STATEMENT OF THE BOARD OF DIRECTORS OF

VIRGINIA WINERY DISTRIBUTION COMPANY

Regarding THE REPORT BY THE DEPARTMENT OF AGRICULTURE AND CONSUMER SERVICES ON THE FINDINGS AND RECOMMENDATIONS OF THE WORK GROUP TO EVALUATE THE NEEDS RELATED TO THE DISTRIBUTION OF WINE AND BEER, AS TRANSMITTED BY THE VIRGINIA WINERY DISTRIBUTION COMPANY

In keeping with the legislative mandate found in Chapter 334 of the 2022 Acts of Assembly, the Board of Directors of the Virginia Winery Distribution Company ("VWDC") transmits the accompanying Report to the Chairs of the Senate Committee on Rehabilitation and Social Services and the House Committee on General Laws.

1. Beer manufacturing is a burgeoning industry in the Commonwealth, with many of the small producers being of relatively recent creation and manufacturing only modest quantities of product. The lack of brand recognition and the modest quantities being produced often make it difficult for many of these producers to market their products effectively. Accordingly, the creation of an entity and/or the modification of certain regulatory restrictions that would facilitate the distribution of limited amounts of beer manufactured in the Commonwealth would provide a cost-effective mechanism for the sale and delivery of product and would benefit the Commonwealth through greater availability of product for consumers and the generation of excise and sales tax revenues.

2. The Report makes certain statements that one or more members of the Board do not believe are entirely accurate and are in need of clarification, including the following:
    a) The cost estimates provided in the Report do not necessarily reflect all costs. For example, there is no cost associated with replacing software over time. If that cost was included, the total cost might be raised by an estimated $60,000 annually.
    b) The expense of growing necessary agricultural inputs is not a distinction between Virginia beer and wine; it is a similarity. There is sufficient grain grown in Virginia to support the small-scale brewing industry, though it is perhaps more expensive than

grain imported from other states; however, Virginia wine grapes are also relatively more expensive to grow compared to other states. Thus, requiring a minimum of 51% or more of Virginia-grown grains for beer production may not be more financially and logistically difficult for breweries than it currently is for Virginia wineries. In fact, it is a matter of cost, which both beverage categories must navigate through market positioning.

c) During the Work Group meetings, brewers and beer wholesalers perceived similarities between cider and beer due to the market positioning of some cidermakers. These perceptions are not grounded in fact. Cider is produced using the same techniques as white wines, using fruit that is available once a year during the fall harvest. Packaging, short shelf life, and additive flavors are cidermaking choices that are not universal. The Code of Virginia (§ 4.1-213 (H)) states that cider is to be considered for all pertinent purposes to be wine.

3. The discussions and discoveries of the Work Group revealed that a good deal of elemental work remains to be undertaken before a framework for legislation or regulatory change can be confidently presented to the General Assembly or regulatory authorities for definitive action. Among the ideas captured about the work that remains to be done are the following:
    a) Although the 2022 legislative mandate referred this study to VDACS in the presumed belief that VWDC might offer a useful model, the group's work revealed that largely not to be the case. The farm wineries served by VWDC are required to have substantial onsite agricultural investments and outputs, hence, the reason VWDC was housed from inception at VDACS. Participants in a new beer distribution vehicle should be held to a standard of agricultural investments and output similar to that imposed on wineries.
    b) The velocity of beer manufacturing and sales is such that the number of transactions likely to be processed through a distribution entity likely will greatly exceed the number of transactions handled by VWDC. VWDC's software (itself in need of upgrades after 15 years of service) is inadequate for this volume of transactions.
    c) The plan for the new distribution scheme must specify what products will be eligible. Late in the Work Group's conversations, it was revealed that small brewers were interested in including other beverage categories in their access to the proposed beer

distribution vehicle. The treatment of these crossover categories had not been carefully considered and no proposal regarding their treatment was advanced.

d) The plan for the new distribution scheme must specify the maximum quantities that may be sold and delivered through the new distribution entity. The Work Group devoted a great deal of effort to unsuccessfully deriving beer equivalencies with the amount of wine that farm wineries are permitted to distribute through VWDC. Similar to the origins of VWDC, better would be a consensus between the manufacturers and the wholesalers as to a definitive limit that would facilitate the sale and delivery of modest amounts of beer while not impinging on the wholesalers' business.

e) The plan for the new distribution scheme must include an implementation plan that takes into account the sequencing of the actions required to make a distribution scheme operational. Despite the efforts of a senior VDACS staffer to lay out to the Work Group what steps will need to be taken and in what order to render a new distribution system workable, there remains no shared or articulated consensus as to a realistic process and launch date.

f) As addressed in the accompanying Report, any start-up appropriation needs to provide for a ramp-up period to reflect the small number of breweries that are likely to use the new distribution vehicle in its first several years of operation and, hence, the modest amount of revenue likely to be derived from processing transactions.

4. Were an independent entity created to facilitate the distribution of limited amounts of beer, of necessity, the VWDC Board would prefer to keep the administrative functions of the two entities separate.

In summary, a great deal of investigation, discovery, and thought remains to be undertaken before a well-conceived, comprehensive plan can be enacted: (i) the creation of a vehicle that would facilitate the efficient distribution of beer in limited quantities would likely benefit small-scale brewers, consumers, wholesalers, and the Commonwealth if funded, structured, and operated in a reasonable and practical way; (ii) absent a requirement that brewers use meaningful amounts of Virginia-grown components in their beer manufacturing, this distribution initiative has only an incidental connection to Virginia-grown agricultural products; and (iii) the distinctions between the requirements for production, sale, and distribution of wine and beer, respectively, are sufficiently pronounced as to require that a vehicle for beer distribution be wholly independent of VWDC and its operations.

VIRGINIA WINERY DISTRIBUTION COMPANY

By______________________________________ October _18_, 2022

Courtney A. Mailey, Chair

REPORT BY THE DEPARTMENT OF AGRICULTURE AND CONSUMER SERVICES ON THE FINDINGS AND RECOMMENDATIONS OF THE WORK GROUP TO EVALUATE THE NEEDS RELATED TO THE DISTRIBUTION OF WINE AND BEER, AS TRANSMITTED BY THE VIRGINIA WINERY DISTRIBUTION COMPANY

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Document Title
Report by the Department of Agriculture and Consumer Services on the Findings and Recommendations of the Work Group to Evaluate the Needs Related to the Distribution of Wine and Beer, as transmitted by the Virginia Winery Distribution Company

Author
Department of Agriculture and Consumer Services

Legislative Mandate
Chapter 334 of the 2022 Acts of Assembly

Executive Summary
As required by Chapter 334 of the 2022 Acts of Assembly, the Virginia Department of Agriculture and Consumer Services (VDACS) convened a work group (Work Group) consisting of representatives of the Virginia Alcoholic Beverage Control Authority, the Virginia Wineries Association, the Virginia Wine Wholesalers Association, the Virginia Beer Wholesalers Association, the Virginia Craft Brewers Guild, and other relevant stakeholders to (i) conduct research to determine the appropriate fee structure and general fund appropriation necessary to adequately address staffing needs and perform information technology system upgrades for the purpose of accommodating winery, farm winery, and limited brewery licensees that wish to utilize the services of the Virginia Winery Distribution Company (VWDC); (ii) evaluate the number of barrels of beer allowed to be distributed by a limited brewery licensee over the course of one year; and (iii) review and evaluate alternative avenues of distribution, other than distribution through the VWDC, that could be made available to limited brewery licensees. The bill directs the Work Group to report its findings and recommendations to the VWDC Board of Directors (VWDC Board) for approval and directs the VWDC Board to report any such approved findings and recommendations to the Chairmen of the Senate Committee on Rehabilitation and Social Services and the House Committee on General Laws no later than October 1, 2022. Through presentations and discussions from Work Group participants during three meetings, the Work Group considered the history and operation of the VWDC, the legislation responsible for the VWDC's creation, agricultural component requirements, distribution limitations, alcoholic beverage control regulations and tax structure, and associated costs as a benchmark for comparison.

