

COVID-19 RESOURCE CENTER

A Pandemic Survival Guide for BC Wineries – Part 3 What Regulators Can do to Help

May 5, 2020

Introduction

British Columbia's wineries are quickly developing new business strategies that will allow them to survive and prosper in the post-pandemic recessionary world. These new business models require accommodating regulatory changes.

The *Liquor and Cannabis Control Branch* and other regulators need to act quickly and decisively to implement the required changes. Failure to do so will deny BC wineries the flexibility required to adjust their business strategies in response to the pandemic and the coming recession.

Details of required regulatory changes

The package of regulatory changes that are required now include the following:

- 1. Are you ready to ship to Ontario beginning July 1st?**

The pandemic has caused an immediate seismic shift in the relative importance of the different sales channels for Canadian wines. With the loss of the hospitality channel and the likely weakness of tasting room sales this summer, BC wineries are relying more heavily on internet sales and direct delivery to consumers. Unfortunately, growth in this channel is geographically limited by prohibitions on inter-provincial direct-to-consumer shipping. Selling into Ontario through the LCBO is not a viable alternative for small producers who cannot supply the necessary inventory volumes or bear the high margins imposed by the LCBO.

BC producers are denied access to 80% of the Canadian market by provincial restrictions on the shipment of wines across provincial boundaries. Eight years ago, the federal government removed prohibition era restrictions on wine trade and BC opened its borders to producers from other provinces. Other provinces did not reciprocate and, in fact, in some cases tightened their restrictions on wine shipments entering their provinces.

It looks like all of this is about to change, thanks to Doug Ford. Last year, when he tightened the restrictions on wine shipments into Ontario by requiring consignment through the LCBO, he built in a 'sunset clause' providing for the automatic expiration of the restrictions on July 1, 2020.

FARRIS

Unless there is some sleight of hand going on here, beginning on Canada Day, BC wineries can freely and openly ship to customers in Ontario. The Canadian wine industry owes a shout out of gratitude to Premier Ford. The next step is to put pressure on Premiers Kenney and Legault to follow Premier Ford's Leadership.

BC wineries need to immediately organize an industry wide marketing campaign reaching out to Ontario consumers. The days of grey market shipping are over. Now that inter-provincial shipping to Ontario is legal and above board, we need to begin openly and aggressively promoting the availability of BC fine wines in Ontario. BC needs to re-activate the position of Honorary BC Wine Envoy to lead as our brand ambassador in building awareness of BC wines across the country. The timing couldn't be better, with a resurgent Canadian nationalism, an increased focus on strengthening our domestic supply chains and stay at home consumers seeking direct delivery of Canadian wine for stay-at-home dining.

Expect Ontario to preserve provincial revenues by requiring shippers to collect and remit sales and other taxes and bottle deposits. To protect LCBO revenue streams, products stocked by the LCBO may be excluded. The next step is to follow the USA by permitting cross border shipments by retailers.

2. Licensing of outdoor tasting rooms.

Wineries are likely to focus mostly on outdoor tastings this summer. Consumers perceive outdoor activities as safer and no doubt they are.

The *Liquor and Cannabis Regulation Branch* needs to fast track the development of a manufacturer's license endorsement that permits wineries to set up an outdoor area, probably under a canopy, where they can conduct tastings, store inventory for immediate sale and process transactions remotely (using an iPad, for example). This could be achieved by expanding the picnic endorsement, which currently allows guests to consume wines purchased from your winery in defined outdoor areas, to also allow sampling in those areas. This shouldn't be a hard concept for regulators to accept since it is essentially the same set-up as wineries are permitted to use at farmers' markets.

Absent such an endorsement, the basic license terms cover sampling as part of a guided tour of your establishment. The 'guided tour' clause opens up the opportunity to conduct outdoor tastings as part of a vineyard tour. This could presumably include a sit down private tasting as part of the tour. For wineries with an outdoor patio attached to their winery, a patio endorsement allows tastings on a patio, but proper social distancing protocols will have to be adhered to. To help wineries open this summer, the LCRB needs to develop a fast track application process for license endorsements.

3. It's time to allow secondary tasting rooms.

Right now, land-based or farm-gate wineries are required to locate their tasting room on site, at the winery. Secondary or satellite tasting rooms located at sites other than the winery are

FARRIS

prohibited. This has resulted in over-building on agricultural land as wineries have added restaurants, accommodation and concert and wedding facilities in response to customer preferences for a more complete tourist experience. The unavailability of licenses for secondary tasting rooms has distorted the growth of wineries, and forced on-site development by prohibiting the location of tasting rooms in urban centres and rural towns.

A little history might be useful. The basic requirements to obtain a license for a land-based or farm-gate winery are a 4500 litre facility on a minimum 2-acre vineyard, with at least 25% of your grapes coming from owned or leased vineyards. Most start-up wineries start somewhere between this minimum required scale and a 2000-5000 case facility. Over the last 12 years of economic prosperity, the successful wineries have grown to 10,000 to 20,000 cases; and sometimes to 40,000 or 50,000 cases.

