Striking the Right Balance:

Modernizing Beer Retailing and Distribution in Ontario

Premier's Advisory Council on Government Assets

Ed Clark, Chair

David Denison

Janet Ecker

Ellis Jacob

Frances Lankin

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EXECUTIVE SUMMARY

In November 2014, the Advisory Council on Government Assets presented our Initial Report to government entitled "Retain and Gain: Making Ontario's Assets Work Better for Taxpayers and Consumers". The Initial Report contained our overall assessment of the beverage alcohol and electricity sectors in Ontario and our thinking on the future direction for these sectors.

Following submission of our Initial Report, the government expanded the Council's mandate and authorized us to move into the second phase of our beverage alcohol review.

In Phase 2 of our review, the Council's first priority was to address the beer retailing and distribution system in the province. We further developed our thinking from Phase 1 with continued analysis and stakeholder consultation and engaged with the current owners of the Beer Store (TBS) directly to negotiate an agreement that will materially reframe the way that beer is sold in Ontario. This has necessitated that the Council work closely with the government at all times. Throughout our review, we have been guided by the government's broader public policy objectives in developing our proposals and negotiating with TBS. Our proposals were discussed in detail with government prior to completing negotiations with TBS and have the government's full support.

Although the issues involved were complex and the negotiations were challenging, the Council would like to acknowledge the business-like manner in which TBS and the management of the owner-brewers approached the process and demonstrated their willingness to voluntarily reach a new agreement with the Province that materially reshapes the system. We also recognize the important role that TBS and its owners play in the Ontario economy as employers and taxpayers.

This report represents our final report to government on the future direction for beer retailing and distribution in Ontario.

However, the scope of our review of beverage alcohol also includes both wine and spirits retailing. We recognize that many participants in the beverage alcohol sector would like the Council to lay out all the details for every part of the sector at the same time. Unfortunately, this is neither practical nor responsible. To achieve a positive outcome, it is essential that we understand in detail the implications of any decisions. This can only be achieved through extensive discussions and dialogues with all stakeholders and government.

Accordingly, the Council would ask that industry participants – and the public – continue to work with us in our review of the sector. The Council remains committed to improving the beverage alcohol sector for consumers, producers, and taxpayers in a socially responsible way. We expect to continue our consultations and analysis in the months following the tabling of the government's 2015 Budget, with a view to developing a carefully considered future direction for wine and spirits retailing in Ontario.

Beer Retailing: Our Perspective

There were two core issues at the heart of the Council's review of beer retailing in Ontario:

- how to materially enhance customer convenience, choice and shopping experience, while continuing to ensure that Ontarians can buy their beer at prices below the Canadian average; and
- how best to establish a level playing field for all producers selling beer in Ontario.

Through our work, we considered whether the best way to address these issues would be to scrap the current system completely and remove the existing quasi-monopoly held by TBS. Our conclusion was that, despite its faults, the current system has one redeeming feature: it is efficient and low cost, allowing consumers to enjoy prices below the Canadian average while supporting a competitive yield for taxpayers (see table).

Beer prices and provincial taxes (average 24-pack)[1]
all figures are approximate

	Ontario	Quebec	Alberta	British Columbia
Consumer price (excluding deposit)	$34 to $35	$34 to $35	$40	$40
Provincial commodity and sales tax	$11	$8	$10	$12

Dismantling a quasi-monopoly system, as has been done elsewhere, provides for a small increase in convenience at either much higher prices for consumers and / or reduced revenues for government. Such a change also does not help to establish a level playing field, as expanded access oftentimes brings a focus on mainstream brands.

However, the current system is not equitable for all producers and TBS provides a basic customer experience.

In light of this, the Council determined that there is a need for material foundational change in TBS and the beer retailing system in Ontario as a whole. The Council's goal was to develop an agreed-upon solution that retains some of the best features of the existing system, introduces a number of significant improvements, and balances the interests of consumers, government, taxpayers, brewers, and restaurants and bars in a socially responsible way. On this basis, we have negotiated a new Memorandum of Understanding that will act as the framework (New Beer Framework) for a new agreement between the Province and the Beer Store, which will replace the current Beer Framework Agreement (2000) that exists between TBS and the LCBO.

[1] Please see note in body of report (page 32).

Conclusion

The Council is satisfied that the New Beer Framework levels the playing field: we have returned the Beer Store to its co-op roots. In our view, the reframed beer retailing system:

- improves customer convenience, choice and shopping experience;
- keeps beer prices for Ontario consumers below the Canadian average;
- maintains efficiencies of the existing system;
- treats suppliers fairly while improving retail access;
- introduces additional competition;
- increases revenue for government while maintaining competitive beer tax rates; and
- remains socially responsible.

The new beer retailing landscape of Ontario will feature increased competition and consumer choice with the availability of beer in up to 450 grocery stores across the province in addition to the 450 existing TBS stores, 113 on-site brewery retail stores, and 651 LCBO stores and 217 LCBO agency stores, an increase of over 30% for a total of more than 1,800 outlets. These grocery stores will only be allowed to sell beer provided that they meet shelf space requirements for small brewers and that they purchase beer from the LCBO at a discount that represents a much lower cost than other retail channels. Uniform pricing and safeguards to ensure social responsibility will be maintained across all channels. Additionally, to protect consumers from the possibility of beer prices increasing in the short-term, prices for certain products of popular brands will be constrained until May 2017.

Throughout our work, the Council has been particularly concerned with improving the system for consumers and ensuring that all brewers are treated fairly. We have, of course, also focused on protecting the interests of Ontario taxpayers, consistent with our original Terms of Reference. We are satisfied that the new system offers each of these groups significant gains.

Consumers

The new system will provide consumers with improved convenience and choice by allowing beer to be sold in grocery stores. The customer experience in TBS stores will be greatly improved through a $100 million capital commitment to modernize their network, and all new stores will be open concept, self-serve formats. In addition, a limited pilot study of selling 12-packs through the LCBO offers an opportunity for greater access for consumers across the province. Furthermore, the New Beer Framework provides protection for LCBO combination stores that currently offer 12- and 24-packs of beer, and improves the mechanism for the LCBO or TBS to open new stores in underserved communities. If the 12-pack pilot is successful, there could be more than 220 LCBO stores (including the existing 167 LCBO combination stores) and 217 agency stores selling 12- or 24-packs of beer in smaller communities across Ontario.

Gains for consumers will not be achieved at the expense of social responsibility. The Council has worked carefully to ensure that increased access does not mean unrestricted access. The grocery store format that we are proposing is for urban grocery stores only, and there will be clear restrictions on hours of sale, uniform pricing, appropriate check-out safeguards, and social responsibility training for all employees facilitating the purchase of beer. In addition, the Ontario Deposit Return Program (ODRP) has been extended with TBS at a significantly improved price for the Province.

Finally, restaurants and bars (licensees) are charged different (and sometimes much higher) prices for beer today. The New Beer Framework will ensure that small licensees will be able to purchase beer through TBS at the same retail price as consumers. Almost 9,000 small licensees, over half the current licensees in the province, will be able to benefit from this change.

Producers

Under the new system, ownership of the Beer Store will be open to all brewers with facilities in Ontario, providing them with an opportunity to benefit from increases in the value of the business and associated shareholder rights. Additionally, their interests will be further protected by having four independent directors on the board with effective veto rights on brewer fairness and other important issues.

All brewers, except for the current owners, will see their costs of retailing beer through TBS decline. Small and mid-size brewers specifically will see their TBS costs fall by about 5% to 10%. Small brewers will have significant advantages, with a minimum of 20% shelf space allocation in TBS and grocery stores, and incentives for the grocers to sell more of their beer. As with existing channels, brewers will retain the ability to set prices in grocery stores and will earn the same margin as if the sale occurred in an LCBO store. Lastly, small brewers will gain the ability to more efficiently deliver their products directly to retail points of sale and licensees by pooling their products with the option of using third party carriers and warehousing.

Taxpayers

The new system provides for government, and by extension taxpayers, to share more equitably in the value currently generated by the system. This value will be achieved on a phased basis with price restrictions limiting the impact on consumer prices.

Any new system needs a degree of long-term stability to permit responsible capital planning by retailers and producers, while not locking the new model in perpetuity. The Council is satisfied that, with the protections built into the New Beer Framework, an initial 10-year term achieves this balance.

The Council recognizes that the new system represents significant change within the Province's current regulated environment for beverage alcohol. Some will argue that we should have gone further. We have examined other models in Canada and found that, in many cases, consumers pay more and taxpayers get less while convenience is not significantly improved. Conversely, some will argue that the current system should be left unchanged. However, today's system limits convenience and may not provide all producers with equitable treatment. The Council has opted for significant, controlled change – the biggest change in beer distribution in Ontario since prohibition. We believe that this new beer retailing system will better serve all Ontarians and stakeholders.

FINAL RECOMMENDATIONS

The Council has now completed its review of TBS and beer retailing in Ontario. This section presents the final recommendations we made in support of the government's 2015 Budget that have been incorporated in the New Beer Framework.

1. TBS should continue to operate, but with broader ownership, and fundamentally improved governance and operating practices, including:

    - opening its ownership to all brewers with facilities in Ontario;
    - establishing a new 'best practices' governance structure that allows it to operate at arm's-length from its owners, with brewer directors nominated based on relative market shares, and a critical mass of independent directors;
    - requiring independent directors to approve any change related to brewer treatment and fairness, as well as any changes to the New Beer Framework;
    - appointing an independent TBS Ombudsman to handle complaints;
    - operating in a more open, transparent and accountable manner;
    - enshrining a new mechanism for determining rates charged to all brewers, lowering costs for all brewers other than the current owners;
    - changing its retail and marketing practices to ensure fairness and equity among brewers; and
    - investing $100 million over four years, 80% of which will help modernize its stores.

2. The Province should increase its annual revenues from beer sales in Ontario through a new beer charge as part of the existing beer tax framework. The principal brewers in the industry have separately confirmed to the Province their intention to comply with the Province's expectation that retail prices for certain products of their most popular brands will not increase before May 1, 2017. The only exceptions would be to reflect changes in the minimum retail price of beer (which is indexed to inflation) and circumstances where the industry context materially changes.

3. The Ontario Deposit Return Program contract should be extended at a discount to the current rates without annual indexing to inflation.

4. The LCBO should be permitted to conduct a 10-store pilot study to explore the viability of offering 12-packs with an option to expand to 60 stores.

5. Small restaurants and bars should be able to buy beer from TBS at the same retail prices as consumers.

6. Small brewers should be allowed to jointly deliver their products to the LCBO and licenced establishments with the ability to use third party carriers and warehousing.

7. The Alcohol and Gaming Commission of Ontario (AGCO) should allow brewers with two production facilities to have an on-site retail store at each facility for the sale of their products only, regardless of the production size of their facilities.

8. The Province should offer to a number of qualifying grocery stores operating in Ontario up to 450 licences or other permissions to sell beer. This new channel should be phased in over time with up to 150 outlets in operation by May 1, 2017. Licences should be made available through an open and transparent process designed to achieve:

    - fair market value for the Province;
    - fair representation of privately-owned grocers;
    - appropriate distribution across urban areas in Ontario; and
    - a diversity of grocers to prevent the creation of a new monopoly.

Retail beer licences should include requirements to:

- operate with restricted hours of sale, appropriate check-out provisions, uniform pricing, and social responsibility training for all employees facilitating the purchase of beer;
- sell all beer – domestic and international – with specific requirements on shelf space and incentives for sales of small brewers' products;
- sell beer only in pack sizes of six or smaller (with no pack-up pricing);
- limit annual beer sales to an average cap per store of the volume equivalent of $1 million, which may be shared across a single grocer's licenced stores;
- position the LCBO as the wholesaler;
- purchase beer from the LCBO at a discount that represents a much lower cost than other retail channels, locked in for at least 10 years; and
- prohibit inducements or monies from suppliers.

