

SUBJECT: Continuing the Texas Alcoholic Beverage Commission

COMMITTEE: Licensing and Administrative Procedures — committee substitute recommended

VOTE: 9 ayes — T. King, Goldman, Geren, Guillen, Harless, Hernandez, K. King, Paddie, S. Thompson

0 nays

2 absent — Herrero, Kuempel

WITNESSES: For — Peter Salatich, Anheuser-Busch; Rick Donley, The Beer Alliance of Texas; Adam DeBower, Texas Craft Brewers Guild; (*Registered, but did not testify*: Price Ashley, Constellation Brands; Robert Floyd, Southern Glazers; Kyle Frazier, Texas Wine and Grape Growers Association; Edward Cooper, Total Wine & More; Joey Bennett, Wine and Spirits Wholesalers of Texas; Tyler Rudd, Wine Institute)

Against — None

On — Merrell Foote and Emily Johnson, Sunset Advisory Commission; Bentley Nettles, Texas Alcoholic Beverage Commission; Carine Martinez, Texas Public Policy Foundation; Keith Strama, Wholesale Beer Distributors of Texas

BACKGROUND: The Texas Alcoholic Beverage Commission (TABC) regulates the Texas alcoholic beverage industry. The agency licenses manufacturers, distributors, and sellers of alcoholic beverages, enforces the Texas Alcoholic Beverage Code, issues certificates to those selling and serving alcohol, develops public education materials related to alcohol, and collects certain taxes.

Governing structure. A three-member commission oversees the agency, and commissioners serve six-year, staggered terms. The governor appoints the commissioners with the advice and consent of the Senate and appoints

the chair of the commission. Commissioners may not have any financial connection to anyone engaged in the alcoholic beverage industry.

Under Alcoholic Beverage Code sec. 5.05, no one may be appointed to the commission, hold an office under the commission, or be employed by the commission who:

- has any financial connection with anyone engaged in an alcoholic beverage business;
- holds stocks or bonds in an alcoholic beverage business; or
- has a pecuniary interest in an alcoholic beverage business.

Under Alcoholic Beverage Code sec. 5.11, the commission is required to appoint an administrator, also known as the executive director, to administer the code.

Funding, staffing. In fiscal 2017, TABC spent about \$54.4 million on agency operations, \$48.4 million of which was appropriated to the agency. The agency collected about \$76 million in fees and other revenues and sent about \$21.3 million to the state's general revenue fund. Law enforcement efforts to enforce the Alcoholic Beverage Code's public safety provisions accounted for 51 percent of TABC's expenditures.

The agency had about 580 employees in fiscal 2017, about 240 of whom were commissioned peace officers. The agency is headquartered in Austin and has five regional offices, 43 field offices, and 30 international land and sea ports of entry.

Three tier-system. Following the repeal of Prohibition in 1933, Texas implemented a three-tier system of manufacturers, distributors, and retailers to regulate the production and sale of alcohol. The system prohibits close ties between manufacturers and retailers by requiring retailers to buy their product from distributors, not directly from manufacturers. TABC oversees the three-tier system and licenses businesses in each tier. TABC issues about 75 types of licenses and permits across the three tiers, and in fiscal 2017, more than 130,000 active

licenses and permits were held by 60,000 entities and individuals.

Manufacturers of alcoholic beverages, the first tier, can produce alcohol and sell it to those in the second or middle tier, wholesalers and distributors. Those in the middle tier buy alcohol from manufacturers and sell it to retailers. Licensees in this middle tier that handle liquor and wine are called wholesalers, and those that handle beer are called distributors. Retailers are the third tier and sell alcohol to consumers. Retailers can be package stores, grocery stores, convenience stores, bars, or restaurants. Permit and license holders in one tier cannot have financial ties or certain familial ties to those in other tiers.

The Texas Alcoholic Beverage Commission will be abolished September 1, 2019, unless continued by the Legislature.

