manufacturers,
10 wineries or distillers is growing but it's still under one
11 percent of all the products we offer. But we have special
12 programs for the Pennsylvania wineries and the Pennsylvania
13 distillers. They are free to come to us and offer up to
14 ten products, and we will automatically put them in ten
15 stores that they choose. And then if the sales trends are
16 good, we will expand them. There's a number of wineries
17 and distillers that have grown over the last three years to
18 be in a couple hundred of our stores through that growth.

19 SENATOR WILLIAMS: And I look to see any
20 suggestions that we can do to enhance that. Of color
21 entities, is there a number you track with regard to
22 inclusion of entities of color?

23 DALE HORST: We do not consider that. We
24 consider the product on its own merits.

25 SENATOR WILLIAMS: No, no, that's favorable. Do

1 you have a statistic on that in terms of representation
2 though? Do you know are there any of-color distilleries or
3 wineries in Pennsylvania that, or period, that are part of
4 our network?

5 DALE HORST: I do not know that.

6 SENATOR WILLIAMS: I'd like to find that out. It
7 also says supply and demand is a portion of the formula in
8 terms of, I guess, selecting what the consumer is going to
9 get. And I will tell you to start out with, the Chairman
10 and Mr. Negra have been tremendous in terms of helping with
11 it. We have a problem with a thing called a Stop N Go.
12 And so logically speaking your best seller is what you
13 would put out front in your stores. In some of these
14 places it should not be the thing that is put out front.
15 So we have liquor being distributed in a place called --
16 some of the members may or may not know what the heck I'm
17 talking about -- so if you don't know what I'm talking
18 about. It's what we used to call a deli that now has a
19 restaurant license attached to it so now you can go into a
20 place in the neighborhood and buy candy, candy bar, a
21 Krimpet, and a shot of, you know, tequila at the same time.
22 Which is absurd to me, but we'll get to that later on.

23 That said, how do we navigate supply and demand
24 best sellers in a space because it says in -- you say in
25 our area, -- you know, it may be a hot seller so you would

1 push it. But I would argue with you on 60th and Market
2 where you have kids going to and from school, going in and
3 out of that Stop N Go, seeing shots sold at 9 o'clock in
4 the morning is not a thing you want to do. So is there
5 anything in this space that we can use creatively to sort
6 of impact that?

7 TIM HOLDEN: Well you're talking about places we
8 toured, Senator.

9 SENATOR WILLIAMS: Yeah, exactly.

10 TIM HOLDEN: You're not talking about our stores.
11 You're talking about ...

12 SENATOR WILLIAMS: Yeah, I'm sorry. You're
13 right. I'm talking about the supplier, of course.

14 TIM HOLDEN: Yeah. Well you know that the
15 General Assembly and the Governor has given us on
16 compliance. We've been enforcing that the best we can, and
17 Pennsylvania State Police have been a wonderful partner.
18 And we just non-renewed a license in Philadelphia that I
19 think your staff is familiar with that was a problem, a
20 nuisance bar. But you're talking about where alcohol
21 products are in a restaurant itself.

22 SENATOR WILLIAMS: In the ...

23 REPRESENTATIVE STAATS: Convenience store.

24 SENATOR WILLIAMS: Right. Exactly. Nice term.
25 Convenience store. Yeah, exactly.

1 TIM HOLDEN: I don't know how we control that.

2 MIKE NEGRA: Yeah, we really don't control that.
3 We can control what's happening in our stores.

4 SENATOR WILLIAMS: You control the . . . I got
5 you.

6 CHARLIE MOONEY: They have an R license as you're
7 familiar with, Senator, and they're picking up their orders
8 from our stores. They call it in or email it in or go
9 through a portal that we supply to them. We package their
10 order and they come and pick it up. It's whatever they
11 want.

12 SENATOR WILLIAMS: So there's no surplus fee or
13 access fee we can charge. So I'll close on this portion.
14 And they'll come in the not-too-distant future because I
15 think you all have done everything possible so far that you
16 can do in the space. I'm to the point where we have to
17 look at language as it relates to that type of R license.
18 It should be unique and different. It shouldn't just be
19 your R license, and frankly at this point in time I think
20 we should be suspending them in Philadelphia. All the work
21 that you all did to, you know, to suspend that one license
22 was tremendous. Of course, they're still operating. And
23 there's just no way that I can suggest to you that the
24 majority of them are responsible, that they operate
25 responsibly. They're still filthy, dirty, decrepit places

1 that are disgusting that wouldn't operate in most places in
2 Philadelphia. I mean in America, let alone they should be
3 operating in Philadelphia. So that's not your charge
4 today. I know that. I'll come back to you and have a
5 talk, a further conversation.

6 TIM HOLDEN: But on that topic, Senator, we get a
7 list every week of inspections and suspensions and
8 reinstatements, so we'll be happy to share that with you.

9 SENATOR WILLIAMS: Thank you very much.
10 Appreciate it. Appreciate your work too, by the way.

11 CHARLIE MOONEY: Thank you, Senator.

12 SENATE MAJORITY CHAIRMAN STEFANO: Representative
13 Gates. Sorry. Yes.

14 REPRESENTATIVE RYAN: I'm sorry. Thank you very
15 much. Just a couple of quick questions, hopefully. One is
16 on the governance structure. Would the board of directors
17 -- do you have things like an audit committee and is the
18 audit committee independent -- that would help with things
19 such as fraud and fraud detection wherever you have things
20 such as buyers. That's one of the most common areas where
21 fraud can occur in our organization. So what type of
22 governance structure do you have?

23 CHARLIE MOONEY: Representative Ryan, we have our
24 finance director sitting behind us. His name is Michael
25 Demko, and he is in charge of finance. We have two

1 different functions that do audit. We have the
2 comptrollers. The GBO Comptroller's office audits our
3 stores and does inspections and risk analysis. And then we
4 also work with the Department of Auditor General who also
5 do an independent study in our stores and have a reporting
6 capacity to Mr. Demko up through our retail operations.

7 REPRESENTATIVE RYAN: And under the last audit,
8 were there any control deficiencies, significant
9 deficiencies or material weaknesses identified in a
10 management report.

11 CHARLIE MOONEY: There was none ...

12 REPRESENTATIVE RYAN: Outstanding.

13 CHARLIE MOONEY: ... and we have just started
14 another one that the chairman is just getting ready to sign
15 off on that initiates the audit.

16 REPRESENTATIVE RYAN: Outstanding. The other
17 question I have is in the nature of markets. My background
18 is in economics as Congressman Holden knows. There is
19 elasticity of demand and elasticity of supply. And we've
20 talked quite a bit about the elasticity of demand and which
21 is this hearing is a little bit more about the elasticity
22 of demand. On the elasticity of supply there are a
23 significant number of factors that influence both
24 elasticity of demand and elasticity of supply. Have you
25 found that this fair pricing formula has had an impact on

1 the elasticity of supply or any suppliers due to their
2 market prominence may have been more or less willing than
3 to participate in a Pennsylvania market?

4 TIM HOLDEN: Dale, I think that's you.

5 DALE HORST: So we do that analysis. Each
6 product we do that analysis on, and certainly there has
7 been products that have fallen out of the listed portfolio
8 due to a supplier not willing to adjust the cost or the
9 retail being too high. And so over time the product just
10 does not sell as well. And it will drop out if it goes low
11 enough. We try to do that analysis on each of our pricing
12 decisions. So the last thing we want to do is raise a
13 price that's going to hurt the sales of that single
14 product, but we also try to keep the pricing consistent
15 across like products from like areas in each category.

16 REPRESENTATIVE RYAN: Outstanding.

17 MIKE NEGRA: And I would add to that that I think
18 that comes into play more so in one-time buys. With the
19 expansion of availability of wine from around the globe and
20 the interest in smaller markets such as Austria, Hungary,
21 Georgia, pick a country, that there are more choices and
22 more interest in smaller, more niche type of areas when it
23 comes to wine. No longer is California or Oregon or France
24 or Italy, whatever, considered that go-to wine all the
25 time. And so it's given Dale, I believe, and his team that

1 opportunity to maybe price one area against another area
2 when it comes to one-time buys in our chairman selection
3 programs.

4 REPRESENTATIVE RYAN: Outstanding. Thank you
5 very much. Mr. Chairman, thank you.

6 SENATE MAJORITY CHAIRMAN STEFANO: Thank you,
7 Representative Ryan. I got it this time. Representative
8 Topper.

9 REPRESENTATIVE TOPPER: Thank you, Mr. Chairman.
10 Good morning. I guess we're still in morning. Gentlemen,
11 I appreciate it. As you know, I struggle a little bit with
12 the idea of flexible pricing, so I appreciate the
13 opportunity to talk about it a little more. And I
14 appreciate Mr. Horst going through kind of the process of
15 what we're looking at now, but sometimes I can be dense and
16 I need to understand it a little more clearly in some plain
17 English. So I'm going to kind of give you a little bit of
18 a theoretical here and see where we go.

