INFORMATION TO SUPPORT SMALL PRODUCER TEMPORARY NON-COMPLIANCE
JANUARY 2023

INTRODUCTION

Preparing for the Scottish Deposit Return Scheme (DRS) is particularly challenging for small producers who lack the financial resources and capacity to fulfil the regulatory requirements. The Society of Independent Brewers (SIBA) has outlined mitigation measures that it believes would alleviate these issues, specifically through an 18 month grace period, fair payment terms of 60 days, ending the day one charge and a low volume exemption. These have been communicated to the Scottish Government and Ministers.

This document outlines in more detail the challenges facing small producers to prepare their businesses for DRS. It is evident that small producers lack the information they need on the full costs and requirements of the scheme to make a decision whether to sell in Scotland and if they do wish to sell lack the financial resources and capacity to deliver within the timeframe.

Small breweries are particularly impacted by the DRS scheme as they are not only producers but also retailers, online retailers and hospitality businesses. Around 40% of breweries own, lease or rent a pub and 70% run a taproom, shop or visitor centre on the brewery site. The vast majority now have an online store to provide their products directly to customers.

CHALLENGES

Small producers are currently in survival mode – they are facing an extremely tough trading environment, combined with an energy cost spike and a cost of living crisis. The vast majority of the limited resources of these small businesses are therefore focused on surviving the next few months not on preparing for the DRS scheme. This contrasts to large companies that have had teams working on this for many months.

Timeframe

- It is currently apparent that the full information of the scheme will not be known until at least March 2023
- Small producers need a minimum of 16 weeks from this point to make decisions in stage 2-6
- Small producers then need a minimum of 12 weeks from this point to make decisions in stage 7 -10
- After which small producers need a minimum of 3-12 months for the remaining stages.

Stage 1 - Being aware of responsibilities

There are thousands of small producers and those who will have to behave as producers (e.g. bottle shops that do crowlers) who are currently unaware of the scheme and their responsibilities. They cannot act until they are informed about the scheme and some may not become aware for some time as these products will not show up in reverse vending machines/ return points.

Example:
A small bottle shop in Kent does a monthly crowler club where a mixture of different and new beers are packaged from the bottle shop into metal containers and posted to Scotland. They only sell a few hundred a month. These products do not have a barcode and because the bottle shop is unaware of the scheme charges no deposit. The consumer cannot return them to a return point as they are not recognised by the scheme. It takes many months if not years before this bottle shop becomes aware of their responsibilities at which point the costs of fulfilling DRS are much greater than the margins on the product and they stop selling in Scotland to comply with the scheme.

Timetable:
This could take 12-18 months or more from go-live for businesses to become aware.

Action:
SEPA and CSL should write to all eligible businesses across the UK to inform them.

A business cannot move to stage 2 until they are aware of the scheme.

Stage 2: Understand what is sold in Scotland

Before a small producer can register its products, it needs to understand what is sold in Scotland. This is extremely difficult if not impossible for most small producers operating across the UK. A small producer may sell to a wholesaler who sells in Scotland or may sell to a bottleshop that has an online shop that then sells into Scotland. This audit process may take some time for them to request the information from all their customers. Note that wholesalers and customers do not have to provide this commercial information and if they do it there is likely to be a cost.

Example:
A wholesaler in Essex buys a pallet of beer cans from a small brewery in Wales. It then sells these cans to a bottleshop in London who sells them online via their shop to Scotland. The small brewery nor the wholesaler are aware they are sold in Scotland and the small brewery is not aware that they are sold in a bottle shop in London.

Timetable:
It could take several months if at all possible for small producers to discover this information. For some small producers they may not be aware that products are sold in Scotland at all.

Action:
Provide additional time for small producers to discover what is sold in Scotland and provide templates to assist them in requesting this information from wholesalers and customers.

A business cannot move to stage 3 until they are aware of what they sell in Scotland.

Stage 3: Full information on the costs and requirements of the scheme

Once aware of the scheme and the products that are sold in Scotland, it needs the full information on the costs and requirements of the scheme before it can determine whether to continue to sell into the Scottish market. Currently this is not available and therefore a small producer is not able to make this evaluation.

a) **Online:**

Currently the Minister has agreed to amend the regulations on the online takeback service. No timetable or details have been published. The vast majority of small producers now have an online presence, along with pubs and bottle shops. Many small breweries in England and Wales only sell into the Scottish market (that they are aware of) via their online shops. These small producers cannot confirm what they will place onto the Scottish market until the details of this are known.

Example:

A small brewery in Cornwall sells bottles through its online shop, some of which go to Scotland. It is not aware of any other product that is sold in Scotland as the majority of its sales are local. Given the current uncertainty over online sales it intends to restrict its online shop in Scotland. Only once the regulations are changed and certainty is provided could this business reconsider selling in Scotland and registering for the scheme.

Timetable:

Given that regulations have not been published and are subject to Parliamentary approval we estimate that small producers will not know until March 2023 what they might place on the Scottish market.

