House Liquor Control Committee
September 10, 2019

Written Remarks Submitted for the Record
On Behalf of the Pennsylvania Liquor Control Board Regarding HB 1512

Tim Holden, Chairman, testifying with
Mike Negra, Board Member
Mary Isenhour, Board Member
Charlie Mooney, Executive Director
Dale Horst, Director of Marketing
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Chairman Pyle, Chairman Deasy and members of the House Liquor Control Committee, thank you for this opportunity to testify regarding House Bill 1512. I am Tim Holden, Chairman of the Pennsylvania Liquor Control Board (PLCB). Testifying with me are Board Members Mike Negra and Mary Isenhour, Executive Director Charlie Mooney, Director of Marketing Dale Horst and Chief Counsel Rod Diaz. The General Assembly and the Governor, through Acts 39 and 85 of 2016, fundamentally changed the PLCB's product pricing authority, which is now commonly referred to as flexible pricing. Over the past three years, the PLCB has sought to implement flexible pricing in a fair manner for both our suppliers and customers. This morning I will briefly provide background on the agency's pricing history and summarize our current policies related to flexible pricing.

Prior to Act 39, the Liquor Code required that the PLCB apply a uniform mark-up on all products. It is often stated that the agency is one of the largest purchasers of wines and spirits in the United States; however, proportional pricing prevented the PLCB from reaping any benefit from its economy of scale or applying basic supply and demand principles to pricing products.

Throughout the history of the agency the product mark-up structure has varied. Immediately before the implementation of Act 39, the PLCB assessed two standard, straight percentage mark-ups (a one percent, then a 30 percent mark-up) and a handling fee called the Logistics, Transportation and Merchandising Factor (LTMF). The statutory 18 percent liquor tax was applied to the retail price after the PLCB's mark-ups were assessed. Act 39 did not change the liquor tax or how it is applied to the retail shelf price.

While the PLCB had discretion to set the mark-up structure, the mark-up had to be applied equally across the product portfolio regardless of whether an item was a mass market chardonnay or a limited-release bourbon. The General Assembly and the Governor recognized this opportunity to reform the pricing structure. As a result, Act 39 allowed the PLCB to no longer use a proportional mark-up structure when pricing its best-selling, limited-purchase and discontinued items. As a practical matter, flexible pricing under Acts 39 and 85 provided the agency with discretion to negotiate product acquisition costs and set the retail price of an item based on specific business factors rather than a one-size-fits-all mark-up.

Three years have passed since Act 39 became effective. During this time the PLCB's approach to flexible pricing has become a standard part of our business model. The agency remains focused on two priorities regarding product pricing. First, maintain fair and competitive prices for consumers on an assortment of products that delivers quality, value and variety. Second, maximize revenue for the Commonwealth to support important General Fund programs that benefit all Pennsylvanians.

Flexible pricing negotiations are not one-off meetings but are rather perpetual conversations with our suppliers. Cooperation between suppliers and the PLCB is central to the success of both parties and the customers we ultimately serve. Our product category managers work closely with suppliers to assess products based on a wide range of market-driven criteria. Product acquisition costs, incremental margin considerations, projected category trends and the manufacturer's suggested retail price are all analyzed as part of the product evaluation process. Retail price adjustments are determined on an item-by-item basis after examining Nielsen sales data from retailers in states bordering Pennsylvania, market demand, key price point thresholds, and comparison of an item's price to its category peers. While the PLCB ultimately determines a product's retail price, some price adjustments are implemented at the request of suppliers. It is also important to note that all special pricing allowances, which are limited-time, supplier-funded product sales, are passed along directly to customers.

The 2016 liquor reforms have had a multifaceted impact on the PLCB and the beverage alcohol marketplace in Pennsylvania. Given the complexity of these changes, it is difficult to isolate the discrete fiscal impact of flexible pricing. Perhaps the best indicator of the financial impact of flexible pricing is the PLCB's financial returns since Acts 39 and 85 were implemented. While not solely attributable to flexible pricing, one indication of the impact of flexible pricing is the substantial growth in the PLCB's net income since Act 39 became effective. Net income increased from $103.9 million in fiscal year 2015-16 to $158.2 million in 2017-18, and $191 million in the most recent fiscal year.

The PLCB has been and continues to be receptive to feedback from its suppliers and the stakeholder community regarding the imposition of flexible pricing, and changes to procedures have resulted from such engagement. For example, suppliers have recently communicated concerns about the timing of retail price changes and the impact of these changes to suppliers' annual marketing plans. We are currently evaluating possible solutions to these concerns and optimistically anticipate a mutually beneficial resolution.

The PLCB would also like to address a recent letter sent to Governor Wolf from a coalition of international wine and spirits trade associations that asserted the flexible pricing model from Act 39 violates international trade law. Foremost, international trade law actions cannot be taken by industry trade groups, but rather occur between countries regarding behavior between federal governments. We are unaware of any government seeking review or repeal of Pennsylvania's flexible pricing law, and we question the General Agreement on Tariffs and Trade's applicability to state governments and the PLCB. Further, while the World Trade Organization does prohibit a higher tax on imported goods than on domestic products – if the intent is to protect the domestic marketplace – that does not mean a standard alcohol mark-up is the only way to ensure fair treatment of international producers. Let us affirm: the PLCB does not engage in preferential treatment of any supplier or country of origin, and therefore passes the three-part test established for evaluating trade law violations. Regardless, the PLCB has reached out to both the National Alcohol Beverage Control Association and the Office of the U.S. Trade representative to pursue conversations ensuring Pennsylvania's law doesn't run afoul of international rules.

Thank you for this opportunity to provide an update on the implementation and status of flexible pricing. We would be pleased to answer questions from the members of the committee.