Wine Council of Ontario

4890 Victoria Avenue North, P.O. Box 4000, Vineland Station, Ontario L0R 2E0

Regulatory Modernization in Ontario's Beverage Alcohol Industry

- *ALCOHOL AND GAMING COMMISSION OF ONTARIO*

Wine Council of Ontario
September 20, 2013

Submission Overview

The Wine Council of Ontario is pleased to submit its comments and contributions to the Alcohol and Gaming Commission as part of its Regulatory Modernization initiatives.

The Submission will offer to the AGCO commentary on the following areas:

- Reducing the Administrative Burden – including concrete proposals around the rationalization of licensing, audit processes and other required filings and reporting
- Removing Barriers to Job Creation and Economic Growth – This would include areas like creating opportunities for wineries to enhance their offering to consumers, enabling industry consolidation, eliminating restrictions on geography and content and leveling the playing field with import competitors and within the Ontario industry. This would include enabling the government of Ontario to expand the retailing of wine in the province.
- Other Issues – This would include celebrity engagement in the industry, frequent buyer promotions, commentary on inducement rules, aligning sampling guidelines with the needs of tourism and the consumer, sales on credit to licensees and facilitating the extension of the business with a distilling licence.

In addition, it is critical that we take the opportunity to highlight other areas that, while out of scope for the AGCO, are certainly part of an intricate and interrelated regulatory framework for this industry. This will include what we might describe as "legacy" regulations and frameworks that the broader Government might want to consider as it rightly moves to address these specific issues that this consultation contemplates. This would specifically focus on the role of the LCBO as a regulator.

- LCBO Issues – This would include off-site warehousing, delivery charges to licensees, and winery pricing policies.

On all of these issues it is our intention to provide relevant data and commentary that might be helpful to the AGCO as it considers its options.

About the Wine Council of Ontario

The Wine Council of Ontario (WCO) is the champion of Ontario's high quality, authentically local Vintner's Quality Alliance (VQA) wines and of promoting wine country as a destination.

As a non-profit trade association, WCO represents 90 wineries from across the designated viticultural areas of the province and in the emerging wine regions across Ontario. We represent the vast majority of commercially active wineries in the province and the majority of VQA sales by value.

Our members are small and medium sized enterprises - they are grape growers, manufacturers and leaders in tourism in their communities. We are leaders in manufacturing and investment across rural Ontario.

Our members are the future of Ontario's wine industry, which is a source of new investment.

The Wine Council of Ontario promotes the unique qualities of Ontario's locally grown wines through its consumer facing brand Wine Country Ontario. The Wine Council is the partner of the Government of Ontario and its Ministry of Economic Development, Trade and Employment in the delivery of the Ontario Wine Strategy and its related funds for investment in industry marketing initiatives.

We believe that wine can be and is a powerful tool for enhancing our culture and our Ontario brand.

We own and operate key tourism assets like the Wine Route and hold the Wine Country Ontario brand.

Reducing the Administrative Burden

Never have so many well intentioned gestures and policies worked to create a complicated and frustrating web for wineries in Ontario. This is acutely illustrated when looking at the licensing procedures for wineries in Ontario

Currently, manufacturers of wine are required to obtain multiple licences or authorizations from the AGCO to operate their businesses. This is despite the fact that many different activities (as currently defined) are actually part of the same overall business model. This overlap of the existing licensing regime causes unnecessary expense, operational inefficiency and undue paperwork.

Recommendation #1 – 2 licenses only for wineries in Ontario with a common renewal date and process

In reviewing all elements of the business, it is our recommendation that only two licenses are required:

1. A hospitality licence that should include, but not be limited to, tied houses, sales of wine by the glass, the ability to pour at trade and consumer shows and any other location where wines can be showcased to the public.

2. A manufacturing licence that will relate strictly to production issues. All licenses should confer the same benefits on every winery regardless of date of establishment.

Though some might suggest that a singular licence makes sense, we have heard concern from many wineries that they would not want to have the operations in the hospitality side of the business create any problems for their manufacturing side of the business if there were any violations and vice versa.