Action:

Scottish Government should publish changes and timetable and expand SEPA registration to allow small producers to register.

b) **VAT:**

This is subject to UK Government decision and small producers do not know the implications of this. It is possible they will not get 20% of their VAT returned so this represents another cash flow issue.

Timetable:

No timetable has been provided but it could be assumed that no answer is provided for several months and so small producers may not know this before the registration deadline.

Action:

UK Government must publish changes before small producers can register and SEPA must expand the registration deadline.

The information small producers require at stage 3 will only be available after the closure of the registration period.

Stage 4: Decide whether to sell into the Scottish market

Small producers need to weigh up the information they will have on the costs and requirements of the scheme, their own resources and ability to raise finance to decide whether to sell into the Scottish market. This will take time for them to make a decision. If a producer decides to sell into the Scottish market it can move onto Stage 5.

Example:

The costs of the scheme for this small brewery would be:

162,500 cans @ 2.03p producer fee = £ 3,298.75 +VAT = £3,958.50
90,000 bottles @ 4.10p producer fee = £ 3,690 +VAT = £4,428
VAT loss on deposit 252,500 x 0.66p (assuming 20% non-returned) = £1,665.50
Annual fee: £365
Direct cost total: £10,417

As they sell product across the UK they decide to continue to use their UK wide SKU and have to pay the 1.133 pence surcharge:

This is 1.133p x 252,500 = £2,860.82 +VAT = £3,432.98

They also use their retained EANs (UK) and therefore have to pay the Day 1 REAN payment of three weeks of the producer fee and deposits:

Producer fee = 10,156 x2.03p + 5,625 x4.10p = £436.78 +VAT = £524.14
Deposit fee = 15,781 x 20p = £3,156.20

They also must pay the month 1 invoice which is also three weeks of the producer fee and deposits:

Producer fee = 10,156 x2.03p + 5,625 x4.10p = £436.78 +VAT = £524.14
Deposit fee = 15,781 x 20p = £3,156.20

In addition, the small brewery has to pay the deposits and producer fee at the end of the month rather than when it has been paid by the customer, which hits their cash flow. The small business must therefore finance a month's worth of fees and deposits.

Producer fee = 13,541 cans @ 2.03p + 7,500 @ 4.10p = £582.38 + VAT = £698.85
Deposit fee = 20,951 x 20p = £4,208.20

So the overall cost is: £26,117.71

The brewery will have to consider whether it has this cash reserves in the next few months to continue to sell in Scotland.

Stage 5: SKU viability consideration

Once deciding to sell into the Scottish market, the small producer must decide which SKUs are viable for them to do so. Small volume specialist products will not be viable given the costs and requirements.

Example:
A small brewery makes an IPA and also a Christmas Imperial Stout which is a limited edition of only 5,000 bottles. They decide to continue selling the IPA in Scotland but stop selling the limited edition bottle as they would have to send samples to the administrator, know the numbers they make and sell varies every year, would have to change its label to include a barcode which would all make the product unviable in Scotland given the small numbers sold.

Stage 6: Direct or through an administrator

Small producers must then decide whether to fulfil their responsibilities through the scheme administrator or directly through SEPA. If they do so through SEPA they must produce an operational plan that demonstrates how the legal obligations will be met. This is a significant burden for small producers so could take several months to design and implement to satisfy SEPA's requirements.

If a small producer decides to fulfil this responsibility through the scheme administrator, they will need to provide details of the number of SKUs they sell along with fulfilling labelling requirements. If they are considering selling through the Scheme Administrator they will need to read and understand the 48 page producer agreement, and some may want legal advice.

Stage 7: EAN strategy

Once deciding whether to sell in Scotland and then which products are viable, the small producer must then decide on its EAN strategy per product. This is a choice of:

a) REAN – Scotland only. This is a continuation of their retained EANs and only sell them in Scotland. This has the benefits of not having to pay the surcharge. This is probably suitable to small producers that don't sell outside of Scotland.
b) REAN – UK wide. This is a continuation of their retained EANs that they sell across the UK. This would include a surcharge and suitable for those who sell across the UK but small amounts in Scotland.
c) OEAN to NEAN. This is a replacement of the old EANs to New EANs in Scotland. This might be suitable for those that sell medium to high volume SKUs in Scotland.

d) OEAN to rest of UK and NEAN in Scotland. This involves keeping the existing SKU to sell outside of Scotland and introduce a new SKU for those sold in Scotland. This is likely to be suitable only for those selling high volume SKUs.

Stage 8: Negotiate pricing between customers

A small producer must decide their pricing strategy, negotiate this and agree revised prices with the Scottish trade. This will depend on who their customers are and their ability and willingness to agree to price changes. Small producers face much higher costs per unit than large producer so may struggle to pass on any additional costs to customers which may make their products unviable in the market.

