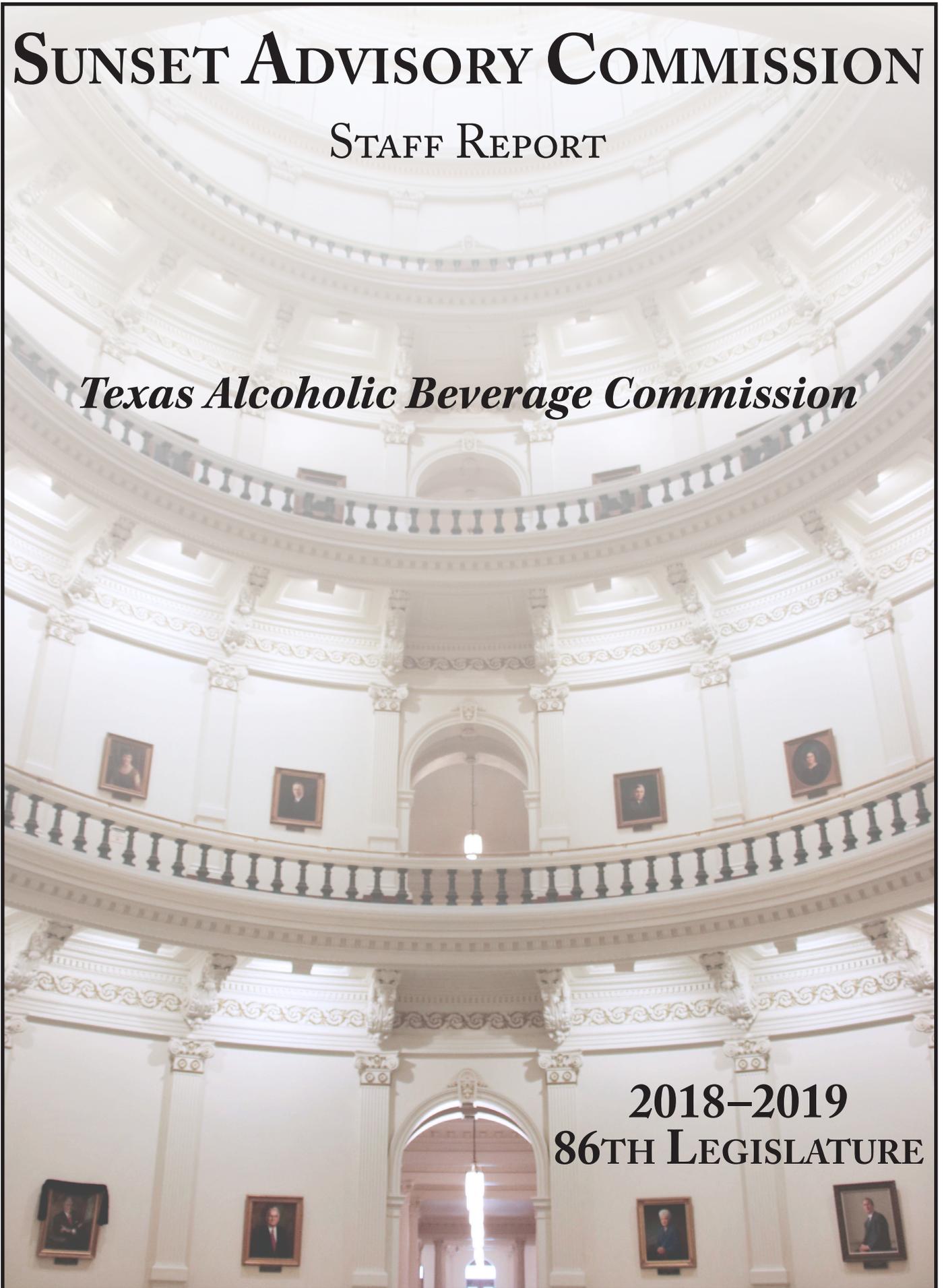


SUNSET ADVISORY COMMISSION

STAFF REPORT

Texas Alcoholic Beverage Commission

**2018–2019
86TH LEGISLATURE**



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TEXAS ALCOHOLIC BEVERAGE COMMISSION

SUNSET STAFF REPORT

2018-2019

86TH LEGISLATURE

HOW TO READ SUNSET REPORTS

Each Sunset report is issued *three times*, at each of the three key phases of the Sunset process, to compile all recommendations and actions into one, up-to-date document. Only the most recent version is posted to the website. (**The version in bold is the version you are reading.**)

1. SUNSET STAFF EVALUATION PHASE

Sunset staff performs extensive research and analysis to evaluate the need for, performance of, and improvements to the agency under review.

