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# Regulation of the Alcohol Beverage Industry: A Sunset Report on the Texas Alcoholic Beverage Commission

by Carine Martinez-Gouhier and Randy Petersen

## Executive Summary

The Texas Alcoholic Beverage Commission (TABC) goes into its sunset review following attention given to inappropriate use of taxpayer money and several lawsuits that question both the current system of regulation of the alcohol beverage industry and the way the state agency is applying the law. Archaic, inconsistent, burdensome, and favoring some actors over others in the market, the regulation of alcohol beverages in Texas is in need of modernization, with government taking a step back from regulating every single aspect of the industry.

However well-intentioned the three-tier system may have been when it was first instituted, it has become a system that favors one tier—the distributors, giving them tremendous power over the other market participants. The alcoholic beverage market as well as Texas' economy and consumers would benefit from the elimination of cronyism. This could be done by allowing cross-tier ownership, eliminating onerous franchise laws, enabling market participants to contract and set provisions of their agreements on a voluntary basis, and streamlining regulations to reduce burdens on businesses and negative effects on consumer well-being.

Several of the recommendations in the Sunset *Staff Report* go in this direction, but others go in the other direction, imposing more regulations on business and increasing costs that will be passed on to consumers. Much more is needed to make the regulation of the alcohol beverage business in Texas a part of—not an exception to—the Texas Model of less regulation, lower taxes, and free enterprise.

### ***ISSUE 1: Vertical Integration and Vertical Restraints—The Antiquated Three-Tier System***

#### **TPPF Recommendation**

*Allow cross ownership between brewers/distillers, distributors, and retailers. Today, the three-tier system only protects the distributors while increasing costs for producers and consumers.*

### ***ISSUE 2: Anti-Competitive Franchise Laws***

#### **TPPF Recommendation**

*Allow brewers to sell their distribution rights to distributors of their choice. Most brewers are currently forced to sign an agreement with a distributor to sell their*

## Key Points

- TABC and the Alcoholic Beverage Code rely on outdated, Prohibition-era regulations.
- The three-tier system imposes a middleman, which gives one tier tremendous power over others.
- Inconsistent treatment of upper tier actors with no benefit for public safety needs to be addressed.
- A freer market will create more competition between all three tiers, leading to more and safer choices for consumers, lower prices, and better economic growth for the industry.

products with few options to cancel it leaving the distributor as the only one able to reap the benefits of what these rights are worth. This leaves tremendous, government-enforced power to the middle tier. Several states either have no franchise laws, or franchise laws that allow for no-cause cancellation. Brewers and distributors can decide the terms of their business agreements without government imposing a one-size-fits-all mandate. Brewers should be allowed to opt out of current agreements with distributors entered into under the current restrictive laws.

### **ISSUE 3: The Unequal Treatment of Different Products with No Public Health or Safety Justification**

#### **TPPF Recommendations**

- Eliminate the distinction between beer and ale, and opt for the lower tax rate for both. This will reduce confusion and red tape for the industry, without endangering public safety.
- Let breweries sell their beer and ale to-go on their premises. This will put breweries at the same level as wineries and distilleries, will allow them to compete with out-of-state breweries that are allowed to sell beer to-go, and can benefit producers, distributors, and most importantly, consumers.

#### **Related Sunset Staff Recommendation**

2.2 Modernize Texas' regulation of malt beverages by eliminating distinctions between beer and ale. **TPPF Position: Support a-b, d-g, i-j. Amend c.**

### **ISSUE 4: The Burden of Doing Business Under the Texas Alcoholic Beverage Code and TABC Regulations**

#### **TPPF Recommendations**

- Allow producers to use federal Certificates of Label Approval (COLAs) for label approval in the state of Texas whenever they are available instead of duplicating the label approval process.
- For those producers who choose not to use the COLA process, change the Texas system so that it is similar to insurance use-and-file laws that allow manufacturers to put products on the market without prior approval of labels. The TABC could then check labels for these products and take appropriate corrective action as necessary.
- Reduce the number of licenses and permits a business in the industry might need to operate on a daily basis,

following the Sunset staff recommendation to streamline the system by combining certain licenses and eliminating obsolete or redundant ones.

#### **Related Sunset Staff Recommendations:**

- 2.1 Streamline the state's alcoholic beverage licensing system by reducing the number of licenses and permits to provide regulatory clarity and administrative efficiency. **TPPF Position: Support a, c-f. Amend b.**
- 2.3 Remove fees from statute to allow TABC to systematically review and adjust license and permit fees on an ongoing basis. **TPPF Position: Amend.**
- 3.1 Streamline TABC's process for approving alcoholic beverages for sale in Texas. **TPPF Position: Support-Amend a-c. Oppose d.**
- 3.2 Make cash payments optional by applying the existing credit law restrictions to beer transactions between retailers and distributors. **TPPF Position: Support.**
- 3.3 Eliminate overly restrictive outdoor advertising requirements. **TPPF Position: Support.**
- 5.3 Authorize TABC to consider profits earned from violating the law when penalizing licensees. **TPPF Position: Oppose.**
- 5.4 Authorize TABC to temporarily suspend licenses and permits if it finds a continuing threat to the public welfare. **TPPF Position: Oppose.**
- 5.5 Make noncompliance with a commission order a statutory violation and authorize TABC to take disciplinary action or deny license or permit renewal for noncompliance. **TPPF Position: Oppose.**
- License Surcharge (Issue 2). **TPPF Position: Oppose.**

### **ISSUE 5: The Enforcement Division of the Texas Alcoholic Beverage Commission**

#### **TPPF Recommendations**

- Conserve TABC's very limited law enforcement personnel for work on large scale violations of the Alcoholic Beverage Code that fall outside of or are not contained within a single local jurisdiction and not for routine local issues unless specifically requested by that jurisdiction.
- Focus the enforcement agents and other TABC personnel on training the vast number of state, county, special jurisdiction, and local police officers on effective enforcement of the Alcoholic Beverage Code as subject matter experts on the topic.
- Defer TABC's criminal enforcement activities to local jurisdictions.

- *Remove other responsibilities from TABC such as the development and maintenance of a Special Response Team to prevent the use of its limited resources for disaster relief or search and rescue functions for which it was never intended.*

#### Related Sunset Staff Recommendations:

- *5.1 Require TABC to regularly inspect every regulated location in the state within a reasonable period and direct the commission to set a minimum inspection period by rule that prioritizes public safety risks.*

**TPPF Position: Amend.** *Considering TABC's resources and its primary mission to protect public safety, regular inspections should be based on public safety risks. There is no need for a regular inspection of every single location in the state. Focusing on those locations that constitute a high risk will free up resources and time for TABC and reduce the burden of overregulation for businesses.*

### ISSUE 6: Alcohol Over-Consumption, Temperance, and Taxes

#### TPPF Recommendations

- *Limit the collection of fees and taxes to what is needed for TABC to cover expenditures in order to protect public safety.*
- *Follow the Sunset staff's recommendation to repeal the tax on alcohol imported for personal use and eliminate TABC's port of entry tax collection program.*

#### Related Sunset Staff Recommendations: Support.

- *6.1 Repeal the state's inefficient tax on alcohol imported for personal use and eliminate TABC's ports of entry tax collection program. TPPF Position: Support.*

### Introduction

#### *To Drink or Not to Drink: The Consequences of Prohibition and its Repeal*

On December 18, 1917, Congress passed the 18th Amendment. The amendment was ratified in 1919 and prohibited the “manufacture, sale, or transportation of intoxicating liquors” in the United States from 1920 to 1933. The 21st Amendment repealed Prohibition in 1933 and left to the states—as opposed to the federal government—the authority to regulate alcohol distribution within each state's territory. Most states opted for one of two solutions. States either took control of the distribution of alcohol, or they established a system that draws a clear demarcation between manufacturers or producers, distributors or wholesalers, and retailers—better known as the three-tier system.