The Work Group consisted of the following members, representing organizations as required by Chapter 334:

- Joseph Guthrie, Commissioner, Virginia Department of Agriculture and Consumer Services (VDACS)
- Marc Haalman, Special Agent, Virginia Alcoholic Beverage Control Authority (VABC)
- George Hodson, Veritas Vineyards, representing Virginia Wineries Association
- Doug Zerbst, Republic National Distributing Company, representing Virginia Wine Wholesalers Association
- Philip Boykin, Virginia Beer Wholesalers Association
- Paige Wernig, Virginia Craft Brewers Guild
- Courtney Mailey, Owner, Blue Bee Cider and Chairman of the Board, Virginia Winery Distribution Company (VWDC)
- Staci Saunders, VWDC Operations Manager
- Kendra Shifflett, Director of Administrative and Financial Services, VDACS
- Parker Slaybaugh, Chief Deputy Secretary of Agriculture and Forestry, Office of Governor Youngkin
- Burnie Gaskill, VABC
- Melissa Assalone, Virginia Food Industry Association

This report summarizes information presented and discussed during Work Group meetings held on June 1, 2022; July 14, 2022; and August 18, 2022.

Background

In 1980, the General Assembly exempted farm wineries from the three-tier system of distribution and allowed farm wineries to sell wine directly to VABC's retail licensees. However, on July 1, 2006, a U.S. district court invalidated some of Virginia's alcohol distribution laws, and farm wineries were then also required to use the three-tier distribution system to sell their wines. The financial impact of this decision was felt by many of the wineries. They were either too small for a wholesale distributor to consider, or the cost to participate in the distribution system was too high. In 2007, the General Assembly enacted legislation that required the Commissioner of Agriculture and Consumer Services (Commissioner) to establish and operate a non-profit, non-stock corporation to promote, develop, and sustain markets for licensed Virginia wineries and farm wineries and to provide wholesale wine distribution services to wineries and farm wineries. The Commissioner subsequently established the VWDC.

VWDC is governed by a board of directors that includes the Commissioner and four members appointed by the Board of Agriculture and Consumer Services, including (i) one owner or manager of a winery or farm winery licensee that is not served by a wholesaler when the owner or manager is appointed to the VWDC Board, (ii) one owner or manager of a winery or farm winery licensee that produces no more than 10,000 cases per year, and (iii) two owners or managers of wine wholesaler licensees. In making appointments to the VWDC Board, the Board of Agriculture and Consumer Services must consider nominations of winery and farm winery licensees submitted by the Virginia Wineries Association and wine wholesale licensees submitted by the Virginia Wine Wholesalers Association. VWDC is required to report to the Commissioner at least annually on its activities, including reporting the quantity of wine distributed for each winery and farm winery during the preceding year.

Many wineries in the Commonwealth use VWDC to distribute up to 3,000 cases of their wine products each year. These wholesale products are sold to retailers through the VWDC's website and subsequently delivered to the purchaser by the member wineries. Today, more than 200 wineries in the Commonwealth are signed on with VWDC.

From 2008 to 2012, VDACS contracted with a third party to conduct the operations functions of the VWDC. By 2012, the complexity of regulatory compliance and mandated reporting responsibilities made it necessary for VDACS to directly administer VWDC operations. The General Assembly appropriated additional general fund support in 2012, and VDACS hired a full time Operations Manager to serve as the VWDC Program Director. The agency also implemented an enhanced online order system and reporting software.

VWDC provides the following benefits to participating wineries:

- Allows smaller wineries and cideries to market their products in a cost-effective manner to a broader audience of business customers.
- Offers retailers 24-hour access to local wineries and cideries online at www.vwdc.org.
- Allows wineries and cideries to deliver their own wine directly to retail stores and restaurants.
- Increases the ease of conducting business for wineries and cideries – VWDC files, collects, and pays wine or cider taxes monthly directly to VABC for each licensed operation.

VWDC's operations model consists of the following key elements:

- Licensing – Wineries complete an online registration request for VWDC to obtain a wholesaler's license for their products. VWDC works with the winery to obtain all necessary information for the two-part application process with VABC and requires the signature of the VWDC Operating Agreement, which outlines all of the required procedures and regulations.
- Ordering – Retailers submit an order via the online ordering system, by email or by phone. For online orders, wineries are electronically notified of the order. In all cases, wineries work directly with the retailer to coordinate delivery and payment.
- Financial – VWDC pays winery partners monthly for all completed and paid transactions occurring during the previous month. VWDC calculates, pays, and reports the taxes for processed transactions and collects a per-transaction fee.
- Compliance – VWDC files and pays liter taxes directly to VABC monthly for each licensee, processes annual renewals, and works with VABC to ensure each licensee is in compliance with current regulations.
- VWDC collects a fee of $6 per transaction processed, as established by the VWDC Board.
- The general fund allocation covers approximately 85 percent of VWDC operating costs.

The 10-year growth data for the VWDC is as follows:

Year	Annual Sales	Transaction Qty	Case Sales
2012	$2.2m	6,900	18,000
2022	$6.2m	9,876	39,000

Work Group Discussion Objectives

In order to address the questions posed by the General Assembly and reflect the discussions held during the Work Group meetings, the group agreed on the following parameters:

1. No recommendation could be made that would harm or detract from the existing VWDC model.
2. Any recommendations made must realistically account for any anticipated operation cost, technology challenges, regulatory complexities, and staffing requirements needed to be sustainable.
3. All recommendations must include a realistic timeline for implementation.

Discovery

The initial meeting on June 1, 2022, began with discovery. Following a presentation summarizing the VWDC history and operations, VABC delivered a presentation that provided legal definitions related to beer and wine and explained the regulatory differences between winery and brewery licenses. Key differences include:

- *Agricultural requirements*:
  - **Farm winery licenses**, which shall authorize the licensee to **manufacture wine containing 21 percent or less of alcohol by volume and to sell, deliver, or ship the wine, in accordance with VWDC Board regulations**, in closed containers, to (i) the VABC Board, (ii) persons licensed to sell the wine so manufactured at wholesale for the purpose of resale, or (iii) persons outside the Commonwealth. In addition, the licensee may (a) acquire and receive deliveries and shipments of wine and sell and deliver or ship this wine, in accordance with VABC Board regulations, to the VABC Board, persons licensed to sell wine at wholesale for the purpose of resale, or persons outside the Commonwealth; (b) operate a contract winemaking facility on the premises of the licensee in accordance with VABC Board regulations; and (c) store wine in bonded warehouses located on or off the licensed premises upon permits issued by the VABC Board. For the purposes of this title, a farm winery license shall be designated either as a Class A or Class B farm winery license in accordance with the limitations set forth in Va. Code § 4.1-219. A farm winery may enter into an agreement in accordance with VABC Board regulations with a winery or farm winery licensee operating a contract winemaking facility.
    - **Such licenses shall also authorize the licensee to sell wine at retail at the places of business designated in the licenses, which may include no more than five additional retail establishments of the licensee. Wine may be sold at these**

business places for on-premises consumption and in closed containers for off-premises consumption, provided that any brand of wine not owned by the farm winery licensee is purchased from a wholesale wine licensee. In addition, wine may be pre-mixed by the licensee to be served and sold for on-premises consumption at these business places.