9. The New Beer Framework should last for an initial term of 10 years, with recurring options to renew for 5-year terms and beyond. The New Beer Framework should include termination provisions that facilitate an orderly wind-down of the agreement with TBS and avoid uncertainty if not renewed.

INTRODUCTION

Background

In November 2014, the Advisory Council on Government Assets presented to the government our Initial Report entitled *“Retain and Gain: Making Ontario’s Assets Work Better for Taxpayers and Consumers”*. The Initial Report included our overall assessment of the beverage alcohol sector in Ontario, detailed reviews of the LCBO, the Beer Store and off-site Winery Retail Stores and our thinking on the future direction of the sector.

Specific to TBS, the Council expressed its view that the TBS structure has the potential to generate advantages for the current owners. We also indicated that we wanted to explore opportunities to improve the customer experience, open up the market for small brewers, and introduce limited competition into Ontario’s beer retailing system.

In response to the Council’s Initial Report, the government issued a statement indicating its support for the direction of the proposals contained in the Initial Report and authorized the Council to move to the second phase of our review.

The government expanded the Council’s mandate for Phase 2 of its review. The amended mandate authorized the Council to conduct further due diligence on the proposals presented in the Initial Report and to develop an implementation plan. The Council was also mandated to provide final recommendations to the government in support of its 2015 Budget process.

Our amended mandate recognized that the Council is both an advisory body and a representative of the interests of the Crown. In this latter capacity, the Council engaged with the current owners of the Beer Store directly to negotiate an agreement that will materially reframe the way that beer is sold in Ontario. This has necessitated that the Council work closely with the government at all times. Throughout our review, we have been guided by the government’s broader public policy objectives in developing our proposals, which were discussed in detail with government prior to completing negotiations with TBS and have the government’s full support.

Approach

TBS

Over the course of Phase 2, the Council held numerous discussions with representatives of TBS and the management of the owner-brewers. We consulted with over 30 stakeholders, including individual brewers, brewers' associations, representatives of restaurants and bars, as well as representatives of grocery chains and independent grocers operating in the province. Additionally, we greatly benefitted from consultations with representatives of a number of social responsibility and public health organizations in the province. We carefully considered input and reaction from these stakeholders.

We also conducted detailed analysis and further due diligence on the beer retailing system and considered a wide range of potential options and scenarios for the future of the system. The input from our consultations, together with our detailed analysis, enabled us to refine our thinking and to develop an actionable framework of proposals. This formed the basis for our negotiations with TBS and its owners on the New Beer Framework. The New Beer Framework is included in the Attachment.

The Council believes that the New Beer Framework appropriately balances the public interest with those of stakeholders and has been developed with a view to securing the best outcomes for the people of Ontario.

Although the issues involved were complex and the negotiations were challenging, the Council would like to acknowledge the business-like manner in which TBS and the management of the owner-brewers approached the process and demonstrated their willingness to voluntarily reach a new agreement with the Province that materially reshapes the system. We also recognize the important role that TBS and its owners play in the Ontario economy as employers and taxpayers.

LCBO

In parallel with our work on TBS, the Council has been working with the LCBO on an implementation plan for the proposals contained in the Council's Initial Report. These include:

- advanced e-commerce offerings;
- alternative store formats, including specialty boutiques for craft beer and spirits;
- co-labeling products;
- productivity improvements;
- revisions to its pricing and mark-up strategies to better leverage its buying power in a transparent and rule-based manner; and
- revised management accounting and reporting.

Good progress is being made on developing each of these areas. The Council will continue to work closely with the LCBO in the coming months as the LCBO's implementation program moves forward and will report on that program in due course.

Off-site Winery Retail Stores

The third stream of our work focuses on wine retailing in Ontario. This is a complex area with a diverse set of stakeholders. It is important to recognize that alternative retail channels already exist for wine in Ontario – there are nearly 300 off-site Winery Retail Stores, three-quarters of which are co-located with large grocery stores in the province. These stores offer certain Ontario VQA wines as well as blended products that are often, in effect, low-cost imported wines containing at least 25% Ontario wine content (an important source of demand for Ontario grapes).

With that said, the Council believes there is an inherent unfairness to other producers in this structure that should be addressed as part of the future direction for beverage alcohol retailing in the province, while recognizing the investments made by existing retail licence holders to build out their channels. The Council will need to address how these existing licences will fit together with the introduction of beer in grocery stores and other private channels.

We expect to continue our consultation and analysis over the months following the tabling of the government's 2015 Budget, with a view to laying out our perspectives on wine retailing in Ontario and our recommendations for its future direction.

Spirits

Similarly, we are beginning work on spirits retailing, and we expect to undertake consultations and analysis of this area in parallel with our work on wine retailing and to bring forward proposals on future directions at the same time.

Our Report

This report represents our final recommendations to the government on the future direction for beer retailing and distribution in Ontario. The report outlines the major issues that the Council considered in light of the detailed due diligence, analysis, and stakeholder consultations that we undertook in Phase 2 of our review, and it describes the significant points of the New Beer Framework reached with TBS.

THE COUNCIL'S PERSPECTIVE

Guiding Principles

As the Council considered the future direction for beer retailing and distribution in Ontario, we developed principles to guide our thinking on how best to reframe the system and balance the interests of taxpayers, the government, brewers (both the TBS owner-brewers and non-owner brewers) and consumers. Our principles were:

- **Enhanced customer experience and convenience**. There should be improved retail access to beer while maintaining social responsibility; the consumer experience should be improved in TBS.
- **Increased competition**. The new system should broaden competition with the existing quasi-monopolies.
- **A level playing field**. The new system should provide equal access to TBS and fair treatment for all beer producers and distributors in Ontario.
- **Improved supplier access**. Producers should have greater access to fair and competitive retail channels outside of the LCBO and TBS.
- **Financial benefits to the Province**. The new system should secure additional financial benefits for the government and the people of Ontario, and keep beer prices in Ontario below the Canadian average.

Key Considerations

In our Initial Report, the Council acknowledged that TBS operates an efficient and relatively low-cost retail system that supports lower beer prices for consumers. However, as our work continued in Phase 2, we had a number of concerns about the system:

- The current owners of TBS face an inherent conflict of interest as its largest suppliers, and may be incentivized to operate the system in their own interests.
- TBS provides a basic customer experience.
- TBS does not provide enough opportunities for brewers to showcase their products.
- TBS lacks transparency and public accountability.

Our view was that the government should not continue to foster a marketplace that may provide unique benefits to a select few stakeholders. More broadly, we expressed the view that some degree of competition is always healthy to provide a challenge to any quasi-monopoly and to incentivize growth and innovation.

We also believe strongly that consumers should benefit from changes to the system. To this end, we have focused on improving customer convenience, choice and shopping experience. It is critical that this be done in a controlled and socially-responsible way that does not erode the efficiencies of the current system and raise prices for consumers.

Our review of the experiences in other jurisdictions showed that the introduction of new retail channels followed a troubling pattern. Over time, as the number of access points grew, retail and distribution costs increased, consumer prices went up, and, in some cases, government tax revenues declined. This is not a desirable outcome. It is our goal to find a better system that will lead to more convenience and competition, but not at the expense of consumers, taxpayers, or social responsibility.

Obtaining greater financial returns from the system was important, but secondary to our priorities of supplier fairness and consumer benefit. The Council believes that the government should earn a greater share of the financial benefits of the system as a whole only after the benefit accrues equitably to stakeholders. In addressing any inequities first, the government avoids the risk that greater value is extracted by crystallizing practices that may tilt the scales in the direction of a select few.

The Council listened to a wide range of views from stakeholders in Phase 2 of our review. The more we heard, the more convinced we became that meaningful change is required for beer retailing in Ontario. Moreover, we came to the view that such meaningful change should be foundational, not simply incremental. This implied a material redesign of the system including oversight and governance of TBS, alternative channels for beer in Ontario with accompanying competition for TBS and the LCBO, and financial arrangements to provide the government and taxpayers with a fair return.

Structure of the System

The first question we asked ourselves was whether we should consider a complete redesign of the beer retailing system. We explored a wide range of possible scenarios for alternative models that would essentially eliminate the current system and start again from scratch. We also looked carefully at possible ways to change the structure of TBS itself to better represent the interests of all brewers and customers. We were mindful of the on-going policy imperative that beverage alcohol remain a controlled and regulated substance.

After weighing these considerations against our guiding principles, we came to the conclusion that starting from scratch would risk losing many of the favourable elements of the existing system – not least the fact that it is relatively efficient and low cost. Such a system can generate competitive tax rates while keeping beer prices in Ontario below the Canadian average. We believe that preserving these benefits is important and is in the best interest of consumers. Accordingly, we focused on establishing foundational change using the current system as a starting point.

Ultimately, we came to the view that the public interest would be best served by materially reframing the agreement signed in 2000 between the government (through the LCBO) and TBS. The Council entered into extensive negotiations with TBS and its owner-brewers, as we prioritized balancing the interests of consumers, taxpayers, and brewers in a socially responsible way, while recognizing the investment in and merits of the beer retailing system operated by TBS. The New Beer Framework introduces a number of significant changes in the retail system for beer in Ontario.

The New Beer Framework

Ownership of TBS

As noted in our Initial Report, TBS was originally established in 1927 as a brewers' co-operative. Over time, ownership has been consolidated to the point that TBS is now owned and controlled by three brewers – Labatt, Molson Coors, and Sleeman. While the system is efficient and relatively low-cost, it has the potential to be inherently biased.

Under the New Beer Framework, TBS will continue to operate as a low-cost, efficient distributor of beer in Ontario. However, TBS will be returned to its co-op roots, opening up its ownership to all brewers with facilities in Ontario and operating on a self-sustaining break-even cash flow basis, where all brewers play by the same rules.

In this model, brewers with brewing facilities in Ontario that sell products through TBS will have the opportunity to become shareholders of TBS for a nominal price. Their ownership interest will reflect their share of the volumes sold through TBS. While existing owner-brewers will continue to own and be responsible for the business, TBS will be recapitalized so that all owners, both current and new, can participate in the appreciation in the book value of TBS' equity.

Governance of TBS

The New Beer Framework envisages a governance structure that moves TBS from a shareholder-managed business to a board-managed business, one which operates at an arm's-length from its owners. The structure will ensure fair treatment for all brewers, providing a voice for all owners and ensuring that consumer interests are properly represented.

Under the proposed model, TBS will be governed by a board of fifteen directors. Eleven of the board seats will be allocated across owner-brewers based on market share, with small brewers guaranteed at least one director. Based on current market shares in TBS, Molson and Labatt will continue to elect a majority of the board. The remaining owner-brewer directors will be elected by mid-sized brewers.

To address the inherent conflict of interest faced by owner-brewers in this system, the New Beer Framework proposes that four independent directors be appointed to the board. The initial four independent directors will be selected jointly by the government and the current TBS owner-brewers, after which new independents will be nominated by a majority vote of the independent directors themselves to ensure their continued independence. The Province will hold the right to require the removal of all of the independent directors. The independent directors will play a pivotal role in the governance of TBS. Specifically:

- key policies related to brewer fairness or neutrality (including retail and marketing principles such as categorization and rate sheet calculations) will require approval by a majority of independent directors;
- any transactions between TBS and its owners must be approved by a majority of independent directors and must be transparent, commercially reasonable, and auditable; and
- all committees of the board must include representation by independent directors.