FIRST VERSION: The *Sunset Staff Report* identifies problem areas and makes specific recommendations for positive change, either to the laws governing an agency or in the form of management directives to agency leadership.

2. SUNSET COMMISSION DELIBERATION PHASE

The Sunset Commission conducts a public hearing to take testimony on the staff report and the agency overall. Later, the commission meets again to vote on which changes to recommend to the full Legislature.

*SECOND VERSION: The *Sunset Staff Report with Commission Decisions*, issued after the decision meeting, documents the Sunset Commission's decisions on the original staff recommendations and any new issues raised during the hearing, forming the basis of the Sunset bills.*

3. LEGISLATIVE ACTION PHASE

The full Legislature considers bills containing the Sunset Commission's recommendations on each agency and makes final determinations.

*THIRD VERSION: The *Sunset Staff Report with Final Results*, published after the end of the legislative session, documents the ultimate outcome of the Sunset process for each agency, including the actions taken by the Legislature on each Sunset recommendation and any new provisions added to the Sunset bill.*

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**SUMMARY OF SUNSET STAFF
RECOMMENDATIONS**

SUMMARY

Even though more than 80 years have passed since the end of Prohibition, in many ways, Texas still regulates the alcoholic beverage industry as if it were 1935. The Sunset review of the Texas Alcoholic Beverage Commission (TABC) 12 years ago found both the agency and Alcoholic Beverage Code in serious need of modernization. Unfortunately, not much has changed today.

Following the repeal of Prohibition, Texas, like many states, chose to regulate alcohol through a three-tier system, separating the manufacture, distribution, and sale of alcoholic beverages. This system was intentionally designed to be inefficient by prohibiting close relationships between the tiers and protecting citizens from business practices that led to excessive consumption and corruption. Although alcohol can be a dangerous substance with serious public health and societal consequences, drinking has become more normalized and the alcoholic beverage industry and market have evolved considerably. Over time, the state has shown an interest in growing the industry and reaping the resulting economic and tax benefits by relaxing the strict separation among the tiers.

TABC and the Alcoholic Beverage Code are still in serious need of modernization.

TABC is in the precarious position of trying to balance its role as a regulator and law enforcement agency with the state's interest in supporting a robust alcoholic beverage industry. As the agency's 2017 management scandal highlighted, TABC leadership has not always been successful in maintaining this balance. However, with new leadership in place at TABC, this Sunset review comes at an opportune time for the Legislature to focus on more significant challenges in administering the complex labyrinth that is the Texas Alcoholic Beverage Code, much of which dates back to the original Liquor Control Act of 1935. Over the years, the Legislature — often in response to powerful industry groups seeking to protect their own interests — has taken a piecemeal approach to responding to the evolving industry, carving out exceptions for various activities and creating ever more complicated nuances in the law instead of taking a more holistic approach to regulating the alcoholic beverage industry in Texas.

In conducting its review, Sunset staff did not evaluate the state's decision to regulate the alcoholic beverage industry through a three-tier system and recognized a complete overhaul of the Alcoholic Beverage Code would entail numerous delicate policy considerations not appropriate for a Sunset review. However, Sunset staff found many opportunities for streamlining and modernizing both the Alcoholic Beverage Code and agency operations in ways that work within the three-tier system. Chief among needed changes is streamlining the state's archaic, overly complex licensing system, which includes an overwhelming array of more than 70 license and permit types, to reduce regulatory burdens on both TABC and the industry. The resulting recommendations also seek to eliminate TABC's involvement in private

business practices and an ineffective tax collection program at the border — functions that cause the agency to expend considerable effort and resources with little measurable impact on public safety. Other recommendations bring certain processes in line with best practices for licensing agencies.

