Support for HB 1512 in Testimony to House Liquor Control Committee
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Wine Institute is a non-profit trade association of nearly 1,000 California wineries. Together, California wineries produce 81% of all domestic wine. Since 40% of PLCB revenue comes from wine, and California wine accounts for about 53% of PLCB wine sales by both volume and revenue, we are particularly interested in the PLCB's pricing policies. We opposed flexible pricing in Act 39/Act 85 three years ago and today support its repeal via HB 1512. A return to a standard markup will support lower consumer prices and improve the transparency of pricing discussions to ensure that PLCB does not pick winners and losers within the Pennsylvania alcohol marketplace.

Wineries are agricultural enterprises that often make decisions about their costs and required revenue years before a consumer picks up their bottle. Further, retail pricing influences 72% of consumer wine buying decisions, so the California wineries are heavily vested in how wine is priced, particularly in a large market like Pennsylvania. Prior to Act 39/Act 85, wineries examined their expected costs, the national wine market and competitors' prices to target a "suggested retail price," then used the PLCB markup formula to back down to a wholesale cost. Because all brands were subject to the same mark-up, wineries knew details of their own brands, but could also figure out at what price their competitors were selling wine. This markup formula was an effective system of commercial checks and balances that ensured PLCB could not single out certain brands or suppliers for unique treatment.

Since passage of Act 39/Act 85 in August 2016, PLCB has changed both its method of pricing and the level of transparency surrounding it. With flexible pricing PLCB negotiates the cost and markup on every item, keeping the details of such negotiations confidential. It provides no schedule or justification for the categories or specific brands it targets for wholesale or retail price changes, and gives suppliers little lead time to respond to notice of intended price changes. While private wholesalers in license states may operate like this, PLCB is not a private wholesaler and Pennsylvania is not a license state. Wineries cannot fire PLCB as a wholesaler like they might do in a license state when faced with unreasonable demands. In short, there is no negotiating with a monopoly. Wineries accept PLCB's terms or risk access to a lucrative wine market.

Act 39 was not intended to apply flexible pricing to all products. Initially it allowed PLCB to price the "150 best selling items" in a manner that "maximizes the return on the sale". Under Act 85, this was expanded from best-selling "items" to best-selling "brands and product types." Then, in March 2018, PLCB asked this Committee to extend flexible pricing to all items; this was NOT granted. In May, PLCB exercised administrative

discretion to extend flexible pricing to ALL listed items. What started as a trial of flexible pricing on 150 wines has ballooned into flexible pricing of all 2,600 listed wines.

Nor did anything in Act 39/Act 85 eliminate the need for transparency and accountability expected from PLCB as a government body. In fact, the statute suggests a tool for pricing oversight that PLCB is not utilizing. The law requires PLCB to publish on its website "a listing of the wholesale and Pennsylvania liquor store retail prices." Knowing the delta between these two numbers would allow anyone to determine PLCB's markup on each product. Instead, PLCB merely directs one to a quarterly retail price listing and a footnote noting that wholesale prices are calculated at 10% off the PLCB retail price. With this language, the Legislature could maintain the transparency expected of PLCB, not merely publicize the simple 10% discount offered to licensees.

All hoped PLCB would use flexible pricing like volume discounts, where wineries sell more wine at a lower cost to wholesalers, with savings passed along through retailers to consumers, who buy more wine at lower prices. Everyone - winery, wholesaler and retailer – would sell more wine and make more money with volume discounts. Unfortunately, flexible pricing is not volume discounting. Any savings on the cost of goods are merely absorbed by PLCB into higher operating costs and Pennsylvania consumers are paying more for alcohol. At the June hearing, PLCB noted that it dropped the retail price on 167 wines and spirits, and raised the retail price on 570 items; this is a net increase in consumer prices on 403 items in 2018.

Here's a specific example of how one winery has lost in an era of flexible pricing: PLCB buyers identified one high-volume, value brand as "under-priced" and raised the retail price by $1 two different times within a short period. Eventually the winery noticed a decline in sales and asked PLCB for a partial reduction of the retail price. In exchange, PLCB expected a new, lower cost of goods going forward. In short, that winery "bought down" their own wine's retail price, eliminating funding for "price supports" it normally would have devoted to marketing. Here, consumers paid more for their wine and sales dropped due to less promotion. Wine Institute members describe other scenarios where they have taken financial hits ranging from $100,000 to over $1 million.

A handful of PLCB buyers cannot be expected to do the pricing work that hundreds of winery sales teams have done for decades using national sales data. PLCB is making forecasting and pricing mistakes that suppliers are having to underwrite. With flexible pricing, PLCB can extract a lower wholesale price from suppliers on the front end of the transaction, then raise the retail price on the back side without limit. New PLCB revenue is derived from supplier margin and is ultimately paid for by consumers. Suppliers are currently giving PLCB a lifeline in the form of lower cost of goods to cover rising operational costs, but at some point, sales start to slide.

There is no question that PLCB is saving money buying alcohol under flexible pricing. However, there are plenty of questions about whether this results in higher consumer prices, suppliers being squeezed too far, or both. Flexible pricing has been an unsuccessful pricing tool in Pennsylvania and Wine Institute respectfully requests passage of HB 1512 to repeal the authority for it.

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