A lead independent director will be selected by the independent directors and will have a tie-breaking vote on any resolution that is required to be passed by a majority of the independent directors.

The new TBS shareholders' agreement will embed the key governance principles, confirm the fiduciary duties of the board, and provide that the board, in addition to giving consideration to the best interests of TBS, will also be entitled to give consideration to broader stakeholder interests in supervising the management of TBS.

Finally, the New Beer Framework introduces the appointment of an independent TBS Ombudsman by the independent directors of TBS. The Ombudsman will report to the TBS board and will hear complaints from brewers and customers.

Openness and transparency

One of the Council's concerns about TBS in its current form is the limited degree to which information on its financial situation and operations is available to anyone other than its current owners.

Under the New Beer Framework, owners and independent directors will receive more detailed and timely information on financial performance, budgets and business and capital plans. TBS will continue to publish an annual Operations Report as well as information on key policies and decisions for the broader public.

The Council expects that the Alcohol and Gaming Commission of Ontario will provide enhanced regulatory oversight of the new TBS.

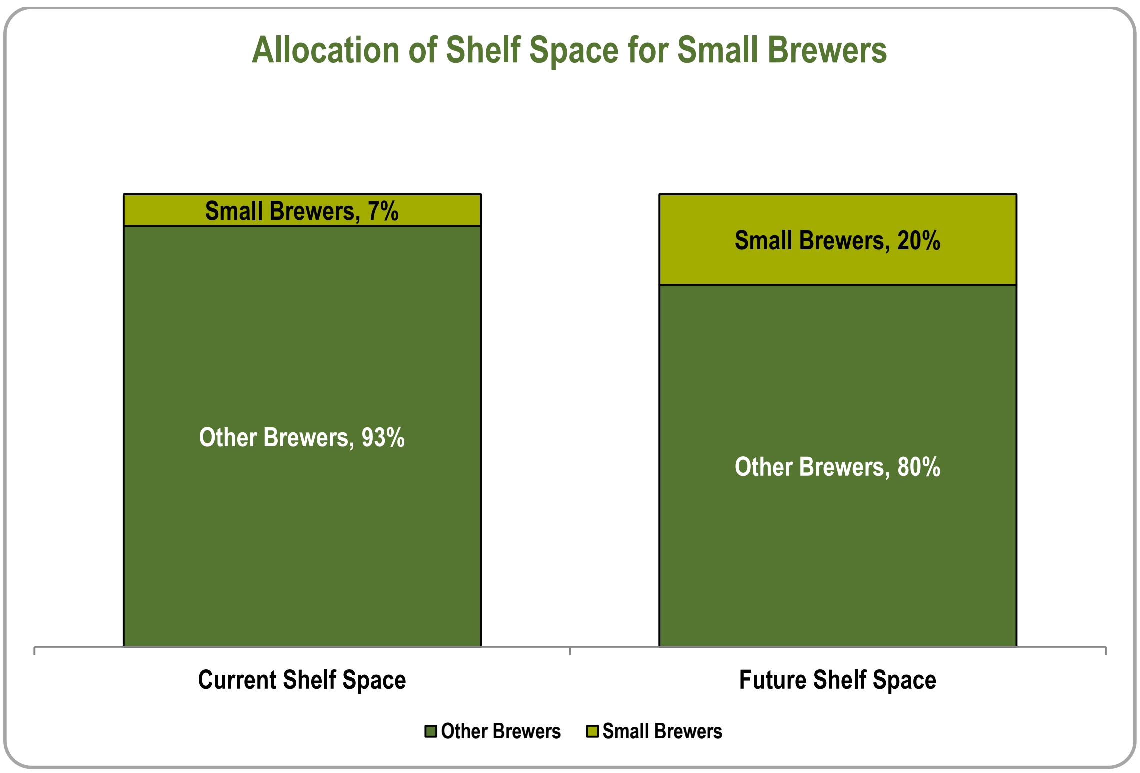
Retail and marketing practices

Today, the Beer Store allocates shelf space, marketing, and promotional programs on the basis of relative market share in Ontario. Although reasonably fair in aggregate, this serves to maintain the market share of existing brands and to limit the ability of small players to grow. Further, this gives the smaller brands no real opportunity for shelf space, even if they are growing at above-average rates.

To address this, the New Beer Framework requires that all shelf space and merchandising, marketing and promotional programs and decisions be made on a category basis and allocated based on local market share with meaningful adjustments for a brand's growth. Categorization decisions must be approved by the independent directors.

Much attention has been paid to the treatment of craft brewers in the Beer Store. However, it is worth noting the difference between small brewers and craft beer. Small refers to the size of a brewer, and can be objectively defined. The definition of craft beer, however, is a subjective marketing term and more of a consumer concept. There is no uniformly accepted definition of craft beer, but craft generally refers to beers that are brewed using traditional methods, natural ingredients, and innovative techniques. Not all small brewers produce craft beer, nor are all craft brewers small. The Council's focus has been primarily on small brewers because we believe they have the best potential to grow, create jobs, and stimulate innovation and competition.

Accordingly, the New Beer Framework requires TBS to allocate a minimum of 20% of all shelf space, and merchandising, marketing and promotional programs within TBS to small brewers, roughly triple their current market share and shelf space. This cannot be changed without the approval of a majority of the independent directors. At the same time, "craft" beer will be established as a category to recognize the growing importance of these products for consumers.



Rate sheet and operations

TBS will become self-sustaining and will run on a break-even cash flow basis: service fees charged by TBS for retail and distribution will represent the fully-loaded costs of running the system. In returning to its co-op roots, TBS will charge all users (including the current and new owners) their fair share of costs based on the same rate sheet.

We recognize that smaller brewers are less able to afford the costs to bring their brands to market. Accordingly, the New Beer Framework requires that the rate sheet continue to be tiered and graduated, similar to how personal income taxes are progressive today.

One of the important factors in computing the new rate sheet for TBS is how best to address the fact that there are currently material historical pension obligations in TBS. As part of the New Beer Framework, we have created a structure where small brewers are not required to pay fees toward these obligations, mid-size brewers are protected from future increases in cost above $3 per hectolitre, and the balance of any required contributions will be borne by large brewers and the current owners. We believe this structure fairly addresses who should bear the cost of these pension obligations, which have the potential to grow should interest rates remain low.

As a result of these changes, all brewers, except for the current owners, will see their costs of retailing beer through TBS decline. Small and mid-size brewers specifically will see their TBS costs fall by about 5% to 10%.

Improving the customer experience in TBS

Historically, TBS has provided a basic retail experience for its customers. This limits a consumer’s ability to discover new products and a supplier’s ability to competitively display its offerings. The Council believes that a key priority for the new TBS should be to improve the experience of its customers.

In order to deliver on this, TBS has committed to funding $100 million of capital spending to help modernize the TBS network over the next four years, 80% of which must be allocated to retail store improvements. TBS will publicly disclose the amounts and use of these investments in its annual Operations Report.

TBS has also committed to ensuring that all new stores will be the open-concept, self-serve format, as shown below. Finally, suppliers will be provided with greater in-store marketing and promotional opportunities, to ensure that consumers are better aware of new and exciting brands and products at the Beer Store.

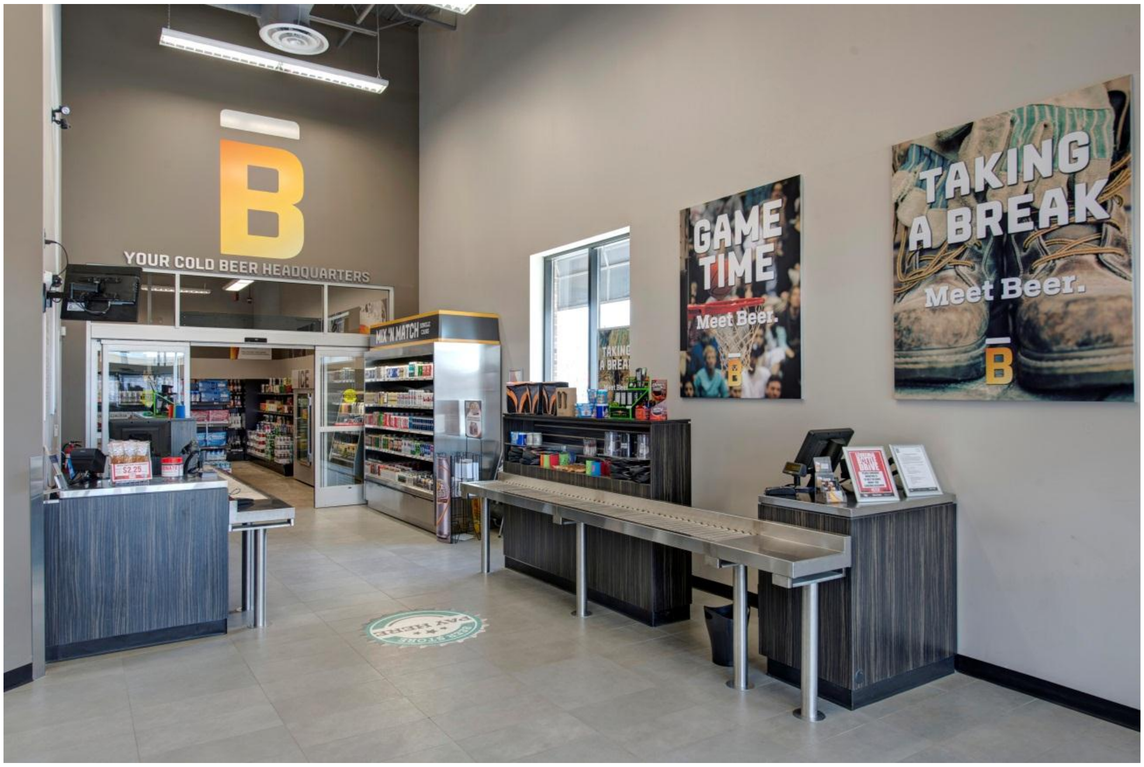


Figure 1 - Front of TBS open concept, self-serve format

Sale of 12-packs

The Council's Initial Report recommended that in order to improve consumer access, the LCBO be enabled to sell 12-packs of beer.

Following further review of this issue in Phase 2, we continue to believe that this additional consumer convenience deserves consideration. However, we also recognize that this initiative may significantly erode the economics of TBS, especially in light of the Council's proposal to sell beer in grocery stores.

Accordingly, we are recommending a pilot study designed to assess the impacts of allowing the LCBO to sell 12-packs. We propose that 10 LCBO stores across Ontario located more than two kilometres away from a Beer Store be selected for the pilot study. The results of the pilot will be audited by an independent third party against agreed criteria to determine the impact on the Beer Store, LCBO, the government, and consumers.

If the pilot is found to be successful, the New Beer Framework provides that the LCBO be allowed to carry 12-packs in up to 60 of its regular stores. We expect that many of these stores will be located in smaller towns across the province.

Sale to licensees

One area that has caused concern is the prices that restaurants and bars (licensees) pay for their beer.

Currently, brewers are able to charge licensees different prices than they charge to retail consumers, in some cases significantly more. In our view, this practice reflects a lack of fairness in the system for licensees who purchase beer in smaller quantities and may not receive services such as free delivery or bottle pick-up from TBS.

Accordingly, the New Beer Framework allows for licensees with annual beer purchases of less than the equivalent of 250 24-packs to purchase beer at TBS retail outlets at the same price as consumers. This would impact almost 9,000 bars and restaurants, over half of all licensees in the province.

