



STATE OF MAINE
DEPARTMENT OF ADMINISTRATIVE AND FINANCIAL SERVICES
BUREAU OF ALCOHOLIC BEVERAGES AND LOTTERY OPERATIONS
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January 23, 2023

Senator Craig Hickman, Senate Chair
Representative Laura Supica, House Chair
Members of the Joint Standing Committee on Veteran's and Legal Affairs
100 State House Station
Augusta, ME 04333-0100

RE: P.L. 2021, ch. 622 An Act To Streamline and Modernize the Department of Administrative and Financial Services, Bureau of Alcoholic Beverages and Lottery Operations

Senator Hickman, Representative Supica and Members of the Committee on Veterans and Legal Affairs:

The bureau of Alcoholic Beverages and Lottery Operations was charged in P.L. 2021, ch. 622 with reporting back to the Committee on Veterans and Legal Affairs on the process by which the State Liquor and Lottery Commission establishes the retail price of spirits sold in the State; the process by which the bureau develops recommended retail prices for the commission's consideration; explains how any pricing formula or calculator employed by the bureau to establish such recommended retail prices operates, the factors that affect a retail price calculated using such a formula or calculator and the reasons that the bureau chose to incorporate those factors in the formula or calculator; and informs the committee of the status of the commission's adoption of rules pursuant to establish an appeals process by which a spirits supplier could request reconsideration of a retail price determination.

The bureau would like to start with a brief level setting before jumping directly into spirits pricing and the spirits pricing formula. It is essential for members of the Committee to understand that under the Three Tier System, the manufacturer, wholesaler, and retailer tiers are each prohibited from having a financial interest in either of the other two tiers. This is intended to prevent tied houses. Furthermore, Maine is a Control jurisdiction, which means that with respect to spirits sales in Maine, the State occupies the wholesaler tier and operates as a business would. The profits from the State's spirit business are state revenues.

Spirits Pricing Background

Under the former spirits contract with Maine Beverage Company, which was in effect from July 1, 2004, to June 30, 2014, there was a requirement to maintain a gross profit margin of 36.8% across all products

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and categories. In addition to the maintenance of gross profit margin, the contract called for defined profits for Maine Beverage Company to be achieved. Gross profit was the standard by which retail price on spirits were set and recommended to the Commission. Retail pricing was set by negotiating with suppliers, which created gross profit margins that were subjective. The goal in pricing was to meet contract obligations and the resulting impact was a wide range of profit margins on products within same categories that could be 8-10 points apart. It was discovered that this system disproportionately favored lower priced products and subsequently the burden of generating profit to the State was placed on higher priced products. It was not an impartial, consistent, or transparent method of pricing products or conducting the State's spirits business.

In early 2016, the bureau worked closely with the State's new spirits vendor Pine State to develop a spirits pricing model that could uniformly be applied to every spirit product listed by the State. Several different models were explored, including applying a single percentage-based markup across all categories and sizes, but the resulting significant changes across all retail prices was undesirable. A single markup would have either overinflated prices on higher priced products or reduced prices dangerously low on lower priced products. The bureau's primary objective in establishing a pricing model was to set competitive everyday prices on a large portfolio of national and local spirits products that would repatriate Maine consumers previously migrating across the border to New Hampshire to purchase their spirits.

In order to mitigate drastic changes in retail prices, the final pricing formula was created by category, proof and size, with a "value" category assigned for vodka. The formula was implemented in February 2016, providing a transparent and consistent pricing mechanism for all parties in the pricing chain. The formula was a mathematical equation, consisting of the markup by category and included the \$1.25 per proof gallon premium tax as required by section 1703(3)(d) and the agency liquor store discount (retailer margin).

In late 2016, the bureau noticed sales growing by 4 to 5% as desired, but State profits remained flat against sales growth. Analysis identified that small sizes and "value" brands were negatively impacting the State's overall profitability. The pricing paradigm was upside down; smaller bottle sizes provided a better value than larger sized bottles, which runs counter to any other consumer goods pricing model. The bureau continued to monitor sales and model solutions before making any changes. Eventually the concept of a Minimum State Profit Threshold by bottle size, paired with expanding the value markup across all categories emerged as the most effective mechanism for achieving the States objective to increase the profitability of the spirits business while minimizing significant changes to retail prices. Building on the original framework, the pricing formula was adjusted accordingly, with the minimum profit threshold and value markup taking effect October 1, 2017.

Communication was sent out in July 2017, notifying industry members of the proposed change. After hearing from industry members, who expressed concern over certain retail prices changing, especially on value priced products, a cap was placed on increases, so no increase due to the implementation of the adjusted pricing formula would be higher than \$1.00. The cap resulted in 351 product SKUs not delivering the minimum state profit.

As adjustments were made to the formula, industry members were provided with a web-based pricing calculator. The calculator is simply the pricing formula in an easy to use, transparent format. The calculator is available to all suppliers and brokers for their use in determining retail prices.

