Spirits Canada

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Mr. Mark Hicken
Chair,
B.C. Liquor Industry & Legislation Advisory Panel
Vancouver British Columbia **(sent by e-mail)**

Dear Mr. Hicken,

On behalf of Canadian Spirits manufacturers, marketers and consumers, we welcome the opportunity to share the attached submission to the Liquor Industry and Legislation Advisory Panel (the "Panel").

As discussed, we were surprised and disappointed that Spirits Canada was not invited to join the Panel.

The sale of our Members' products directly contributes very significantly to the net transfer of income from the sale of beverage alcohol to the Provincial Treasury annually.

Moreover, Spirits Canada Members invest heavily in the B.C. market both in terms of "boots on the ground", as well as in brand investment in support of both the retail and on-premise sales channels. Without these in-market investments by spirits suppliers creating "buzz", excitement and product as well as category knowledge and thus driving traffic to both retail and on-premise establishments, Treasury's liquor revenues would be greatly diminished. For too long, B.C. liquor policy has been developed near exclusively with a lens on local smaller scale manufacturing, resulting in a wide range of market distorting policies.

Many of these market distorting policies have not only been implemented with little regard for their financial cost, or their inconsistency with international and interprovincial trade obligations, they have also inadvertently established significant disincentives to sell B.C. liquor products outside the Province of B.C..

We mote that over 80% of British Columbia consumers enjoy the occasional drink, whether at home, at friends' or in licensed on-premise establishments. The vast majority of these consumers drink all three major product categories, beer, wine and spirits depending on the specific occasion and circumstance.

Today's consumer moves between product categories more frequently than previous generations and values convenience and innovation as well as more traditional purchase drivers such as price, taste, image, packaging, etc.

We note that last year, distilled Spirits sales in British Columbia represented 25% of liquor sales by the BC Liquor Distribution Branch, but accounted for an estimated 33% of its net income provided to the Provincial Treasury.

The attached submission summarizes the primary recommendations for consideration by the Panel.

Sincerely,

Jan Westcott

Jan H. Westcott
President & CEO

1. Urgent Need to Reinstate Standardized, Posted BC LDB Retail Liquor Mark-ups

The BC Liquor Distribution Branch (BC LDB) established separate business units, a retail and a wholesale arm, as part of the province's 2014 liquor policy reforms with the goal of creating a level playing field between private retailers and the government-owned LDB retail stores. We note, however, no separate financial information for these now distinct business units has been published to-date.

A significant element in this structural change was the adoption of a new wholesale liquor mark-up structure introduced in October 2016.

All retailers, both private and government LDB retail stores now purchase liquor products at the same wholesale price from the LDB wholesale unit (excluding products delivered directly by BC liquor manufacturers).

Consistent with long-standing practice and in conformity and consistency with international trade obligations, the wholesale mark-up is both transparent and standardized ensuring fair and equal treatment across similar products.

Table: CURRENT BC LDB WHOLESALE MARK-UP STRUCTURE & RATES

Product	LDB Wholesale Mark-Up Rates
Spirits	124% of LC, with a graduated mark-up for cost portion > $21/litre
Refreshment	73% of Landed Cost (LC)
Wine	89% of LC, with a graduated mark-up for cost portion > $11.75/litre
Beer	$1.08/litre with reduced mark-up for brewers producing < 350,000 hl

However, in direct contrast to the approach adopted for the wholesale mark-up, the BC LDB now applies arbitrary retail mark-ups on liquor products they retail themselves in their own stores.

In defence of this arbitrary retail mark-up policy, we understand the LDB claims such "flexibility", is necessary in order to compete with private retailers and are simply mirroring the pricing practices of private retailers. The BC LDB, however, is simply not any retailer. It has a preferential role in the market through provincial statute, it has a dominant position as defined under the Competition Act and is both a state-owned and a state trading enterprise under the GATT/WTO agreements to which Canada (and B.C.) is a party.

The reality is that B.C. liquor consumers have been subjected to stealth tax increases of enormous magnitude under the guise of operating "like any other retailer". Unlike tax increases approved by the Legislature, these increases have been initiated at the sole discretion of unelected officials with insufficient oversight or transparency.