DIGEST:

CSHB 1545 would continue the Texas Alcoholic Beverage Commission until September 1, 2031, and make several other changes to the laws governing the agency, including:

- expanding the size of the commission and revising the restrictions on conflicts of interest for commission members;
- revising the types of licenses and permits issued by the commission, including reducing the total number and combining beer and ale into one category;
- repealing statutory fees and requiring the commission to set fees by rule;
- revising the agency's process for approving, denying, and protesting license and permit applications;
- revising the agency's enforcement and inspection processes; and
- revising statutes governing product registration and labeling.

Commission. The Texas Alcoholic Beverage Commission would be expanded from three to five members. The governor would have to appoint two additional members to the commission by December 1, 2019.

The bill would revise and narrow the conflict of interest provisions

prohibiting persons with certain financial interests in or connections with the alcoholic beverage industry from being commission members, holding office under the commission, or being employed by the commission. Under CSHB 1545, a person would be considered to have a conflict of interest if they held a specific percentage of an alcoholic beverage business. This would replace the current definition, which applies to individuals with any financial connection with someone engaged in an alcoholic beverage business or who have other pecuniary interests in such a business.

Under the bill, individuals could not be appointed to the commission, hold an office under the commission, or be employed by the commission if they were employed by an alcoholic beverage business or had a financial interest in an alcoholic beverage business. Financial interest would be defined as owning or controlling, directly or indirectly, an ownership interest of:

- at least 5 percent in a single alcoholic beverage business, including the right to share in profits, proceeds, or capital gains;
- at least 5 percent cumulative interest, including the right to share in profits, proceeds, or capital gains, in multiple alcoholic beverage businesses; or
- having a spouse or child with such an interest.

The definition of financial interest would not include ownership under a retirement plan, blind trust, or insurance coverage, or ownership of less than 5 percent in a corporation.

The bill would authorize the commission to establish advisory committees. Government Code provisions on the operation of state agency advisory committees would apply to committees created by the commission.

Permits, licenses, fees. The bill would reduce the number of licenses and permit types issued by TABC from 75 to 36, according to the Sunset Advisory Commission. Some licenses and permits would be combined

and others would be eliminated.

Beer, ale as malt beverages. CSHB 1545 would eliminate the distinction between beer and ale throughout the Alcoholic Beverage Code by referring to both as "malt beverages" and combining their licensing, permitting, and regulations into one category. In most cases, CSHB 1545 would continue the provisions relating to beer and apply them to the new combined category. For example, the bill would apply the hours of sale for beer and beer marketing regulations to all malt beverages. The term "brewers" would be used to refer to makers of malt beverages. The excise tax for beer of nearly 0.194 cents per gallon would be applied to all malt beverages, instead of the current ale tax rate of 0.198 per gallon.

The current requirement that retailers pay beer distributors with cash, check, or electronic payment would be applied to payments made to distributors of malt beverages.

Brewers and distributors of malt beverages would be required to register with the commission each warehouse used to store malt beverages, and TABC would have to establish rules about what information was included with the registration. Certain current permit requirements relating to ale and warehouses would be eliminated. Current prohibitions on beer manufacturers and distributors serving beer at storage warehouses would be applied to malt beverages.

Areas that had approved the retail sale of beer, but not ale, in a local option election before September 1, 2021, would be subject to a grandfather clause and would continue to only allow the sale of beer. In these areas, only malt beverages with 5 percent alcohol or less per volume, the threshold currently applied to beer, could be sold unless a subsequent local option election approved the sale of all malt beverages.

Other licenses and permits. CSHB 1545 would combine some licenses and permits. These would include combining permits to sell or serve alcohol on trains, boats, airlines, and buses into a new permit related to passenger transportation vehicles and combining certain temporary

permits for non-profit organizations to sell or auction alcoholic beverages.

The bill also would combine certain licenses and permits that businesses currently are required to obtain when conducting an activity that might be subordinate to their primary license or permit. These changes would include authorizing the holder of a package store permit to conduct tastings, authorizing the holder of a wholesaler's permit to store liquor, and authorizing hotels holding a mixed beverage permit to provide minibars without obtaining a separate license. The bill also would combine various permits and licenses for late-hours selling into one late-hours certificate.