Texas opted for the latter. In 1935, the 44th Texas Legislature passed the Texas Liquor Control Act, which created the Texas Liquor Control Board. The board became the Texas Alcoholic Beverage Commission (TABC) in 1970, and the Liquor Control Act was codified into the Texas Alcoholic Beverage Code in 1977 ([Texas Archival Resources Online](#)). Although the Alcoholic Beverage Code applies to the entire state, it also allows for local options on types of alcoholic beverages sold. Elections can be held at the county, city, or justice of the peace precinct level ([TABC 2017b](#)).

#### **Bootleggers and Baptists**

Unfortunately for some businesses and for consumers, the regulated alcoholic beverage industry continues to be under the influence of something reminiscent of the Prohibition era. Economist Bruce Yandle explained how two groups could end up supporting and upholding legislation when one group benefits from the legislation while the other wants to advance a public interest ([Yandle](#)). Prohibition was beneficial to two apparently antinomic groups: the bootleggers—those who illegally sold alcohol at a huge markup as compared to a situation where alcohol would be sold legally—and the Baptists—those supporting complete abstinence and hence prohibition for the public good.

Today, the myriad regulations that make up the Alcoholic Beverage Code, and the three-tier system itself, have created just such a situation where one tier gets to benefit from tightened regulations—those imposed of the other two tiers. Just as Prohibition benefitted bootleggers, the three-tier system is a boon for distributors.

Far from promoting fair competition, the three-tier system stifles it through caps that send the message that a business can only be successful up to a point before being penalized by higher taxes, or having to deal with other actors it doesn't necessarily need or want to deal with.

The stricter the law becomes, the more players will start looking for exemptions to try to make sense of it. The more exemptions, the more people not benefitting from them will feel left out and will eventually look for exemptions for themselves too, or for a way to get around the law. As history showed with Prohibition, heavy government intervention can bring the opposite of what legislators are trying to accomplish and generate disrespect for the law itself.

In their book *Bottlenecks: Gaming the Government for Power and Private Profit*, Mellor and Carpenter studied how some businesses support government regulation and especially occupational licenses in order to limit access to their market or occupation—and create a bottleneck. They explain that the origin of the moniker they use, “bottleneck,”

comes from distributors' influence on the alcohol industry: "...lawmakers created a bottleneck. All alcohol sales flowed through, and only through, distributors—the quintessential 'bottleneckers'" (7).

Distributors have little incentive to support a freer market and to let go of the three-tier system. In fact, they are deeply invested at the state and federal level to maintain the status quo (Mellor and Carpenter, 8-10) The National Beer Wholesalers Association is "one of the most influential lobbies in America" and "has consistently been one of the largest contributors to state and federal political candidates" (8).

### *The Texas Alcoholic Beverage Commission (TABC)*

TABC is the "state agency that regulates all phases of the alcoholic beverage industry in Texas. The duties of the commission include regulating sales, taxation, importation, manufacturing, transporting, and advertising of alcoholic beverages" (TABC 2017a). The [Alcoholic Beverage Code](#) describes its function as "an exercise of the police power of the state for the protection of the welfare, health, peace, temperance, and safety of the people of the state. It shall be liberally construed to accomplish this purpose."

TABC grants and renews—and can suspend and deny—permits (liquor) and licenses (beer) that rule every major activity in the alcohol industry, always distinguishing the manufacturing, distribution, and retailing tiers. The agency displays a list of more than 70 different permits and licenses on its website (TABC 2018a). It reported 64 different licenses or permits in 2002, as compared to only 27 in 1935 (TABC 2017c, 140). According to the agency, each permit, license, or certificate "allows it's [sic] holder the authority to perform specific functions in the manufacturing, importing,

exporting, transporting, storing, selling, advertising, labeling, distributing and possession for sale of alcoholic beverages" (TABC 2003, 65).

The agency is also invested with the power of collecting taxes and fees. The TABC reports that it collects "in excess of \$300 million annually ... which aids in the financing of the state's public schools, local governments, research, human services, and other areas in which state government provides services to all Texans" (TABC 2017a).

TABC is facing its sunset review this year. This follows several scandals and lawsuits linked to waste of taxpayer money and inconsistencies in how the agency applies the Alcoholic Beverage Code. The review brings to the collective mind of the Legislature the fact that many of the provisions regulating the alcohol business in the Texas Alcoholic Beverage Code are archaic, relying on a post-Prohibition vision of the world. In addition, the complexity of the law generates exemptions and more favorable treatment of some actors in the business.

The Texas alcohol beverage industry as well as Texas could benefit from a freer market without endangering public safety, which should be TABC's only concern—not temperance, nor creating a competitive environment. Legislators and the agency should take a hard look at the myriad of contradictory regulations and rules and their consequences everyday on businesses, consumers, and the Texas economy. Temperance in the government's approach to the regulation of alcohol would mean a step back to let the market work instead of overburdening businesses, leading to favoritism as well as higher prices and less choice for consumers.

## Issue 1: Vertical Integration and Vertical Restraints—the Antiquated Three-Tier System

### TPPF Recommendation

Allow cross-ownership between brewers/distillers, distributors, and retailers. Today, the three-tier system only protects the distributors while increasing costs for producers and consumers.

One of the concerns after the repeal of prohibition was to prevent a return of the saloon in its pre-prohibition form, owned or in exclusive agreements with a producer, as well as a "storefront for local partisan politics" and "corrupt and 'inefficient' political machines" (McGirr, 16). The fear was that vertical integration in the alcohol industry would push

producers to put their profits first, which meant encouraging over-consumption with little concern for public safety.

The solution implemented was the three-tier system and the institution of a middleman to prevent any entanglement between manufacturers and retailers. The three-tier system puts clear demarcations between the three main aspects of the business: the manufacture of alcohol, its distribution, and its sale. One goal was to prevent situations in which manufacturers would own retailers or in which retailers would be forced to sell only one brand of alcohol—so-called tied houses.

However, these concerns surrounding vertical integration are both outdated and misguided. Antitrust theory today has exposed the problems with an excessive focus on firms and has instead shifted toward using the effects on consumers as the primary area of concern with economic regulation. In addition, the market today is very different than that which existed almost a century ago.

[Section 5.31](#) of the Alcoholic Beverage Code lists among TABC's duties the protection of public health, the promotion of legal and responsible consumption, and ensuring fair competition within the alcoholic beverage industry. However, "fair competition" is usually code for less competition that favors one particular segment of an industry, something that the design of the three-tier system makes very clear. Businesses operating in any of the three tiers cannot hold an ownership interest in one of the other two tiers. They also cannot coordinate activities and must remain, each in their own tier, independent. By separating the industry into these three stand-alone tiers, the three-tier system has turned distributors into de facto monopolists, and as such favors the middle tier over the other two.