Finally, in light of the recent management concerns, Sunset staff took a hard look at the governing body's structure and functions and found the commission, limited by its small size, has delegated too many key responsibilities to staff, abdicating its oversight role and creating an environment that leaves the agency susceptible to industry influence on operations. The commission must take a more active role in the agency — one that sends a clear message to the industry about who is in charge.

An area of concern not specifically addressed in the report since it relates to appropriations, which is usually beyond Sunset's scope, but which merits mention, is the need for significant improvements to TABC's information technology systems, especially its legacy licensing system. While the recommendations to streamline licensing focus on fixing the underlying problems in the Alcoholic Beverage Code, Sunset staff recognizes the difficulty TABC will have implementing the recommendations if the agency is unable to upgrade and modernize its systems. The agency has requested funding for this in its legislative appropriations request and if received, together with these recommendations, would provide a strong foundation to significantly improve TABC's ability to regulate the ever-evolving alcoholic beverage industry. The following material summarizes staff recommendations on Texas Alcoholic Beverage Commission.

Issues and Recommendations

Issue 1

Texas Has a Continuing Need for TABC, but a Weak Commission Limits Its Ability to Effectively Oversee and Regulate the Alcoholic Beverage Industry.

Texas has a continuing, legitimate need to protect the public from the illegal and irresponsible consumption of alcohol. However, the commission's small size and limited role inhibits its ability to adequately direct and oversee the agency. A larger commission would provide more flexibility to allow commission members to develop expertise and make better-informed decisions. Further, engaging in more robust rulemaking and approving other key agency decisions would ensure the commission takes a more active oversight role and fulfills its responsibility for establishing agency policies. Additionally, TABC needs to take a more open, transparent approach to engaging the industry, other stakeholders, and the public.

Key Recommendations

- Continue TABC for 12 years.
- Expand the Alcoholic Beverage Commission from three to five members.
- Modernize TABC's conflict-of-interest provisions by defining financial interest to mean 1 percent or more in an alcoholic beverage business.
- Authorize the commission to establish advisory committees by rule.
- Direct TABC to update its rule describing the separation of duties between the commission and executive director.

Issue 2

TABC Cannot Efficiently Regulate the Alcoholic Beverage Industry Without Modernizing the State’s Byzantine Licensing System.

TABC issues 75 types of alcoholic beverage licenses and permits to nearly 60,000 businesses and individuals. The number of license and permit types has more than tripled since the Legislature passed the Liquor Control Act in 1935, resulting in an overly complex, redundant, and archaic regulatory system. Excessive, duplicative, and obsolete licenses and permits combined with Prohibition-era bifurcation of beer and ale regulations overwhelm TABC and burden the industry for no public benefit. Streamlining and modernizing this cumbersome licensing system, including fees, would enable TABC to operate more efficiently and would provide regulatory clarity for the industry without compromising public safety.

Key Recommendations

- Streamline the state’s alcoholic beverage licensing system by reducing the number of licenses and permits to provide regulatory clarity and administrative efficiency.
- Modernize Texas’ regulation of malt beverages by eliminating distinctions between beer and ale.
- Remove fees from statute to allow TABC to systematically review and adjust license and permit fees on an ongoing basis.

Issue 3

Over-Regulation of Certain Business Practices Creates Burdens on TABC and the Alcoholic Beverage Industry With Little Public Benefit.

The Alcoholic Beverage Code requires TABC to enforce numerous regulations related to a licensee’s business practices and its interactions with businesses in other tiers. Several of these regulations, including those related to beverage labeling and registration, payment transactions, and outdoor advertising are archaic or overly burdensome for both TABC staff and licensed businesses. Eliminating or modifying these regulations would remove unnecessary hurdles on alcoholic beverage businesses and allow TABC to focus its attention on more significant public safety issues.

Key Recommendations

- Streamline TABC’s process for approving alcoholic beverages for sale in Texas.
- Make cash payments optional by applying the existing credit law restrictions to beer transactions between retailers and distributors.
- Eliminate overly restrictive outdoor advertising requirements.

Issue 4

TABC’s Protest Process Needs A Complete Overhaul to Meet Basic Transparency, Accountability, and Fairness Standards.

