Testimony on SB 5519

Joint Committee on Ways and Means Subcommittee on Transportation and Economic Development

Submitted by Michael Selberg - Owner/Head Distiller at Cannon Beach Distillery

Chair Manning, Chair Gomberg, and members of the Committee, thank you for hearing testimony on issues pertaining to the O.L.C.C. and its budget

In 2011, I decided to start my own business in Cannon Beach. I had $150,000 in startup loans, and my own two hands. I decided to start a distillery because I felt I had a talent for producing spirits, and saw value in the vacation community market of Cannon Beach.

Cannon Beach Distillery was licensed as a business in November of 2011, and opened its doors for sale July 1st 2012. I ran the distillery as a one-man operation for two years, producing every drop of my spirits from raw ingredients myself. I would do production in the back room of a 1,100 square foot building and sell the spirits by the bottle out of my tasting room in the front when customers came in. I built Cannon Beach Distillery one bottle at a time. I would spend as much money as I had to produce a batch of Gin or Rum, and reinvest any profit into making the next batch larger.

To this day, I use the same 8 drums for fermentation, an old milk-pasteurizing tank I refurbished from a collapsing barn, and a 100-gallon still (about as much volume as your average bathtub). Starting and maintaining a distillery is very capital intensive, and we have never been able to produce enough revenue to upgrade the equipment.

After 2 years, I was able to hire my first employee to help with a bit of production and watch the sales counter so I could focus on distilling. Once I was able to hire a few employees, it became apparent that I would need more space to safely produce and store the increasing batch sizes. In 2016 Cannon Beach Distillery moved to a 5,000 square foot facility up the street in hopes that we could grow into our potential.

The perception of my Distillery and our brand of Spirits have been tremendous. In the last 5 years Cannon Beach Distillery has been awarded 28 national and international awards on 11 uniquely different spirits. We have been consistently ranked as one of the best Rum producers in the country, but have also won high awards on Gin, Agave Spirits, and Whiskey. USA Today has named us a Top 5 Rum producer in a readers poll, twice, and Travel and Leisure recently named us I top 10 distilleries in the country by consumer review.

Despite the accolades and presumed success, Cannon Beach Distillery has always struggled to turn a profit. Manufacturing spirits is labor intensive, expensive, and can take a very long time. Cash flow is difficult to maintain when we have to wait years for a product to reach maturity in order to see any return on the investment of those raw ingredients. Raw ingredients are expensive when you want to make the best spirits.

Due to the size of Cannon Beach Distillery and its limited production capacity, the vast majority of our bottles sales have occurred in our tasting room. To date, 85-90% of every bottle we have sold has been out of our tasting room. As production efficiency, and time to produce increased, we were able to supply more to distribution, but it often resulted in periods when the tasting room would be sold out and our liquor would be sitting in Milwaukie.

To date, roughly $1.5 million worth of Cannon Beach Distillery spirits have been sold out of our tasting room, exclusively. $500,000 of that money was paid to the OLCC. Not only is that one third of the value of those spirits, but also 25% of our gross receipts since Cannon Beach Distillery opened its doors.

Those payments to the OLCC have been the largest use of cash by my business by far, vastly more than Payroll, Rent, and Raw Ingredients.

Half a million dollars in 6.5 years is a lot of money for a start up that began with $150,000. When we dive into the volume of product sold to produce that money for the State of Oregon, the numbers get even more staggering. For the sake of time and ease, I will explain the rate of OLCC payments over the last two years out of our tasting room:

2017: 8,595 bottles were sold for a total of $313,000.00

$105,000.00 was paid to the OLCC for those sales

2018: 7004 bottles were sold for a total of $275,000.00

$91,522.29 was paid to the OLCC for those sales

The average single bottle of Cannon Beach Distillery spirit sold out of our tasting room produced the OLCC $13.31 in 2017 and $13.12 in 2018. An employee of the OLCC never touched these spirits. They did not need to be received, registered, and stored at the OLCC distribution center. They did not need an OLCC employee to organize, load, ship, and sell. Only my employees and myself ever handled these spirits prior to sale.

On average, the OLCC receives 49% of the listing cost of a spirit in an OLCC liquor store. 51% accounts for the sale price of a distillery or distributor to the OLCC. That means that my average bottle, sold out of my tasting room, produces more revenue for the OLCC than any bottle at an OLCC liquor store priced below $26.00. Those bottles have been fully distributed by the OLCC while mine has never left my distillery.

Let's look at another metric.