The bill would eliminate other licenses and permits identified by the Sunset Advisory Commission as obsolete and deregulate holders of some licenses and permits, including agents who are employees of manufacturers and distributors and industrial alcohol businesses.

Fees. CSHB 1545 would authorize TABC to establish fees for licenses, permits, and certificates by rule and would eliminate statutory references to fees and surcharges. The commission would be required to develop a process for setting fees that ensured the fees would cover the commission's costs in administering the code. TABC would be required to periodically review and adjust the fees to ensure regulatory costs were fairly allocated among certificate, permit, and license holders.

TABC would have to adopt rules setting the fees for each certificate, license, and permit by September 1, 2021, and the new fees would apply only to an original or renewal certificate, license, and permit issued on or after that date.

Application approval, denial, and protest process. CSHB 1545 would restructure the agency's process for approving, denying, and protesting license and permit applications and would designate the roles of the commission, the administrator, and State Office of Administrative Hearing (SOAH) in that process. By December 31, 2020, the agency would have to adopt rules to implement the process.

The commission would have the authority to issue or deny applications for original or renewal permits and licenses. The administrator's current statutory authority to grant or refuse to issue permits and licenses would be eliminated, but the commission would be able to delegate authority to the administrator to issue permits and licenses. The commission would have sole authority for the final denial of licenses and permits. The role of county judges in making some decisions related to protests about beer applications would be eliminated.

The bill would establish a process for handling protests of denials of applications, including the referral of a protested application to SOAH for a hearing in certain circumstances. In some cases, applicants would be able to request SOAH hearings. After all administrative remedies had been exhausted, applicants could appeal a permit or license denial by the commission to a Travis County district court.

The bill would revise the statutes governing the rights of those outside the agency to protest certain permit or license applications or renewals. The public would be authorized to protest certain applications, and the commission could expand the public's authorization to protest to include other applications. The bill would list state and local government officials who would be authorized to protest any application for a permit or license.

Enforcement and inspections. The bill would outline the disciplinary authority of the commission and the administrator over those regulated by the commission, and the commission could use rules to delegate authority to take disciplinary and enforcement actions to the administrator. The rules would have to specify a threshold for the types of disciplinary and enforcement actions that were delegated to the administrator. The commission would be required to make the final decision on disciplinary actions in contested cases that had administrative hearings.

The bill would require the commission to use rules to develop a risk-based approach that prioritized public safety when inspecting permittees and licensees. The plan could allow virtual inspections that included a review

of permittees' and licensees' records or could also require a physical inspection of their premises. The plan would have to include a timeline for inspections that prioritized high-risk permittees and licensees and would have to require physical inspections of all licensees and permittees within a reasonable time. These rules would have to be adopted by January 31, 2020.

The bill would give the commission and the administrator authority to issue an emergency order to temporarily suspend a permit or license if it was determined the continued operation of the permitted or licensed business would constitute a threat to the public welfare. The bill would establish a process for holding a hearing on emergency orders and would allow the commission to create rules for the procedures to appeal an emergency order. Proceedings would be contested cases under the Administrative Procedures Act.

CSHB 1545 would require the commission, when determining the amount of a penalty, to consider whether and how much licensees and permittees had profited from the violation if it were at least a second violation of the Alcoholic Beverage Code. The bill would allow the commission to deny an original or renewal application or to take other disciplinary action against permittees or licenses who violated orders of the commission or administrator.

Registration, labeling, and testing. CSHB 1545 would revise statutes governing product registration and label approval.

The bill would require those wanting to register malt beverages with the commission to submit a federal certificate of label approval (COLA) with a registration application. The bill would eliminate the current process involving prior TABC label approval for beer and ale and the current requirement that the content of malt beverages be tested by laboratories or the commission as part of the registration process to verify the alcohol content. All malt beverages would have a new requirement to list the alcohol content by volume on their labels.

The bill would establish a 30-day deadline for the commission to approve or deny product registrations and would require the commission to use rules to establish certain other procedures related to product registration, including procedures to accept federal COLA for registration. The commission would be able to deny registration to a product with a federal COLA if the commission determined that the product would create a public safety concern, create a cross-tier violation, or violate the Alcoholic Beverage Code.

