

## **POSITION PAPER**

### **Introduction**

During the Sunset Commission's deliberation this interim, Howard Wolf, the Senate public member, attempted to raise several issues related to the review of the Texas Alcoholic Beverage Commission, which were ruled by the Chairman of the Sunset Commission to be outside the scope of the Commission's work. Mr. Wolf subsequently was denied the opportunity to question witnesses about these issues. Following this ruling, the public member submitted a citizen's request to testify before the Sunset Commission. The public member was granted permission to submit this position paper in lieu of testifying as a citizen on these issues before the Sunset Commission.

NOTE: This position paper represents the personal views of Mr. Wolf and was not formally considered or adopted by the Sunset Commission.

### **Purpose of the Texas Alcoholic Beverage Commission**

The Alcoholic Beverage Act, as originally adopted in 1935, provides "This entire Act shall be deemed 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, and all its provisions shall be liberally construed for the accomplishment of that purpose." At the time of repeal of prohibition, the major issues facing the regulation of alcoholic beverages related to (i) assuring that products sold to consumers were untainted and produced in licensed facilities (ii) assuring that the wholesale and retail distribution of products was not controlled by organized crime, and (iii) concern about widespread public intemperance. The creators of the current regulatory system, both in Texas and nationally, were convinced that some manufactures used market dominance and vertical integration with retailers to compel irresponsible marketing practices resulting in high levels of intemperate behavior. These issues were addressed in the statute, as originally adopted, by the creation of a three-tier system designed to license and separately control the production, distribution and retail sale of alcoholic beverages.

Over time, the issues that mandated the creation of the three-tier system became insignificant as the industry changed and expanded. First, commercial relations generally, and

particularly among the three tiers of the alcoholic beverage industry, no longer bear any meaningful similarity to conditions as they existed in 1935. Second, in the past 71 years, an enormous web of laws and rules have been developed, both at the state and federal level, that are designed to protect individuals and commercial entities from socially destructive behavior. This web of law and regulation did not exist in 1935 to the degree that it does today. Intemperate use of alcoholic beverages remains a societal problem, but it is both caused and addressed by different conditions and behavior than existed prior to 1935. Following World War II, changes in society and public behavior resulted in the regulatory structure initially created in 1935 becoming obsolete and mostly irrelevant to the original goal of protecting the interests of the people of the State of Texas.

### **Corruption of the System to Regulate Alcoholic Beverages in Texas**

Laws and regulations embody the authority and provide a framework that facilitates productive activity for society as a whole. The purpose of a law can either be fulfilled or corrupted. When laws become disconnected from the reality of social behavior and commercial activity, the inevitable, even if unintended, result is the use of public authority to advance private, rather than public, goals. The essential definition of corruption in a representative democracy is the usurpation of public authority to the advancement of private interests. The system currently used to regulate alcoholic beverages in Texas now promotes and protects private, rather than public, welfare. This is because this system has failed to adapt to the legal, social and commercial changes of the past 71 years. While the private interests of the commercial entities in the industry are artificially protected from the challenges of dealing with changes in the market place, there is no noticeable advancement of the public welfare. Even worse, in many instances, the public interests are either neglected or ignored. This disconnection, between the valid exercise of public authority and its application to the environment in which the authority operates, corrupts the entire regulatory system.

During the 71-year period since the adoption of the statute, the legislature has permitted the statute to be amended in ways that perverts the original purpose of the law. A statute that was designed to promote public health, safety and welfare has, over time, been subverted by the economic interests of the entities it was intended to regulate. Now, the legalized system operates

primarily to prevent competition, protect anti-competitive conduct and otherwise thwart the functioning of a free market in the manufacture, distribution and sale of alcohol beverages.

There are numerous parts of the statute that have been added by amendment for the sole purpose of serving private interests. For example, one of the central tenets of the three tiered system is that licensees in the manufacturing tier are not permitted to own the premises of retailers. A breach of this provision is considered serious, and can be punishable by outright cancellation of the offender's license. Despite the supposed importance of this proviso, the public welfare is apparently not threatened when a manufacture owns the premises of a retailer in a "marine park", which is partially defined as "an enclosed restricted access area of not less than 254 acres nor more than 255 acres in a county with a population of over 950,000..." Likewise, there are provisions designed to keep in-state and out-of-state chain, grocery and convenience stores and large corporations from competing with existing package stores. These examples are not "three tier" issues, or ways of promoting temperance. They are blatant examples of economic protectionism.