- There are two classifications of farm winery licenses:
  - **Class A** - At least 51 percent of fruits or agricultural products used by licensee to manufacture wine are grown or produced on such farm. No more than 25 percent of the fruits, fruit juices, or other agricultural products shall be grown or produced outside the Commonwealth.
  - **Class B** – 75 percent of fruits or agricultural products used by licensee to manufacture wine are grown or produced in the Commonwealth. No more than 25 percent of the fruits, fruit juices, or other agricultural products shall be grown or produced outside the Commonwealth. Must have operated under an existing Virginia farm winery license for **at least seven years.**

- **Limited brewery licenses**, to breweries that **manufacture no more than 15,000 barrels of beer per calendar year, provided that (i) the brewery is located on a farm in the Commonwealth on land zoned agricultural and owned or leased by such brewery or its owner and (ii) agricultural products, including barley, other grains, hops, or fruit, used by such brewery in the manufacture of its beer are grown on the farm.** The licensed premises shall be limited to the portion of the farm on which agricultural products, including barley, other grains, hops, or fruit, used by such brewery in the manufacture of its beer are grown and that is contiguous to the premises of such brewery where the beer is manufactured, exclusive of any residence and the curtilage thereof. However, the VABC Board may, with notice to the local governing body in accordance with the provisions of Va. Code § 4.1-230, also approve other portions of the farm to be included as part of the licensed premises. For purposes of this subdivision, "land zoned agricultural" means (a) land zoned as an agricultural district or classification or (b) land otherwise permitted by a locality for limited brewery use. For purposes of this subdivision, "land zoned agricultural" does not include land zoned "residential conservation." Except for the limitation on land zoned "residential conservation," nothing in this definition shall otherwise limit or affect local zoning authority. Limited brewery licensees shall be treated as breweries for all purposes of this title except as otherwise provided. There are 321 breweries in Virginia, of which 47 are limited license breweries.

- *Volume classifications:*
  - Farm wineries – there are two classifications of farm winery licenses:
    - 5,000 or less gallons
    - Over 5,000 gallons
  - Limited breweries – there are three classifications of limited brewery licenses:
    - Up to 500 barrels

        - 501 to 10,000 barrels
        - 10,001 to 15,000 barrels

- *VABC reporting and tax payment* – farm wineries, breweries, and wholesalers
    - Wineries – reports and payment due by 15th of each month, for the preceding month.
        - Wine Excise Tax = $.40/liter
        - Cider Excise Tax = $.08/liter
    - Breweries – reports and payment due by 10th of each month, for the preceding month.
        - Twenty-five and sixty-five hundredths cents per gallon per barrel;
        - Two cents per bottle on bottles of not more than seven ounces each;
        - Two and sixty-five hundredths cents per bottle on bottles of more than seven ounces each but not more than 12 ounces each; and
        - Two and twenty-two one hundredths mills (a mill is equivalent to a tenth of a cent) per ounce per bottle on bottles of more than 12 ounces each.

- *Other distinctions between wine and beer*
    - The distribution model in place for beer wholesalers has a strict franchise agreement that does not allow distribution territories contained in agreements to overlap.
    - The shelf life for beer is much shorter than for wine.
    - Breweries produce a high volume of seasonal varieties, meaning the variety of beers offered can change with greater frequency, whereas wineries do not change varietal production as often.
    - One barrel of beer equals 31.5 gallons, and one case of wine equals 2.25 gallons.
    - The most restrictive brewery license allows for up to 500 barrels, which would equal 7,000 cases of wine.

In the discussion following the overview of the VWDC and its creation, the Virginia Wineries Association and the Virginia Beer Wholesalers Association felt strongly that the promotion and increase in sale of Virginia agricultural products was the reason the General Assembly created the VWDC and provided general fund support for the distribution of Virginia wines. A Work Group participant stated that some of the frequently used ingredients and other adjuncts used in producing beer are difficult to grow cost effectively in Virginia and, therefore, are often acquired from outside of the Commonwealth. Beers manufactured in Virginia, including those manufactured by limited license breweries, may contain a lower percentage of Virginia agricultural products as compared to wines manufactured in Virginia. Therefore, supporting breweries similarly to wineries by incorporating them into the VWDC or a similar distribution mechanism does not necessarily promote Virginia agriculture, which makes it difficult to equate wine and beer. The agricultural product component difference between the two industries presented a consistent divide throughout the three Work Group meetings.

The Virginia Craft Brewers Guild stated that its organization's objective is to provide a distribution vehicle for Virginia's craft breweries because larger distribution companies are not accessible. The intent of a governmental distribution vehicle is to gain brand recognition, "test the waters" of distribution, allow breweries to experiment with seasonal varieties, and provide a path to working with a larger traditional distributor.

Work Group Discussions

Chapter 334 of the 2022 Acts of Assembly directed the Work Group to:

(i) Conduct research to determine the appropriate fee structure and general fund appropriation necessary to adequately address staffing needs and perform information technology system upgrades for the purpose of accommodating winery, farm winery, and limited brewery licensees that wish to utilize the services of the VWDC;

(ii) Evaluate the number of barrels of beer allowed to be distributed by a limited brewery licensee over the course of one year; and

(iii) Review and evaluate alternative avenues of distribution, other than distribution through the VWDC, that could be made available to limited brewery licensees

Organizational Structure

All participants of the Work Group agreed that the VWDC should continue as it was created and intended and that the Work Group discussion would concentrate on using the VWDC as a model where applicable and not as the vehicle for beer distribution.

There was a consensus by the Work Group that breweries and wineries may be too different to consider combining the distribution under the existing VWDC. The differences guided the discussion towards the creation of a separate entity, with a separate board of directors (including the Commissioner) and operations manager, operating under the umbrella of VDACS and benefiting from shared administrative resources.

There was a consensus by the Work Group that, if created, a newly formed entity for the limited license breweries should have the same structure as the VWDC. The board of directors of such corporation should be composed of the Commissioner and four members appointed by the Board of Agriculture and Consumer Services, including one owner or manager of a limited license brewery that is not served by a wholesaler when the owner or manager is appointed to the board; one owner or manager of a brewery that produces no more than 100,000 barrels per year; and two owners or managers of brewery wholesaler licenses. In making appointments to the board of directors, the Board of Agriculture and Consumer Services should be required to consider nominations of breweries submitted by the Virginia Craft Brewers Guild and brewery wholesale licensees submitted by the Virginia Beer Wholesalers Association.

Membership – Size and Qualifications

Chapter 334 required the Work Group to gather information and report on results for limited license breweries; however, the group felt it important to consider options that would include the other breweries in Virginia. Expanding participation may allow for economies of scale and increased fee revenue that may limited the appropriation needed for continued operation.