19 Let's say we've got Topper's bourbon, you know,
20 which can be sold -- which could be a surprise to many
21 people in this room -- at \$25 a bottle and that could be
22 marked up 20 percent. And then we have Pyle's bourbon
23 which we're all going to assume would be the better bourbon
24 from the Chairman, but let's just say that's not the case,
25 all things being equal.

1 HOUSE MAJORITY CHAIRMAN PYLE: There probably
2 wouldn't be as much of it.

3 REPRESENTATIVE TOPPER: So if we have the
4 Chairman's bourbon at \$25 as well, but that's marked up 25
5 percent. So, you know, I'm trying to understand why we're
6 not putting one bourbon at a competitive disadvantage.
7 What goes into making that determination of how we can mark
8 up one product -- when we're purchasing at the same cost
9 the same -- again let's say all things being equal, the
10 same product? You know, what goes into saying well --
11 because I heard you earlier, you said about maybe kick-
12 starting certain brands. Like Topper is not selling as
13 much. We need to kick-start him a little bit. That
14 concerns me when we're talking about market supply and
15 demand as opposed to being solely on the product but also
16 now what we're putting on as the markup. So if you could
17 explain to me the process of the Topper Pyle bourbon and
18 how we're going to reach different markups and if that is
19 the case or even if that's happening.

20 DALE HORST: Well the first stage is we would
21 listen to both of you independently. How do you want your
22 bourbon positioned on each product? Then we taste it, and
23 we evaluate it. And where you want that -- and I said we
24 listen to the supplier because the supplier has unique
25 thoughts on where they want it positioned. Do you want it

1 to be positioned with the standard bourbons? Do you want
2 to be positioned with the premium bourbons? And so then,
3 all those other competitive sets have retail pricing
4 levels.

5 You also -- each product, if it's sold outside of
6 Pennsylvania, we know what the pricing is around us. And
7 we ask you to come and tell us what your sales numbers are
8 around us and where this product is positioned before we
9 ever get to retail price.

10 If everything is equal, if the quality of the
11 bourbon is equal, that value proposition between the
12 quality of the bourbon and what the price ultimately is
13 going to be and you want it -- both of you would like it
14 positioned at the same level everything, it's going to end
15 up at the same retail.

16 REPRESENTATIVE TOPPER: And just real quick. The
17 process of making sure that all things being equal --
18 because if you're talking to both of us, one of us will
19 probably suggest that our product might be superior in some
20 way. So what is the process of saying all things are
21 equal? You say there's a testing, there's a tasting,
22 there's a looking around at other states, which I assume
23 that's a job that would be pretty popular within the
24 industry.

25 DALE HORST: So our buyers are all split to where

1 their focal areas are. And as Mike said that, you know,
2 the wine buyers buy for certain regions around the world.
3 But so the wine buyer buying Australia ... We have two
4 spirits buyers, and they divide the spirit portfolio in
5 half by supplier, but they also work closely together. So
6 they are concentrating on their own group of products.
7 They become experts in those group of products.

8 So, as I said, it starts out with a meeting with
9 the supplier when they submit what their marketing plans
10 are going to be in the state. They submit how many times a
11 year they are going to offer a discount. Chairman Pyle may
12 want his bourbon priced higher. Because there is a -- I
13 mean there is a value proposition to where that retail sits
14 on a product. But in the end then, we'll make a decision
15 on the retail price.

16 MIKE NEGRA: And if I could add one thing to
17 that. Is that you're determining what your cost is of \$25.
18 We determine the margin although working with you. All
19 right. So we own the retail price. So you talked about
20 your bourbon being at 20 percent, the Chairman's being at
21 25 percent. Those are in discussions, but Dale and his
22 team really have the ... they own that. Whereas in the
23 past, we didn't own that. So I just wanted to bring that
24 point up, that you can say it's at 20 percent, and it's at
25 25 percent, and those decisions do come out of

1 negotiations. But the final decision is really Dale and his
2 team and ultimately the Chairman and mine.

3 REPRESENTATIVE TOPPER: Thank you. Thank you,
4 Mr. Chairman.

5 SENATE MAJORITY CHAIRMAN STEFANO: Next we have
6 Senator Tartaglione.

7 SENATOR TARTAGLIONE: Thank you. A number of my
8 questions have already been asked, but for the benefit of
9 the public can you speak to some of the critics who say
10 that flexible pricing meant the LCB was going to broadly
11 increase prices on consumers? In other words, is it fair
12 to say that flexible pricing actually means that we are
13 getting lower acquisition prices? Which means we can
14 slightly increase our markup on a lot of different products
15 but still keep prices the same, or in other cases actually
16 lower prices?

17 CHARLIE MOONEY: I'll take it. Senator, we have
18 given a lot of testimony here this morning. I believe Dale
19 went into a lot of detail. But yeah, I do believe that to
20 be true. We do control the shelf price now as just
21 testified. It is allowing us to put more revenue into the
22 state and control the shelf price and stay very competitive
23 with the surrounding states with the studies that we've
24 done for sure.

25 SENATOR TARTAGLIONE: As I do at every hearing, I

1 want to bring up Jacquin's.

2 REPRESENTATIVE ISAACSON: That's right.

3 SENATOR TARTAGLIONE: That's our district.

4 CHARLIE MOONEY: Jacquin's was just in the
5 building.

6 TIM HOLDEN: They're in the building a lot.

7 SENATOR TARTAGLIONE: Everything going okay
8 there?

9 TIM HOLDEN: Talk to Scott. You're doing okay.

10 SENATOR TARTAGLIONE: Okay. Thank you.

11 SENATE MAJORITY CHAIRMAN STEFANO: Thank you.

12 Next, we have Representative Deasy.

13 REPRESENTATIVE DEASY: Thank you, Chairman.

14 Briefly, just a comment. And obviously it's June 3rd now
15 and our big budget winners and budget losers. That's what
16 we're going to read about in the newspapers for the next
17 couple of weeks, hear on tv and the rumors and the budget
18 and this and that. With respects to flexible pricing, it
19 seems like we have two winners. The taxpayers as well as
20 the consumers. What was the figure -- that 84 percent of
21 the prices have not changed?

22 TIM HOLDEN: Only in one of those years.

23 REPRESENTATIVE DEASY: Okay. So it's
24 significant. We have two winners in this particular case.
25 Safe to say?

1 TIM HOLDEN: Yes.

2 REPRESENTATIVE DEASY: Okay. Thank you.

3 SENATE MAJORITY CHAIRMAN STEFANO: Thank you,
4 Representative. Representative Rothman.

5 REPRESENTATIVE ROTHMAN: Thank you. I think, Mr.
6 Horst, I think you said that -- correct me if I'm wrong --
7 that the profit on wine is 42 to 44 percent.

8 DALE HORST: No, the share of the overall
9 business ...

10 REPRESENTATIVE ROTHMAN: Oh, got it.

11 DALE HORST: ... was cited as 44 percent wine.

12 REPRESENTATIVE ROTHMAN: And then 56 percent is
13 spirits.

14 DALE HORST: Spirits.

15 REPRESENTATIVE ROTHMAN: Would then it make more
16 sense for us to start selling spirits through you in
17 grocery stores since that's a big part of the business of
18 selling alcohol?

19 DALE HORST: Well, that is not my decision. That
20 is your decision.

21 TIM HOLDEN: Representative, Dale is right. We
22 will implement and execute any new law that the General
23 Assembly will pass and that the Governor will sign. But
24 putting spirits in grocery stores, I mean, that's going to
25 be very, very hurtful to our stores.

1 REPRESENTATIVE ROTHMAN: Well not if you're the
2 one selling them to the grocery stores.

3 TIM HOLDEN: Well, they'll be buying it at a
4 discount as they are with the wine. I don't know if you
5 want to elaborate on that, Mike.

6 MIKE NEGRA: No, not really.

7 REPRESENTATIVE ROTHMAN: Thank you.

8 SENATE MAJORITY CHAIRMAN STEFANO: Representative
9 Mihalek.

10 REPRESENTATIVE MIHALEK: Thank you, Mr. Chairman.
11 I did have a couple of questions with specific liquors that
12 I've noticed price differences in, especially around the
13 different states. I don't know what the reason for it is.
14 Bookers, for example. I think somebody said that there
15 hasn't been an uptick in the prices for the last few years.
16 Bookers in late 2017 was selling for \$60, and we're now
17 looking at a \$79.99 price tag. JW Black and Double Black
18 is \$27 and \$37 respectively in Connecticut. And it goes
19 for \$10 more on each of them here in Pennsylvania.
20 Talisker Storm, \$39 in Tennessee, is \$49 here. It seems
21 like the surrounding states you get a little bit of a price
22 break, and you come here ... I don't know if it's taxes.
23 I don't know, you know, what the reason is for, you know,
24 the higher price that you are paying in Pennsylvania, but
25 it seems like Pennsylvania has created a secondary market

1 for, you know, those better bottles of alcohol. I don't
2 know if somebody wants to comment on that. I did have
3 another question too.