Modernize Code Project. The bill would require the Sunset Advisory Commission staff, with assistance from the Texas Legislative Council and the Texas Alcoholic Beverage Commission, to review the Texas Alcoholic Beverage Code and make recommendations to the Sunset Advisory Commission for both a modernization and a nonsubstantive technical revision of the code.

The review could include identifying inconsistencies in authorities and treatment of different alcoholic beverages and regulated businesses, reviewing the use of the terms "license" for beer and "permit" for other alcoholic beverages, identifying needed technical changes, and identifying changes to modernize the code within the three-tier system. The review could not consider changes to the overall three-tier regulatory system. The Texas Legislative Council would have to prepare a nonsubstantive revision of the Texas Alcoholic Beverage Code by September 1, 2022. The Sunset Advisory Commission staff would have to make recommendations to the Sunset Advisory Commission on substantive issues by the same date.

Other provisions. CSHB 1545 would state that it was the Legislature's intent to prevent human trafficking at all permitted and licensed premises, that the code should be liberally construed to carry out this intent, and that it was a duty and priority of the commission to adhere to a zero tolerance policy relating to human trafficking and related practices.

The bill would eliminate certain statutory provisions about outdoor advertising and would require the commission to adopt reasonable rules

related to outdoor advertising by retail licensees and permittees on their premises. The bill also would eliminate a permit related to billboards and electric signs near retailers.

CSHB 1545 would make numerous other changes to statutes governing the TABC, including:

- adding standard Sunset across-the-board language about commission member training;
- prohibiting the disclosure under the state's public information law of certain personal records of peace officers while there is a pending internal investigation for alleged employee misconduct;
- establishing a deadline for county clerks and city secretaries to issue certifications about whether certain addresses are in wet areas and whether certain alcoholic beverages are prohibited in that area by local authority;
- giving the commission sole authority to issue orders imposing conditions on permit and license holders to abate a common nuisance and the authority to suspend or cancel permits or licenses of those who violate orders of the commission; and
- implementing other Sunset standard recommendations including replacing language throughout the code with person-first respectful language and eliminating certain reports.

Effective dates. The bill would take effect September 1, 2021, but would include several other effective dates for certain provisions. In general, provisions eliminating license and permits would be effective September 1, 2019; label approval changes would be effective September 1, 2020; and other licensing changes would be effective September 1, 2021.

**SUPPORTERS
SAY:**

The Texas Alcoholic Beverage Commission (TABC) should be continued for another 12 years because the state has an ongoing need for the commission's services, which protect public safety. No other entity has the specialized expertise necessary to regulate the alcoholic beverage industry, and no other agency could perform all of the agency's tasks regarding licensing, law enforcement, and tax collection.

Commission. CSHB 1545 would increase the size of the Texas Alcoholic Beverage Commission from three to five members, which would enable commissioners to better engage in the commission's duties and make better informed decisions. The current three-member commission can be stretched thin trying to regulate such a large industry, and commissioners are sometimes unable to engage with the full complexity and nuances of the state's alcohol regulation. Increasing the commission to five members would allow commissioners to more meaningful engage with issues before the commission and to make use of subcommittees, which would better enable commissioners to develop expertise in certain areas of the agency.

Having a larger commission also would address TABC's current risk of violating the state's open meetings requirements. Because the current commission has only three members, a quorum occurs whenever two members discuss commission business, and commissioners risk violating the Open Meetings Act if they engage in any such conversation without advance posting. Expanding the commission to five members would remove this risk.

CSHB 1545 would update commission conflict-of-interest provisions so that there would be a bigger pool of candidates for the commission. Current law prohibits commission appointments and employment by those having "any financial connection with a person engaged in an alcoholic beverage business," which is undefined and so broad that it limits the pool of applicants. CSHB 1545 would better define a conflict of interest and recognize the complexity of today's business and investments by setting the threshold for a conflict at owning or controlling at least 5 percent ownership in an alcoholic beverage business. The bill would balance the need for qualified applicants with the need to protect against commission members with financial interests in the industry by setting this percentage at 5 percent. Setting it lower could be too restrictive given modern investment practices.