As the successful wineries have grown, they have added restaurants, lodging, merchandise, concert facilities, parking lots and wedding venues. The proliferation of these multi-purpose facilities has drawn the attention of the *Agricultural Land Commission*. Lands within the Agricultural Land Reserve are supposed to be dedicated to growing crops and furthering food security, together with limited ancillary activities. Over-development of ALR lands reduces cultivable acreage and creates problems such as noise pollution and intoxicated drivers on rural farm roads.

It makes sense to impose a moratorium on the further construction of large multi-purpose winery complexes, with grand personing for existing facilities. But this has to be done in a way that is fair to up and coming wineries. The obvious solution is to permit land-based/farm-gate wineries to establish secondary or satellite tasting rooms in major urban areas in proximity to large customer bases (an example is Woodenville, a suburb of Seattle), or to cluster wineries in small rural towns where customers can easily walk from one tasting room to another. (An example is Walla Walla, Washington). Either way, wineries will end up being located in close proximity to restaurants, hotels and entertainment venues.

This solution would treat land-based wineries in a manner that is even-handed relative to the treatment of commercial wineries. Wineries with a commercial license are not required to locate their tasting rooms in a rural vineyard setting, but may locate on municipal or industrial properties. A good example is the wineries going into the new District Wine Village currently being constructed north of Oliver. This business model involves a clustering of wineries, distilleries and breweries, along with restaurant and food services and an entertainment venue; all on a shared property. The wineries share some production facilities, such as a shared crush pad, and co-market their brands.

Land-based/farm-gate wineries should be allowed to add secondary or satellite tasting rooms by way of an endorsement on their manufactures license. With travel and tourism likely to be significantly reduced in the coming recession, the time has come to allow wineries to open secondary tasting rooms in urban centres nearer to their customers. The licensing of secondary tasting rooms was recommended by the Yap Committee liquor policy review in 2013 and still

hasn't been implemented. Now is the time. Washington and Oregon states and other competing jurisdictions allow secondary tasting rooms and they are very popular with consumers.

4. Licensing should encourage co-operative tasting rooms and other joint ventures within sub-appellations.

Similarly to what is allowed in other jurisdictions, such as Washington and Oregon to the south, BC wineries should be allowed to market their products in shared or co-operative tasting rooms where guests can sample the wines of several producers in one venue. Again, there are obvious cost economies.

The existing BC licensing rules do not allow wineries to operate tasting rooms on a shared or co-operative basis. Each winery must have its own tasting room. What is wrong with a group of Naramata producers jointly selling their wines in a tasting room operated by the Naramata Wine Vault; or the 'heart of wine country' producers setting up their tasting tents at one scenic and easily accessible winery location so as to realize optimal cost economies this summer when tourist traffic is expected to be light; or neighbouring wineries, distillers and brewers selling each other's products.

As we enter the coming recessionary period, smaller wineries are going to have to do whatever they can to reduce costs and increase efficiencies. Co-operative tasting rooms might be one of the cost saving strategies that get us through this. Most small BC wineries are under-scaled, and now that much leaner economic times are here they need to do more to reduce costs by joint venturing. The certification of sub-appellations is already spawning increased cooperation and joint venturing among regional producers sharing a common terroir. Licensing rules need to be changed to encourage joint ventures and co-operative endeavors.

5. We need to expand the grocery store channel.

The grocery store channel has proven to be a strong sales channel for small BC wineries. Sales have boomed during the pandemic and this will continue during the coming recession as cost conscious consumers eat and drink more at home, with a focus on locally sourced products.

The Province needs to lift limitations on the number of grocery licenses and municipalities, such as Vancouver, need to ease zoning restrictions. Consumers are now cooking and eating more at home and will continue to do so. Currently over 50% of meals are being eaten at home, a statistic that hasn't been seen since the 1970's. Consumers want local wines with their locally sourced fruits, vegetables, meats and cheeses. Fears that the grocery channel will quickly be flooded with cheap foreign product are overblown. Consumers now have an enhanced appreciation of the value of local supply chains. As the effects of the crashing dollar filter through distribution channels, the prices of foreign wines will increase substantially.

Of necessity, stay-at-home consumers are now picking their wines without the guidance of a restaurant sommelier, and small wineries need to increase their participation in in-store tastings

to help consumers to select the right wines once social distancing restrictions are lifted. In communities where there is no wine in grocery, focus on cultivating your relationship with private retailers, most of which are located adjacent to grocery stores.

Similarly, the Province needs to modernize the remaining private wine store licenses held by manufacturers, and to restore those licenses recently cancelled. Limiting these licenses to sell the products of only one or a few producers in stores owned or leased by these producers made them of limited value, but with modernized terms, they could become a valuable industry asset.