Media reports indicate that the B.C. NDP's own analysis demonstrates that retail prices rose by 12% under this new retail margin enhancement strategy deployed by the LDB.

One also needs to remember that the new wholesale mark-up structure was established at a rate guaranteed to generate 100% of the net revenues generated under the province's previous mark-up policy, one that included both wholesale and retail components. Thus, net revenues generated by the LDB liquor retail mark-up in excess of its retail operating costs are all "gravy", or put more bluntly, hidden tax increases.

In addition to the negative impact on hard working B.C. consumers, the LDB flexible or arbitrary approach to applying its retail mark-ups have a number of additional policy weaknesses, including:

i) as a state-owned enterprise, the LDB has obligations to impose the lowest mark-up on an imported product that it provides to any similar domestic products. That is to say, imported spirits must be provided the lowest mark-up imposed on any domestic spirit and this obligation is equally applicable at the retail as it is at the wholesale level;

ii) the ability for a supplier or brand owner to influence the LDB and be provided a lower retail mark-up than that offered to a competing product, places LDB employees at huge risk of undue influence, a risk exacerbated by the lack of transparency of actual mark-ups being applied on specific products;

iii) the BC LDB's practice of purchasing excess inventory of supplier's products placed on sale through limited time offers (referred to as "bridge buying"), and not passing on the full value of these savings to B.C. consumers for all the product purchased is tantamount to a breach of trust with B.C. consumers. Such a pricing strategy by a private sector player might be viewed as simply gouging, but when undertaken by a government agency it is more likely to be viewed as an expropriation of price reductions, reductions 100% funded and paid for by suppliers that were intended for the benefit of consumers;

iv) and most fundamentally, such an aggressive exploitive pricing policy undermines any public or societal rationale for the LDB to remain a government agency, if its primary goal is to mimic and "act and like any other retailer".

2. CFTA/NAFTA/WTO Trade Compliant Resolution to Grocery Store Liquor Sales

B.C. has adopted a two-tier approach to expansion of liquor into select grocery stores with exclusively B.C. wines on the shelves of grocery stores and all other liquor products restricted to a "store-within-a-store" model.

Preferential market access for B.C. wines has been a point of contention for many years, with B.C. wines benefiting from a grandfathering of B.C. VQA private stores under the 1987 Canada US Free Trade Agreement and brought forward under NAFTA (currently under contentious renegotiation). This derogation from B.C. and Canada's national treatment obligations in favour of local wines is also part of the recently concluded CETA agreement with the European Union.

Moreover, the substance of the 2017 U.S. complaint at the WTO is that the decision to expand only B.C. wines onto the shelves of grocery stores is a substantive expansion of preferential commercial access permitted and negotiated under CUSTA/NAFTA.

Moreover, many of Canada's trading partners, including significant wine producing jurisdictions such as Australia, Argentina, South Africa and New Zealand have not been party to these derogations and all parties including the U.S. and the EU have retained their rights under the WTO Agreements. Australia (joined by Argentina, Chile, EU, New Zealand, and the U.S.) have now, in fact, exercised their WTO rights and have requested formal consultations with Canada under GATT Article XXII:1.

Our principal concern is that a policy decision to expand B.C. wines onto grocery store shelves, likely leads to imported wines provided this same market access in order to meet B.C.'s international trade obligations. However, such an outcome would result in preferential market access for imported wines versus that available to Canadian Spirits.

Those B.C. consumers who choose to drink, tend to drink various products from all categories, whether beer, cider, wine or spirits. Market access (along with tax policies) are significant influences on the competitive position of various alcohol products in any given market. In fact, convenience has become an increasingly important factor in purchase decisions as consumers face increasingly busy lives.

Spirits produced domestically anywhere in Canada must be provided market access treatment no less favourable than that provided to imported wines or beer.