The existence of the corruption of the system has also been evident recently in several different ways. One example occurred in connection with the deliberations by the Texas Tax Reform Commission, which was created by Governor Perry in late 2005 to recommend ways to reduce the state property tax. Mr. Wolf was a member of this Commission. After the Tax Reform Commission had decided to recommend an increase in the tax on cigarettes, it was noted by members on the Tax Reform Commission that taxes on alcoholic beverages, which had not been increased in Texas since 1984, were a possible source of additional revenue to reduce the property tax. In response to the request that this be considered, John Sharp, the Chairman of the Tax Reform Commission, advised the members that the alcoholic beverage industry has a controlling influence with the legislature, and inclusion of increases of taxes on the industry would probably prevent approval of any tax reform legislation. Increasing the taxes on alcoholic beverages in Texas, to the levels that would match the increases enacted in other large states during the twenty years following 1984, would have raised hundreds of millions of dollars to apply to property tax relief. The Tax Reform Commission, however, did not recommend changes in the taxes on alcoholic beverages in Texas, based upon Chairman Sharp's advice.

Other examples of the corruption of the system can be found by a review of the complex licensing requirements, which act as a barrier to entry of legitimate competitors, and the consolidation of the distribution tier of the system into a few entities that control the access of producers to the marketplace and the sources of products available to retailers. The number of types of licenses that are issued by the Commission has now reached 66. Substantially all of these have the effect of carving up the market in ways that restrict and limit competition. If the focus was on public safety and health, the industry could be regulated more efficiently through the use of far fewer categories of licensees. The distribution tier has been corrupted by consolidation to the point that, in Texas, two wholesalers control over 80% of the market for certain types of beverages. No public policy purpose is served by these artificial barriers to competition.

### **The Current System of Regulation is Not Necessary to Protect the Public**

As the philosopher Friedrich Nietzsche said, “Necessary is an interpretation, not a fact.” Various reasons are advanced by the entrenched interests in the industry and the persons that do their bidding as to why the continuation of the current regulatory system is necessary. The advocates for the industry publish turgid tomes on slick paper, laced with factoids, where they make broad claims and conclusions about the value to the public of the system that they have corrupted. All the while, they assiduously avoid presenting any facts, information or evidence in an open forum to support their claims. This is because no empirical evidence exists to support the conclusory pronouncements made to justify the continuation of a corrupt system that no longer serves the public interest.

Members of the alcoholic beverage industry lobby have done everything possible to prevent an objective, critical review of alcoholic beverage regulation by the Sunset Advisory Commission. Poised like lions on a patch of high ground in the Serengeti, occasionally swishing their tails so their presence would be noted, the lions of the lobby watched at hearings to ensure that no Republican elephant or Democratic mule would dare stray from the prescribed path.

Two events at the Sunset Commission hearing on January 10, 2007, epitomize the depth of control that the lions of the lobby exert over the legislative process. The first relates to Issue 9 of the Issues/Recommendations contained in the Decision Material considered by the Sunset

Commission in regard to the Alcoholic Beverage Commission. Issue 9 was recommended by the Sunset Commission staff and was not opposed by the Alcoholic Beverage Commission. Adoption of Issue 9 would have permitted the legislature to establish a joint interim committee to study revision of the regulatory structure for alcoholic beverages. The basic purpose, of course, of the Sunset Commission is to look closely at each state agency and recommend fundamental changes to the agency's mission or operations, if needed. This was exactly the approach taken with respect to all other agencies reviewed.

At the previous Sunset Commission hearing on December 12, 2006, however, Mr. Wolf was not allowed to ask questions about how the Alcoholic Beverage Commission could be made more efficient and effective. The Chairman ruled this was a matter for the legislature. Issue 9 was clearly designed to permit the legislature to do just that. The problem with Issue 9, of course, was that the lions of the lobby were instructed by their industry ringmasters not to permit anything to come out of the Sunset hearings that would continue the critical review of the Alcoholic Beverage Commission.