Stage 9: Cut over strategy

Once settling on the EAN strategy the small producer must decide on their cut over strategy per SKU which is when they will move over from an old SKU to a new one. This will depend on your customer base and how willing the retailers are to accommodate OEANs. For example, it is believed that the supermarkets will not be willing to consider OEANs and require REANs or NEANs.

Stage 10: Risk assessment for UK wide SKUs

If a small producer decides to use a UK wide SKU it must also provide an auditable supply chain and undertake a risk assessment and mitigation plan to provide evidence of due diligence. No agreed template has yet been provided and this must be provided before 1 March 2023.

Stage 11: Labelling changes

There are several labelling changes that a small producer must make depending on the choices they have made above. The order cycle for design and labelling could be 3-12 months.

a) Barcodes

If the small producer decides to fulfil their responsibilities through the scheme administrator, they must make changes to their labels to incorporate a barcode. A third of small breweries do not currently do so, these therefore must register with GS1, redesign their labels to accommodate a barcode and then replace them. Some small producers have 18-24 months of old labels and printed cans which may have to be thrown away if they cannot use them representing an additional cost.

b) Ending OEANS

This will be the discontinuation of labels used to mark old EANs. This might represent a cost to small producers that have to throw away old labels/ printed cans.

c) NEANs

This includes the new design and creation of new labels for NEANs.

Stage 12: Manage Supply Chain Transition

Having decided to continue to sell into Scotland, planned their EAN strategy, and redesigned labels as required, small producers then need to plan their supply chain stocks. This means timing consumption of labels and packaging materials, to meet production dates, and production dates to meet stock requirement dates for the planned cut-over strategy. Small producers may have up to 12 or even 24 months of stock of printed labels and cans on existing designs that will need to be worked through, and then up to 9 months of finished goods stock in certain SKUs.

If producers don't have time to work this stock through the supply chain then they can end up with stranded materials and packaged product without a viable outlet – leading to substantial volumes of waste and substantially higher costs of implementing the scheme. Note that the cost of waste product can be much higher for small breweries than even just the value of the product, as packaged product counts towards their duty bill if they produce over 5,000HL of beer per year, even if not sold. So effectively they will pay up to 50% of the full Duty rate on packaged beer that is destroyed.

Stage 13: Changes to Webshops

Many small producers that have a webshop use a third-party application. They will have to work out how to change their online shops to charge the deposit and potentially pay for the change to take place as they lack the technical knowledge to do so.

Stage 14: Financing

CSL is intending to carry out a credit risk assessment and may require small producers to prepay charges and provide a financial guarantee. They also require a 30-day payment cycle. It is likely that some small producers will find these requirements difficult to meet given their precarious financial position. SEPA must give thought to what happens if a small producer is rejected by CSL because of these financial terms. DRS requires significant upfront costs for the Day One Charge and Month One Invoicing. This is finance that a small producer cannot borrow and may not have the reserves to meet.

Action: consider grants for small producers to meet costs and additional time for small producers to recover from the pandemic and current cost squeeze to build up finance required.

Stage 15: Accounting systems

Small producers will need to change their accounting systems to address the change in VAT, whereby the producer does not receive the VAT from the deposit back until the item is returned. As only 80% of these will be returned in the first year and 90% in future years, this represents an additional cash flow cost for small producers. They will also have to schedule

30-day payments to CSL and account for these in their accounts. No work on this can begin until detailed rules have been published by HMRC, and the myriad complexities of small producers supply chains will throw up hard cases in this area.

Stage 16: Agreeing the producer agreement

The CSL producer agreement is a lengthy legal document and given its implications a small producer may need to consider legal advice. They must sign this before the end of February to be able to sell into the Scottish market after 16 August.

This is a major barrier to many small producers registering with the scheme, and signing the agreement now is not required in the regulations. Urgent consideration should be given to allowing producers to register without signing the agreement, with clarity that they cannot supply the market until the agreement is signed.

Stage 17: Retail/ hospitality obligations

Most small breweries are also retailers, online retailers and have taprooms/ bars and pubs which must meet their collection obligations. These represent additional costs and complexities for small businesses in preparation for the scheme. For example, they will have to consider whether to operate a closed loop system or a full collection point, how to address the storage of waste products within a brewing environment, changes to their ePos system, as well as training staff and agreeing new processes. In addition, security will become an issue for the storage of valuable containers.

Conclusion

As detailed in the 17 stages above, there is a substantial body of work that small producers are required to carry out in only a few months' time to be permitted to continue to sell their products in Scotland from August. Most small producers can only commit limited resources to undertake this body of work and only do so on a part time basis given they are working full time to keep their businesses afloat, especially when faced with the current challenging trading conditions. This contrasts to larger companies that have been able to dedicate teams of full-time resources to DRS.

It is therefore unrealistic for any small producer to meet these requirements in the timescale provided. It is also impossible for the supply chain of wholesalers and retailers to work with a host of small suppliers each with individual timelines to full compliance. The only solution is for a blanket 18 month grace period with minimal expectations after this period. This would provide much needed clarity and a clear set of rules.