4 DALE HORST: So there's a lot of ... So first
5 off, I would have no idea what the costs are into those
6 other states. Suppliers are not required to charge every
7 state the same. Certainly we know through our historical
8 look that suppliers charge different states different
9 costs. So that's the starting point.

10 Second from that, each state has its own way that
11 it marks up products and its own tax structure. So a lot
12 of times we get compared to Delaware. But there's very
13 small liquor tax in Delaware. So each state is different.

14 What I will say is since 2015 that we've
15 contracted to have price surveys done. We can tell how our
16 prices compare to the states around us, and they have moved
17 up on pricing the same way we have moved up. There are a
18 couple of states where we have more -- our percentage of
19 products increase that are lower than those states, and
20 there are states where they did not increase. We keep an
21 eye on the surrounding states, but each state is different
22 in the way they handle their alcohol.

23 REPRESENTATIVE MIHALEK: I had a question about
24 the online -- I guess it's the lotteries that they do and
25 they do it, I guess, every third Wednesday. It seems maybe

1 for the last year or so there have been these random
2 midnight drops where they drop the product and it is
3 immediately sold out. And there's not even, you know, a
4 two-minute window to purchase the product. So I don't know
5 if it's a glitch in the system. I know that, you know, the
6 products can be quite popular especially with the Pappy
7 lotteries and all that. Can somebody comment as to that?

8 CHARLIE MOONEY: I agree with you.

9 REPRESENTATIVE MIHALEK: Uh, hmm.

10 CHARLIE MOONEY: We just last Wednesday put a
11 Weller product up on our ecommerce third Wednesday of the
12 month. There's 255 bottles sold in 4.2 minutes. We had a
13 customer complain that he went in there at like ten or
14 eleven minutes and the product wasn't there, and he's
15 wondering what's going on? What's the problem? Is there a
16 glitch in your system? They sold in four minutes. So what
17 I would like to do is get more than 255 bottles. And with
18 our buying power and our strength and the size of our
19 buying, we're going to push a little harder from these ...
20 particularly the bourbons. It's the hottest thing out
21 there. You mentioned Pappy. It is just crazy about Pappy.
22 But there is a lot of bourbon that there's a large market
23 seeking these certain bourbons. And we just had our buyers
24 down on a Kentucky trip. We sent them down to go buy, look
25 at certain barrels and single-barrel bourbons. We can't

1 get enough of it, so the 255 bottles in four minutes sold
2 on our ecommerce site.

3 MIKE NEGRA: And I'll add to that. There's a
4 difference between what's happening on the third Wednesdays
5 as a promotional opportunity on our ecommerce versus the
6 lotteries. But the third Wednesdays that are happening,
7 we've learned a little bit. We started out first with
8 what, a limit of five or six, depending upon the product.
9 You know, the next time we have Weller, it might be a limit
10 of one, you know, per customer. That spreads it out a
11 little bit more. I think that particular one had a limit
12 of three. So we're learning as the market responds to what
13 we're doing on ecommerce. The lottery has been very
14 successful for Pappy and those other sorts of highly
15 allocated items. And I will say that flexible pricing has
16 allowed us to make a little bit more money for the
17 Commonwealth on highly allocated items versus a
18 proportional pricing.

19 REPRESENTATIVE MIHALEK: Thank you. Just so the
20 record is clear, I don't want to look like I have too much
21 free time on my hands. A little birdie has shared all this
22 information.

23 SENATE MAJORITY CHAIRMAN STEFANO: Representative
24 Gaydos.

25 REPRESENTATIVE GAYDOS: So what is ... Thank

1 you, Mr. Chairman. What is your response time in changing
2 pricing of products? So, for example, if a producer
3 decides to either raise the price or reduce the price, what
4 is your process to be able to adapt to that market so as
5 not to lose money but also, you know, so that if an
6 entrepreneur or a producer wishes to push more product or
7 if they reduce their costs in order to get that product
8 out?

9 DALE HORST: So, they are able to do it in two
10 ways. They can either make a submission for a permanent
11 cost change, or they can make a submission to put it on
12 discount. And we allow suppliers to put each of their
13 products on discount once a quarter, so four times a year
14 they can do that.

15 If they submit a cost submission to us, it comes
16 in and then we have a discussion with them about all of the
17 plans around that cost. You know, are they reducing it in
18 other states? Is the retail going to come down around us?
19 What is their purpose? What do they want to gain from
20 that? And I'll take a very -- without naming names -- a
21 very well-known supplier and brand of rum that the supplier
22 realized that they were priced a little higher than their
23 competitive set. And it had been that way since
24 proportional pricing. And they wanted to get into a
25 discussion about bringing their retail price down. So we

1 worked with them and they brought their cost down and we
2 brought the retail down. And so the sales picked up on
3 that item. That was their goal.

4 But it starts with a discussion. Then they have
5 to submit a written quote so that it could always be
6 audited, and that written quote is always on file of what
7 the pricing was. And then we ask them when do you want to
8 put this in effect. It takes us about 60 to 90 days to go
9 through the whole process and put it in effect. We also
10 then have to build in enough time, and as I testified, it's
11 more like 120 days, because we have to notify the licensees
12 that this retail is going to change because a lot of times
13 licensees will buy ahead. If they know a price is going to
14 go up, they'll buy ahead. So we see that, especially on
15 the wine side, with these large grocers that are now buying
16 and warehousing product, that they'll buy ahead. So we owe
17 it to the licensees to tell them the retail price is going
18 to go up.

19 MIKE NEGRA: Only when it goes up. When it goes
20 down, you don't have to tell them.

21 DALE HORST: We tell them both ways. Yes.

22 SENATE MAJORITY CHAIRMAN STEFANO: Thank you.

23 And to wrap up I just have one more question. We were
24 talking just now about flexible pricing and its
25 relationship with ecommerce. But at last year's hearing we

1 also talked about CRM, or customer relation management.
2 Can you give some insight on and an update on CRM and or
3 ecommerce and how flexible pricing as it impacts both of
4 them.

5 CHARLIE MOONEY: Well I'll give you a quick
6 update on CRM, Senator. We are touching the outside
7 boundaries of CRM. We are doing what we call complex
8 promotions internally where you see it all over the
9 industry buy one, this price, buy two, get that price. The
10 CRM umbrella allows Dale's team to do that, and the
11 suppliers and the brokers are coming in and offering us
12 these deals. Dale mentioned kick-starting earlier. That's
13 one way a supplier can come in and say well we'd like to do
14 this, or give us a sale, give us a flash sale. Dale's team
15 also does weekly flash sales. But the full package of CRM
16 as we testified before is not on our radar at the moment.
17 We are launching our new ecommerce website this fall. And
18 the new ecommerce site is opened and we're hoping to get
19 same-day delivery started by Labor Day. But CRM will be
20 following that. It's got a large price tag at it.

21 SENATE MAJORITY CHAIRMAN STEFANO: Well, thank
22 you. Thank you for the update. Hearing no further
23 questions, I thank you for today's testimony.

24 At this time I call forward the industry
25 stakeholders' panel. Joining us today we have David Ozgo,

1 Chief Economist for the Distilled Spirits Council of the
2 United States, or DISCUS; David Wojnar, Vice President of
3 DISCUS; Matt Dogali, President and CEO of American
4 Distilled Spirits Association; and Terri Cofer Beirne,
5 Eastern States Council for the Wine Institute. If I got
6 that right. Beirne.

7 TERRI COFER BEIRNE: Right. Yes. Thank you.

8 SENATE MAJORITY CHAIRMAN STEFANO: The floor is
9 yours.

10 TERRI COFER BEIRNE: Okay. Good morning. I have
11 submitted a written testimony, so I'll summarize from that
12 and tell you up front that the level of professionalism and
13 integrity at the PLCB leadership today is unparalleled.
14 I've been working with them for ten years, and they've made
15 tremendous progress.

16 Wine Institute is a non-profit trade association
17 of about 1,000 California wineries. We represent the
18 California industry. California produces 89 percent of all
19 domestic wines, even though there's wineries in every state
20 now. As was noted, about upwards of 40 percent of the
21 sales at PLCB come from wine, and about 53 percent of that
22 by volume and dollars is California wine. So we are
23 particularly interested in the pricing that PLCB uses to
24 sell wine here. I'm going to summarize how we see PLCB
25 using flexible pricing and give you an example of the

1 impact on our industry and then get to the meat of what I
2 have to offer which is some, I hope, constructive
3 suggestions about how we can proceed with flexible pricing.