Combined permits, license. CSHB 1545 would revise TABC's licensing

structure to remove overly complicated, duplicative, and unnecessary licenses that burden the agency and industry. The total number of types of alcoholic beverage licenses and permits would be reduced from 75 to 36 by removing layers of licenses, so that a primary license would include the authority to conduct other, related activities, and by eliminating obsolete or duplicative licenses and permits.

The state's regulation of beer and ale in separate categories based solely on alcohol content is outdated, redundant, and unnecessary. CSHB 1545 would combine them into one "malt beverage" category, and in most cases the regulations governing beer would be applied to the new category since beer represents the largest portion of the combined group. This would include extending the cash payment system to ale. The cash system has worked well to support healthy, fair, and competitive practices, and it would be appropriate to expand the system's use for all malt beverages.

CSHB 1545 would respect local decision-making by grandfathering in areas in which local voters had approved beer but not ale. In these areas, ale sales could not occur unless approved in a new election.

CSHB 1545 would eliminate a confusing and illogical system of statutory fees with agency surcharges and replace it with one that allows the agency to set fees by rule. The rulemaking process would allow input by stakeholders so that fees were set at appropriate and fair levels, and setting fees by rule would allow them to be adjusted when necessary rather than waiting for a legislative change.

Application approval, denial, and protest process. CSHB 1545 would revise TABC's process for approving and protesting licenses and permits to establish a more transparent and fair process that was consistent with practices at other agencies. To improve accountability, the commission would be able to delegate approvals of applications but would be required to make final denials. The bill would ensure public input was considered by clearly outlining the rights of the public and public officials in the protest process.

CSHB 1545 would eliminate county judges from certain protests relating to beer applications so that there would be a standard process statewide and so that decisions on cases that were heard by the State Office of Administrative Hearings (SOAH) would be made by experienced administrative law judges. Having a bifurcated process that sends certain protests to a county judge can result in inconsistent rulings, and county judges, who may not be attorneys, can lack experience in conducting these types of hearings. County judges would retain the ability to participate in the protest process under provisions in the bill that allow certain government officials to protest applications.

The bill also would be in line with other decisions made by the Legislature to move certain administrative hearings and decisions to SOAH. Using SOAH would promote consistency in the process and in decision-making, which would help ensure fair treatment for all parties.

Enforcement and inspections. By revamping the commission's enforcement process and mechanisms, the bill would make the most efficient and effective use of state resources. The bill would better protect the public by authorizing a risk-based inspection system while ensuring that all permittees and licensees were inspected within a reasonable time. Requiring a threshold for disciplinary and enforcement actions delegated to staff and requiring the commission to make final decisions in certain cases would increase accountability and transparency. CSHB 1545 would not remove TABC's current requirement to offer licensees and permittees a choice between a suspension and a fine in certain situations to ensure there is balance in the disciplinary process. The agency would be given authority for temporary suspensions through emergency orders, which would allow it to address any threat to public welfare.

The bill would give the commission additional tools for enforcement and would better deter violations by allowing the commission to consider the profit made from a violation when determining the amount of a civil penalty if it was the businesses' second violation of the code. Without this ability, TABC cannot appropriately assess penalties in certain situations. For example, if a business earned more from a violation than it had to pay

for the penalty, the penalty could fail to serve as an appropriate punishment or deterrent to future violations. Allowing the commission to consider the profits from violations when setting penalties would keep penalties effective as enforcement tools.

Registration, labeling, and testing. CSHB 1545 would revise the product registration and label approval process to eliminate the duplication of efforts and other processes that can delay products getting to the market. The bill would reduce inconsistencies in the process as it was applied to different products to create a fair system and would streamline the approval process for malt beverages by requiring TABC to accept products with federal label approval. TABC would be given a reasonable deadline for approval, and the bill would give the agency the necessary authority to enforce current law and protect public safety by creating an exception to the approval requirement if TABC determined a product would create a public safety concern or a cross-tier or other law violation. The new requirement for malt beverage labels to list the beverage's alcohol content would be consistent with requirements placed on distilled spirits and wine and would replace requirements that required either "beer" or "ale" to be on the label.

