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OPINION COMMITTEE



The Legislature
State of Texas

June 1, 2009

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Via Certified Mail, Return Receipt Requested

The Honorable Greg Abbott
Attorney General of Texas
Office of the Attorney General
300 W. 15th Street
Austin, Texas 78701

RQ-0805-GA

RE: Request for Opinion on the Legality of Ownership Restrictions
Found in Chapter 22 of the Texas Alcoholic Beverage Code

Dear General Abbott:

Chapter 22 of the Texas Alcoholic Beverage Code (the "Code") governs eligibility for a Package Store Permit, which authorizes the holder to purchase and sell distilled spirits, wine and ale to retail consumers for off-premises consumption. Tex. Alco. Bev. Code § 22.01 (Vernon 2007). The Code prohibits, with certain exceptions, any person from holding or having an interest directly or indirectly in more than five package stores. *Id.* § 22.04(a). This cap and its exceptions appear to me to have no legitimate or rational basis so as to be unconstitutional and impermissibly anti-competitive.

I am requesting an Attorney General opinion on the following questions:

1. Does the Code's five-store cap and its exceptions violate the Equal Protection Clause of the U.S. Constitution?
2. Does the Code's five-store cap and its exceptions violate the Due Process Clause of the U.S. Constitution?
3. Does the Code's five-store cap and its exceptions violate the federal Sherman Antitrust Act?
4. Does the Code's five-store cap and its exceptions violate any other provisions of the U.S. or Texas constitutions or state or federal law?

The Code provides three exceptions from the cap that render the differences between who does and does not qualify for more than five Package Store Permits unreasonable and illegally anti-competitive. First, any Package Store Permit that was issued before May 1, 1949 will be renewed no matter how many permits the holder had at the time or later acquires. Code § 22.04(c). This grandfather clause does not keep those old permits in the hands of the persons to whom they were originally issued. The Texas Alcoholic Beverage Commission has allowed these old permits to be transferred in bulk to parties who would not otherwise qualify to hold more than five Package Store Permits when the transferee purchased the equity of the companies that originally obtained the now-grandfathered permits. Letter from Alan Steen, Administrator, TABC, to Hon. Senfronia Thompson (Mar. 31, 2009) (copy attached).

Second, persons who are related within the first degree of consanguinity (which the Commission has interpreted to include a parent and child and siblings with the same parents) may consolidate their permits into a single legal entity that can also hold an unlimited number of Package Store Permits. Code § 22.05. According to Administrator Steen's letter to Representative Thompson, 386 of the 2,352 active Package Store Permits have been issued to persons who satisfy the "consanguinity exception" in Section 22.05.

Administrator Steen's letter spells out exactly how a family of five adults, with each member holding five Package Store Permits, could combine all of their separately held permits into one company that would hold 25 permits, and then sell that company to a person who was not a member of the family and did not qualify to hold 25 permits on his own. Then the buyer and his relatives could use the consanguinity exception to continue to expand beyond the 25 stores he bought. The Commission's records show that more than 25 companies have used these types of maneuvers to acquire more than five Package Store permits, including two chains that hold more than 50 permits each.

Finally, corporations operating package stores in their hotels can likewise hold an unlimited number of Package Store Permits. Code § 22.04(d).

The five-store cap, coupled with these exceptions, creates separate classes of permit holders who are treated differently. I believe these distinctions violate the Equal Protection and Due Process Clauses of the U.S. Constitution, and are also illegal restraints of trade that violate the federal Sherman Antitrust Act.

The Five-Store Cap and Its Exceptions Violate the Equal Protection Clause of the U.S. Constitution

The Equal Protection Clause of the Fourteenth Amendment to the U.S. Constitution provides that no state shall "deny to any person within its jurisdiction the equal protection of the laws." The clause has been described as a direction that all persons similarly situated should be treated alike. *Plyler v. Doe*, 457 U.S. 202 (1982). State laws that classify by (and discriminate against) people based on race, alienage or national origin are subject to strict scrutiny and will survive a challenge only if they are suitably tailored to serve a compelling state interest. *City of Cleburne v. Cleburne Living Center*, 473 U.S. 432, 441 (1985). When the group affected by a state law is not a "suspect class," the Equal Protection Clause requires that the discriminatory law be a

rational means to serve a legitimate end. *Id.* at 442. A state may not rely on a classification whose relationship to an asserted goal is so attenuated as to render the distinction arbitrary or irrational. *Id.* at 446.