The continuation of the TABC and, as a consequence, TABC's enforcement, under faulty economic theory has created exemptions, disparities, and inconsistencies in how businesses are treated, based solely on the tier and/or the type of alcohol concerned. The regulation of the alcoholic beverage industry today distorts the market, creates rent seeking—encouraging participants to divert resources away from satisfying consumers and toward obtaining always more government privileges instead—and it eventually creates winners and losers.

## Issue 2: Anti-Competitive Franchise Laws

### TPPF Recommendation

Allow brewers to sell their distribution rights to distributors of their choice. Most brewers are currently forced to sign an agreement with a distributor to sell their products with few options to cancel it leaving the distributor as the only one able to reap the benefits of what these rights are worth. This leaves tremendous, government-enforced power to the middle tier. Several states either have no franchise laws or franchise laws that allow for no-cause cancellation. Brewers and distributors can decide the terms of their business agreements without government imposing a one-size-fits-all mandate. Brewers should be allowed to opt out of current agreements with distributors entered into under the current restrictive laws.

Additionally, several lawsuits also questioned how consistently TABC applies and enforces the three-tier system. Under Texas law, a business pertaining to one tier cannot hold any ownership interest in another tier. This is known as the "one share rule." For example, "in *McLane Company*, TABC went so far as to deny the plaintiff a distributor's license because its parent company, Berkshire Hathaway, has a 2 percent ownership stake in Walmart, which holds retailer permits in Texas through a subsidiary." But considering today's sometimes complicated chain of ownership interests, it is very likely that virtually every license or permit holder could find themselves with an interest in another tier, simply by being publicly traded, for example ([Hunker et al., 68-69](#)).

In an era of global markets and ever-increasing competition among manufacturers, the strict enforcement of a three-tier system is out of date. Take the example of Austin barbecue restaurant Salt Lick. The owners of the popular restaurant and the land on which it stands just south of Austin have been growing grapes to make wine. They cannot legally produce wine and continue to run their restaurant though, because that would make them both producers and retailers, something that the three-tier system in Texas strictly forbids. As a solution, they are looking for an exemption ([Root](#)).

The rigidity of the three-tier system and its origin in an era past makes it clash often with the reality of the present world. Technological advances, the growing number of manufacturers all around the country, public reviews available on a 24/7 basis on the internet make the system not only mostly impractical and archaic, but a burden for businesses, an impediment to growth, and a cost for consumers.

Most franchise laws in the alcohol industry were passed in the 1970s, when breweries were concentrating and a decreasing number of manufacturers faced a very large number of wholesalers or distributors. In 1980, there were 92 breweries in the United States and 4,595 beer distributors ([Brewers Association 2018b](#); [NBWA](#)). The underlying result of these laws was to shelter a single tier—distributors—from competition. The situation today is very different though. In 2017, there were 6,372 breweries in the U.S. (including 6,266 craft breweries) but only 3,000 beer distributors ([Brewers Association 2018b](#); [NBWA](#)).

In most cases in Texas, brewers must contract with a licensed distributor for their products to be able to reach consumers. The Texas code allows for a few exceptions—

such as self-distribution or direct, on-premises sales to consumers for certain breweries—but they are all strictly limited in the number of barrels the brewers can produce and sell.

The [Beer Industry Fair Dealing Law](#), Chapter 102, Sections 102.71 to 102.82 of the Texas Alcoholic Beverage Code, was first adopted in 1981. Indeed, the contract between a manufacturer and a distributor is strictly regulated. It must be exclusive to one distributor within a given territory and a manufacturer cannot “cancel, fail to renew, or otherwise terminate” the contract with a distributor “unless the party intending such action has good cause” ([Hunker, et al., 68](#)). Distributors have 90 days to correct any issue that could be cause for cancellation of the contract. In 2013, the Legislature also made it illegal for manufacturers to sell their territorial rights. They must instead relinquish them for free, while distributors can resell these rights to competitors for a profit. A coalition of brewers has challenged the law, with the case actually pending at the Texas Supreme Court level ([Hunker, et al., 68](#); [Institute for Justice](#); [Texas Judicial Branch](#); Mellor and Carpenter, 15-16).

Some states' franchise laws allow for more flexibility than Texas' beer franchise laws. In Arizona, the law allows exclusive territories but does not impose them. Colorado's law has an option for termination not for cause. New York and North Carolina allow small breweries to terminate without good cause. Alaska, Hawaii, and the District of Columbia have no franchise laws ([Brewers Association 2018c](#)).

Such government-mandated agreements give enormous power to those that benefit from them—here distributors over manufacturers. Once insulated from competition, a party to an agreement faces less pressure to perform at a high level and can be pickier in the number of clients it decides to serve well and how it handles its relationships with them. The result is often that incumbents and big players in the industry benefit, while it increases the barrier to entry for newcomers and innovators. The first agreement between a producer and a distributor might often favor the distributor (Abel et al., 73).

Preventing small and/or new businesses from being able to distribute their products or sell them directly to their consumers—which often is the case in a three-tier system—can create tremendous barriers for a new business to make its products known. Jess Jackson, co-founder of the well-known California winery Kendall-Jackson, had to face this problem firsthand when he established his winery. The new winery struggled to find a distributor at the beginning (Humes, 52-54), because “the prevailing attitude was that no one needed yet another no-name California wine to gather

dust along with all the others no one wanted to buy” (52). Hume explains that Jackson “hated having to plead with one distributor after another in state after state just to get them to carry” his wines (209).

Not only are franchise laws favoring one of the tiers, they end up having a distorting effect on the market, impacting what consumers will eventually find on the shelves: “Because this setup [the three-tier system] confers licenses and territories to the distributors, they have enormous power to boost or impede the sales of a particular brand or product. Large and powerful brands—the market incumbents—end up getting most favorable treatment by distributors, while small upstarts tend to get lost in the shuffle” (Hume, 155-56).

Jacob Burgdorf, assistant professor at the College of Business at the University of Louisville, researched the effects of mandated vertical restraints on craft breweries. He found that franchise laws and restrictions on self-distribution limited entry and production for craft breweries. His research suggests that “these laws do not ease entry by preventing large brewers from coercing wholesalers into excluding access to markets to rival craft breweries, but rather that the mandates increase the cost of entry and production and encourage opportunistic behavior from wholesalers” ([Burgdorf, 2](#)). The result, Burgdorf explains, is “less variety and consumer choice” (3).

In an analysis of empirical studies on the effects of exclusive contracts and vertical restraints on businesses and consumers, Lafontaine and Slade found that the effects differed if these restraints were privately agreed upon or legally enforced. When vertical restraints are privately agreed upon for efficiency reasons between manufacturers and retailers, these restraints can lead to lower prices for consumers. Lafontaine and Slade also note that such restraints can be used for anticompetitive reasons too, such as creating monopolies through exclusive territories. On the other hand, vertical restraints banned or imposed by law usually claim to be in the interest of competition and consumers. However, the authors found that in most cases privately agreed-upon vertical restraints increase consumer welfare or do not make it worse. Mandated vertical restraints tended to have the opposite effect: “when dealers or consumer groups convince the government to ‘redress’ the unfair treatment that they allege to be suffering, the consequences are higher prices, higher costs, shorter hours of operation, and lower consumption as well as lower upstream profits” ([Lafontaine and Slade](#)).