The group's discussion regarding membership was varied. Below are the ideas captured from the statements of various Work Group members:

- The set-up cost for a distribution company would be the same regardless of the number of participating breweries, making a case for including a broader membership beyond limited license breweries in order to generate non-general fund revenue to support operations.
- The VWDC model was created to support Virginia agriculture, and wineries are required to include a specific percentage of Virginia grown products in their wine products. The licensing requirements for breweries do not require a specific percentage of Virginia agricultural inputs.
- If the intent is to incentivize Virginia grown products within the existing brewery licensing structure, it may be possible to create an agricultural requirement for membership or tiers of membership based on the level of agricultural ingredients included in the products.
- As another option, higher transaction fees could be captured for breweries not using Virginia agricultural ingredients.
- The Virginia Beer Wholesalers Association suggests initially only allowing limited licensees to participate, and after two years (or an appropriate timeframe as determined by the board), open participation to all Virginia breweries.

Volume/Transaction Limitations

In an effort to determine an appropriate volumetric limitation for the distribution of beer, the group reviewed the VWDC case limit for wine (as established by Va. Code § 4.1-206.2) as well as historical sales data and attempted to create a model of comparison. Several comparison models were discussed to generate a sales volume maximum, ranging from volume in gallons to annual revenue generated.

The ideas captured in this discussion are as follows:

- The primary purpose of this distribution company should be to provide breweries with a distribution model in order to assist their growth and eventual graduation to an established, traditional wholesale distribution company. The limitations set forth should be in the spirit of this goal.
- It was suggested by some participants that cider, which is classified and regulated as a wine by Virginia law, may be more analogous to beer because of perceived similarities between cider and beer, including shelf life, typical packaging, and seasonal variety production.
- The 3,000 case limit for wineries may be very close to a farm winery's entire production for the year. Without a Virginia agricultural requirement, the production capabilities for breweries are limited only by the production resources of each brewery.
- If approved to be created, the beer barrel volume needs to be clearly expressed in legislation, as the VABC code does not clearly identify beer barrel volume. For the purposes of this discussion, a barrel of beer is equal to 31 gallons, and there are 2 kegs per barrel (15.5 gallons per keg)
- The Virginia Beer Wholesalers Association would support a 250 barrel distribution limit for breweries participating in the newly formed distribution company. This volume equates to 500 kegs per year, or approximately 40 kegs per month.

- The Virginia Craft Brewers Guild is requesting the limitation to be established at no less than 1,500 barrels per year but prefers a limit of 2,000 barrels per year. The volume of 1,500 barrels equates to 3,000 kegs per year, or 250 kegs per month.
- The Virginia Wineries Association expressed concern over the ability of small breweries to self-distribute 1,500 barrels of beer and noted that these quantities seem out-of-scope for the requested report.
- As a volume comparison to the 3,000 case limit for wine distribution under the VWDC, 230 barrels of beer are equivalent in volume to 3,000 cases of wine or cider.

Using Gallons as the UOM for comparison
1 Case of Cider = 9 Liters = 2.38 Gallons
1 Barrel of Beer = 31 gallons
13 Cases of Cider = 31 Gallons = 1 Barrel of Beer
3,000 cases of Cider = 7,140 Gallons = 230 Barrels of Beer
230 Barrels of Beer = 3,000 Cases of Cider

- As a revenue comparison to the data from VWDC for cider sales, 750 barrels of beer are equivalent to the estimated revenue produced by 3,000 cases of cider.

Using Revenue as the UOM for Comparison (Cider)
Avg Wholesale Price for Case of Cider = $60
3,000 Cases of Cider @ $60/each = $180,000
Avg Wholesale price for Barrel of Beer = $240
750 Barrels of Beer $ 240/each = $180,000

- As an estimated revenue comparison to the data from VWDC for wine sales, 2,000 barrels of beer are equivalent to the revenue produced by 3,000 cases of wine.

Using Revenue as the UOM for Comparison (Wine)
Avg Wholesale Price for Case of Wine = $161
3,000 Cases of Wine @ $160/each = $480,000
Avg Wholesale price for Barrel of Beer = $240
2,000 Barrels of Beer $ 240/each = $480,000

Services Provided to Members

The Work Group reached consensus that services similar to those offered by VWDC to its members should be provided to breweries through a beer distribution company. The benefits of these services include:

- Allow smaller breweries to market and sell their products in a cost-effective manner to a much larger audience.
- Provide retailers with 24-hour access to local breweries at the push of button via an online ordering platform.
- Allow breweries to deliver their own beer directly to stores and restaurants.
- Increase the ease of conducting business for breweries – distribution company files, collects, and pays brewery taxes monthly directly to the Virginia ABC for each licensed operation.

Proposed Fee Structure – Anticipated Revenue

The Work Group reached consensus that the fee structure for the proposed beer distribution company should be set by the distribution company board of directors. This will allow for the greatest flexibility to respond to changes in markets and participant needs and is consistent with the VWDC model.

There are some features of beer distribution that may limit the ability of the fee structure to capture the costs of program administration. The transaction volume may be higher due to the shorter shelf life of beer (three months average), and breweries may produce many different seasonal products, thus increasing the administrative burden required to manage VABC label approvals for each catalog. In addition, the tax structure is more complicated for beer than for wine.

Below are the ideas captured from the Work Group discussion regarding an appropriate fee structure:

- The less clear link with agriculture may make sustained general fund support less desirable, so the fee structure should be determined based on the goal of producing a self-sustaining organization.
- It may be possible to have two different fee structures to incentivize the inclusion of Virginia agricultural products in beer. The cost to administer and monitor should be considered.
- The Virginia Craft Brewers Guild suggested that fees be based on a percentage of sales.
- If participation is expanded beyond limited license breweries, it may be possible to differentiate through the fee structure with lower fees charged for limited license brewery participants.
- For parity with the VWDC, the fee structure should support at least 15 percent of the operating costs in year two, with the intention to move toward a greater percentage and possible self-sufficiency. Based on the estimated costs of operations in year two of $373,800 (discussed below), then 15 percent equals $56,070.

Anticipated Operating Costs – Licenses/Infrastructure/Staffing

The anticipated costs of creating a distribution vehicle for limited license breweries are based on the following:

- Past and current operations costs for the VWDC.
- VABC license fees for brewery licenses.
- VABC tax structure for beer.
- The estimated infrastructure costs for software development are significant and based on discussions with current information technology providers. The differences in container sizes, seasonal products, and tax reporting required for beer cannot be accommodated with the existing software used by the VWDC.
- Startup costs for initial setup of the beer distribution function exist whether there is parallel structure for beer and wine or not.

The chart below shows the anticipated startup costs as well as year two operating costs after the infrastructure is developed.

Category	Year 1	Year 2	Notes
Agency Support / Overhead	$25,000	$25,000	
Banking/Insurance	$30,000	$30,000	
Infrastructure	$400,000	$40,000	Year one includes initial system implementation and monthly hosting. Year two includes monthly hosting and additional software development if needed.
Licensing	$56,400	$6,000	Year one : Application fees @ $195 each, Initial License Fees @ $1005 for 47 Breweries. Year two: Estimate 5 new Breweries (Application fee & initial license fee)*
Marketing	$47,000	$47,000	
Reserve	$20,000	$20,000	
Staffing	$205,800	$205,800	Includes Operations Manager and Financial Specialist position
Total	**$784,200**	**$373,800**	

Notes:
- Year 1 – General Fund to cover 100% of costs. Year 2 – General Fund to cover 85% of costs, based on roughly 15% coming from transaction fee revenue.
- Year 2 transaction fees should equal approximately $56,070 to serve as 15% of overall budget
- *Initial application fee and license fee to be paid by Distribution Company. Renewals to be paid by brewery.