In the *City of Cleburne*, the city required the operator of a group home for mentally retarded adults to apply for a special use permit (which the city denied), but did not require other multi-occupant users, such as boarding and lodging houses, fraternity or sorority houses, dormitories and nursing homes, to hold such a permit. In ruling against the city, the U.S. Supreme Court held that although the occupants of the home were different than some other people, the record did not reveal "any rational basis for believing that the Featherston home would pose any special threat to the city's legitimate interests." *Id.* at 448.

When the requirements of the Equal Protection Clause are applied to the five-store cap in Chapter 22, it is clear that there is no rational basis for distinguishing between people who qualify to hold more than five Package Store Permits and those who do not. The state of Texas will not be able to demonstrate that a legitimate purpose is served by limiting the number of Package Store Permits that some (in reality, most) people or companies can hold while allowing a few others to hold an unlimited number of permits.

The Five-Store Cap and Its Exceptions Deny Substantive Due Process that is Guaranteed by the U.S. Constitution

Another aspect of the Fourteenth Amendment is that it prohibits a state from depriving a person of life, liberty, or property without due process of law. A claim resting on the Fourteenth Amendment must first identify a protected life, liberty, or property interest. *Philips v. Vandygriff*, 711 F.2d 1217 (5th Cir. 1983). While courts have long held that an interest in obtaining or keeping a state license to conduct a business is not a property right, courts have recognized that there is a liberty interest in pursuing a chosen occupation. *See Philips*, 711 F.2d at 1222.

When a statute denies a person a liberty interest, substantive due process demands that the statute be reasonable and not arbitrary or capricious and that the provisions that result in the deprivation have a real and substantial relation to the object sought to be obtained. *Chandler v. Gutierrez*, 906 S.W.2d 195, 203 (Tex. App.—Austin 1995, writ denied) (State law setting claim-filing deadlines against insolvent insurance companies survived substantive due process challenge because it was rationally related to policyholders' and claimants' interest in a timely winding up of a receivership estate). A law is arbitrary and unreasonable if the social necessity it serves is not sufficient to justify the restrictions on the rights involved and the restrictions are not rationally related to the claimed social necessity. *Id.* at 202.

Denying more than five Package Store Permits to a person who does not qualify for one of the exceptions to the cap denies that person a liberty interest because it denies him the opportunity to conduct his chosen occupation on the scale and in the manner he desires. Limiting the number of Package Store Permits a person can hold would be like the State Bar granting a person a license to practice law, but limiting him to practicing

only admiralty law. The state could not place such a restriction on the lawyer's liberty without substantive due process. Similarly, Texas law cannot shackle the scale of a person's package store operations without a legitimate reason and a means that is rationally related to the reason.

The five-store cap will not survive a substantive due process review because no social necessity is served by refusing most people more than five Package Store Permits while allowing others to hold an unlimited number of permits.

The Five-Store Cap and Its Exceptions Violate the Sherman Antitrust Act

Federal law prohibits two or more persons from engaging in a combination or conspiracy in restraint of trade or commerce. 15 U.S.C. § 1. A state law can be struck down when the statute on its face irreconcilably conflicts with federal antitrust policy; as when the statute permits private parties to engage in a per se violation of the Sherman Act. Per se rules of illegality apply to practices "which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use." *Costco Wholesale Corp. v. Maleng*, 522 F.3d 874 (9th Cir. 2008) (citing *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 50 (1977)).

State statutes that constitute a "unilateral" restraint will not be struck down as a violation of the Sherman Act. "Hybrid" restraints can be struck down. Courts and scholars acknowledge that the difference between a unilateral and hybrid restraint can be difficult to distinguish. *Costco*, 522 F.3d at 887. The difference might best be described by way of example. Rent control regulations setting maximum rent rates are "classic" examples of permissible unilateral restraints because the rent rates are set and enforced by the government. *Id.* at 888.