Even when Kendall-Jackson became a well-known and respected brand, the advantages created for the distributors

by the state-enforced system sometimes proved difficult to work with (Hume 209-13), so much so that Jess Jackson finally decided to create his own distribution company—because he could. The system in place in California at the time, Jackson explained, was “assembled to favor the established players, the incumbents, the good old boy network, and the huge and financially powerful corporations, to the detriment of entrepreneurs and family businesses who are trying to innovate and build something good. Something had to change” (210).

Steve Hindy, co-founder of the Brooklyn Brewery, explained in a *New York Times* article that “state laws continue to empower distributors to select brands and manage them however they want—selling those they choose to sell, while letting other brands sit in their warehouses. The only recourse is to sue, and many small breweries lack even a fraction of the resources needed to take on a big distributor in court. As a result, they’re stuck with the bad distributor,

which severely hampers their ability to perform and grow as a business.” He gives a couple of “war stories” between distributors and craft brewers and explains that “some small brewers refuse to enter certain markets because of the local distributors’ reputation” (Hindy).

In such situations, and despite any sincere legislative intention to protect the small businesses in a market, the winners are the big players and incumbents; the losers are the consumers, as well as small and innovative businesses.

Distributors often explain that franchise laws are necessary to protect the investments they make in marketing the brands they distribute—without franchise laws, a manufacturer could choose to change distributor once a distributor has invested money in its brands. But this is a business risk, and if the distributor performs well, there is no reason for a manufacturer to be willing to look for a competitor. There is no right to a protection against competition, which is exactly what franchise laws are doing.

## Issue 3: The Unequal Treatment of Different Products with No Public Health or Safety Justification

### TPPF Recommendations

- Eliminate the distinction between beer and ale, and opt for the lower tax rate for both. This will reduce confusion and red tape for the industry, without endangering public safety.
- Let breweries sell their beer and ale to-go on their premises. This will put breweries at the same level as wineries and distilleries, will allow them to compete with out-of-state breweries that are allowed to sell beer to-go, and can benefit producers, distributors, and most importantly, consumers.

### *Beer vs. Ale*

An “alcoholic beverage” regulated by TABC is defined as a beverage with more than one half of one percent alcohol by volume, as defined in [Sec. 1.04 of the Texas Alcoholic Beverage Code](#). The code also makes a differentiation between beer, “a malt beverage containing one-half of one percent or more of alcohol by volume and not more than four percent of alcohol by weight” and ale or malt liquor, “a malt beverage containing more than four percent of alcohol by weight.”

Although for most consumers a beer is just a beer, this difference in definition in the code has several consequences for producers. Brewers who wish to produce both beer and ale must acquire a brewer’s permit and a manufacturer’s

license, and the two products, as defined by the code, are taxed differently. The results are additional paperwork and costs, which are ultimately passed on to consumers in higher prices.

In *Toward Liquor Control*, which influenced legislation passed throughout the U.S. after repeal, the authors recommend different levels of taxation in order to dissuade consumers from drinking beverages with higher alcohol by volume, considered the most dangerous for public safety, and to support temperance. But not only is the support for temperance not a role for a limited government, the difference between the taxation of ale and beer in Texas is unlikely to make a difference in the fight against alcoholism. It does constitute a burden for businesses though.

### *Beer vs. Wine and Distilled Spirits*

The regulation of the alcohol industry in Texas also created important inconsistencies between different types of alcohol. Distilled spirits and wine appear to benefit from more flexibility than beer.

For example, while wineries and distilleries were allowed to organize tastings in their facilities, breweries had to wait until the 83rd Legislature to be able to open taprooms. Even such a small liberalization of the market proved beneficial to consumers who can now enjoy more choice in craft beer than ever before. The number of craft breweries more than

doubled in Texas since 2013, with 96 craft breweries operating in 2013 and 251 in 2017 ([Brewers Association 2018a](#)). This is no surprise since taprooms allow brewers to put their products right in front of their customers and to receive immediate feedback. Consumers benefit from more choice and the possibility to try different products before having to buy a larger quantity.

There still exist differences in treatment between breweries and other alcohol manufacturers, such as wineries and distilleries. A major one is the possibility for a consumer to buy wine at a winery and distilled spirits at a distillery to bring home, but not beer or ale to-go at a brewery. There are exceptions, such as for brewpubs and a few other cases, but these are linked to limitations on alcohol produced and sold. It is difficult to understand how such a restriction is maintained to protect public health or safety. How is buying a 6-pack of beer from your local brewery a greater danger than buying a bottle of moonshine or whiskey from your local distillery? In fact, wouldn't allowing consumers to bring alcohol home be a better public safety solution than prohibiting them from doing so and possibly encouraging them to drink more before driving home?

This ban on beer to-go has important economic and consumer well-being consequences. For brewers, it means losing potential sales. The visit of local craft breweries has become part of the activities tourists enjoy doing when traveling. Currently, if you drive from Little Rock to visit Austin and have found a craft brewery that makes beer you really like but is not distributed in your state, in most cases you cannot bring a 6-pack home. According to the Texas Craft Brewers Guild, "to-go sales are now legal for manufacturing craft breweries in all 49 other states" and it is currently legal in Texas only for wineries, distilleries, and brewpubs to sell their products to-go (Texas Craft Brewers Guild 2018a).

For craft brewers, letting their customers buy beer to-go is also a way to get their products into consumers' hands while distributors and retailers may favor better-known brands.

A defense against such direct interactions between producers and their customers is that it may jeopardize the three-tier system. This is very well possible. But who is the system supposed to serve, or who should it serve? Even distributors could benefit from more demand for some products brought about by the possibility for consumers to bring beer home after a visit to a brewery and then requesting it at their local supermarket or liquor store.

However, it appears distributors hold on to their state-imposed position, firmly limiting as much as possible the freedom of breweries to sell their products directly to consumers. HB 3287, passed in the 85th Legislature, reinforced restrictions on how much owners of brewery permits or beer manufacturer licenses could produce to be able to sell their products directly to consumers. Forcing producers of beer and ale over a certain production cap into a transaction with a distributor to sell their own products in their own taprooms, with the distributor doing nothing but cashing on the transaction can only exist through the heavy hand of government intervention. Such a transaction has no positive effect for public safety, consumers, or the industry—it only benefits distributors. On the other hand, it negatively affects the valuation of a taproom—with less flexibility to sell your manufacturing facility and possibly higher costs with greater success—and increases costs for consumers.

### Sunset Staff Recommendations:

2.2 Modernize Texas' regulation of malt beverages by eliminating distinctions between beer and ale. **TPPF Position: Support a-b, d-g, i-j. Amend c.** *Rather than apply the "current more restrictive beer marketing laws and regulations ... to all malt beverages," the Legislature should direct the TABC to revamp the marketing laws and regulations to be the least restrictive possible.*

## Issue 4: The Burden of Doing Business Under the Texas Alcoholic Beverage Code and TABC Regulations

### TPPF Recommendations

- Allow producers to use federal Certificates of Label Approval (COLAs) for label approval in the state of Texas whenever they are available instead of duplicating the label approval process.
- For those producers who choose not to use the COLA process, change the Texas system so that it is similar to insurance use-and-file laws that allow manufacturers

to put products on the market without prior approval of labels. The TABC could then check labels for these products and take appropriate corrective action as necessary.