4 PLCB has a mandatory distribution system where
5 the California wineries can only sell to brokers who can
6 only sell to the PLCB which is the only wholesaler here,
7 which then sells to retailers, including their own stores,
8 and those stores sell to you and me. Direct shipping and
9 those direct-to-consumer sales are outside of this sales
10 channel completely. But PLCB is the exclusive wholesaler
11 into Pennsylvania. In license states -- which is not what
12 Pennsylvania is. Pennsylvania is a control jurisdiction.
13 But in license states the wineries can choose between
14 wholesalers to sell their products to retailers. And they
15 compete for our business. But here in Pennsylvania, PLCB
16 is the only wholesaler. It's the only game in town. So as
17 a result, there is no equal bargaining power to negotiate
18 with the monopoly. The suppliers accept the PLCB terms or
19 risk the loss of a lucrative market for their wine
20 business.

21 Under flexible pricing the PLCB negotiates the
22 cost and the markup on every item and they keep those
23 negotiations confidential as you've heard. Unfortunately
24 there's no schedule for or justification for the categories
25 or brands that it chooses to target for price changes, and

1 there's little lead time for suppliers to respond to any
2 notice that they get of those proposed changes.

3 Wineries remain agricultural enterprises. We're
4 always looking at weather and land costs and other things,
5 and we're setting our prices, in some cases, a year out.
6 So changing retail prices with short notice is a concern of
7 ours. These negotiations may be how they happen with
8 private wholesalers in license states, but wineries just
9 don't have a choice in who we do business with here in
10 Pennsylvania. And PLCB is a government agency that's been
11 delegated authority by this legislature to participate in
12 the alcohol sales marketplace. And since Act 39 they've
13 changed how they price alcohol, as you've heard, and the
14 level of transparency surrounding those changes. We're
15 concerned about the accountability for the business
16 dealings that they have -- that our suppliers have with a
17 government entity. And more importantly, we are concerned
18 about the ability to audit their price negotiations with
19 suppliers.

20 Sonoma State University's Wine Business Institute
21 indicates that 72 percent of consumers make their decisions
22 about buying wine based on price. So that's why we're so
23 concerned about what's happening here. And since retail
24 pricing has such a direct impact, we are always starting
25 with the suggested retail price, as you heard earlier.

1 That's where all the negotiations begin.

2 Before Act 39 our suppliers looked at the
3 national wine market and they looked at our competitor's
4 prices to target a retail price point. And then we could
5 back that out into the formula that PLCB has always used.
6 Everyone knew the markup. Everyone could figure out PLCB's
7 wholesale cost. And, of course, wineries knew the details
8 of their own pricing but, more importantly, they could look
9 at the prices their competitors were selling their products
10 to PLCB. This was a really effective system of commercial
11 checks and balances that ensured the PLCB wasn't picking
12 winners and losers as being policed by the competitors.
13 That's gone away with flexible pricing.

14 I have one specific example of how everyone has
15 lost in an era of flexible pricing. Over the last couple
16 of years, PLCB identified one high-volume, value brand as
17 being underpriced. A value brand would be less than \$20,
18 for example. So they raised the retail price two times
19 over a very short time period, and the supplier noticed a
20 decline in sales and went into the PLCB and said here's a
21 problem. The PLCB agreed to a partial reduction of the
22 price, the retail price, but only if the supplier accepted
23 a lower cost of goods going forward. So therefore that
24 supplier had to buy down their retail price of their own
25 products. That buy down eliminated any funding that we had

1 for price supports, which are the things that we do to
2 market our products to consumers to increase sales. So the
3 sales have continued to decline because we're not promoting
4 it as we normally do. Wine Institute members have
5 described this and other scenarios where they've lost
6 anywhere from \$100,000 to over a million dollars in revenue
7 in Pennsylvania.

8 There's no way a handful of PLCB buyers and a
9 pricing coordinator can be expected to do the pricing
10 analysis that dozens of wineries have done over decades in
11 a national marketplace. With flexible pricing PLCB can
12 negotiate a lower wholesale cost for suppliers on the front
13 end of the transaction, but then they can also raise the
14 retail price at the back end. All the extra money that
15 PLCB is generating is their margin and they're honestly
16 calling -- what we call flexible pricing they are calling
17 margin optimization. And they are optimizing their
18 margins. Suppliers are now providing PLCB a lifeline in
19 the form of lower cost of goods that is covering their
20 rising operational costs, but there's a limit to how much
21 suppliers can offer before the sales will start to be
22 impacted.

23 Without question they are spending less money to
24 acquire alcohol, but we have plenty of questions about
25 whether this will result in higher consumer prices or

1 unsustainably higher margins at PLCB, or both. And we want
2 to ask PLCB to clearly list how it is going to use
3 additional monies that it generates in this system to
4 improve sales going forward.

5 When the legislature passed Act 85 -- excuse me,
6 Act 39 and 85 -- it didn't intend for flexible pricing to
7 apply to all the products. You'll recall that it was
8 originally the 150 best-selling items, and then Act 85
9 expanded it to 150 best-selling products and brand types.
10 In March of 2018 the PLCB came before these committees and
11 asked for the legislative authority to extend flexible
12 pricing to all of their products, all their listed items.
13 That was not granted to them in the past, but shortly
14 thereafter, they exercised their own administrative
15 discretion and interpreted the statute to extend flexible
16 pricing to all of their products. The statutory limit on
17 flexible pricing has been ignored, and we feel that the
18 ability to audit their pricing practices has been lost.
19 The original effort to allow flexible pricing on the 150
20 best-selling wine brands has now been extended to all 2,594
21 listed wine brands.

22 Further, nothing in Act 39 eliminates the
23 requirement for transparency in product pricing in
24 Pennsylvania. In fact, the statute itself suggests that
25 you had in mind a tool for legislative oversight that we

1 don't think is being properly utilized by PLCB. It
2 requires them to publish on their website a listing of the
3 wholesale and Pennsylvania liquor store retail prices.
4 That's the language of the statute and to comply the PLCB
5 merely directs you to a quarterly retail price listing on
6 their website and a footnote that says the wholesale prices
7 are calculated by taking 10 percent off of the retail
8 price. Well, that's the 10 percent price that the
9 licensees pay. That's not the wholesale cost. That's on
10 the front end. That's the discount that they are giving to
11 the licensees on the back end.

12 So only with greater transparency and public
13 access to the wholesale pricing scheme can the legislature
14 and our suppliers determine if the PLCB is treating
15 suppliers fairly and consistently. So I've finished
16 complaining and now I'd like to offer a couple of
17 constructive suggestions to how PLCB might be able to do
18 those things.

19 We think that the legislature should require PLCB
20 to create a supplier advisory committee which would draft
21 and then annually revisit a written policy which would
22 govern all aspects of flexible pricing, particularly five
23 things.

24 An annual schedule of when the wholesale cost of
25 each category of products, for example all the chardonnays,

1 are going to be revisited. So it's a renegotiation
2 schedule to give us some notice of when a product might be
3 revisited for a retail price increase.

4 Secondly, if it could provide some limits on how
5 often both PLCB and suppliers can request price changes.
6 What's good for the goose is good for the gander here,
7 really.

8 Thirdly, a price floor or ceiling on how much the
9 retail prices can be raised or lowered at any one time. So
10 maybe no more than one percent or no less than whatever the
11 numbers are, whatever the industry groups decides.

12 Another thing that would be important to both
13 parties is written notice between them with at least 30
14 days in advance of an intention to raise a price or change
15 a price.

16 And then finally some duration of how long those
17 existing prices must stay in place.

18 So that's the first thing. The second is that
19 the PLCB be required to pass along the benefits of volume
20 discounting purchases to consumers.

21 Thirdly, we'd like to prohibit the wholesale cost
22 of any one item from being tied to or contingent upon the
23 wholesale price of another. Remember, the wine companies
24 that we're talking about here are selling multiple brands,
25 dozens, in some cases hundreds of SKUs.

1 Fourth, that we would have the PLCB list on their
2 website, as Act 39 currently requires, the wholesale FOB
3 cost, or the acquisition cost, for all the listed products
4 alongside the retail price.

5 And then finally, list that, provide that to the
6 committee and maybe to the public on a multiple year-over-
7 year comparison so we can all see how much prices are
8 increasing or dropping to have a better idea of what's
9 happening at PLCB.

10 So that's it. I'd be happy to answer any
11 questions that you might have. Thank you.

12 SENATE MAJORITY CHAIRMAN STEFANO: I figure we'll
13 go through the panel and then we'll ask questions
14 afterwards.

15 TERRI COFER BEIRNE: Okay.

16 SENATE MAJORITY CHAIRMAN STEFANO: Matt, would
17 you like to present?

18 MATT DOGALI: Thank you for allowing me to come
19 and speak with you today. I have a brief prepared comment
20 I'll share. I'm Matt Dogali, President of the American
21 Distilled Spirits Association, a trade association
22 representing suppliers of distilled spirits. Our 27 member
23 companies represent over half of all distilled spirits sold
24 in the U.S. and Pennsylvania. ADSA firmly believes in and
25 supports a state's right to choose how alcohol is regulated

1 inside its borders as envisioned by the 21st Amendment.
2 Because of this, ADSA has been a longtime supporter of the
3 National Alcohol Beverage Control Association and state
4 liquor commissions and boards like the Pennsylvania Liquor
5 Control Board.