Pooled delivery for small brewers

In order to help small brewers manage costs and grow their businesses, the New Beer Framework will permit them to jointly deliver their products to the LCBO and to licenced establishments. Use of third party carriers and warehousing will also be allowed under the authority of the LCBO. This initiative will also benefit the licensees and retail channels themselves, as it will reduce the number of deliveries they each have to accept.

On-site brewery retail stores

Today, an Ontario brewer is only permitted to have one on-site retail store, even if it has more than one production facility in Ontario, unless its overall production exceeds a certain threshold. The Council believes this restriction unfairly favours larger brewers. Accordingly, we support the AGCO's proposal to eliminate the minimum production threshold. This change would allow any brewer with two production facilities to have an on-site retail store at each facility, subject to existing AGCO restrictions on sales.

Increasing the Province's revenue from beer

In our Initial Report, we stated that "Ontario taxpayers deserve their fair share of the profits generated from the Beer Store." As our discussions with industry stakeholders – including TBS owners – continued during our second phase of work, we looked at different alternatives for Ontarians to get this greater share.

The New Beer Framework is designed to return TBS more closely to its roots as a brewer-owned co-op, effectively eliminating any unique value that may accrue to the current owner-brewers, as all stakeholders will benefit equitably. We believe that the government should earn a greater share of the value of the system, but only once those benefits are distributed equitably to all market participants.

The measures contemplated in the New Beer Framework would allow the government to raise $100 million annually, to be phased in over the next four years. This will be achieved by applying a volumetric charge across all beer sold in all channels in Ontario. Annual increases in the legislative minimum retail price of beer have, over time, corresponded with beer price increases at all price points. Our proposal would increase the share of these price increases going to taxpayers and decrease the share going to beer producers. As we have previously stated, we do not believe that suppliers should receive windfall profits as a result of social policy objectives.

Further, the LCBO in-store and out-of-store cost of service charges on beer, which have not been raised in over 20 years, should be indexed to inflation in the future.

Price restrictions

In our negotiations, we wanted to mitigate the impact on consumers of these changes. As a result, we have separately discussed with some of the largest brewers in the industry the expectation of the Province that retail prices for certain products of their most popular brands will not increase before May 1, 2017. These brands represent around 50% of sales in the Beer Store. The principal brewers in the industry have separately confirmed to the Province their intention to comply with this expectation. The only exceptions would be to reflect changes in the minimum retail price of beer (which is indexed to inflation) and circumstances where the industry context materially changes.

Extension of the Ontario Deposit Return Program

Currently, TBS is the Province's service provider of ODRP, for which it charges a handling fee to the LCBO. TBS, which operates this program alongside their own recycling program for beer bottles, handles the returns of all alcohol containers sold by the LCBO, off-site Winery Retail Stores, and on-site winery, brewery, and distillery retail stores, providing the redemption of deposits to consumers and coordinating the recycling of containers. Through this program, no returned containers go to landfill or road bed. As part of the New Beer Framework, the current ODRP contract with TBS will be extended at $1 million per year less than the price of the current contract, with no more annual increases over the extension for inflation. We estimate that, relative to the current ODRP contract, this change could represent cumulative savings to the LCBO of over $30 million over the term of the extension.

Further, under the current ODRP contract, TBS can cancel with 90 days' notice should there be significant changes in the beverage alcohol system in the province. The New Beer Framework requires there be a standstill agreement regarding the current ODRP contract between the Province and TBS, which will prevent TBS from cancelling the contract and provide longer-term certainty to the Province.

Combination stores

Currently, the LCBO has 167 combination stores, which operate in rural locations where no TBS outlets exist. These stores are permitted to sell beer in 12- and 24-packs. Under the old model, if TBS opened a store near an LCBO combination store, the LCBO would have to convert its store to a regular format (i.e., one which only sells beer in package sizes of six or less). This model has, over time, created a disincentive for the LCBO to open new combination stores.

Under the New Beer Framework, existing LCBO combination stores are protected. Further, if the LCBO wishes to open a new combination store in a community in which TBS does not operate, it will notify TBS, which will have 90 days to decide whether it wishes to open a store in that community. If TBS declines, the LCBO may open its combination store, one which will also remain as-is should TBS subsequently decide to open an outlet in the community.

Instead of the stalemate that has occurred in the past, this change will make it more likely that a new store will be built in an area that the LCBO identifies as underserved. Whether through a TBS or an LCBO location, those consumers will have access to a new beer outlet in their community.

Term

One of our goals in reframing the beer retailing system was to provide for some degree of long-term stability without necessarily locking in the proposed model in perpetuity as the current agreement is structured. To achieve this goal, the initial term of the New Beer Framework has been set at 10 years to allow for responsible capital planning, particularly in the context of the Beer Store's commitment to invest $100 million into its network over the next four years. It will be subject to renewal for successive 5-year terms unless terminated by either party.

Should any party decide not to renew the New Beer Framework, there is provision for a minimum notice period of two years from the time at which that decision is made. The New Beer Framework also includes termination provisions that facilitate an orderly wind-down of the agreement with TBS and avoid uncertainty if not renewed.

Increasing Consumer Access and Introducing Competition

In our Initial Report, we expressed our belief that there could be a limited expansion of competition in Ontario's beverage alcohol retailing system and indicated that we would like to establish new outlets that would provide on-going competition to the existing quasi-monopolies and apply pressure for continued innovation in the system.

In our Phase 2 work, we spent a considerable amount of time exploring this issue, both for beverage alcohol generally and specifically for beer retailing. Developing a comprehensive proposal requires thoughtful consideration of each of beer, wine, and spirits. It also requires balancing the benefits of increased convenience and access for consumers with important issues such as social responsibility, fairness to all stakeholders, government revenues, consumer prices, and the financial viability of existing beverage alcohol retailers.

As indicated earlier in this report, our work on the potential direction for the wine and spirits retail system in Ontario is still on-going. This work will include consideration of alternative retail channels for wine. Depending on the outcome of that exploration, we will need to ensure that our proposals for an alternative retail channel for beer are aligned with our final recommendations for wine. Acknowledging the need for this further study to complete the picture, the Council has developed its thinking on a possible model for alternative retail channels with specific respect to beer.

Experience of other jurisdictions

In designing a private channel model for Ontario, the Council examined other models that operate in Canada, particularly in Alberta, British Columbia, and Quebec. Each model results in different and important consequences and implications that need to be carefully weighed against the principles of the Council.

Alberta

Alberta began fully privatizing liquor retailing in 1993. Store formats are limited to stand-alone stores carrying a full range of liquor products with no restrictions on the number of outlets. Today, Alberta has over 1,300 private liquor stores and no government-owned outlets. Alberta has uniform wholesale pricing, set by producers, and paid by liquor retailers and licensees. Retailers then apply a mark-up on top of the wholesale price to cover their costs and earn a profit. This retail mark-up can represent 15% to 25% of the retail price.

As a result of unrestricted privatization, consumer prices for beer in Alberta are some of the highest in the country. This pricing is primarily driven by three important aspects of Alberta's model: relatively high tax rates on beer, no limits on the number of liquor stores, and requirements that liquor stores be stand-alone format only.

Not limiting the number of liquor stores reduces sales per store, driving the retailer to increase its mark-up and, as a result, consumer prices to earn an appropriate profit. This also results in higher distribution costs, as beer must be delivered to more stores. Since suppliers set the wholesale price, any increased cost is passed on to consumers through higher prices. Further, stand-alone stores are inefficient relative to big box or grocery stores, which can spread fixed costs over greater volumes and more efficiently utilize store employees. This format requires higher retail mark-ups to cover costs, further increasing consumer prices.

British Columbia

In British Columbia, liquor retailing has evolved to become a partially privatized system. There are just under 200 government-owned outlets, just over 200 rural agency stores and about 670 privately-licenced retail stores selling a full range of liquor products. The BC Liquor Distribution Board (BCLDB) wholesales liquor products to private outlets.

Prior to BC's recent review of its beverage alcohol retailing and distribution system, private outlets purchased liquor from the BCLDB at a discount to the retail price. BC's experience is similar to Alberta's in that the distribution inefficiency caused by a high number of liquor outlets and the poor economics of stand-alone format liquor stores have led to higher consumer prices. However, under BC's old model, there was an additional consequence. Since the government was the wholesaler, the discount at which private retailers purchased beer directly impacted government revenues. Over time, this discount increased as the system became less efficient, negatively impacting government revenues.

Quebec

In Quebec, beer is primarily sold through over 8,000 grocery and convenience stores. The Quebec system benefits consumers by providing widespread, easy access and one-stop shopping convenience. The price for beer is set by retailers, not producers, based on market demand and competitive dynamics, including consumers' willingness-to-pay.

A source of debate throughout the Council's work has been whether Ontario or Quebec has lower beer prices. This is a challenging question to answer given that Quebec, unlike Ontario, has beer prices that are not uniform and that can differ significantly across retailers. Many academic studies have been conducted on this topic.

Based on our reviews of these studies and our own research, we do not believe that there is a meaningful difference in the average prices of beer between Ontario and Quebec. This does not mean that a consumer can't find a case of beer in Quebec at a cheaper price than in Ontario – non-uniform pricing in Quebec, including short-term promotions, virtually guarantees this. However, on average, we believe that prices within the two provinces are generally comparable.

Despite relatively similar prices, there is a significant difference in the amount of tax the two provinces receive on purchases of beer. Ontario's taxes are about $3 higher than Quebec's on a 24-pack of beer. In essence, retail prices are comparable, but taxes are much higher in Ontario.

There are two reasons why this is the case. First, distribution costs are higher in Quebec than in Ontario due to the greater number of beer outlets (more than 8,000 vs. 1,400, respectively). Second, there is no competitive advantage for selling beer because any grocery or convenience store is able to obtain a licence. Therefore, grocers are not able to achieve better efficiencies or benefit from incremental foot traffic. The Ontario taxpayer is better off because they enjoy the same low prices as the Quebec taxpayer, but substantially more revenues go to the government.

Our approach

Considering the consequences and implications of expanded liquor retail access in other jurisdictions, the Council has moved with deliberate caution to develop a proposal on how to introduce limited liquor retail competition into the Ontario marketplace. We want to maintain the efficiencies of the current quasi-monopoly system which, as shown, benefit both consumers and taxpayers:

Beer prices and provincial taxes (average 24-pack)[2]
all figures are approximate

	Ontario	Quebec	Alberta	British Columbia
Consumer price (excluding deposit)	$34 to $35	$34 to $35	$40	$40
Provincial commodity and sales tax	$11	$8	$10	$12

We believe Ontario would benefit from new retail access options for the sale of beer beyond TBS and the LCBO. We are satisfied that, with careful application, many of the issues and concerns raised in other jurisdictions can be addressed. In addition to improving retail access and convenience for consumers, the Council believes that introducing limited competition will apply positive pressure on TBS and the LCBO to innovate and improve their service. So, how will this work?

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[2] Ontario consumer price range represents the weighted average price of all home consumer packaged beer products sold through TBS and the weighted average price of only those products that overlap with Quebec; Ontario provincial commodity tax represents the beer basic tax / mark-up, volume tax / levy and environmental tax / levy, weighted based on the share of non-refillable beer containers sold in Ontario.

Quebec consumer price range represents the weighted average price of all beer products and the weighted average price of only those products that overlap with Ontario; Quebec provincial commodity tax represents the beer tax for large brewers.

Alberta consumer price represents the weighted average Alberta Gaming and Liquor Commission wholesale beer price, adjusted for private liquor store mark-ups; Alberta provincial commodity tax represents the beer mark-up for large brewers.

British Columbia consumer price represents the weighted average large brewer price at BC Liquor Stores, agency stores, and Liquor Retail Stores (LRS); LRS price adjusted to remove Liquor Distribution Branch discount and apply a mark-up; BC provincial commodity tax represents the beer mark-up for large brewers.