- Reduce the number of licenses and permits a business in the industry might need to operate on a daily basis, following the Sunset staff recommendation to

streamline the system by combining certain licenses and eliminating obsolete or redundant ones.

According to lawyers specialized in the alcohol beverage industry, the industry is one of the most regulated industries in the U.S. and the most regulated within the food industry (Abel et al., 34, 52, 65). The regulation of the industry today remains stuck in the Prohibition era with little regard for the realities of today's world—or the damages that overregulation has done before and is doing today.

Without endangering the public, Texas could ease regulation on the industry by avoiding duplication and complexities.

### ***Duplication of Regulation***

The 21st Amendment gave the states the power to regulate every aspect of the alcohol industry within their state boundaries, but the industry is also regulated at the federal level by the Alcohol and Tobacco Tax and Trade Bureau (TTB) in the U.S. Department of the Treasury.

In Texas today, a business in the alcohol beverage industry may have to go through several levels of regulation, paperwork, and taxation. At the federal level, it may have to apply for a license, in some cases have the labels for its products approved, and pay excise taxes. Because Texas allows local options, that is, for local communities, the opportunity to decide whether and what kind of alcohol can be sold within that community, the business must obtain the necessary documentation confirming that it would be legal in the chosen community. Finally, the business must apply for a license or permit to the TABC, pay fees and taxes, comply with laws regarding employee certification, for example, and, depending on the product, have the labels approved—a second time.

The TTB focuses on regulating the production, importation, and distribution of alcohol. It issues and can also suspend and revoke federal permits. It regulates labeling and issues COLAs for alcoholic products with more than 7 percent of alcohol per volume of importers and producers involved in interstate commerce. It also regulates advertising and marketing practices. Finally, the TTB collects the federal excise tax ([TTB 2018a](#); [TTB 2018b](#); [TTB 2018c](#)).

### ***TABC Label Approval Process***

The TTB “reviews and approves almost every wine, malt beverage, or spirit label before a product can be sold” (Abel et al., 35). TABC also requires a similar process to be completed in Texas: “A certificate of label approval ... is required for all alcoholic beverages marketed in the State of Texas. The manufacturer, winery, distiller, or owner of the product when it becomes a marketable product is responsible

for completing the label approval process” ([TABC 2018b](#)). TABC describes the approval process as establishing “state standards for alcoholic beverages sold in Texas, reviewing products for quality, purity, and identity in order to protect public health” and a “deterrent to product counterfeiting ... provid[ing] consumer protections with regard to product and labeling standards” ([TABC 2017c, 6](#)).

As of this writing, TABC's website lists the average label processing time to up to 38.1 days for malt beverages, 24.62 days for wine, and 16.65 days for distilled spirits ([TABC 2018b](#)). In its self-evaluation report to the Sunset Advisory Commission, TABC notes that the number of label approval applications has greatly increased, with an average of 1,638 applications per month in 2016 and 2017, which created “a backlog of applications, particularly for malt beverages” ([TABC 2017c, 16](#)).

Beer is also treated differently than wine and spirits in the requirement process. TABC requires a different label approval for every size and container type (bottle, can, or keg) for malt beverages, but not for wine and spirits. For the latter, “the TABC Rules mirror the TTB Rules for issuing COLAs. There must be at least one TABC label approval to cover sizes smaller than 237 ml, one TABC label approval to cover sizes from 237 ml to 3 L, and one TABC label approval to cover sizes greater than 3 L.” Malt beverages have to pay a \$25 fee per size and container type, while wine and spirits will have to pay the same fee only once per product for all sizes listed on the federal certificate. Finally, TABC requires product samples for analysis or an analysis from an independent laboratory for each new product label approval for malt beverages—not for spirits and only for wines with an alcohol content under 7 percent of alcohol per volume, and hence without a COLA ([TABC 2018c](#)). In fact, in 2007, the requirement to test distilled spirits and wine was eliminated to allow TABC to accept COLAs instead.

The Texas label approval process delays the time when a business can put its product on the market, forcing the business to lose precious time and money. Additionally, businesses must first have obtained a license or permit before they can go through this process, which adds to the time before they can put their products on the market. COLAs can be used by TABC instead of duplicating the process for businesses that already have to register their beverages at the federal level.

The *Sunset Staff Report* found that “Texas' duplicative label approval process delays products from getting to market while creating obstacles to consistent regulation” ([35-38](#)).

In cases where TABC cannot rely on COLAs because the manufacturer doesn't need to secure one, a system similar to the system of use-and-file in insurance could be used. This means that manufacturers would have to file their labels but could put their products on the market without prior approval from TABC. They would file the label(s) and TABC could require changes if some of the mandatory information is missing, misleading, or incorrect, and in situations endangering public safety, fine any business in violation of the law. There is a strong incentive for businesses to get the mandatory information right on the label the first time since required changes from TABC could mean increased costs and damage to the public image of a product or brand.

#### **Barriers to entry and increased costs for businesses**

Licenses and permits constitute another cost and barrier to entry for beer, wine, and spirits entrepreneurs. TABC's website lists more than 70 licenses and permits regulating every aspect of the business, from manufacturing to the transportation, the storing, the distribution, the retailing, etc., which means that a business might need several licenses and permits to be able to operate—"one to five different licenses or permits to perform all the activities necessary to conduct its business operations" according to TABC ([TABC 2017c, 271](#))—creating hours of paperwork to fill out.

In a panel discussion, Adam DeBower, co-founder of the brewery Austin Beerworks and board director of the Texas Craft Brewers Guild indicated that "at Austin Beerworks ... we carry something like 14 licenses and permits to be able to do what it is that we do on a daily basis" ([Texas Craft Brewers Guild 2018b](#)).

TABC recognizes the need to simplify the system and consolidate some of the licenses and permits to make it more simple for stakeholders and consistent between beer and liquor ([TABC 2017c, 271](#)).

The *Sunset Staff Report* agrees with this need finding the current system "complicated, duplicative, and unnecessary" ([21-33](#)).

In addition to recommending reducing the number of licenses and permits, and eliminating the distinction between beer and ale, the *Sunset Staff Report* recommends reforming several other areas of overregulation of the industry such as the cash and credit laws or the restrictions on some advertising practices ([38-40](#)).

While these regulations may have initially been well-intentioned, today they result in time taken away from TABC staff to focus on potent public safety issues; they create complexities for industry actors; and as a final consequence,

they result in higher prices, fewer choices, and diminished well-being for consumers.

### **Sunset Staff Recommendations:**

**2.1** Streamline the state's alcoholic beverage licensing system by reducing the number of licenses and permits to provide regulatory clarity and administrative efficiency.

#### **TPPF Position: Support a, c-f. Amend b.**

*Sunset staff recommends eliminating agent licenses and permits but would require businesses to keep agents' employment records for a minimum of four years in case of a complaint. But the Sunset Staff Report notes that agents "pose little risk for public safety, with TABC taking enforcement action against agents only six times for administrative violations" (23) in the past five years. There does not appear to be a sufficient threat to public safety to require businesses to keep records for longer than is already required by law.*

**2.3** Remove fees from statute to allow TABC to systematically review and adjust license and permit fees on an ongoing basis.