The Alcoholic Beverage Code envisions a process whereby certain local officials and the public can challenge the issuance or renewal of an alcoholic beverage license or permit by protesting a business’s

application. However, the entire protest process is unnecessarily convoluted, inconsistent, confusing for applicants and those protesting, and difficult for the agency to administer. A more streamlined approach would bring TABC's process in line with standard practices for state agencies and promote consistent, fair decisions about who is licensed to do business in Texas.

Key Recommendations

- Restructure TABC's protest process to align with best practices, improving consistency and accountability for applicants and TABC.
- Direct TABC to clearly inform applicants of their due process rights.

Issue 5

Several TABC Enforcement Practices Do Not Follow Common Standards, Limiting Regulatory Efficiency and Effectiveness.

TABC staff investigate and adjudicate violations of state law and agency rules, including through audits of licensee records, open inspections of regulated locations, and undercover operations. Several of TABC's enforcement practices lack standard provisions common for other regulatory agencies. Specifically, TABC cannot fully prioritize its enforcement actions on areas of greatest risk to the public because of a requirement to inspect a large percentage of regulated businesses each year. Additionally, TABC lacks tools needed to effectively penalize businesses and individuals violating the Alcoholic Beverage Code. Finally, the commission needs to take a more active role in overseeing the agency's enforcement efforts. The recommendations would ensure TABC remains focused on the most significant public safety concerns and is better equipped to regulate the alcoholic beverage industry.

Key Recommendations

- 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.
- Remove the requirement that TABC offer licensees a choice between a suspension or fine, and instead authorize TABC to determine the appropriate penalty for each violation.
- Authorize TABC to consider profits earned from violating the law when penalizing licensees.
- Authorize TABC to temporarily suspend licenses and permits if it finds a continuing threat to the public welfare.
- Require the commission to make final determinations on all enforcement and disciplinary actions.

Issue 6

The High Cost of Collecting Alcohol Import Taxes at the Border Outweighs the Negligible Public Safety Benefit.

At ports of entry stations along the Texas-Mexico border and in cruise ship terminals in Galveston, TABC tax compliance officers collect taxes from individuals importing alcohol and cigarettes, and disallow alcohol that exceeds statutory limits on the amount individuals can bring into Texas for personal use. The cost of operating the Ports of Entry Program exceeds the taxes and administrative fees collected

to the extent that the program had a net deficit of almost \$7 million over the last six years. Not only is the program losing money, but its fee structure and rules are not fair or transparent to taxpayers, and it offers a negligible public safety benefit. Eliminating the tax on alcohol imported for personal use and the ports of entry tax collection program would save the state money without significantly sacrificing any regulatory or public safety benefit.

Key Recommendation

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

Issue 7

TABC's Statute Does Not Reflect Standard Elements of Sunset Reviews.

Among the standard elements considered in a Sunset review are across-the-board recommendations that reflect criteria in the Sunset Act designed to ensure open, responsive, and effective government. TABC's statute does not contain updated requirements for commission member training, such as a training manual and discussion of the commission's rulemaking authority. Additionally, the Sunset Act directs the Sunset Commission to recommend the continuation or abolishment of each reporting requirement imposed on an agency under review. Sunset staff found the commission's single reporting requirement is no longer necessary. Finally, the recommendations would revise three statutes in the Alcoholic Beverage Code to use person-first respectful language.

Key Recommendations

- Update the standard across-the-board requirement related to commission member training.
- Discontinue the requirement for TABC to prepare a limited report on after-hours violations.
- Update the agency's statute to reflect the requirements of the person-first respectful language initiative.

Fiscal Implication Summary

Overall, the recommendations in this report would result in a savings to general revenue of about \$398,000 per year and a possible loss of \$420,000 per year to the Property Tax Relief Fund, as detailed below.

Issue 1 — Expanding the commission from three to five members would result in minimal additional costs of approximately \$4,000 per year in per diem and travel expenses for two new members.

Issue 2 — The recommendations to modernize and streamline the state's alcoholic beverage licensing structure are designed to improve the efficiency of TABC's licensing and regulatory operations and, with the exception of a reduction in excise taxes on malt beverages, should be cost-neutral to the state since TABC is required to generate revenue sufficient to cover the cost of regulation. Applying the beer excise tax rate to all malt beverages would result in a loss to general revenue of approximately \$350,000 per year. This estimate is based on applying the beer excise tax rate of about \$0.194 per gallon to approximately 79 million gallons of ale taxed in fiscal year 2017.