The Federal Government, and most other States, use a metric to measure and tax the amount of alcohol manufactured and sold by distilleries called a 'Proof Gallon'. A proof gallon (PG) is the amount of alcohol in 1 gallon of 100 proof (50%ABV) spirit. It is equivalent to 6.31 bottles of spirit, if the bottle is 750mL and the spirit is 80 proof.

This metric is useful because alcohol containers often vary in size, and spirits often range in alcohol content. The amount of spirit a distillery produces can thus be standardized into a metric that every distillery uses to pay Federal Excise Tax. You may recognize the term from the recent Federal Excise Tax debates Senator Wyden has championed. He assisted in reducing the federal excise tax (FET) from $13.50 to $2.70.

The reason I bring this up is that many of the bottles I sold out of my tasting room were 375mL, while others had higher alcohol concentrations. So, to give you a real sense of how much alcohol was sold:

2017: 1,249.38 PG sold out of tasting room

2018: 1,105.14 PG sold out of tasting room

As a thought experiment, let's think about OLCC revenue in terms of the amount of alcohol sold rather than the sale price. If we divide the amount of OLCC revenue produced by the amount of alcohol we sold to produce it, we get this:

2017: $84.05 per Proof Gallon Sold

2018: $82.82 per Proof Gallon Sold

Again, the Federal Excise Tax rate was $13.50 per PG before there was uproar by craft distillers to drop it to $2.70 per PG. The majority of other States use an excise tax, like this one, to tax their distilleries. The average rate among those states is $3.77 per PG. Prior to privatization, Washington State had the highest excise tax at a little over $30 per PG.

It is conceivable that Cannon Beach Distillery pays the highest rate of tax, based on the volume of alcohol sold, in the United States. I'm yet to find anyone that averages higher out of their tasting room.

The reason the OLCC gives for controlling distilled spirits in this State pertains to issues of public health. A bottle of spirit can be more easily abused than other beer and wine based on its concentration, therefore it must be controlled. This reasoning has been reiterated again, and again as debates pop up over the role of the OLCC. I agree that distilled spirits are more dangerous to public health. However, The system of revenue production, especially out of tasting rooms, produces a market that drives down the cost and quality of spirits, while punishing higher value products.

For example:

There are Oregon distilleries that purchase, blend, and bottle their product. They purchase no raw ingredients; they have nobody that needs to understand fermentation or complex distillation. They can purchase a high-purity vodka from a company in Indiana, add water to it, filter it, and sell it as an Oregon Craft Distilled product for $8 (750mL bottle at 80 proof).

Let's say they sell that $8 bottle out of a tasting room on the first of the month. The wholesale price from the distillery to the OLCC is probably around $4.05 based on their average markup. That tasting room receives 8.15% of the sale price of that bottle plus an additional 14.25% on the first $10,000 sold. Since it's the first of the month, they get the maximum amount. That means the tasting room makes $5.84 and the OLCC makes $2.16

The Cannon Beach Distillery tasting room functions on the same rules. However, when you look at the amount of money produced based on the amount of alcohol sold, there is a massive discrepancy. That $8 bottle of purchased and blended Vodka has an effective tax rate of $13.64 per proof gallon. Remember, my average for the last two years was over $80 per proof gallon. Not only does the other distiller skirt all the manufacturing costs, but they are rewarded for it by paying dramatically less to the OLCC per ounce of alcohol sold.

It becomes a race for whoever can produce the most alcohol for the least amount of money. You tell me. In terms of public health, which is more damaging, an $8 bottle of vodka, or a $60 half-bottle of locally manufactured Whiskey?

I would like to think that this committee and the OLCC could agree that there are clear problems in the way revenue is produced from Distillery Tasting Rooms. Personally, I would love to see all OLCC revenue disappear from tasting rooms, but realize the Oregon budget cannot relinquish 2 million in revenue from one source with recouping it elsewhere.

I recommend that this committee and the OLCC think about replacing the current method of revenue production in Distillery Tasting Rooms. OLCC revenues should come from a flat rate excise tax on the amount of alcohol sold rather than the percentage of that bottle's value. This evens the playing field for distilleries and maintains revenue for the state. It also reflects the OLCC's continued claim that distilled spirits are more harmful to public health by taxing the amount of alcohol rather than its value.

Today my business is on the verge of collapse. I can no longer increase my batch sizes based on the carrying capacity of bottle sales out of our tasting room. If I put spirits into OLCC distribution, they sell slower and I receive less revenue. My debts have nearly doubled since I've started, so I'm trying to find ways to exit the market with the least amount of financial ruin as possible. My only options to keep the business alive involve moving it out of state. If Cannon Beach Distillery cannot be saved, please, please, learn something from this testimony and make some much-needed changes