The Work Group discussions prompted adjustments to the original estimated budget. The items adjusted are as follows:

- Infrastructure costs in Year 1 were increased from $310,000 to $400,000 due to the complexity of the ABC tax requirements.
- Year 1 licensing costs were increased to include all of the 47 limited license breweries.
- Year 2 licensing costs were reduced based on the assumption that breweries would bear the cost of annual renewal fees.

The below calculation may provide an illustration of the required participation to generate revenues equaling 15 percent of operations costs.

If 30 limited license breweries chose to participate in a newly formed distribution company with a distribution limitation of 250 barrels per year and each of the 30 breweries reached that maximum distribution, that would equate to 7,500 barrels distributed. Using the average wholesale pricing of $240 per barrel, the necessary fee would be 3.125 percent of sales, or $7.50 per barrel, in order to generate the 15 percent of operations costs, estimated to be $56,070.

Timeline for implementation

VDACS estimates that the necessary infrastructure for such a distribution company could be developed approximately 12-18 months following the provision of the necessary resources to support the endeavor. If legislation is introduced and passed to establish a brewery distribution company during the 2023 Session of the General Assembly, it is estimated that operations would begin in July 2024 or January 2025.

Conclusion

This report is not a complete transcript of everything said by all participants. However, the report presents an accurate summarization of the Work Group's material findings, discussions, recommendations, and points of consensus. All three Work Group meetings were well attended by the participants listed above, who each demonstrated their commitment to participating in the group.

The following general topics on which the Work Group reached consensus are:

- The existing VWDC model should not be disrupted.
- The differences between beer and wine, including practical and regulatory differences, make the combination of distribution under the existing VWDC unacceptable to all parties.
- The agricultural requirements for Virginia wine production are the basis for the existing general fund appropriation and support for the VWDC.
- Should a policy decision be made to allow for distribution of beer in a similar manner to VWDC, the parties agree that a separate entity should be formed for the limited distribution of Virginia beers.

The following operating parameters were discussed, and general agreement was reached by the group:

- Organizational structure
- Services provided
- Estimated costs
- Implementation timeline.

The following operating parameters were discussed but no general agreement was reached by the group:

- Membership and size qualifications
- Volume and transaction limitations
- Fee structure

APPENDIX A

VWDC Background Presentation

Virginia Winery Distribution Company
Operations Overview

OUR STORY

- **1980**

  The General Assembly exempted farm wineries from the three-tier system of distribution and allowed them to sell directly to ABC licensees.

- **2006**

  A U.S. district court invalidated Virginia's distribution laws, and farm wineries were then required to use the three-tier distribution system to sell their wines. The financial impact of this decision was felt by many of the wineries. They were either too small for a wholesale distributor to consider, or the costs were too high.

- **2007**

  The General Assembly approved legislation allowing small farm wineries to distribute as many as 3,000 cases of their own wine each year to stores and restaurants through the state agriculture department.

- **2008**

  Virginia Winery Distribution Company (VWDC) was born and brought wholesale distribution back to the farm wineries. For the first years of the corporation's existence, the daily activities were managed through a contract with a private wholesaler.

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OUR STORY - CONTINUED

- **2010**

  The complexity of compliance and reporting responsibilities made it necessary to discontinue contractual services for VWDC operations and VDACS assumed daily management.

- **2012**
  - VDACS submitted a budget amendment and was appropriated funding to support a dedicated staff position for VWDC winery assistance, training, compliance, and decision making. VDACS hired a full time Operations Manager to serve as the VWDC Program Director.
  - Transition to our current online ordering platform performed

- **2022**

  Today, more than 250 wineries in the Commonwealth of Virginia are signed on with VWDC. It is a non-profit, non-stock corporation created by the Virginia Department of Agriculture and Consumer Services (VDACS) to provide wholesale wine distribution services for Virginia farm wineries. Many wineries in the Commonwealth use VWDC to distribute and personally deliver their wines to local retailers.

4

A

VWDC BOARD

The board of directors of such corporation shall be composed of the Commissioner and four members appointed by the Board, including one owner or manager of a winery or farm winery licensee that is not served by a wholesaler when the owner or manager is appointed to the board; one owner or manager of a winery or farm winery licensee that produces no more than 10,000 cases per year; and two owners or managers of wine wholesaler licensees. In making appointments to the board of directors, the Board shall consider nominations of winery and farm winery licensees submitted by the Virginia Wineries Association and wine wholesale licensees submitted by the Virginia Wine Wholesalers Association (§ 3.2-102.B.2, Code of Virginia).

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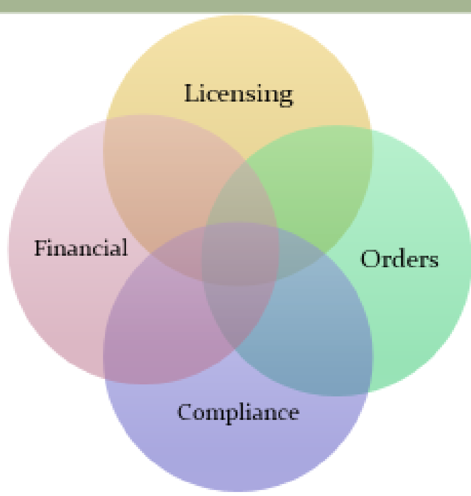
SERVICES PROVIDED TO MEMBERS

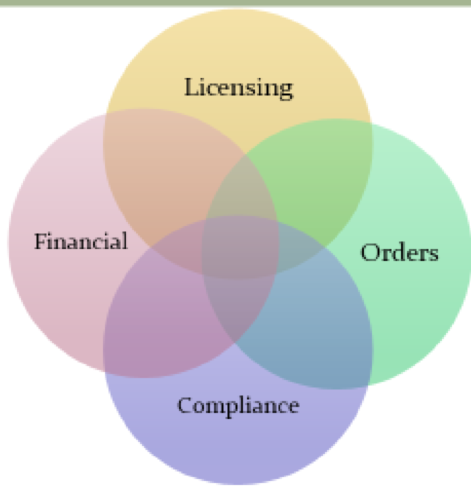
- Allows smaller wineries and cideries to market their products in a cost-effective manner to a much larger audience.
- Gives retailers 24-hour access to local wineries and cideries at the push of button @ vwdc.org.
- Wineries and cideries are able to deliver their own wine directly to stores and restaurants.
- Ease of doing business – VWDC files, collects and pays wine or cider taxes monthly directly to the Virginia ABC for each licensed operation.