6 When Act 39 of 2016 was passed, we had some
7 concerns of how the mechanics of flexible pricing would
8 work. ADSA member companies spend a tremendous amount of
9 time calculating their suggested retail prices to both
10 maximize value to the consumer and to properly represent
11 their products in the marketplace. Flexible pricing was
12 purported to be a mechanism to give the PLCB better
13 bargaining power with suppliers and lower consumer retail
14 price. In actual practice and my member companies'
15 experiences, the retail price on dozens of products have
16 increased, increasing costs to consumers in the
17 Commonwealth. These prices have increased after our
18 members have already set their unit price cost which means
19 the increased margin benefits revenue collection, not
20 consumer cost. These retail price increases occur with
21 little notice to our member companies, and we have limited
22 ability to negotiate with the PLCB to adjust the retail
23 price to keep them in line with our national sales
24 strategies.

25 If we feel the PLCB has arbitrarily increased the

1 retail price on one of our products, the only recourse we
2 have is to pull the product from the market. This system
3 lacks transparency for both the supplier and the consumer
4 and does nothing to make Pennsylvania more competitive with
5 neighboring states or better serve their customers. My
6 member companies are competitors and they also compete with
7 DISCUS member companies, and yet here we are today ADSA,
8 Wine Institute, and DISCUS, in complete agreement that this
9 current system harms the consumer, lacks transparency, and
10 harms the overall marketplace in Pennsylvania. I think
11 both organizations being here today representing distilled
12 spirits, and the Wine Institute representing wine,
13 expressing concerns about Act 39 speaks volumes to the
14 problems it has created. And it doesn't have to be this
15 way.

16 Representative Jesse Topper has introduced
17 legislation, House Bill 1512, that would repeal flexible
18 pricing and revert back to pre-Act 39 pricing process. We,
19 the members of ADSA, would like to request the members of
20 this Committee consider revisit flexible pricing.

21 Thank you for your time today. I have supplied
22 written testimony as well as an addendum that contains an
23 actual example of a negotiation one of my member companies
24 experienced. Thank you, and I'm happy to answer any
25 questions.

1 SENATE MAJORITY CHAIRMAN STEFANO: Thank you.
2 David Ozgo.

3 DAVID WOJNAR: Great. Thank you, Mr. Chairman.
4 Chairman Pyle, Chairman Stefano and members of the
5 Committee. My name is David Wojnar. I am Vice President
6 of State Government Relations for the Distilled Spirits
7 Council. One of my responsibilities is covering
8 Pennsylvania, but I also cover a number of control states
9 around the country. And I want to offer you just sort of a
10 perspective on DISCUS and what we do and how we
11 communicate. And one of the things I'm really fortunate
12 about in my job is our member companies provide us with the
13 resources that we need to be able to communicate not only
14 effectively but with credibility.

15 And with that, we've brought our Chief Economist,
16 David Ozgo, who many of you have met before and have spoken
17 to before. But I feel like having that level of expertise
18 that we can provide for you goes above and beyond the
19 typical lobbying duties that I do on a day-to-day basis.

20 With that said, in my role I have worked
21 collectively with control state officials around the
22 country. In Oregon, we've partnered -- David and I have
23 taken our road show to Oregon and that has resulted in a
24 number of store outlets opening in that jurisdiction. Same
25 thing in Ohio. We presented to Ohio in working on a very

1 complex wholesale situation in which we pointed out that
2 rather than going up on markups and fee increases but
3 bringing in additional stores was a way to raise revenue
4 that was consumer friendly without zapping the consumer.
5 In addition to that, we worked in Virginia where we passed
6 Sunday sales laws that have been increased over time. Most
7 recently we passed Sunday sales in West Virginia. I share
8 that with you, not to brag, but to show you and demonstrate
9 our level of credibility and expertise as an advocate on
10 behalf of the industry.

11 And I will say I want to echo what Terri said
12 earlier is that this is somewhat of a conundrum because Tim
13 Holden and Mike Negra and Charlie and the team there, they
14 are great people to work with. Whenever I've had a
15 question or complaint, they've always afforded me a venue
16 or the microphone to do that. However, this isn't an issue
17 of the PLCB. It's an issue of Act 39, what its intention
18 was and what the practical application is now. And we
19 agree with Matt that Representative Topper's bill is the
20 perfect opportunity to do a reset, look at ways that we can
21 raise revenue without zapping the supplier, your partner
22 and also the consumer. So for that, thank you very much.
23 I'd like to turn it over to my colleague, David Ozgo.

24 DAVID OZGO: Thank you so much, David. Well, as
25 David just mentioned we do, in fact, work with control

1 states. We work with them very often. He mentioned the
2 instance in Oregon where I worked close with the Oregon
3 Liquor Control Commission to help get some changes in their
4 law. At one point a number of years ago, I believe it was
5 Commissioner Goldstein here in Pennsylvania that we used to
6 joke at DISCUS that I was essentially his staff. I was
7 running up here to do work for him so often. But Act 39
8 was passed with great fanfare in 2016. Excuse me. It was
9 -- gosh, I'm all choked up about this issue obviously. It
10 was touted as the first consumer friendly modernization
11 change in the beverage alcohol laws in Pennsylvania,
12 probably since you began allowing self service.
13 Unfortunately, the flexible pricing provision in Act 39 was
14 anything but consumer friendly.

15 Prior to implementation of flexible pricing, the
16 PLCB had to follow a strict pricing formula that required
17 proportional pricing. Retail prices were determined by a
18 known markup formula that, a known formula, that included a
19 logistics transportation marketing fee, a markup of 31
20 percent, and the 18 percent tax. All of this offered the
21 consumer a certain level of protection.

22 Under the pricing formula the PLCB was required
23 to pass along any savings, any reduction in supplier
24 prices, along to the consumer. But now that the PLCB has
25 flexible pricing authority, the PLCB is free to increase

1 its 31 percent markup thereby increasing its profit margin.
2 While it is true that retailers in open states, or license
3 states as you might call them, do vary their markup
4 according to market conditions, open-state retailers also
5 face competition. If an open-state retailer raises his or
6 her markup too high, they will lose business to
7 competitors.

8 But the PLCB faces no such competition and is not
9 constrained by market discipline. Without market
10 discipline, flexible pricing gives the PLCB enormous market
11 power to the detriment of consumers and, yes, suppliers.
12 That is why the PLCB was traditionally required to use
13 proportional pricing and had a set markup formula.

14 By allowing the PLCB carte blanche to increase
15 markups as it desires, we now have a state-sponsored entity
16 that is not constrained by any kind of government
17 regulation or by market competition. It's essentially the
18 worst kind of economic outcome for the consumer.

19 So, what have been the practical implications of
20 flexible pricing here in Pennsylvania?

21 The PLCB will notify a supplier that it intends
22 to increase the retail price on certain items. These
23 notifications are arbitrary and will often conflict with
24 supplier marketing plans developed oftentimes more than a
25 year in advance. The supplier must then decide whether to

1 accept the PLCB's retail price increase. If the supplier
2 accepts the price increase, the higher prices are foisted
3 onto the consumer and the supplier will oftentimes see
4 reduced sales. The PLCB obviously collects higher profits.

5 Now, if the supplier instead lowers his FOB
6 price, the FOB price that it charges the PLCB, the supplier
7 must take reduced margins. Naturally, suppliers have
8 budgets just like anyone else that they must meet and any
9 reduction in planned supplier margin must be made up
10 elsewhere. Typically, the supplier will make up for lost
11 margin by reducing funds allocated to special purchase
12 allowances or SPAs. SPAs are the funds that suppliers use
13 for price promotions throughout the year. To be clear,
14 these funds are supplied solely by the supplier. PLCB does
15 not participate in SPAs. Traditionally, when a supplier
16 used SPA funds they were to benefit consumers. But with
17 flexible pricing, SPA funds are more and more used to pay
18 for the PLCB's higher profit margins.

19 In some instances, the PLCB will ask for price
20 increases on one bottle size for a particular brand and a
21 short time later ask for a price increase on the same brand
22 but a different bottle size. This also makes planning
23 very, very difficult for suppliers.

24 Because even agreed-upon retail prices are
25 subject to such random changes, the unpredictability of

1 price changes has caused consumers to trade down from
2 premium price points to lower price value brands or to
3 simply take their business to neighboring states.