6. The restaurant industry needs help to re-start.

The pandemic has decimated the restaurant industry and it needs help to restart. It is almost 2 years since the Business Advisory Technical Committee recommended a switch to wholesale pricing for the hospitality sector, together with changes to allow restaurants to source product from private liquor stores. The Province appears to have accepted these recommendations but implementation seems to be stalled. Although the changes would mean lower margins for wineries in the hospitality channel, it would also mean greater sales and help in revitalization of the restaurant industry.

7. The time has come for alternative packaging.

The time has come to embrace alternative packaging. It makes no sense in a recessionary market to pay \$25 to ship \$24 worth of glass to a consumer who would prefer the pricing and convenience of bag-in-box. Bag-in-box is easier to store, maintains product freshness after opening and is environmentally friendly. The only problem is that quality VQA wines are not currently available in that format. In the coming recession, consumers will be on-line seeking out high quality BC wines for day-to-day home consuming. Every producer needs to offer the pricing and convenience of bag-in-box for at least one or more of his or her premium varietals. The *Wines of Marked Quality Regulation* needs to be changed to permit bag-in-box and wine in cans. Among the BCLDB's top 100 bestselling wines, over 50% by volume are bag-in-box. Product labelling also has to be changed to provide more transparency. Again, it is what consumers want.

8. Delivery of wine with takeout meals is here to stay.

This temporary regulatory change to permit the inclusion of wines with restaurant takeout orders needs to extend beyond its current cutoff date of May 30th and become permanent. There was already a trend towards more takeout and more curbside pickup; and this will continue through the recession. There is no policy reason why delivery of wine should not continue with the delivery of meals. The idea should also be extended to deliveries by food prep services. No purpose is served by the requirement that the delivery person hold the Serving it Right qualification and that requirement should be eliminated.

9. The LCRB needs to permit shipping of wine to consumers directly from offsite storage.

With the dramatic increase in customer reliance on direct delivery, wineries need changes to their BCLDB manufacturer's licenses to allow them to pick, pack and ship to consumers from registered storage facilities. This would reduce both costs and environmental impacts. Currently, delivery to consumers is permitted from your retail store only. Some wineries have been setting up 'pop-up' off-site storage sites for third party delivery without LCRB approval. The LCRB is focused on dealing with these illegal activities rather than providing industry-wide solutions.

10. Something needs to be done about abusive BCLDB selling practices.

Current abusive and anti-competitive activities of the BCLDB that are injurious to BC wineries need to be eliminated. These include: (i) abruptly raising prices and margins on fast moving VQA wines, making it difficult for the winery to position its wines price competitively relative to perceived competitors; (ii) the BC Select Program which achieves high volumes through temporary low margin pricing, sometimes injuring brand reputation; (iii) over-buying during limited time offers and selling that stock at full price after the LTO promotional period; and (iv) private branding of foreign product.

11. The Province needs to eliminate BCLDB conflicts of interest.

The BCLDB is both a quasi-regulator and the monopoly wholesaler in the Province, as well as an aggressive retailer with a 60% retail share. Regulation should be consolidated in the LCRB; and BCLDB's wholesale and retail divisions should be restructured under separate management.

12. We need a buy-BC program for BC wines.

BC wines are underrepresented in BCLDB stores (less than 8% of shelf space versus an overall provincial market share of 18%). The BCLDB is single-mindedly focused on maximizing provincial government revenue through the promotion and sale of low price, high volume foreign wines. The government needs to make it crystal clear to the BCLDB that its mandate includes the promotion of local products and that it will be held accountable for fulfilling this responsibility.

13. Assistance to grape growers.

The assistance offered by governments to date to grape growers and other growers of fruits and vegetables has been underwhelming. Without a substantial financial assistance program for farmers, there is a serious likelihood that many will not be able to bring their crops through to maturity and harvest this year. This is a serious threat to the security of our local and national food chains.

Conclusion

Success in business requires innovation and rapid adjustments to adapt to change, particularly changes of the magnitude being imposed by the pandemic. Bureaucratic regulators fear change and their immediate instinct is to put a damper on it. Survival of BC's small wineries depends on our industry regulators responding pragmatically to changing industry circumstances.

Note. To view a copy of Part 1 of this White Paper - 'A Pandemic Survival Guide for BC Wineries', click [here](#). Part 2 with suggestions on how to re-open your tasting room is available [here](#).

Al Hudec is a semi-retired lawyer with a home in Oliver, currently working and sheltering in place in Vancouver. He practices in the areas of commercial and aboriginal law with a particular interest in winery law, including the regulation of the wine industry and the purchase and sale of wineries. Al can be reached at the contact information below.



Al Hudec
Partner
778 886 9356
ahudec@farris.com
Bio

Farris communications are intended for informational purposes only and do not constitute legal advice or an opinion on any issue. We would be pleased to provide additional details or advice about specific situations if desired. For permission to republish this content, please contact the Marketing Department at ssangha@farris.com. © 2020 FARRIS LLP