3. Fair & Reasonable Access to Products for All

Recent liquor enforcement action by the BC LCLB brought to the fore the requirement that licensed on-premise operators must purchase all their liquor from the BC LDB (or directly from in-province licensed manufacturers), and not from private liquor stores. This is true even for product not available in BC LDB retail stores locally or even listed by them provincially.

Recognizing, as noted earlier, that the BC LDB wholesale mark-up was designed to ensure full remittance to the provincial Treasury of the full "commodity tax" equivalent previously included in the combined wholesale and retail mark-up, allowing on-premise operators to buy from their retailer of choice would have no negative consequences to the Provincial Treasury.

In such a more open and competitive market for purchasing by licensed on-premise operators, the BC LDB should adopt a posted, transparent and standardized "licensee" mark-up for these sales to on-premise establishments at a lower rate than the posted, transparent and standardized retail mark-up recommended under Section 1 reflecting the cost efficiencies of handling these sales.

4. Improper Intrusion by the B.C. LDB into the Brand Business

Canadian provincial liquor boards largely exited the "house brand" or "in-house bottling" business many years ago in recognition of the inherent conflict of interest such encroachment entails (sole exception being Rock Spirits in Newfoundland).

However, the BC LDB has introduced a handful of exclusive "own-bottlings" of various products, including Canadian Whisky, in recent years.

Such activities puts these stores in direct and unfair competition with suppliers who may not operate their own retail establishments.

Potential preferential treatment for such "house brands" are almost limitless and include listing and delisting decisions, merchandising and placement opportunities, directed staff recommendations and preferential retail mark-ups.

In order to reintroduce a measure of transparency and fairness to the market, the BC LDB should not offer for sale in its stores any proprietary brands.

5. Annual Review & Periodic Adjustments to BC LCLB Minimum Retail Prices

Canada's National Alcohol Strategy includes a recommendation that liquor products be subject to minimum social reference prices with these prices reviewed at least annually in relation to the change in prices of other goods and services in the market.

We note that B.C.'s minimum liquor retail social reference prices were last adjusted in May 2016 with the province's all items CPI having increased by 2.9% over the intervening period.

These 2016 changes (B.C. LCLB Policy Directive No 16-4) included a number of very progressive elements, including the extension of the application of such minimum social reference price to all retail sales channels, and a one-time adjustment to the rates of certain categories to correct for historic discrepancies between product categories based on their relative alcohol content.

We specifically recommend a CPI-type adjustment for spirits this year, as well as a further phase in of catch-up adjustments for other product categories to more closely align minimum retail prices with alcohol content by product category

Table: CURRENT MINIMUM RETAIL SOCIAL REFERENCE PRICES

Product	Minimum Price/L Excl. Sales Taxes	Minimum Price/Std. Drink* Excl. Sales Taxes
Wine	$6.44	$0.92
Spirits	$27.88	$1.19
Liqueurs	$20.39	$1.66
Packaged Beer	$3.19	$1.08
Draught Beer	$1.97	$0.67
Coolers/Ciders	$3.75	$1.07

* Note: where a standard drink is any drink that contains 17.05 ml or pure alcohol, including a 5 oz. serving of 12% abv wine, 1½ oz. serving of 40% abv spirits, and a 12 oz, serving of 5% abv beer.

6. Alignment of B.C. LCLB Minimum On-Premise Drinks Prices with Canada's Low-Risk Drinking Guidelines and Standard Drinks

B.C. adopted a minimum drinks price for on-premise consumption of liquor in licensed establishments in 2014.

Table: Current B.C. LCLB On-Premise Minimum Drinks Prices

Product	Minimum Price Including Sales Taxes	Minimum Drink Price Per Std. Drink
Bottle/Can of Beer	$3.00 per 341/355 ml	$3.00
Draught Beer	$5.00 per pint	$3.00
Pitcher of Draught	$12.00 per 60 oz.	$2.40
Wine	$3.00 per 5 oz. glass	$3.00
Spirits	$3.00 per oz.	$4.50

The laudable policy objective of minimum on-premise drinks prices is to discourage over consumption, particularly over consumption driven by aggressive or predatory pricing strategies.