4 Additionally, when it comes to new listings, one-
5 time buys or luxury listings, suppliers long used the
6 traditional PLCB pricing formula to derive a fair FOB price
7 and a fair retail price. With flexible pricing, suppliers
8 submit a fair price to the PLCB, only to be met by PLCB
9 efforts to drive down supplier margins. If suppliers do
10 not give the PLCB the margin that they demand, new listings
11 simply are not approved. With reduced product selection,
12 it is the consumer that again ends up losing out.

13 There are many special addition products or
14 products sold on allocation. As you might imagine, when
15 supplies are limited, such products are allocated to
16 markets where suppliers can generate their highest margins.
17 Increasingly as the PLCB has been squeezing suppliers,
18 Pennsylvania consumers are losing access to those sought-
19 after products. That's why they only got 255 bottles of
20 whatever it was the product we were talking about earlier.

21 So it's ironic that the flexible pricing
22 provisions in Act 39 were part of a market modernization
23 bill. The increased PLCB markups that flexible pricing has
24 allowed are anything but market modernization. Across the
25 country retailer markups in open states are going down, not

1 up. In fact, when we did our modeling, we used to assume
2 that retailers had an average markup of around 25 percent
3 including discounts. Well, today many of the large
4 retailers that take advantage of economies of scale have
5 markups in the 20-22 percent range with promotional markups
6 down around 10-15 percent.

7 So from the perspective of the PLCB's customers,
8 far from modernizing the marketplace, flexible pricing that
9 allows the PLCB to increase its margins at the expense of
10 consumers is a step backwards. In the interest of fairness
11 to consumers, we urge you to end the PLCB's flexible
12 pricing authority.

13 Now Pennsylvania can, however, generate new
14 revenues in a consumer-friendly fashion. Currently
15 Pennsylvania has one of the lowest outlet densities of any
16 control state. In Pennsylvania you have around six to
17 seven tenths of a store for every 10,000 customers, for
18 every 10,000 adults. Well, the average control state has
19 about 2.6, so Pennsylvania is seriously behind the curve.
20 Many control states use what are known as agency stores to
21 increase outlet density in a risk free and low-cost
22 fashion. We urge the committee to consider this consumer-
23 friendly option. Thank you.

24 SENATE MAJORITY CHAIRMAN STEFANO: Thank you for
25 your testimony. We have questions now. I'll open up the

1 panel for questions and first we have Senator Williams.
2 Senator Williams.

3 SENATOR WILLIAMS: Thank you, Mr. Chairman.
4 Thank you all for being here. Before I start, I've got
5 like five or six, like I stated before you all were here.
6 But I want to give you a little bit of background on me
7 since I don't know anybody here.

8 I am a Democrat and from a city. But I'm also a
9 Democrat who worked for Pepsi Co. for a number of years,
10 specifically in the area of brand development and
11 marketing. So I know a lot about what you're talking
12 about. We worked a lot with wine industries way back in
13 the 70's, 80's, and well, 80's and 90's for me. And so I
14 listened intently to the things that you all are sort of
15 testifying about today.

16 So let me start with the most obvious. The
17 majority of your suppliers are outside the State of
18 Pennsylvania; is that correct?

19 TERRI COFER BEIRNE: All of mine are, yes sir.

20 MATT DOGALI: Jacquin's is a member of mine which
21 is in Pennsylvania, but all the others are outside.

22 SENATOR WILLIAMS: That's like 80 percent.

23 MATT DOGALI: No, no, it's a minority.

24 SENATOR WILLIAMS: I'm sorry?

25 MATT DOGALI: It's a minority. The Jacquin's ...

1 SENATOR WILLIAMS: No, 80 percent are outside
2 Pennsylvania.

3 MATT DOGALI: Yes, yes.

4 SENATOR WILLIAMS: Significantly. So in this
5 space you are sort of supplying to the consumers, not
6 necessarily employing the folks in Pennsylvania; would that
7 be accurate?

8 TERRI COFER BEIRNE: Well, since 40, 53 percent
9 of the PLCB sales are from California wine -- 53 percent of
10 the 40 percent that is wine, or California wine -- why we
11 are not employing people in the vineyards in California --
12 I mean Pennsylvania. Folks are selling California wine and
13 that's creating jobs in Pennsylvania, yes sir.

14 SENATOR WILLIAMS: I'm in politics. I don't know
15 what the heck you just said. I'm sorry.

16 TERRI COFER BEIRNE: If you don't have anything
17 to sell ...

18 SENATOR WILLIAMS: Are the employees in
19 California or Pennsylvania?

20 TERRI COFER BEIRNE: If you don't have any
21 product to sell from California in Pennsylvania, you would
22 lose a lot of jobs in Pennsylvania.

23 SENATOR WILLIAMS: Okay, but the majority of the
24 employees of those vineyards are in California; correct?

25 TERRI COFER BEIRNE: Absolutely.

1 SENATOR WILLIAMS: So, that's the first one. The
2 other thing that I heard was basically to increase the
3 volume is to increase the outlets and increase the
4 consumption; is that accurate?

5 DAVID OZGO: People purchase spirits for beverage
6 alcohol across the country. Right now you lose, I believe
7 it's around \$300 million each year to sales in neighboring
8 states. So I know what you're getting at. We have seen an
9 increase in distilled spirits sales across the country over
10 the last 15 years or so. Over that time, underage drinking
11 has declined and the level of alcohol use ...

12 SENATOR WILLIAMS: I'm not -- alcohol figures --
13 going some place where I'm not. Just answer my question.
14 I'm not talking about underage drinking. I'm just saying
15 in order to increase -- your suggestion sounds like it says
16 increase outlets and increase consumption; is that accurate
17 or not?

18 DAVID WOJNAR: No sir. It's actually how you
19 split up the marketplace. So now with Act 39 you have a
20 disproportionate number of wine outlets. You always have
21 had more beer outlets versus spirits outlets, so it's just
22 trying to settle that inequity that's been created as a
23 result of Act 39.

24 SENATOR WILLIAMS: I thought I heard in the
25 gentleman's testimony, he said that we are significantly

1 behind other states in terms of outlets.

2 DAVID OZGO: Of spirits outlets. However, you
3 have a lot of beer outlets that you are consistent with
4 national averages. There are a number of ways -- what
5 we're suggesting is the use of agency stores. Very often
6 when you have agency stores, you're simply selling spirits
7 in places where beer and wine were already sold. So it's
8 not necessarily increasing alcohol availability. It's just
9 giving spirits a shot at the market like everyone else.

10 SENATOR WILLIAMS: That's fine. And I did hear
11 Sunday sales; correct?

12 UNKNOWN: Yes sir.

13 UNKNOWN: Yes.

14 SENATOR WILLIAMS: So those are -- okay just for
15 the baseline. So I'm a little bit confused. You said
16 profit margin? Where is there a profit margin by the
17 Commonwealth? To the economist.

18 DAVID OZGO: What was your question? I'm sorry.

19 SENATOR WILLIAMS: You mentioned the word profit
20 margin.

21 DAVID OZGO: Yes.

22 SENATOR WILLIAMS: Where do we make a profit in
23 the Commonwealth of Pennsylvania?

24 DAVID OZGO: Where does the profit come from for
25 the state?

1 SENATOR WILLIAMS: No where. We don't make
2 profits. The government doesn't make a profit, so I'm
3 trying to figure out how that language got into your
4 testimony when you said profit margin. So ...

5 DAVID OZGO: Well, the PLCB certainly makes a
6 profit.

7 SENATOR WILLIAMS: No, the PLCB does not make a
8 profit. It collects revenue that the Commonwealth uses,
9 but I'm trying to figure out what you're ...

10 A for-profit entity makes money. That's not what
11 we do. That's not what the PLCB does. They don't make
12 money. They generate revenue that we use in the
13 Commonwealth, so I'm just trying to get clarity about what
14 you were saying when you said it.

15 DAVID OZGO: If the PLCB does not make profit,
16 then I stand corrected.

17 SENATOR WILLIAMS: Okay. And there was a comment
18 about ...

19 Did you say a state's right or states' rights?

20 MATT DOGALI: A state's right.

21 SENATOR WILLIAMS: All right. So I guess -- and
22 then you -- well you admitted it, so I appreciate your
23 commentary. Use words like schemes and margins, etc. and
24 that kind of thing, so -- I want you to understand, I come
25 here and try to be objective about all the approaches to

1 generate revenue but ... And I respect your
2 responsibilities to defend the suppliers. I don't have
3 anything in what you said with regard to consumers.
4 Consumers have not seen a dramatic spike in prices. I have
5 a degree in economics. Very familiar with that so that's
6 why when you say the word profit margin, those things that
7 were introduced to the conversation which frankly don't
8 represent the bottom line, and when people start saying
9 things that sort of dramatize the other side, I get moved
10 in a different way. I'm a very independent person. People
11 who know me as a Democrat know I can see issues for what
12 they are.