This common approach to licencing would also make it easier for wineries to deal with planning and development issues with the municipality. In submitting plans for development and approval, it will be much simpler to deal with the demands and understanding of the uses permissible on the property if there in universal permission to conduct the full range of business (potentially with conditions), rather than anticipate adding permissions as the business grows and evolves.

Renewal periods should be synchronized. They should also be multi-year in line with the AGCO's risk-based approach to licencing.

This change should be simple. This has been a challenge long reviewed by various ministries within the government and at the AGCO itself. The suite of licences and authorizations is well understood and never once has there been a suggestion that an effort like this would create unnecessary complications. Quite the contrary - what has been missing in the past has been the framework for action that this consultation and workplan from the AGCO has provided. As wineries we are confident that this change is manageable and impactful and would encourage the AGCO to move quickly in addressing this Open for Business issue.

Recommendation #2 – Adopt a risk based approach to the renewal of the two new winery licences.

The approach for licencing should focus less on prescriptive rules and more on the identification and management of risk and the promotion of compliance by licensees. A "risk-based" model would be much more efficient for wineries in performing business administrative operations, and it would encourage good business practices by all licensees. This should also result in efficiencies at the AGCO, and allow the AGCO to focus its resources where they will have the greatest impact (as opposed to unnecessary and redundant administration).

At a minimum, if a licensee's business has not changed over the licence period, there have been no changes in the licensee's ownership structure and no licence infractions have been incurred, the renewal process could consist of a written assurance that no material changes in the business have occurred since the last application/renewal. In addition, license periods could be extended (i.e. the 2-year period for Manufacturers' Licenses could be extended to three).

All licencing, whether it be the types and number of licences that exist now, or if we can move to a 'two licences' system, would benefit from the adoption of risk-based principles. This would include, but not be limited to:

- Wine manufacturing
- Retail stores
- Tied Houses
- Wine By-the-Glass
- Manufacturers' Representatives
- Special Occasion Permits
- Auction Authorization

Recommendation #3 – Adopt a risk-based approach to the audit function and extend time periods between audits to reduce the burden on wineries.

Currently, various types of liquor licensees and operational and financial reporting are subject to annual audits by multiple government agencies and organizations to ensure compliance with regulatory requirements in such areas as provincial and federal taxation, manufacturing practices, alcohol content and quality, retail sales, and inventory.

Specifically in the wine sector, several different agencies and organizations collect audit-related information from wineries each year (including the AGCO, the LCBO, the Ontario Ministry of Finance (and Ministry of Revenue), the Canada Revenue Agency (Taxation and Excise) and the Vintners Quality Alliance of Ontario (VQAO). While the LCBO conducts audits on behalf of the AGCO and the VQAO, the majority of these audits and inspections are generally conducted separately by each individual organization. MANY of these audits involve the gathering of exactly the same information – the result is enormous duplication of efforts, and inefficiencies in winery staff time (often involving winery principals).

Currently, the AGCO designates the LCBO to audit the wineries' operations as often as every 6 months. With a more appropriate risk-based approach, these audits could be done less often (once per vintage as an example).

Recommendation #4 – Create an environment where shared data is accepted by audit agencies and ensure redundancies in the audit of wineries are eliminated.

There are many examples of duplicate information, redundancies and audits by different organizations, including:

- Ministry of Revenue conducting detailed audits to verify that wineries correctly submitted ZERO taxes with respect to promotional (no sale) wine.

- CRA Excise conducting audits of wineries with post-1993 Manufacturers' Licences – these wineries can only manufacture 100% Canadian wine, so it is impossible for them to have excise tax payable.

Within the various documentation and filing requirements that currently exist, there are also a number of instances where required information appears to be redundant and unnecessary. This includes:

- The monthly LCBO reporting form (J10) is an Excel spreadsheet which requires significant manual data entry every month; as a result, this is a very time-consuming, inefficient use of winery administrative personnel. There should be increased automation of this process.