OPERATIONS - LICENSING



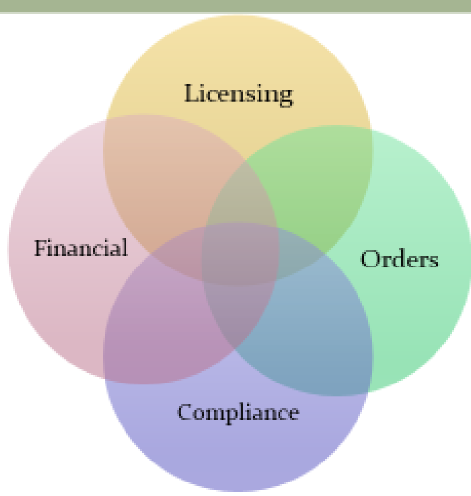
1. **REGISTER** — Wineries complete online at www.vwdc.org. using their farm winery license number.
2. **SUBMIT** — VWDC will submit the initial application and pays the application fee to ABC. VWDC notifies wineries of initial ABC approval.
3. **DOCUMENTS** — Wineries submit operating documents to VWDC including products for sale, floor plan, and delivery counties.
4. **POSTING & PUBLISHING** — Wineries post the required ABC notice at their winery location for two weeks. VWDC publishes a corresponding legal notice in your local newspaper.
5. **LICENSE ISSUANCE** — VWDC pays the initial license fee and ABC issues the license to VWDC. VWDC will send the license to the winery, to be displayed in the approved VWDC space.

OPERATIONS - ORDERS



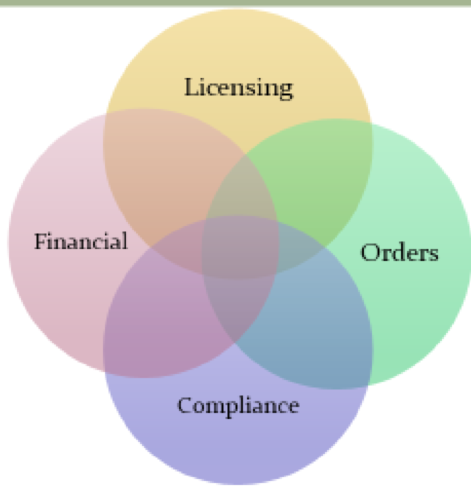
1. CREATE ORDER
   A purchase order is created in the system by either the winery or the retailer.
2. ACCEPTANCE
   Winery reviews and accepts the order, then contacts the retailer to work out delivery logistics.
3. DELIVERY
   Winery moves products to the approved VWDC space before delivery. Upon delivery of goods, wineries collect payment and have the retailer sign the invoice.
4. PAYMENT
   Payment received upon delivery. Checks mailed to VWDC lockbox for payment processing. Payments also received via Fintech or iControl (third party payment processor).

OPERATIONS - FINANCIAL



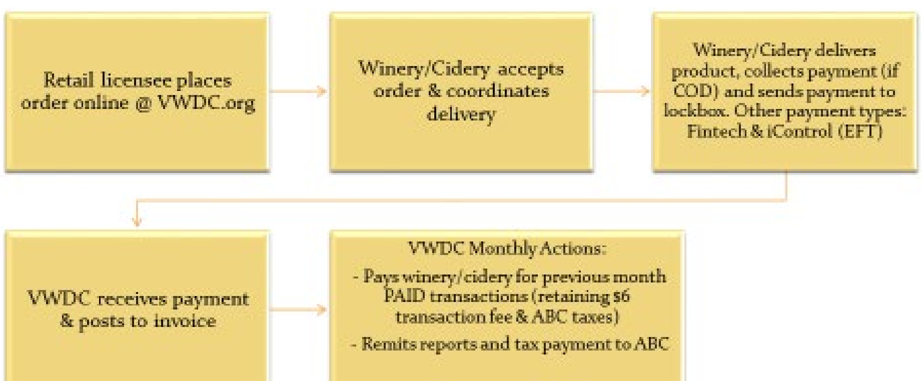
1. PAYMENT
   VWDC pays out winery partners for all transactions no less than once a month. Transactions received after the last date of the month are paid in the subsequent month.
2. FEES AND TAXES
   Winery payments are reduced by transaction fees and ABC taxes.
3. REPORTING
   VWDC performs monthly bank reconciliations, monthly ABC tax reporting, completes monthly and annual financial reporting.

OPERATIONS - COMPLIANCE



1. TAXES
   VWDC files and pays liter taxes directly to ABC monthly for each VWDC license.
2. RENEWALS
   ABC bills VWDC for license fees. VWDC notifies wineries of license renewals and processes fee payments. Wineries are responsible for renewal fees.
3. ACTIVITIES
   Compliance with applicable laws and regulations in maintaining VWDC license (documentation, licensed space, wine sales activities, agents).
4. AUDIT
   Relationship with ABC Law Enforcement to strengthen compliance efforts of VWDC (on-site audits, site visits, new licensees).

VWDC PROCESS



MONTHLY REPORTING

- ABC Tax report & payment – due by the 15th of each month
  - For previous month transactions
- Winery / Cidery payments – due by the 15th of each month
  - Payments are disbursed for paid transactions occurring in the previous month
- VWDC Financial reporting
  - Bank Reconciliation
  - Financial Statements

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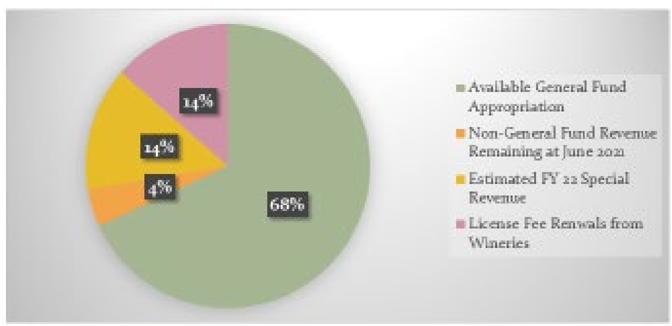
FUNDING

Resource	Total
General Fund Appropriation	$242,399
Non General Fund remaining June 2021	$15,000
Estimated FY22 Special Revenue	$50,000
License Fee Renewals from Wineries	$48,220
Total	$355,619



Special Revenue – Generated by collecting fee of $6 per transaction

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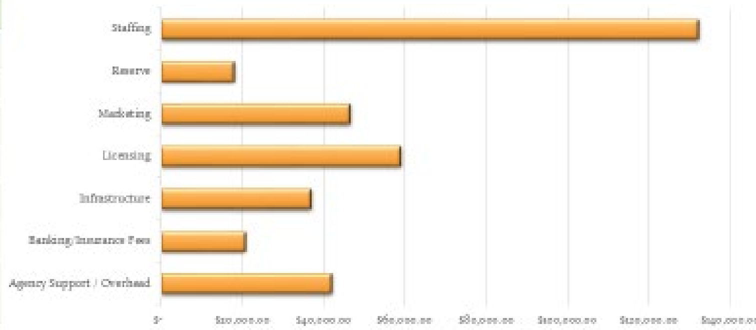
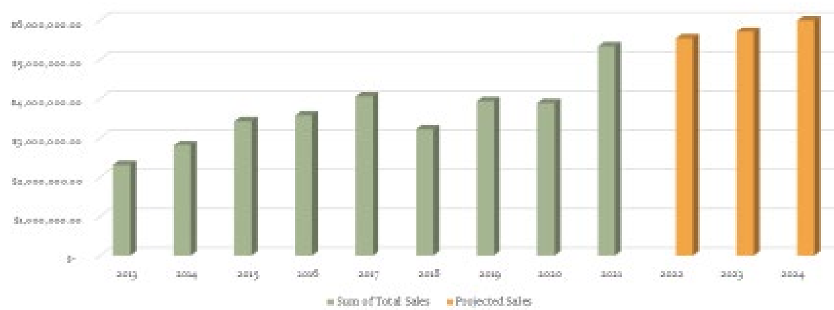
OPERATIONS COSTS (BUDGETED)