13 I have a great deal of sensitivity to one item
14 which you mentioned. That's time sensitivity and
15 appropriate notification. I didn't know I was going to
16 come here and talk about reset. That's not a reset to get
17 rid of -- that the pricing process we have in Pennsylvania
18 -- to say we're going to go back to the good old days when
19 it's on your side, not our side. I don't think that's a
20 compromise. I don't think it's a reset. I think that's
21 frankly going back to what the industry desired because we
22 got an advantage to them which I will respect that that's
23 what you said. But that's not what you said. You sounded
24 like you're trying to suggest that you are fighting for
25 consumers. I don't know that there's anything in this

1 conversation that talks about fighting for consumers.

2 Prices have not dramatically spiked. Frankly,
3 product distribution in Pennsylvania is increasing, not
4 decreasing. Now maybe we're way behind the other states
5 but frankly because we've done this, we are increasing in
6 different areas that we haven't. Certainly to the product
7 you mentioned, may have never been a part of Pennsylvania's
8 product line before. At least it's now a part of the
9 product line in Pennsylvania. I live in Philadelphia which
10 is famous for going to New Jersey to buy its product.
11 That's no longer the case and Pennsylvania is a part of it.
12 The bottom line for consumers who are taxpayers is
13 dramatically different in Pennsylvania. I think frankly
14 you'd be well served to start talking about taxpayers and
15 how your industry can help us generate more revenue to that
16 bottom line.

17 And lastly, most important for me, I mentioned
18 earlier, responsible consumption of alcohol in Pennsylvania
19 is a problem in certain areas. Sunday sales I would be
20 dramatically opposed to. Dramatically opposed to. A
21 different type of pricing system which would increase
22 distilled beverages in my district, in certain parts of my
23 district, I'd be dramatically opposed to. Now that said,
24 increasing consumption in certain product lines, high
25 retail product lines, those kinds of things I'd be quite

1 open to, because that's responsible. But to suggest that I
2 coming from -- and you need to be researching on what a
3 Stop N Go is -- because specifically in the area you're
4 talking about, shots being consumed by adults in front of
5 minors in Pennsylvania should be criminal, but not
6 encouraged. And to suggest that we're protecting consumers
7 in this conversation from an economic standpoint is
8 irresponsible. So there's nothing frankly other than
9 defending the suppliers in your commentary today that I
10 heard, other than what I just mentioned that was I think is
11 fair -- its ample notice. I do think that weather,
12 environment, those things should be taken, if you're really
13 working in concert, because we do want to drive the bottom
14 line on both parts. We don't want to discourage anybody in
15 the industry to be driven out of Pennsylvania but that
16 said. And by the way a monopoly is not necessarily the
17 best thing to have in any place in America. I'm not a fan
18 of that either, but it is what it is. And to the extent
19 that we can make it relevant and productive, I think, is
20 important.

21 I think I would revisit some of the comments you
22 made in terms of your testimony because it's not fact
23 driven. It's opinion driven. And if it's going to be a
24 defense of the industry, then just say it's going to be
25 defending the industry as opposed to suggesting that we're

1 losing out on consumers because the reality is that I can
2 take you to parts -- if you ever choose to come visit, I'd
3 be happy to give you a tour of the areas where I'd like to
4 work out a balance. But there are some significant issues
5 with regard to suggesting that we should be increasing
6 distilled beverages in certain sections of Pennsylvania,
7 not just urban Pennsylvania but rural Pennsylvania as well.
8 That's a problem in parts of Pennsylvania, so with that I
9 will close and look forward to suggestions when it comes to
10 the timing, notification, working to much more openly
11 transparent. I think those are all appropriate things to
12 be done. I think frankly there should no be -- you
13 shouldn't be tricked on either side and leveraged. But,
14 you know, leverage is always a part of an economy in the
15 capitalist society so to say that that's a problem. Well,
16 it's a problem no matter where you are. Thanks.

17 DAVID WOJNAR: Mr. Chairman, if I could just
18 address the Senator. Senator, you have a deal. Is that we
19 have Distilled Spirits Council -- our member companies have
20 been proud supporters and funders of some amazing
21 responsibility programs; Responsibility.org, the Foundation
22 for Advancing Responsible Retailing. We encourage you.
23 We'd love to partner with you. We've got great spokesmen
24 ranging from Shaquille O'Neal to Olympic gold medalists who
25 talk about underage drinking.

1 SENATOR WILLIAMS: I don't like Shaquille O'Neal.
2 Never a 76er. I don't like him. That's that. We'll
3 accept that as an apology.

4 DAVID WOJNAR: If you played for the Sixers you
5 would have loved him. I guarantee it.

6 SENATOR WILLIAMS: I would have loved him.
7 Exactly right. Look forward to working together.

8 DAVID WOJNAR: Thank you.

9 SENATE MAJORITY CHAIRMAN STEFANO: Representative
10 Ryan.

11 REPRESENTATIVE RYAN: Thank you very much. I do
12 appreciate your testimony today. Just a little bit of
13 background since you don't know me. I'm a retired Marine
14 Colonel. I'm an expert in economic warfare. I'm probably
15 the only person in the room that's been in seven nations
16 that have collapsed economically, some of which I helped
17 do. We have a very similar group in Washington DC. It's
18 called Congress.

19 I worry in all of this -- and I have tremendous
20 respect on both the state and the supplier end -- but it
21 goes back to consumers, and I need to just make one other
22 comment. I've never had a drink in my life. And you might
23 then question whether or not I was really in the Marine
24 Corps but there was a fluke. I was admitted.

25 I mention this though because in everything I've

1 heard today tells me that it's gone and defied the economic
2 logic. I was part of a group that helped the automobile
3 industry to execute part of its turnaround. And whenever
4 you have a control market, you have a market supplier.
5 It's why I asked the questions about elasticity of supply
6 and elasticity of demand. You can't have a market player
7 on one side of the equation that's the big brother and then
8 turn around and say that we've turned over \$200 million
9 back to the state when someone like myself who is a free-
10 market economist will tell you that's a defacto price
11 increase on the consumer. You can't turn around and sit
12 back and say we have a situation in which we have
13 controlled markets in which any type of a fair-pricing
14 discussion is done without the free market determining what
15 that will be done.

16 I watched General Motors, Ford and Chrysler, and
17 other automobile manufacturers absolutely abuse the tier
18 one and tier two suppliers of which I used to be one when I
19 did a turnaround of a financially troubled company. And I
20 can absolutely assure you when you do that, any type of
21 market presence, be it in the beverage industry, be it in
22 the alcohol industry, whatever the case may be. And I've
23 done a turnaround of an alcohol distillery. And when you
24 look at those kinds of issues you have to recognize that
25 any time anyone interferes with the market and controls it,

1 the consumer will ultimately lose.

2 Any time that I've done -- when I was in Iraq. I
3 was called to active duty out of retirement to go to Iraq
4 and do the economic redevelopment plan for the Republic of
5 Iraq. The first thing I did was the transfer of 265 state-
6 owned enterprises back to the free market. I did the same
7 thing in Poland in 1998 and 1999.

8 I mention that for this reason is that I heard
9 the testimony and I appreciate this. This is an elasticity
10 of supply and of demand, both of which relate to the
11 consumer. And no matter what we do, we as a state, we have
12 to recognize it's the consumer that will decide. I heard
13 my colleague from the Pittsburgh area discuss some issues
14 that she brought up about different prices in different
15 areas. Cost means nothing in a marketplace. Cost will
16 determine my profit margins, your profit margins, and the
17 state's profit margins. If there are tax differences in
18 one area versus another, that then is borne by the supplier
19 or the manufacturer or the seller. The consumer -- if they
20 can buy a better price of the same product in a different
21 state, they will migrate to those states.

22 If you don't believe me, talk to the Maryland
23 State Police for the number of people that go to Virginia
24 to buy cigarettes and then bring them back into Maryland.
25 If that's the case, Delaware would not advertise that we

1 are the home of tax-free shopping except that the State of
2 Delaware is encouraging Pennsylvania to not report on the
3 use tax, that which is so prevalent and important because
4 they tax certain items and not others.

5 So I would just ask you. I saw your comments.
6 I'm new to the committee. I appreciate the feedback, and I
7 would like to work with both sides of this equation and
8 then my dear Senator -- we've just met today for the first
9 time -- that we have an opportunity to sit down and come to
10 a successful resolution to this.

11 And with all of that diatribe that I just said,
12 any comments or any thoughts or perspectives on this.

13 And I do appreciate the comment that California
14 vineyards are creating jobs in the Pennsylvania distilled
15 spirits stores, an opening in which by the way I was just
16 very pleased to see with Congressman Holden when we were
17 there. And I thank you for that opportunity.

18 DAVID OZGO: Well, Senator, given that the
19 sincerest form of flattery is to copy someone, if you don't
20 mind, I might use some of what you just said the next time
21 I testify in another state. That's very good. Thank you.