- The LCBO also requires an annual reporting form (J11), which requests summary information of what was submitted in the J10 forms. This is completely redundant, and should easily be accommodated through automation.

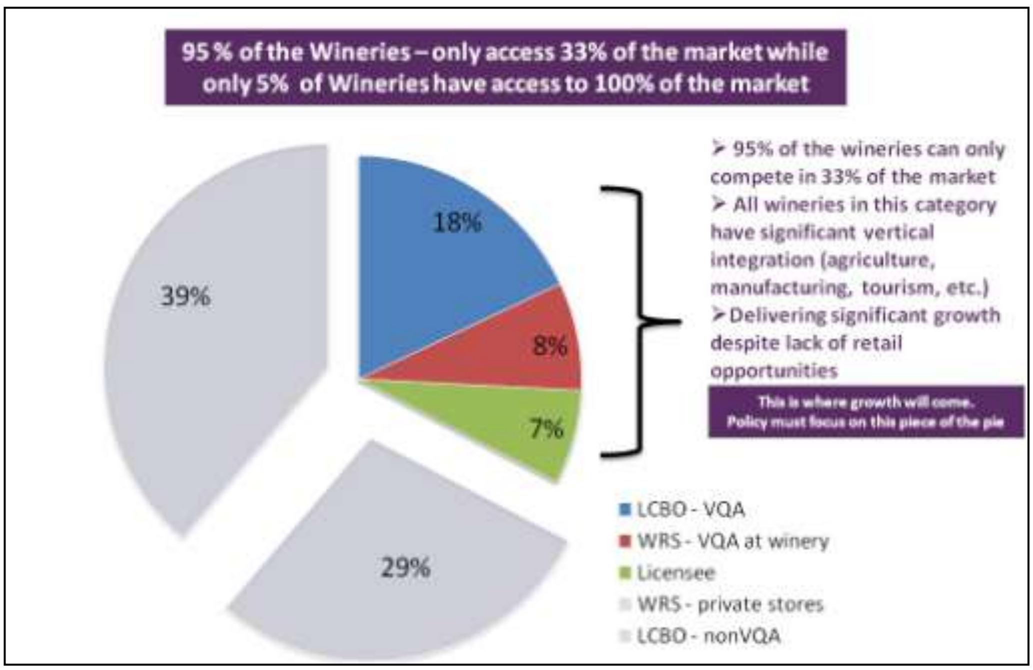
The J11 also requires the winery to submit certain information with respect to HST (and ITCs), excise taxes, exports and interprovincial sales, which are irrelevant to the LCBO and should not be required.

On the other hand, the J10 filings currently do NOT require wineries to separate their retail sales between 'on-site' winery stores and 'off-site' stores (located in grocery stores, strip malls, etc.). Asking wineries to provide this information is not onerous, and would provide valuable information to the Province to make informed policy decisions, and the industry at large.