In order to be effective, such policies must treat all competing liquor products equally. There is simply no policy rationale, for example, to incent consumers to purchase draught beer in containers with a capacity in excess of 60 ounces.

Table: Recommended B.C. On-Premise Minimum Drink Prices

Product	Minimum Price Including Sales Taxes	Minimum Drink Price Per Std. Drink
Bottle/Can of Beer	$3.00 per 341/355 ml	$3.00
Draught Beer	$5.00 per pint	$3.00
Pitcher of Draught	$15.00 per 60 oz.	$3.00
Wine	$3.00 per 5 oz. glass	$3.00
Spirits	$3.00 per 1½ oz.	$3.00

A minimum price policy that distinguishes between certain products, or between serving sizes, sends a potentially dangerous message to consumers that consuming these drinks have different effects or implications. Indeed, the health evidence is clear that consuming a standard drink of draught beer is exactly the same as drinking a standard drink of a bottled beer.

7. Review and Modernize B.C. LCLB Liquor Manufacturer Inducement Rules with Consistent Enforcement

The B.C. Liquor Control and Licensing Branch initiated consultations last year with Industry representatives in regards to the rules and enforcement pertaining to manufacturer and licensee business relationships within the liquor industry.

These consultations were suspended subsequent to the launching of the last provincial general election campaign.

We believe there are three key drivers that motivated the LCLB's desire to engage in these consultations at this time:

- The policy decision to expand the number and type B.C. licensed liquor manufacturers permitted to deliver direct to private retailers and licensed-on premise establishments with such products not subject to any LDB liquor product mark-up;

- The elimination of the need for manufacturers and private retailers and/or licensed on-premise establishments from the obligation of keeping written records of their sales and promotional ("buy-sell") agreements; and

- The expansion of B.C. wines onto the shelves of certain grocery stores.

These three policy decisions combined to create, in the minds of certain industry players, the impression that the regulator was either no longer interested or no longer motivated to ensure existing restrictions on manufacturer – licensee business interactions would be enforced.

We believe it is essential for the return of an orderly market that long-standing restrictions be maintained and effective enforcement be applied on all industry players, regardless of size or product category.

8. "Tax Expenditure" Review Of Tax-Payer Subsidies to Liquor Manufacturers

The Government of B.C. continues to provide very significant policy and financial support for certain in-province liquor manufacturers. There may be significant value and benefit to some of these support programs.

However, it has been some time, if ever, that a fundamental review of these programs has been undertaken.

Similar to other provincial government "tax expenditures", the value of these programs and their beneficiaries should be published and available, publicly, online to improve the transparency of these programs and to ensure value for the tax dollars being spent. The general impression is that the value and benefit of a number of these programs actually accrue to some of the highest net worth individuals in the province.

Moreover, the expansion in the scope and magnitude of the overall level of policy support may have engendered other unanticipated consequences such as favouring of grape wine agriculture over food production, contributed to rising real estate values or other land use issues.

9. Alcohol Labelling Issues

The Province should refrain from introducing any new labeling requirements for beverage alcohol products as such issues are best dealt with at the federal level. Canada already has very extensive federal labeling requirements and a robust regulatory regime controlling nearly all aspects of beverage alcohol sales and distribution.

The main objective of the newly enacted Canada Free Trade Agreement (CFTA) and the work of the CFTA Alcoholic Beverages Working Group was to improve interprovincial trade and to reduce or eliminate non-tariff barriers.

New provincial alcohol labeling requirements, on the other hand, would constitute the erecting of new non-tariff barriers and additional new costs to accessing the Canadian beverage alcohol market.

10. Access to Supplier Own Brand Sales Information

Suppliers must have full access to product sales information by individual location in order to properly manage their businesses and investments. This includes specific shipment data from the BC LDB to individual retail stores and on-premise licensed premises.

In any open market, a supplier would contract with a distributor and would know on a daily basis their shipments by SKU to all its customers. It is only because spirits suppliers and manufacturers are mandated to be distributed through the BC LDB is this essential information not readily available to them.

In addition, the BC LDB should reinstate the general dissemination of its over-the-counter sales by store location.