Category	Total
Staffing	$132,269
Reserve	$18,000
Marketing	$46,600
Licensing	$59,000
Infrastructure	$37,000
Banking/Insurance	$20,750
Agency Support/Overhead	$42,000
Total	**$355,619**



SALES BY FISCAL YEAR

(REPORTING BASED ON FISCAL YEAR BEGINNING IN JULY AND ENDING IN JUNE)



- Sales $2.3 million (2013) grew to $5.3 million in (2021). Current FY22 Sales - $5.1 million (July 2021 – April 2022)
- Sales are projected to reach $6 million by 2024

CASE SALES BY FISCAL YEAR

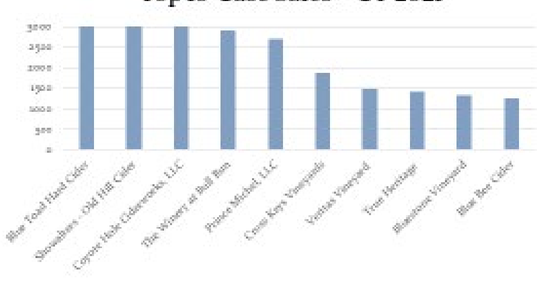
(REPORTING BASED ON FISCAL YEAR BEGINNING IN JULY AND ENDING IN JUNE)

Cases sold grew from 18,000 (2012) to 39,000 (2022)

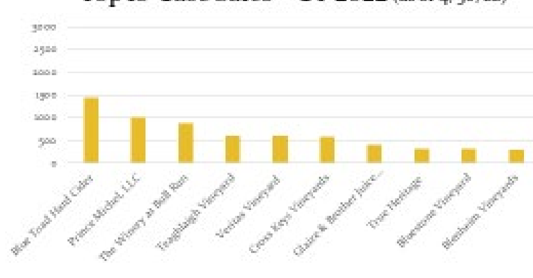
TRANSACTION LIMITS / CURRENT UTILIZATION

The Board may grant a wholesale wine license to a nonprofit, nonstock corporation created in accordance with subdivision B 2 of § 3.2-102, which shall authorize the licensee to provide wholesale wine distribution services to winery and farm winery licensees, provided that no more than 3,000 cases of wine produced by a winery or farm winery licensee shall be distributed by the corporation in any one year.

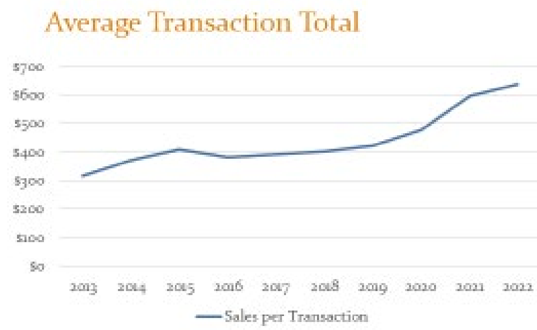
Top 10 Case Sales – CY 2021



Top 10 Case Sales – CY 2022 (as of 4/30/22)



TRANSACTIONS



While the Transaction qty has stayed within the range of 7,000 to 10,000, the average transaction total has more than doubled ($317 in 2013 to $636 in 2022)

ANTICIPATED VWDC NEEDS

- Infrastructure – Existing online ordering platform approaching end of life, needs redesign
- Marketing – Wineries have requested additional marketing assistance
- Staffing – Increasing membership will require additional staffing

ASSUMPTIONS FOR BREWERIES

- Winery funding is not subsidizing the addition of Breweries
- General Fund Appropriation
- Transaction Fees will generate the same percentage of the budget as wine model (Approximately 15%)
- Brewery operating budget will cover expenses of necessary staffing