#### **TPPF Position: Amend.**

*This recommendation would allow TABC to update "the licensing fees as needed to ensure the agency's regulatory costs are fairly allocated to each license and permit. The agency should develop a logical formula to set its licensing fees based on a clear rationale, considering the types of businesses regulated and the level of regulatory activities associated with each type of license and permit" (32). Considering the inconsistencies currently existing in statutes in treatment between different kinds of actors in the industry and the uncertainty it will generate for actors of all three tiers regarding the cost of doing business in the industry constantly changing, we recommend that caps on the fees remain in statute to limit any potential increase in licensing fees. If the TABC believes there is a need to increase these fees in the future, it can ask the Legislature to do so.*

**3.1** Streamline TABC's process for approving alcoholic beverages for sale in Texas.

#### **TPPF Position: Support-Amend a-c. Oppose d. Recommendations 3.1.a-b:**

*The Sunset Staff Report goes in the right direction of eliminating duplication of label approval by relying on COLAs when they are available. However, instead of requiring all malt beverage manufacturers to obtain a COLA, a system similar to use-and-file insurance regulations could be used for those manufacturers who choose not to obtain a COLA. Manufacturers could use their labels and file them with TABC, which could check these labels for compliance as needed.*

**Recommendation 3.1.c:**

While we support the recommendation to eliminate mandated alcohol testing requirements, suggesting that TABC could create a regular testing program in the future is counterproductive.

**Recommendation 3.1.d:**

The Sunset Staff Report recommends giving TABC the authority to “deny label approval and registration for any product that has received a COLA but still violates Texas laws” (41). The report specifies that the cases are rare where labeling federal standards violate Texas law. The issue appears to be with private labels, when a product is produced and made available to one retailer specifically, with the retailer’s name on the label. Private labels violate Texas’ tied-house laws and are another example of the archaic nature of the three-tier system. With thousands of producers and retailers today, private labels are but an innovative way for producers and retailers to offer a special product to consumers, hardly a sign of collusion between tiers. Neither does it constitute a risk for public safety. It does show how it can create burdens for agency staff and businesses, and less choice for consumers. In the interest of all parties involved, private labels should be allowed.

3.2 Make cash payments optional by applying the existing credit law restrictions to beer transactions between retailers and distributors.

**TPPF Position: Support.**

3.3 Eliminate overly restrictive outdoor advertising requirements.

**TPPF Position: Support.**

5.3 Authorize TABC to consider profits earned from violating the law when penalizing licensees.

**TPPF Position: Oppose.**

This recommendation would allow TABC to take into account the profits a business generated as a result of a violation in order to appropriately calculate the level of the fine and discourage the violation. The level of a fine for a violation should be based on the seriousness of the violation and the potential danger to public safety, not how “skillful” a business was in generating profits out of a violation. Allowing such a provision could take the focus away from the most serious violations to businesses that generate the most profits out of any violations. It also may result in the process becoming the penalty as businesses settle claims not because they are guilty but because the potential fine makes it too risky to fight the accusations.

5.4 Authorize TABC to temporarily suspend licenses and permits if it finds a continuing threat to the public welfare.

**TPPF Position: Oppose.**

TABC already has the authority to suspend or cancel a permit if the permittee is found, after a notice and a hearing, to be in certain situations that include the conviction of the violation of the code ([Texas Alcoholic Beverage Code, Sec. 11.61](#)). TABC should continue to use this procedure that allows due process to permit holders.

5.5 Make noncompliance with a commission order a statutory violation and authorize TABC to take disciplinary action or deny license or permit renewal for noncompliance.

**TPPF Position: Oppose.**

Establishing noncompliance with a commission order as a statutory violation expands the bureaucratic power of the administrative state further outside the checks and balances intended by our state system of government. First of all, a commission order is already an exercise of an agency’s power in interpreting its delegated power from the Texas Legislature, which may or may not be lawful. Then, this proposal would allow for agency officials to exercise subjective discretion in interpreting the orders of the agency. The intent of this proposal is to allow TABC decision making in terms of licensee violations fall both outside the purview of the courts and administrative process, which lessens constitutional due process protections.

**License Surcharge. TPPF Position: Oppose.**

The Sunset Staff Report estimates that the changes recommended in Issue 2 would require TABC to initially keep staffing and licensing resources at current levels and as a result would create a negative fiscal impact initially: “TABC is required to generate revenue to cover the cost of regulation, so any loss of licensing fee revenue or additional expenditures as a result of these recommendations should be cost-neutral. TABC could assess a temporary surcharge until the new fee structure is in place to offset the loss of approximately \$4 million in licensing fees from deregulating agents and industrial and manufacturing businesses” (32). However, as indicated in the Sunset Staff Report, “...the agency spent \$48.4 million in appropriation year 2017. ... In the same year, TABC collected fees and other revenue totaling almost \$76 million, as well as an additional \$226.2 million in state excise and import taxes. Historically, the agency has generated revenue through fees in excess of that needed to cover agency expenditures. ... the agency transferred \$21.3 million in excess licensing revenue and other fees and fines to the General Revenue Fund” (7). TABC should live within its means and not increase any fees or add surcharges. Instead, it should rapidly move to readjust staffing levels to match with the reduced workload anticipated from these changes.

## Issue 5: The Enforcement Division of the Texas Alcoholic Beverage Commission

### TPPF Recommendations:

- Conserve TABC's very limited law enforcement personnel for work on large-scale violations of the Alcoholic Beverage Code that fall outside of or are not contained within a single local jurisdiction and not for routine local issues unless specifically requested by that jurisdiction.
- Focus the enforcement agents and other TABC personnel on training the vast number of state, county, special jurisdiction, and local police officers on effective enforcement of the Alcoholic Beverage Code as subject matter experts on the topic.
- Defer TABC's criminal enforcement activities to local jurisdictions.
- Remove other responsibilities from TABC such as the development and maintenance of a Special Response Team to prevent the use of its limited resources for disaster relief or search and rescue functions for which it was never intended.

The number of personnel assigned to the enforcement division (those with peace officer certifications) in the TABC appears to be arbitrarily determined. One could make the claim that it is overstaffed or conversely that it is grossly understaffed using the agency's own identification of its functions. Both arguments have merit, and the present staffing defies justification.

The Sunset *Staff Report* found that TABC should not have its functions dispersed to or consolidated with other state agencies and makes the following statement in its report:

Although other state and local agencies in Texas perform a variety of similar licensing, enforcement, and tax collection functions, TABC is unique in that all its efforts focus solely on the regulation of the alcoholic beverage industry ([Sunset Advisory Commission Staff, 14](#)).

It would be a reasonable conclusion that an agency focused solely on one area of a complex code such as the Alcoholic Beverage Code would be more proficient and more efficient in its enforcement, except that TABC's own self-evaluation report contradicts some of that claim. In that report, TABC states the following:

TABC's public safety mission is among its top priorities. Through its law enforcement activities, the agency is able to investigate reports of illegal activity. Violations include single incidents such as sales of alcohol to minors and intoxicated persons as well as deeper, ongoing criminal activity such as human trafficking, narcotics trafficking, or money laundering. Violations also include prohibited relationships between tiers resulting in price fixing and other schemes that can ultimately drive down prices and encourage over-consumption ([TABC 2017c, 3](#)).