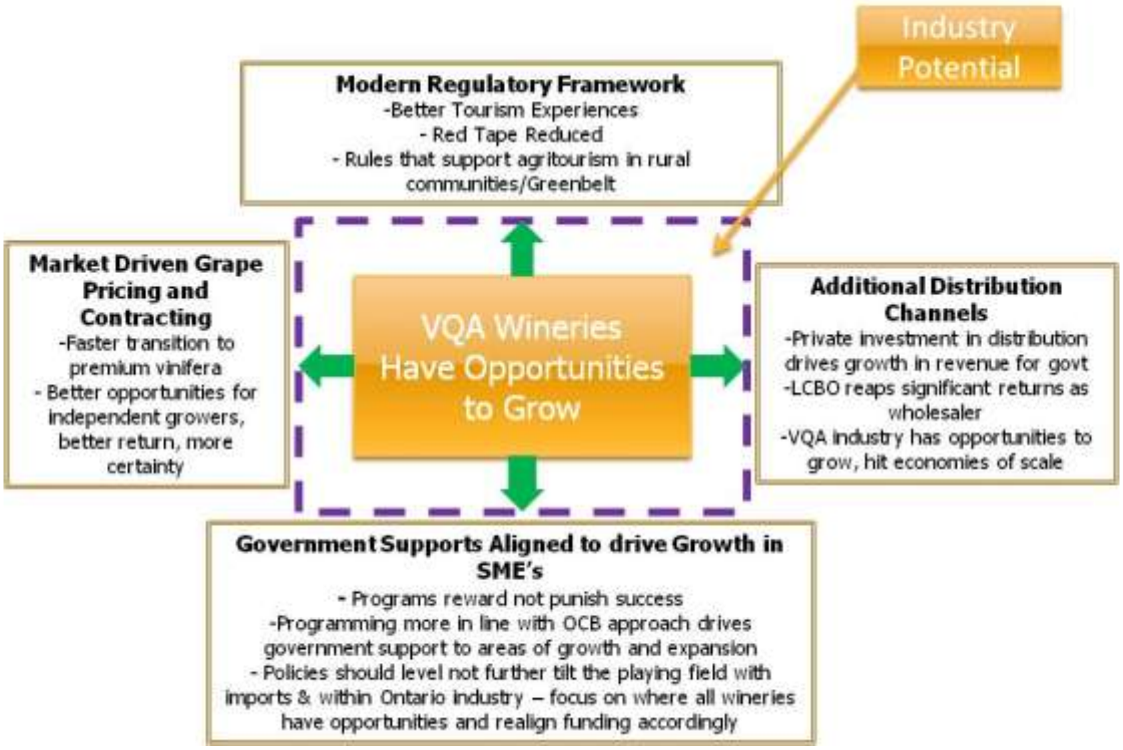
Removing Barriers to Job Creation and Economic Growth

The economic impact of the wine industry is seen across Ontario. Whether it be the doubling of investment in wineries in Prince Edward County or the significant capital investments being made across the province, one thing is clear – the VQA wine industry is unique in its ability to deliver return to the economy. No other sector in Ontario drives growth in agriculture, tourism, manufacturing, sales and marketing, and retailing at the same time. As well, wineries remain and will always remain invested here in rural Ontario. To make our products we need to be here and stay here. There is no risk of outsourcing our success.

What is less understood at how focused the policy framework needs to be in order to build and support the growth and success of VQA going forward. It is the stated policy of the province to support VQA wines. This means a sharp focus on those areas where all wineries have access to the market. This should be considered in evaluating all proposals as they emerge. Policy changes designed to support areas that are only meaningful to 5% of the wineries in the province does not make sense.



In focusing the policy efforts in the area of economic development and sectoral growth, it needs to be understood that the real challenge to our wineries is that they are not allowed to grow and evolve in a way that other industries are able to do because of the regulatory framework around our business.



It is important for the AGCO and the government more broadly to appreciate these burdens and how far reaching they are. Though not all of these challenges are within the scope of the AGCO, it is important to appreciate the opportunities to grow our business that are vested collectively in regulations across government. The changes that might be finally recommended by the AGCO will address a small part of the challenge, but to truly be impactful it will take an effort across the government to truly rectify the structural challenges and regulatory restrictions that impede the full development of the potential of our industry.

We have both responded to the direct issues contemplated by the AGCO's policy review and some broader issues, all within the same legislative framework that would address some of the challenges noted above and would hope that these would all be considered when it can be seen how they all interrelate to a broader picture.

Recommendation #5 – Allow for more flexibility for wineries to enhance their retail offering

In 2001, the AGCO adopted existing LCBO policies governing the eligibility and operation of manufacturer retail stores, including rules governing the sale of non-liquor products ("ancillary items") at stores. There were 50 VQA wineries in 2001 – there are nearly 150 today. While a number of piecemeal changes have been made to the AGCO's manufacturer retail store policies over the years, core policies that have existed for so many years do not facilitate the creation and expansion of economic growth in the industry.