Price post-and-hold laws, in which a state requires alcoholic beverage producers or wholesalers to post their prices and then adhere to those prices for a designated period of time, have repeatedly been found to be impermissible hybrid restraints. See e.g., *Costco*, 522 F.3d at 894; *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980). The restraint in these cases is hybrid because even though state law requires that prices be posted and then adhered to, the statutory scheme allowed producers and wholesalers complete discretion and control as to the prices they set. In other words, "What is centrally forbidden is state licensing of arrangements between private parties that suppress competition—not state directives that by themselves limit or reduce competition." *Mass. Food Ass'n v. Mass. Alcoholic Beverage Control Comm'n*, 197 F.3d 560, 566 (1st Cir. 1999).

The five-store cap in Chapter 22, in conjunction with the exceptions to the cap, is an impermissible hybrid restraint of trade. The five-store cap, were it to be applied without any exceptions, would likely be considered a unilateral restraint, which would be permissible even in the face of proof that the cap limits or reduces competition. See *Mass. Food Ass'n*, 197 F.3d at 564. But the restrictions in Chapter 22 allow private parties to manipulate implementation of the exceptions and thereby suppress competition

Hon. Greg Abbot

June 1, 2009

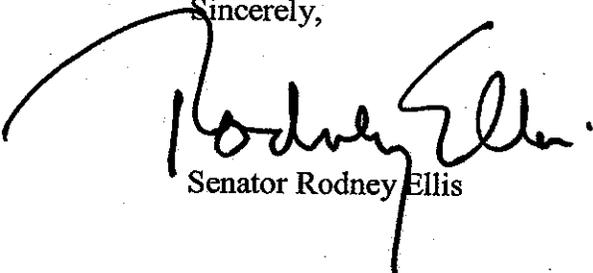
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in an impermissible fashion. That is because private parties are given unregulated discretion and control over whether, when, where and how to construct business contrivances that comply with the exceptions and thereby expand their ownership and control beyond five stores. These exceptions, as implemented by private actors, allow market-power aggregation and allocation arrangements.

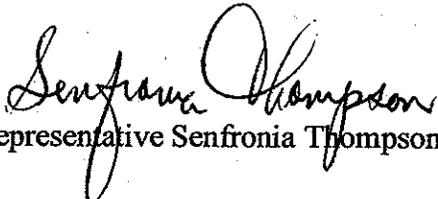
One only needs to review Administrator Steen's letter to Representative Thompson describing step-by-step how families have been able to implement the consanguinity exception to expand beyond five stores, and how anyone, even someone who does not qualify for the consanguinity exception, can collaborate with others by bulk-purchasing dozens of permitted package stores. The statute thus provides open-ended opportunities for private actors to engage in anti-competitive conduct and collusion in expanding their commercial reach, making the five-store cap with its exceptions an unlawful hybrid restraint.

The five-store cap, in conjunction with the exceptions to the cap, in the Texas Alcoholic Beverage Code appear to be clearly unconstitutional and anti-competitive. Application of longstanding legal principles demonstrates that, as a matter of law, the continued enforcement of the cap is preventing businesses from starting, growing and competing "on the merits" and on a level playing field in Texas. I appreciate your prompt consideration of this request.

Sincerely,



Senator Rodney Ellis



Representative Senfronia Thompson



TABC

TEXAS ALCOHOLIC BEVERAGE COMMISSION

service ★ courtesy ★ integrity ★ accountability

José Cuevas, Jr.
Presiding Officer-Midland

Steven M. Weinberg, MD, JD
Member-Colleyville

Melinda S. Fredricks
Member-Conroe

Alan Steen
Administrator

March 31, 2009

The Honorable Senfronia Thompson
Texas House of Representatives
P.O. Box 291
Austin, Texas 78768-2910

Dear Representative Thompson:

Please find our responses to your inquiry dated March 12, 2009, concerning the issuance of package store permits and how they relate to §§22.04 and 22.05 of the Texas Alcoholic Beverage Code (Code).

1. How many current package store permits are issued under the exception in Sec. 22.04 (c) issued before May 1, 1949?

There are approximately 2,351 active package store permits. (The number is an approximation because permits can be issued or expire daily.) Seventeen of those permits were issued before May 1, 1949.