While the argument could be made that human trafficking, narcotics trafficking, and money laundering *may* be discovered in the course of an alcohol-related investigation, this statement reads as though such investigations are a primary function of the Enforcement Division, tasks for which it was not designed. With the Sunset staff's observation that TABC focuses solely on Alcoholic Beverage Code violations and that its enforcement officers are experts in this area to the great benefit of other agencies, the question should obviously be raised why such investigations outside TABC's area of focus could not be more proficiently investigated by agencies experienced in those areas of crime, such as federal, state, county, and local jurisdictions. The term used generally for such a phenomenon is "mission creep," where an agency begins to expand its function beyond what it was intended for and continuously needs more resources to fund the expansion.

If the expansion were limited to tangential activities uncovered during the course of a TABC investigation into a violation of the areas of the law it was designed to investigate and enforce, there would be little to argue. Citizens would not expect a law enforcement official with powers to enforce *all* laws within the state, as TABC law enforcement officers are, to simply ignore such offenses uncovered in the course of their work. However, it is not clear from the above statement in TABC's self-evaluation report whether this expansive enforcement activity is always generated directly relating to an investigation of the Alcoholic Beverage Code. It is made even less clear from a later statement in the same report that chronicled TABC's history:

TABC formed a Special Response Team (SRT) made up of Enforcement agents. The team assists local communities during disasters and provides public protection, search and rescue and any other duties that will provide

stability to the overall health and safety of the general public ([TABC 2017c, 30](#)).

The Special Response Team (SRT) moniker is synonymous with a SWAT team in law enforcement circles. Their stated mission of providing assistance for local communities during disasters, search and rescue missions, and “other duties” is a drastic departure from the findings of the Sunset staff that the agency is solely focused on alcohol-related enforcement. The need for a SWAT team within such an agency is unclear and is not made evident by TABC’s own explanation of its function. With overlapping law enforcement jurisdictions throughout the state, many with their own SWAT teams, the need for TABC to have one is questionable even for the enforcement of the laws it was originally tasked with enforcing. The need for TABC to establish such a team to assist with search and rescue missions for local agencies is inexplicable.

Mission creep is not efficient for the taxpayer. The training of police officers is expensive and time-consuming, not only at the beginning of their career but throughout it. A properly trained SWAT team or SRT team is exponentially more expensive, as the training is more frequent and potentially more dangerous, leading to the potential for injury to the officers involved. For an agency such as TABC to maintain a Special Response Team for the sole purpose of assisting other agencies with actions outside TABC’s own responsibilities does not make fiscal sense.

Even within its area of responsibility, the use of TABC law enforcement officers for what most often appears to be local issues is questionable in its practicality. TABC lists 250 budgeted full-time employees in the Enforcement Division (238 actual as of August 31<sup>st</sup>, 2016), with another 33 full-time employees in programs relating to enforcement such as training or the Special Investigations Unit ([TABC 2017c, 59](#)). For comparison, the Bureau of Justice Statistics (BJS) shows that, in 2008, the Houston Police Department had 5,053 sworn officers and Dallas Police Department had 3,389 police officers and offers a comparison for just how many police officers cover an area ([Bureau of Justice Statistics, 14](#)). These do not include the overlapping jurisdictions of the county sheriff’s police, the Texas Department of Public Safety troopers, and any number of special jurisdiction police officers that overlap each of these areas. If TABC is to be the sole or even the primary enforcement agency for the Alcoholic Beverage Code throughout Texas, then they are grossly understaffed.

The total number of law enforcement personnel assigned to TABC is minuscule in comparison to any of the larger agencies. In fact, BJS reported a total of 1,913 law enforcement

agencies in Texas with 59,219 sworn police personnel in 2008 ([Bureau of Justice Statistics, 15](#)). Despite the obvious question of how much impact less than 250 TABC law enforcement officers make in a state with 59,000 officers, TABC makes the following statement in defense of their continued enforcement activities:

Should local law enforcement agencies no longer have the assistance of TABC Enforcement, their ability to address serious public safety issues involving TABC-licensed businesses would be severely hampered. Calls for service to licensed locations would likely increase due to decreased monitoring, and alcohol-related violations occurring in or emanating from those licensed premises would seldom be detected and addressed ([TABC 2017c, 10](#)).

There is no premise for such a claim. With less than 250 officers for the entire state, the “decreased monitoring” is not likely to be noticed, and the prediction for an increase in calls for service is given no other substantiation. The overlapping jurisdictions of state, county, and local police officers within every part of the state renders the argument of a significant impact in monitoring caused by the removal of 250 officers covering the entire state relatively difficult to make.

In its self-evaluation report, TABC answers the question of whether there are other state or federal agencies that overlap the function of TABC with the following response:

The statutory authority and the responsibilities granted to TABC are narrow, unique and specific to the TABC. It is true that any peace officer of the state may pursue criminal charges when violations of the Alcoholic Beverage Code are discovered. It is also true that TABC Inspectors (Enforcement agents) are peace officers that can pursue criminal action for offenses outside the Alcoholic Beverage Code. However, only Inspectors (Enforcement agents) can pursue administrative action against violators of the Alcoholic Beverage Code. When the Liquor Control Board was initially created, the Texas legislature recognized that administrative sanctions would often be greater motivation to change behavior than criminal actions. While there are other agencies whose responsibilities and activities are similar or occur on the periphery of TABC functions, there is no organization that duplicates TABC activities ([TABC 2017c, 20](#)).

While in parts contradictory to the stated purpose of their SRT team and other activities claimed in the report, this statement does provide some insight into a valuable

function that TABC provides in that it alone can pursue administrative actions against violators of the Alcoholic Beverage Code. This can be more desirable in many situations than a criminal case. It is also unlikely that the agency would need sworn personnel alone to pursue the administrative cases in most instances.

Where the real value of TABC does appear to remain is in their ability to train other police officers in the enforcement of the Alcoholic Beverages Code. The code remains extremely complex, and TABC notes in their self-evaluation report that:

It is not enough for a law enforcement agency to have a copy of the Alcoholic Beverage Code and read it – it is imperative they have the direct contact with a subject-matter expert that can communicate what TABC does and the operational processes that are in place ([TABC 2017c, 11](#)).

In terms of efficiency, a much better argument can be made for training the 59,000 or so law enforcement officers in the state on best practices in enforcing the Alcoholic Beverage Code than can be made for 250 TABC officers trying to

conduct enforcement activities throughout the state. It is also debatable whether those responsible for training the other police officers need to actually be police officers themselves, in which case TABC's enforcement division might be overstaffed. In terms of a force multiplier, TABC's ability to train large numbers of officers to enforce the Alcoholic Beverage Code within their own jurisdictions makes great fiscal and logistical sense, far more sense than trying to use TABC to extensively monitor issues like serving an underage person or an intoxicated person throughout the state's many overlapping local jurisdictions.

### Sunset Staff Recommendations:

**5.1** Require TABC to regularly inspect every regulated location in the state within a reasonable period, and direct the commission to set a minimum inspection period by rule that prioritizes public safety risks.