All beverage alcohol retailers should have exactly the same rules with respect to the sale of ancillary items. There is no need for the AGCO to play ANY role with respect to selling 'ancillary items' in any store. Retailers should be allowed to be creative and responsive to consumer demand, by being allowed to sell any products they would like to (including food and food-related products) (subject to established alcohol-specific regulations/policies).

The following amendments to retail store policies would encourage innovation at retail, while respecting international trade obligations:

- Allow, even on a limited basis, cross-selling of other manufacturers' (wine) products at (winery) on-site stores. This is already done for special instances of 'co-packing' (i.e. gift or commemorative boxes).
- Allow the sale of wine to third-party companies for resale in gift baskets (for both personal and corporate gift baskets).
- Allow wider (even unlimited) range of ancillary items for sale at on-site stores
- Allow sale to consumers of bottles of wine at Farmers' Markets, trade and consumer shows and events (as an extension of winery retail store sales).
- Allow case (volume) discounts on sale of wine – although this is allowed now, it is done through an apparent 'loophole' in existing policies.
- Allow wineries to donate wine to charitable organizations for purposes of fundraising (silent or live auctions, door prizes, etc.).

Recommendation #6 – Enable industry consolidation to allow for blending of products when one winery purchases another at both sites.

As an industry, the Ontario wine business has not evolved in the ways of traditional SMEs. Where it has significantly lagged is in the area of industry consolidation. While at 30 years of age you would expect the industry to have contracted through consolidation a number of years ago, in Ontario we haven't and it is significantly a function of the regulatory environment.

The AGCO should enable a mechanism whereby wineries would be able to market products from one site to the next if they acquire another winery and all of its licenses. Right now the two entities would have to continue as a stand-alone concern. What needs to happen is to allow those two stores to market each others' products.

Recommendation #7 – Remove legacy regulations around geography and content.

Wineries located outside DVAs currently have to produce a minimum of 50% of its total wine from grapes grown within its own 'territory' ('territory' is not defined). Currently, any/all wineries that have production problems in one year are exempted from this policy with permission from the AGCO – a permission that has been granted every time. Because the AGCO has consistently allowed a variance in a policy, it should signal to all that the policy has run its course. With more wineries expected to open outside of DVAs rather than inside it is critical that this policy should be abandoned, as it unfairly harms the business operations of any winery outside of a DVA.

Recommendation #8 – Allow wineries to operate on a level playing field with its import competitors

When wineries in Ontario were granted the right to direct deliver product to licensees, one of the punitive aspects of the rules was to prohibit the charging of fees for delivery to customers. This is in contrast to importers being able to pass through other charges in lieu of delivery fees to customers. This needs to be rectified. As part of its initiative the AGCO should ensure that all wineries in Ontario be able to charge a fee for delivery of product to licensees if it chooses to do so.

Expanding Distribution will Grow Ontario

A significant element not noted in the AGCO discussion paper was the ability of the AGCO, with a Liquor License Act change, to expand the options for government around the sale of wine. As we have noted earlier in our submission, limitations on distribution continue to restrict the growth and efficiency of Ontario wineries and also continue to exacerbate the unlevel playing field between pre and post 1993 licensed wineries.

Recommendation #9 – Amend the LLA and its regulations to allow the government, if it chooses to do so, to expand sales of wine to consumers by a new class of licensee.

This can be enabled quite simply in the following way:

1. Enable the AGCO to establish Independent Wine Retail Stores

    - Amendment of 3(1)(d) of the Liquor Control Act (LCA) to allow the establishment of Independent Retail Wine Stores.
    - Amend Table 1 of Ontario Regulation 141/01 to assign to the Registrar of the AGCO the powers that would otherwise be assigned to the LCBO.
    - Section 3(1)(g) should also be modified so that the Registrar can determine the municipalities within which Independent Retail Wine Stores shall be established or authorized and the location of such stores in such municipalities.
    - Amend Section 8 of the LCA to authorize the Lieutenant Governor In Council (LGIC) to make regulations governing the operations of these stores by adding parallel clauses to clauses c-f in the section that would applicable to these stores.
    - Amend the General Regulations of the LCA such that the Registrar is able to set hours of operations for these stores.