2. How many current package store permits are issued under the exception in Sec. 22.05 consolidation of permits?

Section 22.05 of the Code allows for the consolidation of package store permits into legal entities. Approximately 386 of the 2,351 package store permits currently held were issued under §22.05.

Sec. 22.05. CONSOLIDATION OF PERMITS. If one person or two or more persons related within the first degree of consanguinity have a majority of the ownership in two or more legal entities holding package store permits, they may consolidate the package store businesses into a single legal entity. That single legal entity may then be issued permits for all the package stores, notwithstanding any other provision of this code. After the consolidation, none of the permits may be transferred to another county.

3. What is the TABC's interpretation of what relationship constitutes the first degree of consanguinity for the purposes of Sec. 22.05?

Section 22.05 is the only reference in the Code to "first degree of consanguinity." Consanguinity means: of the same blood or origin; descended from the same ancestor.

There are two methods of determining consanguinity, both of which are used in the United States. These two methods are known as Canon law (or common law), which is collateral consanguinity, and Civil law, which is lineal consanguinity.

Because §22.05 of the Code does not provide which method is to be used in determining the first degree of consanguinity, the Commission has historically used Canon law, or the collateral method.

Using the Canon law method, parents and children, and brothers and sisters with the same parents, are within the first degree of consanguinity.

4. Please explain any differences in the interpretations of the degrees of consanguinity for different sections of the Alcoholic Beverage Code.

Section 11.13 is the only other section of the Code where "consanguinity" is referenced. This section was adopted in 2007 and specifically adopts the method used in Chapter 573, Government Code. The degree of consanguinity under §573.021 is calculated using the Civil law method.

5. For those permits issued under the exception in Sec. 22.05, what is the relationship, (i.e. parent, child, sibling, etc) that each permit was consolidated under?

The consanguinity of individuals holding package store permits issued under §22.05 is not subject to disclosure under the Texas Public Information Act; however, most of the permits issued under §22.05 involve permit holders who have a parent/child relationship.

6. Please describe the process the TABC undertakes to review, process and verify compliance with Sec. 22.04 and Sec. 22.05.

The commission reviews all applications to ensure that each individual or legal entity meets the qualifications to hold the permit applied for. Identifying information of Individuals, legal entities and relationships (owners, directors, officers, managers, etc.) that are required to be disclosed on an application are entered into our licensing data base. If an individual applying for a package store permit is associated with more than 5 package stores, a report is generated and commission staff conducts a detailed investigation to ensure the individual is qualified to hold the permit applied for. In a

consolidation of permits under §22.05 of the Code, each individual is required to submit a request for consolidation supported by a sworn statement describing how the consanguinity requirement is satisfied. Family relationships can be easily verified through the production of public documents if there are any concerns.

In addition to the ability to consolidate permits under §22.05 and hold numerous package store permits, the commission has allowed "bulk buys." "Bulk buys" is a process by which an individual or legal entity may purchase all the ownership interest in a legal entity holding a package store permit.

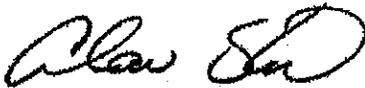
7. Please describe the process for consolidation of permits under Sec. 22.05. Under the Alcoholic Beverage Code, how is Texas able to have large package store chains?

Here is an example of how §22.05 can result in a large "chain" of package stores:

- Jones Incorporated, a Texas legal entity, is the holder of 25 package store permits. Jones Incorporated was created when the mother and father Jones, each holding 5 permits, consolidated with their three daughters, each of whom were the holders of 5 package store permits.
- Joe Applicant, an individual, acquires 100% of the ownership interest in Jones Incorporated, a Texas legal entity.
- Joe Applicant files a change of ownership interest reflecting his 100% ownership of Jones Incorporated.
- Jones Incorporated continues to be the legal entity that is the permit holder in 25 package stores.
- Joe Applicant's mother is the holder of five package store permits. Under §22.05, these permits may be consolidated under Jones Incorporated. Jones Incorporated would then be the holder of 30 package store permits.

Please let me know if you would like to sit down with me or my staff to explain any of this further or in more detail.

Sincerely,



Alan Steen
Administrator