Modernize code project. Because of the arcane nature of the Alcoholic Beverage Code and the need to modernize it, CSHB 1545 would establish a team to make recommendations to the Legislature for a modernization and nonsubstantive technical code revision. The Sunset Advisory Commission and Texas Legislative Council staff would be the best entities to head the project because of their expertise and experience. This structure would be similar to the one used previously to examine the Health and Human Services Code. CSHB 1545 would ensure the project was focused by including parameters for the study, including prohibiting the review from considering changes to the overall three-tier system. All policy decisions would rest with the Legislature, and the two agencies' staff would simply provide the information to make those decisions.

OPPONENTS
SAY:

While the Texas Alcoholic Beverage Commission should be continued, CSHB 1545 would make several unnecessary and potentially harmful

changes to the agency, including to TABC's enforcement and protest processes.

Commission. The Texas Alcoholic Beverage Commission should not be expanded because doing so could dilute the commissioners' sense of responsibility. Other state boards, including the Public Utility Commission, Texas Commission on Environmental Quality, and the Railroad Commission, function well with three commissioners. Simply expanding the number of commissioners would not improve the workings of the commission.

Changes to the conflict of interest provisions might be too lenient. A percentage of ownership threshold smaller than 5 percent might be better as an initial change.

Permits, license, fees. In combining beer and ale into one regulatory "malt beverages" category, CSHB 1545 should not apply the antiquated cash payment system from beer to the combined category but instead use the existing credit law that is used for ale and other alcoholic beverages.

Rather than remove all fees from statute, CSHB 1545 should institute caps on fees to ensure there was a limit to how high fees could be set. With no statutory limit, the alcoholic beverage industry could face uncertainty about the cost of doing business and the prospect of ever-increasing fees. Statutory limits could be adjusted as needed by the Legislature.

Application approval, denial, and protest process. The protest process for certain applications for beer licenses should continue to include local county judges, and this process should be extended to ale if the two categories are combined. Removing local elected officials from the process could remove the ability of Texans affected by a decision to have a voice in the protest process and to have local considerations taken into account. The change would focus the process on the state government, instead of the local community.

Provisions in CSHB 1545 that would require certain hearings to be held

by SOAH should require them to be conducted locally and should require appeals to go local district courts rather than to the Travis County district court. This would help ensure local input and consideration of the issues by officials elected by those affected by the decision.

Requiring all final application protest decisions to be made by the commission could burden the commission and could lead to delays in decision-making while waiting for the commission to meet.

Enforcement and inspections. CSHB 1545 should remove the requirement in current law that TABC offer licensees and permittees a choice between a suspension and a fine in certain situations so that the commission can apply appropriate penalties and deter future violations.

The agency already has several enforcement tools, and some of the enforcement provisions in the bill could go too far. For example, CSHB 1545 should not require TABC to consider the profits earned from a violation when assessing a civil penalty, even on a second offense. Penalties should be determined based on the harm to the public and the nature and seriousness of a violation.

Registration, labeling, and testing. The bill should include revisions to the labeling process that would institute a file-and-use system for labels so that once a label with federal approval was filed with TABC, the labeled product could be sold in the state. Although the bill requires the commission to approve products with federal labels, it also allows the commission up to 30 days to issue approval, which could delay products getting to market.

Modernize code project. Any review of the Alcoholic Beverage Code should be undertaken by a body with the formal involvement of policy makers and entities with substantive experience on the issue, similar to the recent School Finance Commission created to study the school funding system. The Sunset Advisory Commission and Texas Legislative Council are not policy-making bodies and should not be required to lead this type of code review.

OTHER
OPPONENTS
SAY:

If the commission is to be expanded, it might be beneficial to establish requirements for some members, such as legal, financial, or industry experience.

NOTES:

According to the Legislative Budget Board, the bill would have a negative impact of \$4.5 million in general revenue related funds through fiscal 2020-21.