This approach would remove the LCBO – a direct competitor of the nascent retail establishments – from the process and provides some protection against predatory behavior.

2. Allow for the creation of a licence which permits the operation of stores

    - Amend Section 6 of the LLA to allow a person to apply the Registrar for a Licence to Retail Wine. Make requirements identical to those in Section 6(2).

- ❖ Apply the prohibitions in Sections 6(4), 6(4.1), and 6(4.2) to apply to Licenses to Retail Wine. This would prevent manufacturers from entering and controlling the market.

- ❖ The LGIC would be able to make regulations relating to the issuance of licenses in concert with those in the LCA.

- ❖ Amend Regulation 8 of the Licenses to Sell Liquor Regulations to indicate that it captures both a License to Sell and a Licence to Retail. This would include adding an additional class of licence at 8.1 that would authorize the retailing of wine and articles incidental to the consumption of wine by Independent Wine Retail Stores to members of the public

- ❖ In order to maintain certain public policy objectives it is assumed that there would be similar conditions on a Licence to Retail Wine similar to those in Section 22 of the Regulations.

3. Make it lawful for members of the public to purchase wine from Independent Wine Stores.

    - ❖ Amend Section 27 of the LLA to provide that no person shall purchase liquor from a government store or from a person authorized by a licence or permit to sell or retail wines.

    - ❖ Amend Section 33.1(1) to ensue that persons can purchase for personal use wine from Independent Retail Stores.

4. Allow holders of a licence to retail wine to purchase wine in the same manner as holders of a licence to sell.

    - ❖ Amend Section 31 of the LLA to align provisions from Licence to Retail with Licence to Buy.

    - ❖ Add Section 31.2(1) which would provide that a holder of a licence to retail wine may keep for sale and sell only wine the holder has purchase from a government store. This will maintain the LCBO's role as the importer of record for non-Ontario wine.

    - ❖ Section 31.2(2) should be added to provide that when purchasing a wine under the Retail Licence that the licence holder should provide the government store with the licence number.

    - ❖ An amendment to Section 32.1(1) would require a holder of a Licence to Retail Wine to keep in stock and offer for sale a variety of wines from a variety of manufacturers. This provision would preclude a Retail Licensee from stocking wines from a single manufacturer.

5. Allow VQA Manufacturers to Direct Deliver to holders of a Licence to Retail Wine

    - Amend the current licencing framework in Section 5 of the Liquor Licence Act such that there is no restriction under Section 5(4) and its related regulations. This would ensure that the holder of a manufacturer's licence or a licence to represent a manufacturer is not prohibited from selling or delivering wine from a manufacturer to a retail licensee. Such a sale, replicating the current direct delivery process, would be deemed a sale from a government store under the LLA.

    - Direct Deliveries are LCBO sales. The Direct Delivery Authorization Form, a standard form contract drafted by the LCBO, requires amendment to reflect that a wine manufacturer may direct deliver to holders of a licence to retail wine.

6. Allow for minimum pricing legislation to be applied to Independent Retail Wine Stores

    - Amend Section 15 of the Minimum Pricing of Liquor and Other Pricing Matters Regulations from the LCA such that Section 15.1 is added to provide that the operator of an Independent Retail wine Store shall not acquire wine for retail at a cost that is less than the reference rate established in accordance with the regulations.

Through this approach, the government of Ontario would be able to control the size and scope of an expansion of distribution of wine. This is a prudent approach and is worth considering if this process is truly serious about expanding the economic growth potential of VQA wines.

OTHER ISSUES IN THE SCOPE OF THE REVIEW

Recommendation #10 – Amend the current policies around the use of celebrities to facilitate legitimate business ventures that include celebrity participation.