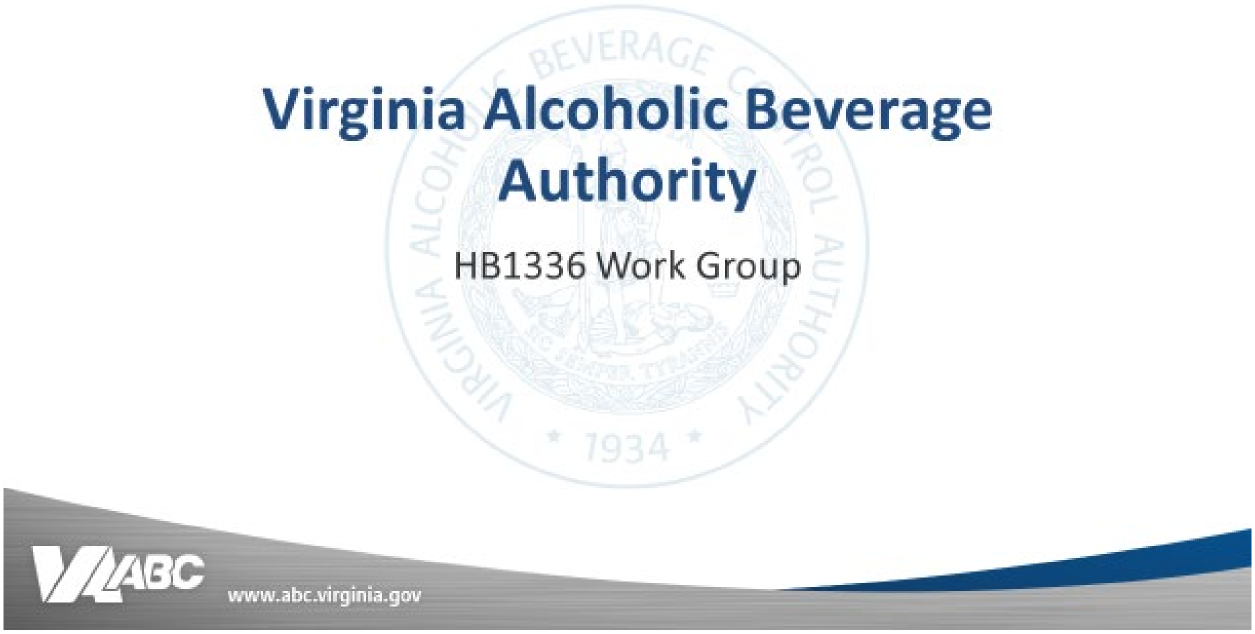
BREWERY COST ESTIMATES

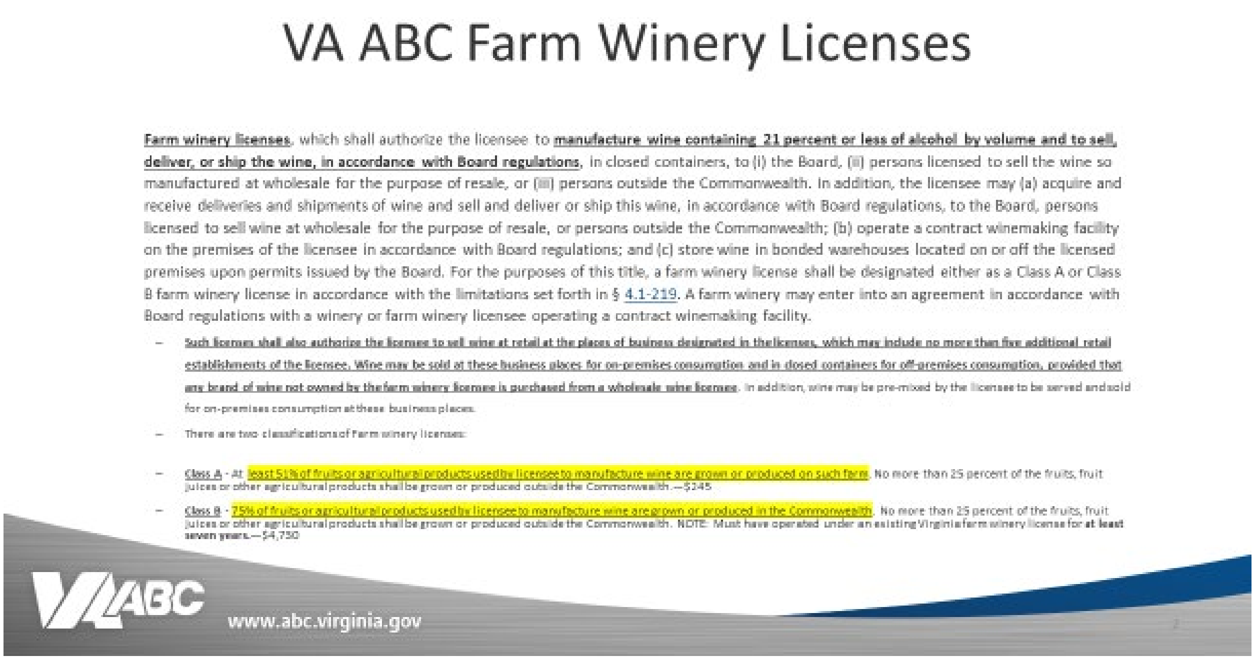
Category	Year 1	Year 2	Notes
Agency Support / Overhead	$25,000	$25,000	
Banking/Insurance	$30,000	$30,000	
Infrastructure	$310,000	$40,000	Year one includes initial system implementation and monthly hosting. Year two includes monthly hosting and additional software development if needed.
Licensing	$50,400	$48,210	Year one : Application fees @ $195 each, License Fee @ $1005 for 42 Breweries. Year two: License fee renewals and estimate 5 new Breweries
Marketing	$47,000	$47,000	
Reserve	$20,000	$20,000	
Staffing	$205,800	$205,800	Includes Operations Manager and Financial Specialist position
Total	**$688,200**	**$416,010**	

Notes:
- Year 1 – General Fund to cover 100% of costs. Year 2 – General Fund to cover 85% of costs, based on roughly 15% coming from transaction fee revenue.
- Year 2 transaction fees should equal approximately $63,000 to serve as 15% of overall budget (10,500 transactions @ $6 each)

APPENDIX B

Virginia Alcoholic Beverage Authority Presentation





Winery Licenses

Winery licenses, which shall authorize the licensee to **manufacture wine and to sell and deliver or ship the wine, in accordance with Board regulations**, in closed containers, to persons licensed to sell the wine so manufactured at wholesale for the purpose of resale, and to persons outside the Commonwealth for resale outside the Commonwealth. In addition, such license shall authorize the licensee to (i) operate distilling equipment on the premises of the licensee in the manufacture of spirits from fruit or fruit juices only, which shall be used only for the fortification of wine produced by the licensee; (ii) operate a contract winemaking facility on the premises of the licensee in accordance with Board regulations; (iii) store wine in bonded warehouses on or off the licensed premises upon permit issued by the Board; and (iv) **sell wine at retail at the place of business designated in the winery license for on-premises consumption or in closed containers for off-premises consumption, provided that any brand of wine not owned by the winery licensee is purchased from a wholesale wine licensee and any wine sold for on-premises consumption is manufactured on the licensed premises.**

- There are two classifications of Farm winery licenses:
- **5,000 or less gallons**—$215
  Over 5,000 gallons—$4,210

Brewery License

Brewery licenses, which shall authorize the licensee to **manufacture beer and to sell and deliver or ship the beer so manufactured, in accordance with Board regulations**, in closed containers to (i) persons licensed to sell the beer at wholesale and (ii) persons outside the Commonwealth for resale outside the Commonwealth. **Such license shall also authorize the licensee to sell at retail at premises described in the brewery license (a) the brands of beer that the brewery owns for on-premises consumption, provided that not less than 20 percent of the volume of beer sold for on-premises consumption in any calendar year is manufactured on the licensed premises, and (b) beer in closed containers, which shall include growlers and other reusable containers, for off-premises consumption**.

- There are three classifications of Brewery licenses:
- **Up to 500 barrels**—$380
  501 to 10,000 barrels—$2,350
  Over 10,000 barrels—$4,690

Limited Brewery License

Limited brewery licenses, to breweries that **manufacture no more than 15,000 barrels of beer per calendar year, provided that (i) the brewery is located on a farm in the Commonwealth on land zoned agricultural and owned or leased by such brewery or its owner and (ii) agricultural products, including barley, other grains, hops, or fruit, used by such brewery in the manufacture of its beer are grown on the farm.** The licensed premises shall be limited to the portion of the farm on which agricultural products, including barley, other grains, hops, or fruit, used by such brewery in the manufacture of its beer are grown and that is contiguous to the premises of such brewery where the beer is manufactured, exclusive of any residence and the curtilage thereof. However, the Board may, with notice to the local governing body in accordance with the provisions of § 4.1-230, also approve other portions of the farm to be included as part of the licensed premises. For purposes of this subdivision, "land zoned agricultural" means (a) land zoned as an agricultural district or classification or (b) land otherwise permitted by a locality for limited brewery use. For purposes of this subdivision, "land zoned agricultural" does not include land zoned "residential conservation." Except for the limitation on land zoned "residential conservation," nothing in this definition shall otherwise limit or affect local zoning authority.

- **Limited brewery licensees shall be treated as breweries for all purposes of this title except as otherwise provided in this subdivision.**

Limited Brewery Licenses cont.

- There are three classifications of Limited Brewery licenses:

- **Up to 500 barrels**—$380
  501 to 10,000 barrels—$2,350
  10,0001 to 15,000 barrels—$4,690

Reporting Excise Tax

- Farm Wineries and Wine Wholesale
  - Due 15th of each month, for the preceding month.
- Breweries and Beer Wholesale
  - Due 10th of each month, for the preceding month.
- Wineries
  - Due when product is moved from bonded location.

Reporting Excise Tax cont.

- Pursuant to **§ 4.1-236. Excise tax on beer and wine coolers; payment of tax; exceptions.**
- A. There is levied on all beer and wine coolers sold in the Commonwealth an excise tax at the rate of:
  - 1. Twenty-five and sixty-five hundredths cents per gallon per barrel;
  - 2. Two cents per bottle on bottles of not more than seven ounces each;
  - 3. Two and sixty-five hundredths cents per bottle on bottles of more than seven ounces each but not more than twelve ounces each; and
  - 4. Two and twenty-two one hundredths mills per ounce per bottle on bottles of more than twelve ounces each.

- https://www.abc.virginia.gov/bwcrpt/public/malt_tax_cal.jsp

- https://www.abc.virginia.gov/webtax/login.do?linkURL=https://www.abc.virginia.gov:443/webtax/public/main_tax_menu.do