This instruction gave rise to what can best be analogized to a "drive by shooting" that almost missed. A legislative member of the Sunset Commission appeared at the hearing on January 10, 2007, and separated Issue 9 from the blanket motion to approve the Sunset Commission report on the Alcoholic Beverage Commission. This legislator had attended only one of the previous meetings of the Sunset Commission, and had been present to vote on only one of the 26 motions previously submitted to vote at meetings in the current term of the Sunset Commission. It would be dramatic to assume that this legislator had an epiphany that killing Issue 9 was an exercise in good public policy. This view of events would, however, be delusional.

While it is impossible to know with certainty, the most likely reason this legislator appeared briefly at the meeting was because a "hit" had been ordered on Issue 9, and this legislator had accepted the assignment to execute this instruction. Confident that it was clear the hit on Issue 9 had been ordered by the ringmasters watching in the gallery, after isolating Issue 9 for separate vote, this legislator left the Sunset Commission meeting, without hearing any

discussion, and before the vote was taken, and did not return. Mr. Wolf moved the adoption of Issue 9 and the motion was seconded by the other public member of the Sunset Commission.

In discussion, it was pointed out that, by charging the legislature to examine the Alcoholic Beverage Commission, Issue 9 would deal with the matter in exactly the manner the Chairman of the Sunset Commission had previously mandated in the December meeting. Seeing the logic in this position, three legislative members joined the two public members in support of the motion. With two legislative members of the Sunset Commission absent, the “drive by shooting” was barely successful, and Issue 9 narrowly failed to pass by a vote of five for and five against. Obviously, the lions of the lobby and their ringmasters had instructed that there was to be no action taken by the Sunset Commission that would permit a continued critical review of the Alcoholic Beverage Commission by the legislature. Since, as Chairman Sharp observed, the lobby controls the legislature on this subject, these instructions were followed.

### **The Only Thing Worse than Hypocrisy is Sanctimonious Hypocrisy**

The other action at the January 10, 2007, meeting of the Sunset Commission that demonstrates the depth of the corruption of the regulatory system was the vote on New Issue 15. This issue recommended the abolishment of the cash law governing payments for beer deliveries and the credit law governing payments for liquor deliveries. New Issue 15 was proposed by the two public members of the Sunset Commission. To the knowledge of these two Commission members, no other provision of Texas law dictates the terms of private business activity by requiring cash payments for commercial transactions.

The cash law is, in substance, a governmental subsidy that has been corruptly continued for the benefit of the politically powerful distribution tier of the industry. It serves no valid public policy purpose. Today, if another industry appeared at the Capitol and requested passage of a cash payment law that would remove the risk of extending credit to its customers, the self described conservative members of the legislature would find the request ridiculous. Obviously, however, the lions of the lobby would not permit an exception to their instructions that there be no changes in the corrupt regulatory system. Thus, in a vote that would be more fitting of action by the Committee to Free Eugene Debs, the legislative members unanimously out-voted the two public members of the Sunset Commission to defeat New Issue 15. Again, Chairman Sharp’s

assessment of the depth of the corruption of the system for regulating the alcoholic beverage industry was proven accurate.

While sanctimoniously professing the value delivered to the public by the system they control, the lions of the lobby for the alcoholic beverage industry do everything possible to prevent a critical review of this system. Despite growing pressure from competing economic interests to open the market in ways that would make the system more efficient and effective, the lions feed on the fruits of the uncompetitive markets and the restraints on trade in the industry. All the while, they continue to hypocritically profess that public interests are being served through their efforts.

One legislative member of the Sunset Commission argues for the continuation of the three tier system without examining ways to remove corruption and refocus regulation on public health, safety and welfare. The sophistic reason given for this position is that the industry has done such a good job through the years of handling a controversial product. This argument is as ludicrous as saying that the Sherman Anti-Trust Act should not have been passed to break up the Oil Trusts, because the participants in the monopoly were doing such a good job of selling petroleum products to consumers.