The Pricing Formula

The pricing formula is a mathematical equation that considers category, proof, bottle size and supplier price, through which every spirit product passes. It objectively determines the wholesale price which is set by the bureau and the retail price recommended to and approved by the Commission. The supplier can influence the retail price by adjusting the price they charge the State to buy their product. Using the online pricing calculator, suppliers can quickly and easily determine how to set their case cost, to achieve their desired retail price.

Because the agency liquor store discount is part of the retail calculation, when the State's overall sales reached certain thresholds, pursuant to the retailer incentive program established in rule, the discount rate increased. Between 2016 and 2020, the rate increased multiple times, and by five percentage points cumulatively, to an 18% discount rate on all products. This resulted in a loss of profit to the State because suppliers continued to charge the same case cost to the State for products that were then being sold at a higher discount to agency liquor stores. The result of these increases meant that there were approximately 1,200 product SKUs that no longer delivered the minimum state profit threshold that was established in 2017. In September 2021, the decision was made to bring all products into compliance with the Minimum State Profit Threshold, including those SKUs that were capped in 2017. Again, an adjustment to the existing pricing formula was made to account for the 18% discount rate for agency liquor stores.

Each time the bureau has initiated changes to the spirits pricing formula, they've communicated the resulting proposed pricing changes, as well as the supporting rationale, to the brokers and suppliers two months in advance of them taking effect so as to provide ample time for feedback. In all instances the pricing changes resulting from updates to the spirits pricing formula have been approved by the Commission.

Rulemaking

The bureau is currently engaged in a number of large projects and has not yet commenced rulemaking to establish an appeal process by which a spirits supplier could request reconsideration of a retail price determination. However, the bureau included the intended rulemaking in the 2023-2024 DAFS Regulatory Agenda and plans to engage in the required rulemaking this year.

Components of the Pricing Formula

The pricing formula consists of a Category Markup, coupled with the Premium Tax (\$1.25 per proof gallon), and the Minimum State Profit Threshold (MSPT).

Category Markups			
Category	375 and under	750-1000	1750
Alcohol/Grain	1.98	1.98	1.98
Brandy	1.98	1.84	1.76
Brandy Value	2.13	1.98	1.90
Cognac	1.92	1.80	1.73
Cognac Value	2.13	1.95	1.82
RTD/Cocktails	1.93	1.93	1.93
RTD/Cocktails Value	1.93	1.93	1.93
Cordials	1.91	1.77	1.69
Cordials Value	2.13	1.95	1.82
Gin	1.96	1.82	1.75
Gin Value	2.13	1.95	1.82
Rum	1.95	1.81	1.72
Rum Value	2.13	1.95	1.82
Tequila	1.94	1.80	1.73
Tequila Value	2.13	1.95	1.82
Vodka	1.89	1.76	1.67
Vodka Value	2.13	1.95	1.82
Whiskey	1.91	1.77	1.70
Whiskey Value	2.13	1.95	1.82
Whiskey Canadian	1.98	1.84	1.76
Whiskey Candian Value	2.13	1.95	1.82
Whiskey Irish	1.98	1.83	1.72
Whiskey Irish Value	2.13	1.95	1.82
Whiskey Scotch	1.93	1.76	1.72
Whiskey Scotch Value	2.13	1.95	1.82

The “Value” Threshold is based on the wholesale price and size as follows:

- 1.75L size, the price is less than \$22.00
- 1L size, the price is less than \$13.00
- 750ml size, the price is less than \$12.00
- 375ml size, the price is less than \$7.00

Minimum State Profit Thresholds are as follows:

- 1.75L is \$6.00
- 1L is \$4.50
- 750ml is \$4.00
- 375ml is \$2.50
- 250ml is \$2.25
- 200ml is \$2.00
- 100ml is \$1.30
- 50ml is \$0.75

How the Calculation Works

Step 1. Calculating the Initial Retail Price

- Bottle cost (supplier price sold to State) multiplied by the applicable category markup plus the premium tax.
- The initial retail price is rounded up to end in .49 or .99 (or .29, .49, .79, .99 for sizes less than 375 ml), as required by law.

Step 2. Determining wholesale price

- Retail price is discounted by the agency liquor store discount rate (18%).

Step 3. Determining whether the Wholesale Price meets the Value Threshold

- If the wholesale price is less than the value thresholds listed above, then the retail price must be re-calculated as follows:
 - Bottle cost multiplied by the category value markup plus the premium tax.

Step 4. Determining whether the Wholesale Price meets Minimum State Profit Threshold

- If the wholesale price minus the bottle cost and the premium tax from either Step 2 or 3 is less than the MSPT as listed above, then the retail price is increased by 50¢ to the next price point (ending in either .49 or .99 etc.) until it achieves the required MSPT. This may happen multiple times to meet the MSPT.