Consumer prices exclude deposit and include sales tax. Consumer prices based on 2013 data, adjusted (for illustrative purposes) to include subsequent changes in provincial taxes.

Licences to sell beer

We are proposing that a limited number of licences or other permissions to sell beer be offered to grocery stores in Ontario. Key features of the licensing program include:

- Licences will be issued through a competitive process based on the discount off the retail price at which grocers will purchase the beer from the LCBO.
- There will be requirements for hours of sale, appropriate check-out provisions, uniform pricing, and social responsibility training for all employees facilitating the purchase of beer.
- The licences will be issued without territory protection, and there will be no restrictions on relative location to other liquor points of sale.
- Licences will be granted in urban areas and will be geographically dispersed across the province.
- Licences will be granted in a manner to ensure a fair representation of privately-owned grocers.
- Retailers will sell all beer – domestic and international – with specific requirements on shelf space and / or incentives for sales of small brewers' products.
- The licences will only allow the sale of beer in pack sizes of six or less. Sale of 12- and 24-packs will not be allowed nor would discount pricing on purchases of multiple six-packs (referred to as pack-up pricing).
- Except for liquor delivery licences currently issued by the AGCO, consumer electronic ordering and home delivery will not be permitted for the licenced grocery stores. However, existing arrangements currently permitted may continue.
- The licences will allow for beer sales at each outlet of, on average, around $1 million per year. Where a grocery chain operates more than one outlet, this limitation will apply to the average volume sold across all of its licenced outlets.
- Suppliers will not be permitted to pay grocers for any marketing, merchandising, or shelf space programs.

LCBO as wholesaler

Under the Council's proposal, the LCBO would act as the wholesaler, selling beer to grocers at a discount on or from the retail price. The discount is expected to be much lower than both the LCBO's cost of retailing beer as well as the discount currently provided to LCBO agency stores, and will be established through a competitive process. By positioning the LCBO as wholesaler, the Province will benefit from an additional low cost channel, and producers will be protected from direct negotiations with the grocers. To avoid the discount increasing over time, as has been the experience in other jurisdictions, a discount ceiling would be enshrined in legislation.

The LCBO and TBS will be allowed to physically distribute beer to the grocery retailers as will any brewer licenced by the regulator. Uniform pricing will continue to apply across Ontario, and consumers will pay the same price for the same product regardless of whether they buy it at TBS, the LCBO, or a grocery store.

Low cost channel

We believe that grocery stores are best positioned to serve as a low cost channel for retailing beer, while providing an enhanced customer experience and improved convenience. Operating in a highly competitive environment, grocers are motivated and organized to provide a shopping experience and product offering that customers want. We are confident that, given grocers' consumer-focused business models, grocers will be keen to celebrate and serve local and small brewers' products. This additional competition will apply pressure on the other liquor quasi-monopolies to innovate and improve their value proposition, all to the benefit of the consumer.

A critical component to a grocery store's competitive offering is price. To compete on price, grocers have evolved and innovated over the decades into a channel that can support low prices on food and beverage products. Unlike stand-alone stores selling only liquor products, grocers will be able to cross-sell other products. If carrying beer increases the overall foot traffic to a grocery store, sales of other products will increase. Grocers are therefore best able to offer the lowest discount to retail beer and the best return for the Province.

Limited number of licences

We believe that by offering a limited number of licences, scarcity will be maintained. Were beer sales simply allowed in all grocery stores, grocers would have a lower sales volume in each store and there would be no competitive advantage from carrying beer. Under our proposal, grocers with beer licences would have a differentiated product offering from competing grocery stores, attracting new customers and driving increased sales on non-beer products.

We believe this scarcity helps to address the challenges faced by other provinces. Distribution costs in BC, Alberta, and Quebec are higher than those in Ontario because there are significantly more outlets per capita with lower volumes. Limiting the number of new outlets in Ontario helps to mitigate this. Further, the cap on the number of outlets limits the potential cannibalization of the LCBO or the Beer Store, better maintaining the efficiencies of the quasi-monopoly system.

Customer convenience

The proposed model would allow for beer sales in up to 450 grocery stores across Ontario. This is the same number of outlets that TBS currently operates in Ontario. The Council believes that this level of density is reasonable both in terms of its competitive impact as well as in terms of consumer access. The New Beer Framework provides for a phased introduction of the new grocery channel, allowing up to 150 new outlets to be in operation by May 1, 2017.

In terms of access, we believe that the proposed landscape for beer sales would provide more-than-adequate access for Ontario consumers. Today approximately 86% of Ontarians live within a five minute drive of a store that sells beer. This figure is even higher in urban areas. Under the Council's proposals, the total number of points of sale for beer in Ontario would increase by over 30% to over 1,800 outlets. Although lower in density than in some provinces, the Council believes this allows for a high level of access for consumers. Most importantly, consumers will have a choice of whether to shop at an LCBO store for the experience, at a TBS store for larger pack sizes and greater value, or at a grocery store for one-stop shopping convenience.

Social responsibility

A critical component of any new retail channel for liquor in Ontario is maintaining the same social responsibility standards that exist today in the LCBO and not encouraging increased consumption. We believe that this is achieved by controlling the roll-out of grocery licences and the sales in each outlet, restricting operating hours, ensuring that the LCBO acts as the wholesaler, maintaining uniform pricing and minimum retail pricing, restricting sales to packs of six or less, and requiring appropriate check-out provisions and training for all employees facilitating the purchase of beer.

Figure 2 - Socially responsible format for beer in grocery stores (zoomed out)

Figure 3 - Socially responsible format for beer in grocery stores (zoomed in)

Flexibility going forward

While our analysis above contemplates beer in grocery stores, we have, through the New Beer Framework, preserved the flexibility to add beer to stand-alone stores as well. This will provide us and the government the ability to make adjustments during implementation or to incorporate future decisions that are made about wine and other categories of beverage alcohol. However, we accept – and agree with – the government's position that to sell liquor in convenience stores would not be a socially responsible decision.

* * *

The New Beer Framework represents a significant change in the beverage alcohol retailing system in Ontario. Its implementation will require thoughtful application and careful management, but the Council believes strongly that it offers a major step forward in terms of enhancing customer convenience, choice and shopping experience in a socially responsible manner, as well as acting as a catalyst for increased competition in the beer retailing sector.

The Council's view is that this model much more effectively balances the interests of brewers, consumers, and taxpayers while still offering a varied and relatively high-density of retail outlets. As noted earlier, we are still working through our approach to alternative channels for wine retailing. When this is complete, we will ensure that the two approaches are aligned.

CONCLUSION

The Council is satisfied that the New Beer Framework levels the playing field: we have returned the Beer Store to its co-op roots. In our view, the reframed beer retailing system:

- improves customer convenience, choice and shopping experience;
- keeps beer prices for Ontario consumers below the Canadian average;
- maintains efficiencies of the existing system;
- treats suppliers fairly while improving retail access;
- introduces additional competition;
- increases revenue for government while maintaining competitive beer tax rates; and
- remains socially responsible.

The new beer retailing landscape of Ontario will feature increased competition and consumer choice with the availability of beer in up to 450 grocery stores across the province in addition to the 450 existing TBS stores, 113 on-site brewery retail stores, and 651 LCBO stores and 217 LCBO agency stores, an increase of over 30% for a total of more than 1,800 outlets. These grocery stores will only be allowed to sell beer provided that they meet shelf space requirements for small brewers and that they purchase beer from the LCBO at a discount that represents a much lower cost than other retail channels. Uniform pricing and safeguards to ensure social responsibility will be maintained across all channels. Additionally, to protect consumers from the possibility of beer prices increasing in the short-term, prices for certain products of popular brands will be constrained until May 2017.

Throughout our work, the Council has been particularly concerned with improving the system for consumers and ensuring that all brewers are treated fairly. We have, of course, also focused on protecting the interests of Ontario taxpayers, consistent with our original Terms of Reference. We are satisfied that the new system offers each of these groups significant gains.

Consumers

The new system will provide consumers with improved convenience and choice by allowing beer to be sold in grocery stores. The customer experience in TBS stores will be greatly improved through a $100 million capital commitment to modernize their network, and all new stores will be open concept, self-serve formats. In addition, a limited pilot study of selling 12-packs through the LCBO offers an opportunity for greater access for consumers across the province. Furthermore, the New Beer Framework provides protection for LCBO combination stores that currently offer 12- and 24-packs of beer, and improves the mechanism for the LCBO or TBS to open new stores in underserved communities. If the 12-pack pilot is successful, there could be more than 220 LCBO stores (including the existing 167 LCBO combination stores) and 217 agency stores selling 12- or 24-packs of beer in smaller communities across Ontario.

Gains for consumers will not be achieved at the expense of social responsibility. The Council has worked carefully to ensure that increased access does not mean unrestricted access. The grocery store format that we are proposing is for urban grocery stores only, and there will be clear restrictions on hours of sale, uniform pricing, appropriate check-out safeguards, and social responsibility training for all employees facilitating the purchase of beer. In addition, the Ontario Deposit Return Program (ODRP) has been extended with TBS at a significantly improved price for the Province.

Finally, restaurants and bars (licensees) are charged different (and sometimes much higher) prices for beer today. The New Beer Framework will ensure that small licensees will be able to purchase beer through TBS at the same retail price as consumers. Almost 9,000 small licensees, over half the current licensees in the province, will be able to benefit from this change.

Producers

Under the new system, ownership of the Beer Store will be open to all brewers with facilities in Ontario, providing them with an opportunity to benefit from increases in the value of the business and associated shareholder rights. Additionally, their interests will be further protected by having four independent directors on the board with effective veto rights on brewer fairness and other important issues.

All brewers, except for the current owners, will see their costs of retailing beer through TBS decline. Small and mid-size brewers specifically will see their TBS costs fall by about 5% to 10%. Small brewers will have significant advantages, with a minimum of 20% shelf space allocation in TBS and grocery stores, and incentives for the grocers to sell more of their beer. As with existing channels, brewers will retain the ability to set prices in grocery stores and will earn the same margin as if the sale occurred in an LCBO store. Lastly, small brewers will gain the ability to more efficiently deliver their products directly to retail points of sale and licensees by pooling their products with the option of using third party carriers and warehousing.

Taxpayers

The new system provides for government, and by extension taxpayers, to share more equitably in the value currently generated by the system. This value will be achieved on a phased basis with price restrictions limiting the impact on consumer prices.

Any new system needs a degree of long-term stability to permit responsible capital planning by retailers and producers, while not locking the new model in perpetuity. The Council is satisfied that, with the protections built into the New Beer Framework, an initial 10-year term achieves this balance.

The Council recognizes that the new system represents significant change within the Province’s current regulated environment for beverage alcohol. Some will argue that we should have gone further. We have examined other models in Canada and found that, in many cases, consumers pay more and taxpayers get less while convenience is not significantly improved. Conversely, some will argue that the current system should be left unchanged. However, today’s system limits convenience and may not provide all producers with equitable treatment. The Council has opted for significant, controlled change – the biggest change in beer distribution in Ontario since prohibition. We believe that this new beer retailing system will better serve all Ontarians and stakeholders.

FINAL RECOMMENDATIONS

The Council has now completed its review of TBS and beer retailing in Ontario. This section presents the final recommendations we made in support of the government's 2015 Budget that have been incorporated in the New Beer Framework.