Persons who have an in-depth understanding of the current regulatory system, and who are objective with no ax to grind, have repeatedly said that the method of regulating the production, distribution, and sale of alcoholic beverages in Texas should be significantly revised. A clear example of this was the testimony of Allan Shivers before the Sunset Commission on November 16, 2004. Mr. Shivers, who had served for three and one-half years as a member of the Alcoholic Beverage Commission, and then six additional years as Governor Bush's appointee as Chairman of the Commission, testified that his recommendation would be to "amend the Alcoholic Beverage Code by attaching an amendment that abolishes the current code and rewrites it in its entirety so that it is clear and understandable and simple." This kind of "sunshine" was not focused on the Alcoholic Beverage Commission in the Sunset Commission hearings in 2006, because the lions of the lobby instructed the Republican elephants and the Democratic mules not to open the Alcoholic Beverage Code to critical examination and review.

## **It's A Long Road That Never Turns**

Like any corrupt system, the current regulatory structure cannot survive exposure to daylight and critical examination. Changes to the regulatory system have occurred in recent years primarily as the result of litigation. The Supreme Court of the United States further opened the door to the interstate sale of wine in a case decided in 2005. Large retail entities that want to compete in the alcoholic beverage industry are filing suit and also pursuing change by legislation in various states.

The implications of the trend toward more court challenges to the regulatory system are two fold. First, the state regulatory systems routinely and uniformly lose in these cases, and each loss accelerates the number of challenges filed. Second, while injustices can be corrected in the court room, effective regulation cannot be developed and implemented by judicial fiat. Texas experienced this by the long running judicial stewardship of its prisons, mental health and mental retardation systems. Obviously, a continued long term failure to modify the Alcoholic Beverage Code to adapt to modern conditions condemns the public interest to a similar future in this domain of regulation.

Widespread commercial activity that is rife with corruption often leads to turf battles, and the current regulatory structure is no exception. The liquor wholesalers from the distribution tier are now asserting that they should be permitted to supply establishments where patrons drink on premises, and are supporting legislation to accomplish this goal. Currently, the law allows only package liquor stores to supply these establishments. This has started a war over which participant will succeed in manipulating a corrupt system for economic gain. The battle will be won by the faction of the industry that is able to control the legislature in regard to this issue.

This dispute has nothing to do with public health or safety in the regulation of alcoholic beverages. One owner of an on premises establishment is quoted in the media as saying, "Clearly, the liquor laws in this state are not in the interest of the consumer." At the same time, a distribution industry participant is quoted as saying, "We think it's an inefficient and archaic system for the distribution of distilled spirits and we're going to seek a change." Meanwhile, a person from the package store side of the dispute is quoted as saying, "The monopolistic system sought by the wholesalers would inevitably result in higher prices and poor service." This is a

shocking, but truthful, exchange that demonstrates that the public interests of health and safety are not even considered when legislative changes to the system are proposed. The weapon of choice in this war between the package stores and the wholesalers is money. The media is filled with stories about the enormous amounts currently being contributed to elected officials by the alcoholic beverage industry ringmasters. It remains to be seen if any elected official will dare step forward and ask the obvious question – why not deregulate the licensing requirements that only function to limit competition, and allow the free market to determine the winner?

To enable the implementation of effective regulation today, only manufactures and the entities that sell the products to the public need to be licensed. This simple regulatory change would open the market to competition without lessening the protection of public health and safety. Licensed manufactures should be free to sell to any retailer licensed to sell to the public, and licensees should be free to sell to other licensees without restrictions. As is the case with other dangerous products, such as prescription drugs, it should be the responsibility of the manufacture to ensure the products are delivered to licensed retailers.

Even though the “territory” in dispute is a Texas statute, the people are not represented in this war. The Sunset Commission was denied the opportunity to constructively participate in this dialogue from a vantage point of good public policy. Issue 9, the casualty of the “drive by shooting”, was designed to allow the legislature to undertake a broad review of alcoholic beverage regulation. The lions of the lobby were able to perpetuate the corruption of the system by exerting a controlling influence over the work of the Sunset Commission.

Because the economic stakes are so large, continued pressure for changes to the system are inevitable. Hopefully, the legislature will, at some point in the future, sublimate its addiction to the political contributions from the lions of the lobby and act responsibly for the benefit of the citizens of Texas. If the legislature does not act in this regard, many of these changes will occur as a result of litigation. All the while, as this happens, the lions of the lobby will use political contributions to sooth the feelings of the Republican elephants and the Democratic mules as elected officials whine about the intrusion of the courts into their domain. Continued corruption of a governmental system makes good political drama and, of course, huge political contributions, but bad public policy.