Example 1

Calculation for Vodka, 80 proof, 1.75L, 6 pack case:

Case cost (referred to as FOB) for the bottles in the case:	\$124.07
Bottle cost is determined by case pack size:	\$124.07 divided by 6 = \$20.68

Step 1 - Initial Retail Price Calculation:

- Bottle cost of \$20.68 multiplied by the vodka category markup of 1.67, plus the premium tax of \$.4624 results in an initial retail price of \$34.99.

$$(\$20.68 \times 1.67) + \$.4624 = \$34.99$$

Step 2 - Wholesale Price Calculation:

- Initial retail price of \$34.99 reduced by the agency liquor store discount rate of 18%, generates a wholesale price of \$28.69.

$$(\$34.99 \times .82) = \$28.69$$

Step 3 - Value Threshold Determination:

- Wholesale price for this 1.75L Vodka exceeds the value threshold.

Step 4 - Minimum State Profit Threshold Determination:

- Wholesale price of \$28.69 minus the bottle cost of \$20.68 and the premium tax of \$.4624 equals \$7.55 which exceeds the MSPT of \$6.00 for a 1.75L bottle.

$$\$28.69 - 20.68 - .4624 = \$7.55$$

Example 2

Calculation for Vodka, 80 proof, 1.75L, 6 pack case:

Case cost (referred to as FOB) for the bottles in the case: \$35.02
Bottle cost is determined by case pack size: \$35.02 divided by 6 = \$5.84

Step 1 - Initial Retail Price Calculation:

- Bottle cost of \$5.84 multiplied by the vodka category markup of 1.67, plus the premium tax of \$.4624, rounded up to end in .49 or .99 results in an initial retail price of \$10.49.

$$(\$5.84 \times 1.67) + \$.4624 = \$10.22, \text{ which must be rounded up to } \$10.49.$$

Step 2 - Wholesale Price Calculation:

- Initial retail price of \$10.49 reduced by the agency liquor store discount rate of 18%, generates a wholesale price of \$8.60.

$$(\$10.49 \times .82) = \$8.60$$

Step 3 - Value Threshold Determination:

- Wholesale price minus the bottle cost and premium tax for this 1.75L Vodka is below the value threshold.
- Recalculate the retail price using the vodka value markup.
 - Bottle cost of \$5.84 multiplied by the vodka value category markup of 1.82, plus the premium tax of \$.4624 equals \$11.09, rounded up to end in .49 or .99 results in a new retail price of \$11.49.

$$(\$5.84 \times 1.82) + \$0.4624 = \$11.09, \text{ which must be round up to } \$11.49.$$

- Retail price of \$11.49 reduced by the agency liquor store discount rate of 18%, generates a wholesale price of \$9.42.

$$(\$11.49 \times .82) = \$9.42$$

Step 4 - Minimum State Profit Threshold Determination:

- Wholesale price of \$9.42 minus the bottle cost of \$5.84 and the premium tax of \$.4624 equals \$3.13, which does not meet the MSPT for a 1.75L bottle.

$$\$9.42 - 5.84 - .4624 = \$3.13$$

Step 5 - Lowest Retail Price Determination to meet the Minimum State Profit Threshold:

- Add \$.50 to the retail price until the results meet the MSPT.
 - This is an iterative process to achieve the proper retail price to achieve the MSPT for this bottle size. In this case, \$.50 was added 7 times.

- Retail price of \$14.99 reduced by agency liquor store discount rate of 18% generates a wholesale price of \$12.29.

$$(\$14.99 \times .82) = \$12.29$$

- Wholesale price of \$12.29 minus the bottle cost of \$5.84 and the premium tax of \$.4624 equals \$6.00, which does meet the MSPT for a 1.75L bottle.

$$\$12.29 - 5.84 - .4624 = \$6.00$$

Web-based Pricing Calculator

While the examples provide an explanation of how the pricing formula calculation works, the bureau has provided suppliers and brokers with a web-based calculator that will perform these steps instantaneously: <https://b2bs.pinestatetrading.com/mspc/pricing/calculator/>

Using Example 2, the data is entered into the calculator for an instant result. There is additional data that shows the components of the calculation that will also appear under Calculation Details. Implementing a calculator that could be accessed by suppliers and brokers, provides transparency from the bureau.

Pricing Calculator

Check if you are a craft distiller, based in Maine, producing 50,000 gallons or less annually.

<p>Select Class: <input type="text" value="VODKA"/></p> <p>FOB: <input type="text" value="35.02"/></p> <p>Proof: <input type="text" value="80"/></p> <p>Effective Date: <input type="text" value="01/12/2023"/></p>	<p>Select Size: <input type="text" value="1750 ml"/></p> <p>Unit Pack: <input type="text" value="6"/></p> <p>Retail Pack Size: <input type="text" value="1"/></p> <p>Calculated Retail: <input type="text" value="\$14.99"/></p> <p>Pricing Category: <input type="text" value="VODKA VALUE"/></p> <p style="text-align: center;"><input type="button" value="Calculate Retail"/></p>
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We are happy to answer any questions and provide further detail.

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 Director

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