1. TBS should continue to operate, but with broader ownership, and fundamentally improved governance and operating practices, including:

   - opening its ownership to all brewers with facilities in Ontario;
   - establishing a new 'best practices' governance structure that allows it to operate at arm's-length from its owners, with brewer directors nominated based on relative market shares, and a critical mass of independent directors;
   - requiring independent directors to approve any change related to brewer treatment and fairness, as well as any changes to the New Beer Framework;
   - appointing an independent TBS Ombudsman to handle complaints;
   - operating in a more open, transparent and accountable manner;
   - enshrining a new mechanism for determining rates charged to all brewers, lowering costs for all brewers other than the current owners;
   - changing its retail and marketing practices to ensure fairness and equity among brewers; and
   - investing $100 million over four years, 80% of which will help modernize its stores.

2. The Province should increase its annual revenues from beer sales in Ontario through a new beer charge as part of the existing beer tax framework. The principal brewers in the industry have separately confirmed to the Province their intention to comply with the Province's expectation that retail prices for certain products of their most popular brands will not increase before May 1, 2017. The only exceptions would be to reflect changes in the minimum retail price of beer (which is indexed to inflation) and circumstances where the industry context materially changes.

3. The Ontario Deposit Return Program contract should be extended at a discount to the current rates without annual indexing to inflation.

4. The LCBO should be permitted to conduct a 10-store pilot study to explore the viability of offering 12-packs with an option to expand to 60 stores.

5. Small restaurants and bars should be able to buy beer from TBS at the same retail prices as consumers.

6. Small brewers should be allowed to jointly deliver their products to the LCBO and licenced establishments with the ability to use third party carriers and warehousing.

7. The Alcohol and Gaming Commission of Ontario (AGCO) should allow brewers with two production facilities to have an on-site retail store at each facility for the sale of their products only, regardless of the production size of their facilities.

8. The Province should offer to a number of qualifying grocery stores operating in Ontario up to 450 licences or other permissions to sell beer. This new channel should be phased in over time with up to 150 outlets in operation by May 1, 2017. Licences should be made available through an open and transparent process designed to achieve:

    - fair market value for the Province;
    - fair representation of privately-owned grocers;
    - appropriate distribution across urban areas in Ontario; and
    - a diversity of grocers to prevent the creation of a new monopoly.

Retail beer licences should include requirements to:

- operate with restricted hours of sale, appropriate check-out provisions, uniform pricing, and social responsibility training for all employees facilitating the purchase of beer;
- sell all beer – domestic and international – with specific requirements on shelf space and incentives for sales of small brewers' products;
- sell beer only in pack sizes of six or smaller (with no pack-up pricing);
- limit annual beer sales to an average cap per store of the volume equivalent of $1 million, which may be shared across a single grocer's licenced stores;
- position the LCBO as the wholesaler;
- purchase beer from the LCBO at a discount that represents a much lower cost than other retail channels, locked in for at least 10 years; and
- prohibit inducements or monies from suppliers.

9. The New Beer Framework should last for an initial term of 10 years, with recurring options to renew for 5-year terms and beyond. The New Beer Framework should include termination provisions that facilitate an orderly wind-down of the agreement with TBS and avoid uncertainty if not renewed.

ATTACHMENT

Modernizing the Distribution of Beer in Ontario Framework of Key Principles

The following sets out the key principles (the "**Key Principles**") under which Brewers Retail Inc. operating under the name "The Beer Store" ("**TBS**"), Molson Canada 2005 ("**Molson**"), Labatt Brewing Company Limited ("**Labatt**"), Sleeman Breweries Ltd. ("**Sleeman**"), the Premier's Advisory Council on Government Assets (the "**Council**") and the Ontario Ministry of Finance (the "**MoF**") intend to negotiate in good faith detailed changes to the beer retail and distribution system in Ontario, on terms acceptable to the parties, in the implementation of the Council's recommendations to the Province of Ontario (the "**Province**") with respect to that system.

Certain additional defined terms are set out in a Schedule to this document.

Subject to clause 10(c), pursuant to the laws of Ontario the Province would direct, authorize and agree to a revised beer retail and distribution system for Ontario that would allow TBS and the Current Owners to retain certain elements of the existing system subject to the Key Principles and the more detailed terms and conditions of the documents necessary to implement the Key Principles (the "**New Beer Agreements**"). In consideration for that, and in accordance with the laws of Ontario, the parties will be authorized and agree to the following:

1. TBS will continue to operate as a low cost, efficient distributor of beer in Ontario

(a) TBS will continue to operate on a self-sustaining basis as a low cost, efficient distributor of beer in Ontario.

(b) TBS will be operated as a self-funding corporation on a break-even cash flow basis. As an important element of this, the schedule of listing and service fees to be charged by TBS to all brewers selling products through TBS (the "**Rate Sheet**") will be set each year to provide sufficient, but not excess, revenue to cover all of the cash requirements of TBS consistent with approved operating and capital plans.

2. The ownership of TBS will be open to all brewers with facilities in Ontario

(a) All Qualifying Brewers (as defined in the attached Schedule) will be offered a meaningful opportunity to become equity shareholders of TBS by subscribing for new shares of TBS as set out in part 3.

(b) Any transactions between TBS and its shareholders will be transparent, auditable, and commercially reasonable.

3. TBS will be capitalized in such a way as to reflect any embedded value that should be attributed to the Current Owners while providing for the financing of ongoing capital requirements on commercial terms

(a) The capital of TBS will be divided between First Preferred Debentures, First Equity Shares and Second Equity Shares.

(i) The First Preferred Debentures will be issued to any Qualifying Brewers (including the Current Owners) providing new capital to TBS from time to time to fund capital replacement or improvements (e.g., when TBS cannot borrow from third parties on reasonable commercial terms), and will entitle the holders to annual interest at a reasonable commercial rate as well as the return of their principal when redeemed by TBS or upon liquidation of TBS, in priority to any distribution to the holders of any class of shares of TBS. The First Preferred Debentures will contain limited covenants only (such as with respect to the payment of interest and acceleration upon an event of insolvency).

(ii) The First Equity Shares will be issued to all Qualifying Brewers (including the Current Owners) for nominal consideration, and will provide the holders with voting rights in proportion to the volume of their annual sales of beer through TBS that is produced at a facility in Ontario or imported into Ontario in accordance with Ontario's Inter-Plant Transfer Policy for beer ("**Annual Beer Volume**") from time to time. The First Equity Shares will also entitle the holders to share in any increase in the book value of TBS from the Effective Date (subject to certain adjustments to reflect legacy assets and liabilities of the Current Owners) on liquidation of TBS in proportion to the service fees that they have paid to TBS over the term of the New Beer Agreements, after the return of principal and payment of any accrued interest on the First Preferred Debentures but before any residual amounts are distributed to the holders of the Second Equity Shares. The First Equity Shares would be entitled to receive any dividends declared by the Board of TBS with the approval of a majority of the Independent Directors.

(iii) The Second Equity Shares will be non-voting and will be issued to the Current Owners in exchange for their existing equity in, and any other financing (other than trade payables) provided to, TBS (effected through a court approved plan of arrangement or other tax-efficient mechanism), and will entitle the holders to receive any residual value upon liquidation of TBS, after the return of principal and payment of any accrued interest on the First Preferred Debentures and any liquidation amount payable to the holders of the First Equity Shares. The Second Equity Shares would not be entitled to receive dividends.

(b) Ongoing capital requirements of TBS will be financed on arm's length commercial terms.

(c) All shareholders will be provided with an equal opportunity to subscribe for any additional required capital (in the form of First Preferred Debentures), if any, from time to time.

4. The corporate governance of TBS will reflect the majority ownership of the Current Owners while ensuring fair representation for other brewer shareholders as well as a significant role for Independent Directors representing the broader public interest

(a) The Board of TBS will have a fixed size of 15 directors.

(i) 11 of the directors will be nominated and elected by the shareholders as follows:

(A) 1 director will be nominated and elected by holders of voting shares each of which (together with its affiliates) had less than 50,000 hectolitres per year of sales of beer through TBS in the prior year. That board position will rotate on an annual basis to provide a number of such Qualifying Brewers with the opportunity to have a representative serve on the Board of TBS.

(B) Each holder of voting shares that has an Annual Beer Volume equal to or greater than 10% (without any rounding up) of the total Annual Beer Volume in the prior year will be entitled to nominate and elect 1 director for each full 10 percentage points of such volume that it had through TBS (rounded up, in the case of 7 percentage points or more, to the next full 10 percentage points), to serve on the Board during that year (e.g., a Qualifying Brewer with 41% of such sales would be entitled to nominate and elect 4 directors; one with 37% of such sales would also be entitled to nominate and elect 4 directors; one with 34% of such sales would be entitled to nominate and elect 3 directors), provided that so long as Molson and Labatt together account for more than 50% of such volume they will together be entitled to nominate and elect the majority of the directors, each in equal numbers. At the Effective Date, this will result in Molson and Labatt each being able to nominate and elect 4 directors.

(C) The remaining directors will be nominated and elected by all shareholders other than those referred to in clause 4(a)(i)(A) or 4(a)(i)(B), provided that no such shareholder will thereby be able to nominate and elect more than 1 director.

(ii) Independent Directors will make up the remaining 4 board positions (see the attached Schedule for the qualifications of an Independent Director). The initial Independent Directors will be nominated by a selection committee composed of an equal number of members appointed by the Province, on the one hand, and the Current Owners, on the other hand (operating under appropriate procedures to avoid any deadlock), and will be agreed as of the Effective Date. After that time, their replacements will be nominated by majority vote of the Independent Directors themselves, thereby ensuring their continued independence. The Province may in its discretion require the removal of all of the Independent Directors at any time, in which case their replacements will be selected and nominated in accordance with the procedure above.

(iii) The Chair of the Board will be elected by the Board from among the directors. The Chair will not have any additional or tie-breaking vote on any resolution. A Lead Director will be elected by the Independent Directors from among the Independent Directors. The Lead Director will only have an additional tie-breaking vote on any resolution that is required to be passed by a majority of the Independent Directors.

(iv) Independent Directors will be compensated for their service and receive reasonable expenses, indemnities and insurance, all at fair market rates.

(v) The Chief Executive Officer of TBS would not be a member of the Board, but may be invited to attend Board meetings and will report to the Board.

(vi) The TBS Board will adopt and operate under best practices for board governance, to be reflected in greater detail in the New Beer Agreements.

(vii) Quorum requirements for the Board and Committees of the Board will be set to include an equal number of nominees of each of Labatt and Molson who together constitute a majority of the directors present at any Board or Committee meeting so long as Molson and Labatt are entitled to nominate and elect a majority of the directors as well as at least 2 Independent Directors for each Board meeting and 1 Independent Director for each Committee meeting, while ensuring that no director or group of directors could prevent decisions being made by not appearing.

(viii) The shareholders agreement to be entered into among the shareholders of TBS (the "**Shareholders Agreement**"), which will replace the existing shareholders agreement among the Current Owners, will embed the Key Principles to the extent relevant, confirm the fiduciary duties of the Board to TBS and provide that, in addition to giving consideration to the best interests of TBS, the Board will be entitled to give due consideration to broader stakeholder interests in accordance with applicable law in supervising the management of TBS.

(b) All material matters relating to the business or affairs of TBS will be determined by the Board.

(c) The decisions or changes set out in the attached Appendix will require the additional approvals beyond a simple majority of the Board, in addition to any special approval requirements that would apply under the *Business Corporations Act* (Ontario), as set forth in the Appendix.

(d) An independent Beer Ombudsman will be appointed by the Independent Directors of TBS to hear complaints from brewers and customers regarding operational issues. If the Beer Ombudsman is unable to resolve a complaint, it may be submitted to a dispute resolution process that will be established by TBS and set out in the New Beer Agreements.