#### *TPPF Position: Amend.*

*Considering TABC's resources and its primary mission to protect public safety, regular inspections should be based on public safety risks. There is no need for a regular inspection of every single location in the state. Focusing on those locations that constitute a high risk will free up resources and time for TABC and reduce the burden of overregulation for businesses.*

## Issue 6: Alcohol Over-Consumption, Temperance, and Taxes

### TPPF Recommendations

- Limit the collection of fees and taxes to what is needed for TABC to cover expenditures in order to protect public safety.
- Follow the Sunset staff's recommendation to repeal the tax on alcohol imported for personal use and eliminate TABC's port-of-entry tax collection program.

Throughout its history in the United States, government intervention in the alcohol industry resulted in unintended consequences, counterproductive results, and the creation of special interest groups.

Even *Toward Liquor Control* predicted that the three-tier system would create special interests:

Any licensing system tends to project the whole question into politics and to keep it there. Indeed, it compels the traffic to be in politics of self-protection. The licensing body becomes a powerful political engine. Every licensee ... begins to marshal his own political strength to serve his own ends.

The only solution *Toward Liquor Control* did not envision is a free market, as the title of the study made clear. Focused on the issue of over-consumption of alcohol and the support for temperance, government officials may have failed to see that the lack of temperance in regulating markets was indeed a problem.

While there is a role for a limited government to protect public safety, it is not its place to try to limit how much consumers will consume of a product such as alcohol as long as they do not cause harm to others—and when it tried before, it failed each time—nor to try to regulate the population into being a virtuous one.

#### *The use of taxes and fees to limit consumption and encourage temperance*

Excises taxes are levied both at the federal and at the state level. Tax rates vary according to the beverage and the quantity of alcohol per volume. One recommendation found in *Toward Liquor Control* was to increase the rate of taxation with the content of alcohol, because a higher content of alcohol per volume was deemed more intoxicating.

From the beginning, one goal of taxation of alcohol was to encourage temperance.

Indeed, TABC's self-evaluation report warns of the danger of decreasing both taxes and the agency's presence: more violations, over-consumption, and under-age drinking would increase.

However, one goal of alcohol taxation that was not supported by the influential study commissioned by Rockefeller was to generate revenues for government. In fact, the authors of *Toward Liquor Control* even recommended never assigning the revenues of alcohol taxes to a specific spending item. There is an obvious contradiction between trying to tax a product to make it less consumed, while expecting to raise revenues to fund state spending from this product.

The role of a state agency controlling the alcohol industry should be limited to strict purposes of public safety. As such, any collection of fees and taxes should serve to finance its expenses, not grow revenues for the state. Yet, TABC appears to link both as part of its mission. It describes itself as "unique in that the agency generates revenue for the State of Texas" ([TABC 2017c, 195](#)). The agency states that "Alcohol is a legal recreational drug and as such is extremely popular throughout the state and generates large sums of revenue for the State" ([89](#)) or that:

In addition to providing a revenue source for the state, excise taxes also help to reduce alcohol consumption, especially among minors. Studies indicate that minors and young adults consume less when alcohol costs more. Any change in the excise tax, which is included with the price of a drink, would have a major impact. Lower excise taxes are associated with an increase in consumption for both minors and adults, whereas higher taxes correlate to fewer motor vehicle crashes and fatalities and fewer deaths from cirrhosis of the liver ([7](#)).

Since TABC does not cite the studies mentioned, it is hard to know if these take into account the possibility that taxes that make some alcohol products prohibitively expensive to some might not actually decrease demand, but divert it toward other drugs or substances that might be more dangerous. Prohibition, by driving alcohol production underground, did not stop people from drinking, but left them with fewer choices, some of them more dangerous than the substance the law was trying to forbid.

TABC collects fees and charges from license and permit applications, as well as state excise taxes from the upper tiers. In FY2016, it collected more than \$72,453,630 in revenues from the issuance of more than 82,000 licenses and more than \$225 million in state excise taxes ([TABC 2017c, 7](#)).

In 2017, the agency transferred more than \$21 million in excess licensing, fee, and fine revenues to the General Revenue Fund ([Texas Sunset Advisory Commission, 7](#)).

Texas is among the U.S. states with the lowest state excise tax rates on alcohol—the Lone Star State ranks 46th for spirits, 44th for wine, and 31st for beer ([Scarboro; Loughhead 2018a; Loughhead 2018b](#))—but it can do even better by reducing the revenues collected to expenses needed strictly for public safety purposes, such as fighting underage drinking. Reducing the number of licenses and permits, suppressing the duplication of labeling approval, and other measures recommended here could also save TABC time and resources to focus on public safety.

Any fee and tax revenues over what is needed for TABC to carry out its main mission should be returned to taxpayers who can use it to save, invest, or spend and support the state of Texas and its economy better.

Similarly, the *Sunset Staff Report* notes that the collection of taxes on private imports of alcohol at the border costs more to the agency—hence Texan taxpayers—than it collects in revenues. In fact, the *Sunset Staff Report* explains that in 2011 already, the administrative fee "for alcohol tax collection"—which means in addition to the tax—at ports of entry was increased because the program was not self-sufficient ([61-62](#)). According to the *Sunset Staff Report*, TABC has run a deficit of \$7 million over the last six years. The report also assesses that the program has "minimal public safety value" and that "Compliance with the state's alcohol import laws is on the honor system and inconsistently enforced, undercutting effectiveness and fairness. TABC relies on individuals to honestly disclose what they are bringing into Texas since TABC's civilian tax compliance officers do not have authority to search individuals or vehicles" ([61-68](#)).

We support the recommendation of the Sunset staff to get rid of the program. Not only is this a waste of taxpayer money, it does nothing to protect either Texas consumers or businesses, which the program is supposed to do in the first place.

### **Sunset Staff Recommendations:**

Support: 6.1 Repeal the state's inefficient tax on alcohol imported for personal use and eliminate TABC's ports of entry tax collection program.

***TPPF Position: Support.***

## Conclusion

The Texas Alcoholic Beverage Commission and the Texas Alcoholic Beverage Code need to be modernized to take into account all business stakeholders and to think about—not to try to insulate—consumers in the process.

Today, consumers have many more options than they had 100 years ago. The number of producers of alcohol in the United States has increased tremendously, leaving them with many more choices that force producers to compete by offering *better* products—not by forcing the choice of consumers with unethical practices. The boom in craft brews is a good example. A freer market would offer not only more choice to today's consumers but even better quality and lower prices.

Consumers can also obtain information about products at any hour of the day using producers' or review websites. The importance of social media puts tremendous pressure on businesses to deliver quality lest any customer make it instantly available to the world that a product is “not what it claims to be.”

Today, the regulation of the alcohol industry in Texas has created a system that favors incumbents with little regard for what Texas consumers need or the benefits they could get from a freer market.

The deregulation to a great extent of the alcohol industry in Texas would create a freer, more competitive market for consumers, one in which each current tier would still have a role to play, but with a renewed focus on consumer welfare, not on some entrenched interests. ★

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**Carine Martinez-Gouhier** joined the Foundation as managing editor in May 2016. She is now managing editor and policy analyst.

Prior to working at the Foundation, she worked as a research associate for the Charles Koch Institute in Washington DC, and previously as a policy analyst for Texas Action during the 84th Texas Legislature.

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Randy is passionate about law enforcement and criminal justice policy issues and is pursuing his doctorate of management in homeland security. His research specialties include the militarization of law enforcement, police training, and police assisted diversion programs. Randy holds a B.S. in legal studies and an M.S. in justice administration and crime management from Bellevue University.

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