22 SENATE MAJORITY CHAIRMAN STEFANO: Representative
23 Topper.

24 REPRESENTATIVE TOPPER: Thank you very much. I
25 appreciate what you guys ... I appreciate the shout out

1 that usually I try and duck under the table when somebody
2 says the name of a bill that I have out there because very
3 few of them seem to be non-controversial anymore. But I
4 guess that's being in the legislature for a while.

5 So I have a question about what other states do
6 in terms of varying the markup prices. So my question is
7 centered around the idea that two similar products could be
8 marked up differently for any reason, maybe to drive one
9 out the doors quicker, maybe to pick up pricing. Is that
10 done anywhere else in any other states that you are aware
11 of or that you work in?

12 DAVID WOJNAR: Not like currently Pennsylvania is
13 doing it. One of the ... In all the control states, by
14 and large, you've got a set markup formula. There's a
15 process that's open and transparent to everyone. Everyone
16 knows what the rules are. They know what the terms of
17 engagement are and then once the price is set, the price is
18 set. So Pennsylvania is an anomaly. I'll say that whoever
19 came up with the concept of flexible pricing on behalf of
20 the LCB was smart. I mean, look. What it's done though,
21 it's turned a loophole into a lasso.

22 TERRI COFER BEIRNE: And then on the wine front.
23 There are only five jurisdictions where the state is the
24 seller of wine, and it is the same case. It's a set
25 formula. Yes sir.

1 REPRESENTATIVE TOPPER: All right. Thank you
2 very much. Thank you, Mr. Chairman.

3 SENATE MAJORITY CHAIRMAN STEFANO: Thank you.
4 Chairman Pyle.

5 HOUSE MAJORITY CHAIRMAN PYLE: Thank you very
6 much, Chairman Stefano. Well, when we started we all made
7 the comment that this was going to be a lot of new
8 learning. And I've got to tell you, this has been an eye
9 opener. I mean, from every person sitting right in front
10 of us right now, yeah, transparency is absolutely vital in
11 any kind of governmental ... You know, Topper's bill. We
12 have a little issue of Topper's bourbon versus Pyle's
13 bourbon. Once we're done with that, we should be great.

14 Mr. Ozgo, I love listening to economists and I
15 agree with you, Mr. Wojnar. I think competition in rural
16 areas -- and I happen to be one of those. And for the
17 record, I'm not from Philadelphia, not from Philadelphia,
18 not from Philadelphia. I am from a sixth-class county.
19 Okay. We have to drive great distances to buy nice wine or
20 nice liquor. And if Ford City does not fit into the LCB's
21 economic models, I would have no problem whatsoever with
22 opening up to an agency-type store or a franchise-type
23 store, whatever you want to call it. Just so my little
24 Ukranian bubbas could go get their sacramental wine. Many
25 of them don't drive. Having it right there in the

1 neighborhood, like it was ten or twelve years ago, would go
2 a great, great way for us. I appreciate all of your
3 comments. I learn from each of you every time I hear you.
4 And thank you very much, Chairman.

5 SENATE MAJORITY CHAIRMAN STEFANO: Thank you. I
6 have one last question then to wrap up. This is more
7 geared towards the spirit sales. But what do you think is
8 more impactful to your sales? The losses you feel have
9 come from flexible pricing or the fact that we have low
10 outlet density?

11 DAVID WOJNAR: To us, both of them. It's a
12 double whammy. The fact that there is ... But we think
13 that the fundamental, the fatal flaw in the system as we
14 see it right now, is the lack of stores. So the lack of
15 stores leads or puts the LCB or the Legislature in a
16 position to force something like flexible pricing. It's
17 forced that so it's sort of an under-utilized asset,
18 especially now with the pressure of wine and R licenses is
19 driving that even more, so we think the secret sauce is to
20 build up the asset by allowing more spirits outlets.
21 However you get there is up to you to decide. And that
22 will then take the pressure off of having to rely on
23 flexible pricing and margin optimization. And so when the
24 supplier offers that discount it makes its way back to the
25 consumer. That's what we believed flexible pricing was

1 supposed to be. When you think about, it was to get those
2 discounts into the hands of the consumer. So Act 39 was a
3 double whammy. Less stores. I mean, more wine outlets.
4 Spirits stagnant in this flexible pricing scheme, if you
5 will.

6 MATT DOGALI: I can't speak necessarily to the
7 store density issue, but what I can say is that the way our
8 members position their products is heavily researched by
9 sometimes trial and error, sometimes market tests. And
10 what has happened is there are products that are selling
11 very well in Pennsylvania right now, where the price is
12 being raised to a point where it's moving outside of the
13 intent of the supplier. As far as, we built a brand around
14 this product to sell at a very specific price point. And
15 when the product goes above that price point, people will
16 look to a different product. Because there's different
17 grades. There's different quality levels. So not being
18 able to have the ability to have influence over the retail
19 price really impacts the marketing of our products.

20 SENATE MAJORITY CHAIRMAN STEFANO: Thank you. I
21 have, I believe, one more question. Representative Deasy.

22 REPRESENTATIVE DEASY: Thank you. I apologize
23 for not getting on the list sooner. We talked about
24 spirits sales going up nationally as well as in
25 Pennsylvania. If I'm not mistaken, since the

1 implementation of Act 39, luxury spirits went up from 4.8
2 million to 6.3 million? The numbers that I had seen.

3 DAVID OZGO: Yeah, however when you look at the
4 State of Pennsylvania and when you look at what's being
5 shipped into the state by our member companies,
6 Pennsylvania is decidedly behind other states when it comes
7 to luxury products. I believe within our member companies,
8 15 percent of everything they ship in is considered a
9 super-premium brand, you know, sort of the highest-priced
10 tier. Whereas in the surrounding ... I'm sorry, ten to
11 eleven percent of what's going into Pennsylvania is in that
12 super-premium category whereas in the surrounding states
13 it's around 15 percent. So in that area, Pennsylvania is
14 really considerably behind as of 2018.

15 REPRESENTATIVE DEASY: Okay. As well as the
16 spirits sales overall, I've got 1.32 billion from 1.29 the
17 previous year. Does that sound about right?

18 DAVID OZGO: Yeah. I mean supplier sales were up
19 in revenue terms by a little over 5 percent, I believe, in
20 2018. So the market is growing fairly rapidly. We are
21 gaining market share from beer. We have, I think, out of
22 nine out of the last ten years. So it's definitely a
23 growing marketplace.

24 REPRESENTATIVE DEASY: Thank you. And I just
25 want to thank Chairman Stefano for putting the hearing

1 together. And I think, from my perspective -- this is my
2 first year on the Committee as well as being the Chairman -
3 - it's been a learning experience. And I think we did some
4 good things in Act 39 and from my perspective we're always
5 taking a look at legislation and seeing what we have done
6 and where we need to go. So is there some changes? Yeah,
7 maybe there are some things that need to be addressed. And
8 I think probably communication in a hearing like this today
9 where both sides are at the table, to hear suggestions, and
10 we appreciate your suggestions I'm sure. Chairman Holden
11 and the folks at the PLCB have an open-door policy to talk
12 about those issues, so I look forward to having these
13 discussions in the future. But thank you for scheduling
14 the hearing.

15 SENATE MAJORITY CHAIRMAN STEFANO: Well, thank
16 you for your testimony today. I have appreciated the
17 opportunity to learn more about what you have to say from
18 your perspective.

19 DAVID WOJNAR: Mr. Chairman, if I could just
20 share with you one bit of historical tidbit here. It's
21 probably 16-17 years ago, this young man here was talking
22 about Sunday sales, trying to convince the legislature and
23 the PLCB on the value of Sunday sales. And that Sunday
24 sales law, when it was originally passed, only allowed,
25 permitted the PLCB to open 25 percent of their stores to be

1 opened on Sunday.

2 One positive that came out of Act 39, some 15-16
3 years later, is that allowed the PLCB to open statewide
4 Sunday sales. It is was David Ozgo's testimony,
5 credibility, back then that convinced the legislature to do
6 Sunday sales, and his numbers worked out to the point where
7 you all decided to allow Sunday sales statewide as part of
8 Act 39. Thank you very much.

9 SENATE MAJORITY CHAIRMAN STEFANO: Thank you.
10 Now as originally planned I had allowed the LCB to come
11 back and provide additional testimony. Did you wish to do
12 that?

13 TIM HOLDEN: Mr. Chairman, it's up to you.
14 There's going to be a session starting in 15 minutes in
15 both chambers so. If you're fine with leaving it there,
16 that's fine with us. Whatever is the will of the Chairman.

17 SENATE MAJORITY CHAIRMAN STEFANO: I think it's
18 been determined by majority rule to leave. The Chair
19 adjourns today's meeting to the call of the Chair. Thank
20 you.

21

22 (Hearing concluded at 12:42 p.m.)

C E R T I F I C A T E

I hereby certify that the foregoing proceedings are a true and accurate transcription produced from audio on the said proceedings and that this is a correct transcript of the same.

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