(e) The By-laws of TBS and the user agreement with brewers selling beer through TBS will not be inconsistent with the Key Principles.

5. TBS will operate in an open and transparent manner

(a) The directors of TBS, including the nominees of brewers and the Independent Directors, will be entitled to access to all TBS information in accordance with Ontario corporations law.

(b) Board members will be permitted to share confidential information of TBS with shareholders, and provision will be made for such information to be so shared with shareholders in addition to the Current Owners on an equitable basis.

(c) In addition to the information required under Ontario corporations law, all shareholders will be entitled to receive the following:

  (i) quarterly unaudited and annual audited financial statements;

  (ii) TBS's annual budget and its annual business and capital plans, together with an analysis of the impact of those on the Rate Sheet; and

  (iii) any information reasonably required by publicly owned shareholders to comply with their own reporting obligations.

(d) TBS will continue to follow compliance protocols to ensure that the manner in which it operates, including in respect of access to information concerning TBS, is in compliance with laws, including the *Competition Act* (Canada).

(e) TBS will publish in a timely manner its audited financial statements and operations report to the general public, including details of the amount and use of capital expenditures.

(f) TBS will also publish to the general public any policies adopted by the Board that give effect to any of the Key Principles.

(g) The composition of TBS's Board and Board committees will be posted in a timely manner on TBS's website along with its Board and committee mandates.

(h) It is acknowledged that the Regulator is empowered to require additional disclosure from TBS, and to monitor, investigate, audit and enforce applicable legislation and regulations and any relevant guidelines established by the board of the Regulator under AGRPPA, including compliance with social responsibility requirements, in order to ensure compliance with the Key Principles and the New Beer Agreements.

6. TBS will make changes to its retail and marketing practices to enhance the customer experience and to ensure that it operates in a manner fair to all brewers, brands and package configurations

(a) All merchandising, marketing, promotions and shelf space programs and decisions will be made on a category basis with all categories being distinctly and prominently incorporated. Categories will be established based on fair and reasonable criteria which, along with the categories themselves and the brands to be included in those categories, must be approved by a majority of the Independent Directors. There will be a category called "Craft". All brewers will be allowed to have products listed in all categories, and the criteria established for each category will not be structured to exclude any brewer from participating in any category based on ownership or production volume.

(b) TBS will provide increased opportunities for all brewers to participate in more merchandising, marketing and promotional activities and other activities directed to growing brands and brewers. All merchandising, marketing and promotions will be allocated in accordance with these Key Principles and paid for by brewers based on competitively set rates.

(c) TBS will allocate merchandising, shelf space, marketing and promotions for Small Brewers based on Adjusted Market Share multiplied by a Small Brewer Index Factor.

(i) The "**Small Brewer Index Factor**" will be equal to the Minimum Small Brewer Allocation divided by the share of Small Brewers of all volume of products sold through TBS, where the "**Minimum Small Brewer Allocation**" is equal to 20%. For example, if the volume share of all Small Brewers is 10%, the Small Brewer Index Factor would be 2 (20% divided by 10%). The Small Brewer Index Factor cannot have a value less than 1.

(ii) "**Adjusted Market Share**" means a brewer's share of all volume of products sold through TBS by geographic district/region, meaningfully adjusted for the growth of each brand.

The Board of TBS may deem other Qualifying Brewers (other than the Current Owners) to be Small Brewers for purposes of this clause 6(c) for so long as they remain Qualifying Brewers:

(A) if they are Qualifying Brewers as of the Effective Date; or

(B) with the approval of a majority of the Independent Directors.

(d) TBS will allocate remaining merchandising, shelf space, marketing and promotions for all other brewers based on Adjusted Market Share.

(e) The Rate Sheet will continue to be tiered and will be structured to achieve the objectives set out in clause 1(b) such that, from the Effective Date:

(i) There will be separate rate categories for packaged and draught beer.

(ii) For each of packaged and draught beer, the following rates will be established per hectolitre of beer sold through TBS:

(A) "**Basic Service Fees**", which will not include more than $3.00 in respect of Pension Adjustment Per Hectolitre; and

(B) "**Lower Tier Fees**", which will not include any amount in respect of Pension Adjustment Per Hectolitre. The Lower Tier Fees will be at least $2.00 per hectolitre less than the Basic Service Fees.

(iii) All brewers will pay the same Basic Service Fees on volume of beer sold through TBS with the following exceptions:

(A) brewers (together with their affiliates) with worldwide production of beer of less than 1,000,000 hectolitres per year will be entitled to pay Lower Tier Fees on their first 50,000 hectolitres of beer sold through TBS each year; and

(B) the Basic Service Fees to be paid by the Current Owners and brewers (together with their affiliates) with worldwide production of beer of 1,000,000 hectolitres per year or more will be adjusted upwards for any portion of the aggregate Pension Adjustment Per Hectolitre that is not recovered by TBS as a result of clause 6(e)(ii) and 6(e)(iii)(A).

"**Pension Adjustment Per Hectolitre**" means the solvency amortization portion of the aggregate cash pension payments of TBS in any particular year divided by the number of hectolitres of beer sold through TBS in that year.

(iv) The methodology by which the Rate Sheet is calculated will remain constant during the term of the New Beer Agreements.

(v) All elected service fees, with the exception of those for merchandising, shelf space, marketing and promotions, will reasonably approximate the actual cost of providing such services.

(vi) Except as otherwise contemplated by the Key Principles, Qualifying Brewers other than the Current Owners will be treated no less favourably than any other brewer, including with respect to any rebates or other adjustments to service charges and elected service fees.

(f) Qualifying Brewers having Annual Beer Volume of less than 10,000 hectolitres per year would be provided with 2 free product listings in 7 TBS stores proximate to their breweries. All Qualifying Brewers would be permitted 2 free seasonal SKU swaps for one existing SKU.

(g) TBS will not impose any restrictions on the retail, distribution or marketing channels that brewers may use and will not penalize brewers who use such channels outside TBS. For clarity, this would not apply to policies that TBS may adopt from time to time with respect to the use of its keg pool and similar owned assets.

7. Ontario consumers will have improved convenience and choice and an improved TBS customer experience

(a) TBS will improve the customer experience across its retail network, including by converting stores to more modern retailing formats such as self-serve, open concept formats, and will ensure that all new stores will have self-serve, open concept formats.

(b) TBS will spend $100,000,000 from 2015 through 2018 on capital expenditures (80% in respect of retail stores), which may be funded through the sale of existing assets.

(c) The Province will direct the LCBO not to sell beer in its stores, other than in combination stores, in formats larger than 6-packs (with the exception of the one 8-unit SKU currently carried by regular LCBO stores) and the LCBO will not provide discounts or rebates for purchases of multiple 6-packs (i.e., no “pack-up” pricing), subject to the following pilot program:

(i) The LCBO will initiate a 12-pack pilot in 10 stores across the Province, prioritizing stores at least two kilometres from TBS stores.

(ii) In advance of the pilot, the LCBO and TBS will develop clear evaluation criteria, taking into consideration volumes of the LCBO and the Beer Store, net revenues to the Province from the sale of beverage alcohol, and consumer feedback. A representative control group of LCBO and TBS stores will be jointly established.

(iii) The Province will engage a firm of independent consultants to determine the impact of the pilot on TBS, the LCBO, the Province and consumers. The results of this study will be shared with TBS and other stakeholders. If the predetermined evaluation criteria are met, the LCBO will be granted authority to continue to add 12-packs to stores.

(iv) Notwithstanding the above and excluding combination stores, the LCBO will be limited to carrying 12-packs (being 12 bottles or cans with a maximum unit size of 500 ml) in 60 stores, and the LCBO will not provide discounts or rebates for purchases of multiple 12-packs (i.e., no “pack-up” pricing).

(d) The Province may authorize new private channels (in addition to the second onsite stores referred to in clause 11(d)) to sell beverage alcohol to retail consumers.

(i) These new channels will be limited to 450 grocery or standalone outlets. No more than 150 of such outlets will be in operation before May 1, 2017.

(ii) Each license for these outlets will specify an annual volume limit of sales, and the average annual sales of all such operating outlets will not exceed 2,250 hectolitres (which limit will be increased or decreased by any percentage change in aggregate beer sales in Ontario from the Effective Date, provided that such limit will never be less than 2,250 hectolitres). Where an entity and its affiliates operate more than one such outlet, the applicable annual volume limit of sales will be applied to the average volume sold across all such outlets operated by such entity and its affiliates.

(iii) These new channels will not sell beer in formats larger than 6-packs and will not provide discounts or rebates for purchases of multiple 6-packs (i.e., no “pack-up” pricing).

(iv) Consistent with the *Liquor Control Act* (Ontario), retail pricing will continue to be uniform across all retail channels.

(v) Electronic ordering will not be a feature of this new channel initiative. However, existing arrangements allowing electronic ordering and home delivery will not be terminated or curtailed.

(vi) The operator of each new channel outlet will select the assortment of products based on fair and commercially reasonable criteria reflecting market demand that will not be structured to exclude any brewer based on ownership or production volume. Small Brewers will be provided with support in this new channel.

(vii) The LCBO will be the wholesaler of record to these new channels and all beer products sold through these new channels will be subject to LCBO markups and charges, with the LCBO’s in-store cost of service charges being applied equally to all beer sold.

(viii) Notwithstanding the LCBO’s role as the wholesaler of record, and consistent with current policies concerning deliveries to existing retail points of sale (but without limiting the Province’s ability to allow other distribution to these new retail outlets), Ontario brewers licensed by the Regulator will be permitted to distribute beer directly to these new retail outlets either individually or collectively through TBS or as may be otherwise permitted.

(ix) These new channels will be prohibited from receiving supplier monies, promotional material or other trade inducements. In addition, these new channels will not be permitted to charge a brewer more than such brewer’s own cost for delivery.

8. The current ODRP Agreement will be extended on revised terms

(a) TBS will enter into a standstill agreement regarding the ODRP Agreement in form and substance satisfactory to the Minister of Finance for the Province (the "**Minister**").

(b) The current ODRP Agreement will be extended until the end of the initial term of the New Beer Agreements at a rate that is $1,000,000 per year less than the rate charged under the current ODRP Agreement, which rate will no longer be adjusted for any measure of inflation.

9. The New Beer Agreements will be in place for a fixed term to allow for appropriate capital planning, subject to renewals

(a) The New Beer Agreements will be in effect for an initial period of 10 years, subject to renewal for successive 5 year renewal terms unless terminated by a party or the Province at the end of any such term or renewal term or earlier for cause or upon a termination event. Should any party or the Province wish not to renew the New Beer Agreements, a minimum of 2 years notice must be provided prior to the end of the then current term. Following termination:

  (i) in accordance with applicable law, the Current Owners will be allowed to distribute or arrange to have distributed their products in Ontario on a basis similar to that of other brewers; and

  (ii) TBS will, subject to applicable law, provide transitional distribution services over a reasonable period of time sufficient to enable brewers to obtain alternative distribution services, at rates determined on a cost-recovery basis.

(b) The New Beer Agreements will provide for certain other limited termination rights.

10. General matters

(a) TBS and the Current Owners will work diligently and in good faith with the Province to negotiate the New Beer Agreements on terms acceptable to TBS and the Province, with the view to entering into the New Beer Agreements between the relevant parties as soon as possible and in any event before June 30, 2015 (or such later date as may be agreed).

(b) TBS and the Council, each acting reasonably, will discuss and agree upon any additional legal, operational and financial due diligence review of TBS and its assets and liabilities that the Council may request.