Current policy disallows celebrity endorsement of wine; this policy precedes the current industry landscape which includes wineries owned or associated with certain celebrities (i.e. Aykroyd, Gretzky, Weir). While advertising rules restricting celebrity endorsements as they apply to underage, lifestyle and other inappropriate associations should remain, the policies should be adapted to reflect legitimate business ventures that include celebrity participation (whether through ownership or otherwise).

Recommendation #11 – Allow for frequent buyer promotions or other similar promotional programs.

Wineries should be able to operate "frequent buyer programs" as other businesses are able to do. This would encourage creativity, innovation and competition within the industry.

Recommendation #12 – Abolish the inducements rules if they are not going to be enforced and if there are to be rules, ensure full disclosure by both manufacturer and licensee.

Inducements to licensees by Manufacturers are not allowed under existing Liquor Advertising Guidelines. However, not only do inducements occur on a wide-spread basis, this practice is well known and accepted in the industry (by licensees and Manufacturers). To date, the AGCO has not been able to correct this practice. Due to the obvious challenges in enforcing this policy (including necessary significant increases in inspecting AGCO staff), this policy should be abolished. In other jurisdictions, inducements are allowed on a basis of full disclosure.

Most importantly, there should be NO guidelines or policies in effect which cannot be enforced – this leads to an uneven playing field where Manufacturers' are forced to make moral and ethical judgments on an individual basis. Due consideration should be given, prior to the establishment of any policy or guideline, of AGCO or other enforcement capacity.

Recommendation #13 – Ensure that all of the sampling guidelines allow for a positive connection between customer and winery and allow for ease of winery engagement in existing opportunities like festivals.

The existing sampling guidelines require a full-scale, comprehensive review, to providing greater clarity and better targeting of the risks associated with sampling activities. There are a number of overly prescriptive and inconsistent rules in the Sampling Guidelines that should be reviewed.

Festivals, trade/consumer shows should NOT have to pay for wine ‘up front’, which is in turn to be sampled/sold during the event. Many events where there are not admission fees have ceased operation (i.e. Fiesta Buckhorn) because they could not finance the product prior to the event (including a 15% premium) – this hurts not only Manufacturers, but other event participants (local industry) and tourism in general.

Recommendation #14 – Modernize rules to facilitate a better and more competitive sales environment and innovation.

The following policies would help to improve competitiveness and fairness within the wine industry, make it more comparable to other jurisdictions, and generally modernize regulations and policies:

- Allow sales to licensees on credit. Although this is specifically disallowed under current regulations, abuse is widespread and unenforced. It is significant that sales NOW from manufacturers to the LCBO are done on credit terms of 90 to 120 days.

- Certain wineries would also like to have a Distilling Manufacturers’ license (to produce distilled spirits for sale and use in fortified wines). Current policies make this an onerous process.

Regulation without a Conflict of Interest

It is critical that we take the opportunity to highlight other areas that, while out of scope for the AGCO, are certainly part of an intricate and interrelated regulatory framework for this industry. This will include what we might describe as "legacy" regulations and frameworks that the broader Government might want to consider as it rightly moves to address these specific issues that this consultation contemplates. This would specifically focus on the role of the LCBO as a regulator

Recommendation #15 – Review the rules currently written and enforced by the LCBO in the interest of fairness and recognition of the inherent conflict of interest where the LCBO is both regulator and competitor. This could include repatriating some of these regulatory functions, if they are still required, to the AGCO.

Current practice is that the LCBO, the principal customer of Ontario wineries, has jurisdiction over many policies which Manufacturers must follow. In many instances, this results in a blatant conflict of interest. ALL alcohol-related policies in Ontario should be under the jurisdiction of the AGCO. Such policies include:

- Manufacturers' should have the ability to maintain off-site warehousing for direct distribution to licensees or LCBO

- Delivery charges should be allowed on VQA wines sold directly to licensees

- Currently, if a wine SKU/bottle is sold at both the on-site retail store and through the LCBO, the price of that bottle must be identical at both channels. Wineries should be allowed to sell these wines at prices ***equal to or higher*** than the LCBO (which would still respect the fact that wineries should not 'undercut' sales through the LCBO).