(c) When agreement is reached on the detailed terms and conditions of the New Beer Agreements among the relevant parties, the Council would recommend that the Minister propose to the Cabinet and/or the Legislative Assembly of the Province, any laws or other approvals deemed necessary or desirable to implement, monitor and enforce such detailed terms and conditions. Any statutory amendments proposed would be subject to approval by the Legislature. Nothing in the Key Principles or the New Beer Agreements would derogate from current or future legislative or regulatory authority under the *Liquor Control Act* (Ontario), *Liquor Licence Act* (Ontario), AGRPPA or any other statute or regulation of the Province.

(d) Upon the execution of the New Beer Agreements, TBS and the LCBO will terminate the agreement dated June 1, 2000 "Serving Ontario Beer Consumers: A Framework for Improved Co-operation and Planning" (the "**MOU**") that was entered into between the LCBO (at the Province's direction) and TBS. Following that termination:

(i) If the LCBO wishes to open a new LCBO owned and operated retail outlet in a community where TBS does not operate its own retail outlet (including a community in which the LCBO has an agency store that the LCBO is considering replacing with its own retail outlet), then the LCBO will provide TBS with prior notice in writing (an "**LCBO Notice**") of such intention. TBS will have 90 days from the date of any LCBO Notice to advise the LCBO by notice in writing (a "**New Outlet Notice**") that it intends to open a TBS retail outlet in the same community. If TBS does not provide a New Outlet Notice in response to an LCBO Notice, or it provides such a New Outlet Notice but fails to begin construction of TBS's retail outlet within 1 year of the date on which such New Outlet Notice was provided to the LCBO or such construction is not completed diligently and the new TBS retail outlet opened within a reasonable period, the LCBO may construct or acquire and operate the retail outlet that was the subject of such LCBO Notice and such new LCBO retail outlet may sell the full range of beer pack sizes at the full range of price points (i.e., it will be and remain a combination store) whether or not TBS subsequently opens a retail outlet in the same community. If TBS provides a New Outlet Notice in response to an LCBO Notice, begins construction of TBS's retail outlet within 1 year of the date on which such New Outlet Notice was provided to the LCBO and such construction is completed diligently and the new TBS retail outlet opened within a reasonable period, any LCBO store established in that community shall be subject to clause 7(c).

(ii) Any existing LCBO combination stores (i.e., the 167 combination stores in operation as of April 1, 2015) may continue to sell the full range of beer pack sizes at the full range of price points (i.e., remain a combination store) whether or not TBS subsequently opens a retail outlet in the same community.

(iii) The LCBO will not sell to licensees any beer product listed for sale through TBS, including products that are sold through both TBS and the LCBO.

(iv) The following will continue to apply with respect to agency relationships (provided that this will not limit any new agency relationships entered into in connection with the new private channels contemplated in clause 7(d)):

(A) TBS will retain the right to enter into commercial contracts with agents in southern Ontario regarding the sale of domestic beer listed for sale through TBS, including the setting of commissions on beer sales and handling fees for the return of empty containers (including in relation to the ODRP Agreement).

(B) The financial arrangements applicable to agents in northern Ontario will remain unchanged (i.e., the LCBO will continue to apply its cost of service charge to such agents and fund the discount paid to such agents) and TBS will continue to act as the delivery agent for such agents, with the cost of freight shared with the LCBO.

(C) The geographic boundary between northern Ontario and southern Ontario specified in the MOU will continue to apply.

(e) The New Beer Agreements will contain appropriate dispute resolution provisions as well as the commitment of the parties to make such other changes as are required to give full effect to the terms of the New Beer Agreements.

(f) The New Beer Agreements will contain typical language confirming that they set forth the entire agreement of the parties with respect to the subject matter of those agreements, and supersede and replace any prior agreements between the parties relating to that subject matter (and any rights arising in respect of such prior agreements), including the MOU.

11. Other related matters

(a) TBS will change its policies and practices effective November 1, 2015, or as soon after that as is feasible from a systems and operations perspective (but no later than January 31, 2016) to permit small licensees (i.e., those that purchase up to 250 cases (i.e., 24 containers of 341 ml each, or volume equivalent) of packaged beer per year through TBS) to purchase up to that quantity of packaged beer at a TBS store or other outlet at consumer retail prices.

(b) Any brewers with a licensed production facility in Ontario and with annual worldwide production of less than 150,000 hectolitres of beer will be permitted to arrange for pooled delivery with other such brewers of their products from their Ontario production facilities to licensees and the LCBO, and will be permitted to use third party carriers and warehousing.

(c) LCBO in-store and out-of-store cost of service charges on beer will be at current 2015 rates, indexed to inflation in subsequent years.

(d) The Regulator will eliminate the production threshold for brewers to open a second on-site store. The second on-site store would operate in accordance with the Regulator's policies (e.g., at least 50% of sales at an on-site store must be produced on site) in place from time to time. Brewers will not be permitted to cross-sell other brewers' products in on-site stores.

(e) The Province will take other actions that will have the effect of increasing its annual revenues from all beer sold in Ontario by approximately $100 million by applying a volumetric tax or markup, as the case may be.

(f) It is the expectation of the Province that consumer prices charged for the most popular beer products will not increase before May 1, 2017, as a result of the changes being introduced by the Key Principles and the New Beer Agreements, though they may be subject to ordinary course price changes tied to increases in the minimum retail prices established under Ontario law. These expectations have been communicated to the principal brewers in the industry separately, and each has separately confirmed to the Province that it is its intention to comply with these expectations, other than in circumstances where the industry context has changed significantly. The Council has recommended to the Province that, as part of the Province's authorization of the Key Principles and the New Beer Agreements, it affirm the authority of the Province to enforce its expectations in this respect, should that become necessary.

It is understood that this document is a statement of the intention of the undersigned to proceed as outlined above, is not an offer and does not create any legally binding obligations of any party. Any legal obligations will be subject to the execution of definitive New Beer Agreements to be negotiated. In particular, while the representatives of the Council do not have authority to bind the MoF or the Province, they unanimously agree to recommend acceptance of this document by the MoF and the Province.

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Schedule – Additional Defined Terms

"AGRPPA" means the *Alcohol and Gaming Regulation and Public Protection Act* (Ontario) and any successor legislation.

"Annual Index Factor" means the allowed annual percentage increase in the MRP for beer calculated pursuant to the regulations made under the *Liquor Control Act* (Ontario).

"Current Owners" means Labatt Brewing Company Limited, Molson Canada 2005 and Sleeman Breweries Ltd.

"Effective Date" means 5 business days after the date on which the relevant parties will enter into the New Beer Agreements and the Legislature of Ontario has passed any enabling laws, and the Lieutenant Governor-in-Council has promulgated any enabling regulations, that may be required in order to give effect to the New Beer Agreements, as determined in the discretion of the Province.

"Independent Director" means a member of the Board of TBS who meets the following qualifications:

(a) need not be a Canadian or Ontario resident, except as may be required to ensure that the Board complies with Canadian residency requirements under applicable law (provided that any such residency requirements are satisfied proportionately by both Independent Directors and other directors);

(b) has the appropriate level of experience and expertise to perform the duties of a director of a company of the size and complexity of TBS;

(c) has the ability to read and understand financial statements that present the breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can be expected to be raised by TBS's financial statements; and

(d) does not have a direct or indirect material relationship with an Industry Participant or any of its affiliates or the Province or any of its agencies that could reasonably be expected to interfere with the exercise of that person's independent judgment as a director of TBS.

"Industry Participant" means any person, trade association or trade union involved in the beverage alcohol industry in Ontario including, for clarity, the Current Owners, any other Qualifying Brewers and any of their affiliates.

"LCBO" means the Liquor Control Board of Ontario.

"MRP" means the minimum retail price as such term is defined in the *Liquor Control Act* (Ontario) and the regulations thereunder.

"ODRP Agreement" means the agreement dated as of the 1st day of September, 2011 among Her Majesty the Queen in Right of Ontario as represented by the Minister, TBS and the LCBO providing for the management of a province-wide deposit return program for program containers.

"**Qualifying Brewer**" means a brewer that operates a brewery in Ontario, sells beer through TBS and satisfies the following criteria:

(a) it has a valid Ontario manufacturing license issued by the Regulator;

(b) it has a valid Canadian manufacturing license issued by the Canada Revenue Agency;

(c) it conducts the full brewing process, including mashing, lautering, boiling, hop separation and fermentation (but excluding packaging) in its Ontario plant; and

(d) it either (A) does not produce beer in any other jurisdiction or (B) its Ontario facility has a minimum annual capacity of 10,000 hectolitres and a minimum annual production of 2,500 hectolitres;

"**Regulator**" means the Alcohol and Gaming Commission of Ontario.

"Small Brewer" means, in respect of a sales year, a brewer that has:

(a) worldwide production of beer in the previous production year that was not more than 400,000 hectolitres or, if this is the first production year in which it manufactures beer, worldwide production of beer for the production year that is not expected to be more than 400,000 hectolitres;

(b) not entered into any agreement or other arrangement pursuant to which any beer manufacturer that is not a Small Brewer manufactures beer for it;

(c) not entered into any agreement or other arrangement pursuant to which it manufactures beer for any beer manufacturer that is not a Small Brewer; and

(d) any affiliate it has that manufactures beer is a Small Brewer.

For this purpose, the following will be included in determining the amount of a Small Brewer's worldwide production of beer for a particular production year:

(e) all beer manufactured during the production year by the Small Brewer, including beer that is manufactured under contract for another beer manufacturer;

(f) all beer manufactured during the production year by an affiliate of the Small Brewer, including beer manufactured by the affiliate under contract for another beer manufacturer; and

(g) all beer manufactured during the production year by another Small Brewer under contract for the Small Brewer or for an affiliate of the Small Brewer.

Appendix – Additional Approvals

1. The following matters would require the approval of at least 80% of the directors then in office (in addition to other required approvals):

   (a) Amendment of the articles or by-laws of TBS

   (b) Any material change in the nature of the business of TBS.

2. The following matters, in addition to those referred to in clauses 3(a)(ii), 6(a) and 6(c), would require the approval of a majority of the Independent Directors then in office (in addition to other required approvals):

   (a) Amendment of the articles or by-laws of TBS

   (b) Terms of any First Preferred Debentures to be issued by TBS

   (c) Any material change in the nature of the business of TBS

   (d) Transactions with shareholders or other related parties

   (e) The provision of confidential information of TBS to shareholders (whether directly or by director nominees), except to the extent contemplated by the New Beer Agreements (see in particular clause 5(c))

   (f) Any potential future distributions to shareholders, including any redemption or early repayment of First Preferred Debentures

   (g) Any change in the number of directors

   (h) Delegation of Board powers to any committee of the Board

   (i) Any policies to the extent relating to the Key Principles, including policies in relation to TBS's dealings with governments, other than ordinary course operational policies

   (j) Any matter that would result in any class of brewer being treated differently (other than as contemplated by the Key Principles), including with respect to product categorization

   (k) The sale of any material assets of TBS not provided for in an approved budget

   (l) Any transfer of shares of TBS other than one resulting from a merger, acquisition or other similar transaction involving a shareholder

   (m) Changes to the user agreement with brewers selling beer through TBS

   (n) Appointment of the independent Beer Ombudsman

(o) The amendment of the New Beer Agreements or any other documents to the extent that they embody the Key Principles

(p) The sale of all or substantially all of the assets of TBS

(q) Each annual budget, business plan and capital spending budget, and any material variation from any such approved budget or plan, including the resulting Rate Card (the "**Budget**"). If the majority of the Independent Directors does not provide such approval of any Budget following the first Budget approved by the new Board, the prior year's approved Budget will continue with adjustments necessary to reflect changes in costs over which management of TBS cannot exercise control.