Issue 3 — The recommendation to transition to a federal Certificate of Label Approval (COLA) as the basis for the malt beverage registration process would reduce the number and amount of fees collected

from malt beverage applications. In fiscal year 2017, licensees paid a \$25 fee for 3,553 additional sizes of a malt beverage product beyond the first size being approved. Under a COLA-based approval process, licensees would only be required to pay a single \$25 fee, regardless of container size, resulting in an estimated loss to general revenue of \$88,825 annually.

Issue 6 — The recommendation to repeal the tax on alcoholic beverages imported for personal use and its administrative fee would result in an annual loss of approximately \$6.5 million to general revenue. Additionally, assuming the comptroller would choose not to expend resources to collect the cigarette tax at the border, the state would see a loss of \$194,000 to general revenue and a loss of \$420,000 to the Property Tax Relief Fund, as a portion of the cigarette tax collections are deposited to the latter. However, these losses would be offset by annual savings of \$7.6 million in operating costs associated with closing TABC’s 30 tax collection stations, including 119 positions and associated benefits, \$243,000 in lease expenses, and \$659,000 in indirect costs.

Texas Alcoholic Beverage Commission

Fiscal Year	Savings to the General Revenue Fund	Loss to the General Revenue Fund	Costs to the General Revenue Fund	Loss to the Property Tax Relief Fund	Change in FTEs
2020	\$7,578,238	\$7,176,331	\$4,000	\$420,000	-119
2021	\$7,578,238	\$7,176,331	\$4,000	\$420,000	-119
2022	\$7,578,238	\$7,176,331	\$4,000	\$420,000	-119
2023	\$7,578,238	\$7,176,331	\$4,000	\$420,000	-119
2024	\$7,578,238	\$7,176,331	\$4,000	\$420,000	-119

AGENCY AT A GLANCE

AGENCY AT A GLANCE

After the repeal of Prohibition, the Texas Legislature created the Liquor Control Board in 1935 as “an exercise of the police power of the state” to protect the welfare, health, peace, temperance, and safety of Texans.¹ Today, the Texas Alcoholic Beverage Commission (TABC) regulates the alcoholic beverage industry by

- licensing all phases of alcoholic beverage manufacture, distribution, and sale to consumers;
- enforcing the Texas Alcoholic Beverage Code;
- issuing certificates to trained retail alcoholic beverage sellers and servers and developing public education campaigns on public safety issues, such as underage drinking and drunk driving; and
- collecting excise and import taxes on alcoholic beverages.

Key Facts

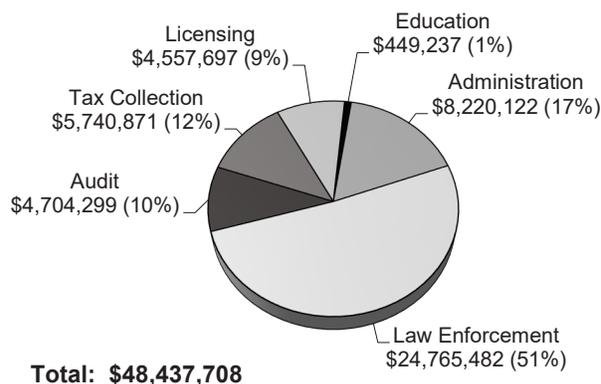
- **Commission.** Three part-time, governor-appointed commission members oversee the agency. The table shows the current commissioners, all of whom must be public members with no financial ties to the alcoholic beverage industry. The commission members serve six-year terms and typically meet six times a year.

Texas Alcoholic Beverage Commission Members

Name	Term Expires	City
Kevin J. Lilly, Chair	2021	Houston
Ida Clement Steen	2019	San Antonio
Vacant		

- **Funding.** As shown in the *Texas Alcoholic Beverage Commission Expenditures* pie chart, the agency spent \$48.4 million in appropriation year 2017.² The agency’s largest expenditure by far, 51 percent, was for law enforcement efforts to enforce the Alcoholic Beverage Code’s public safety provisions. 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.

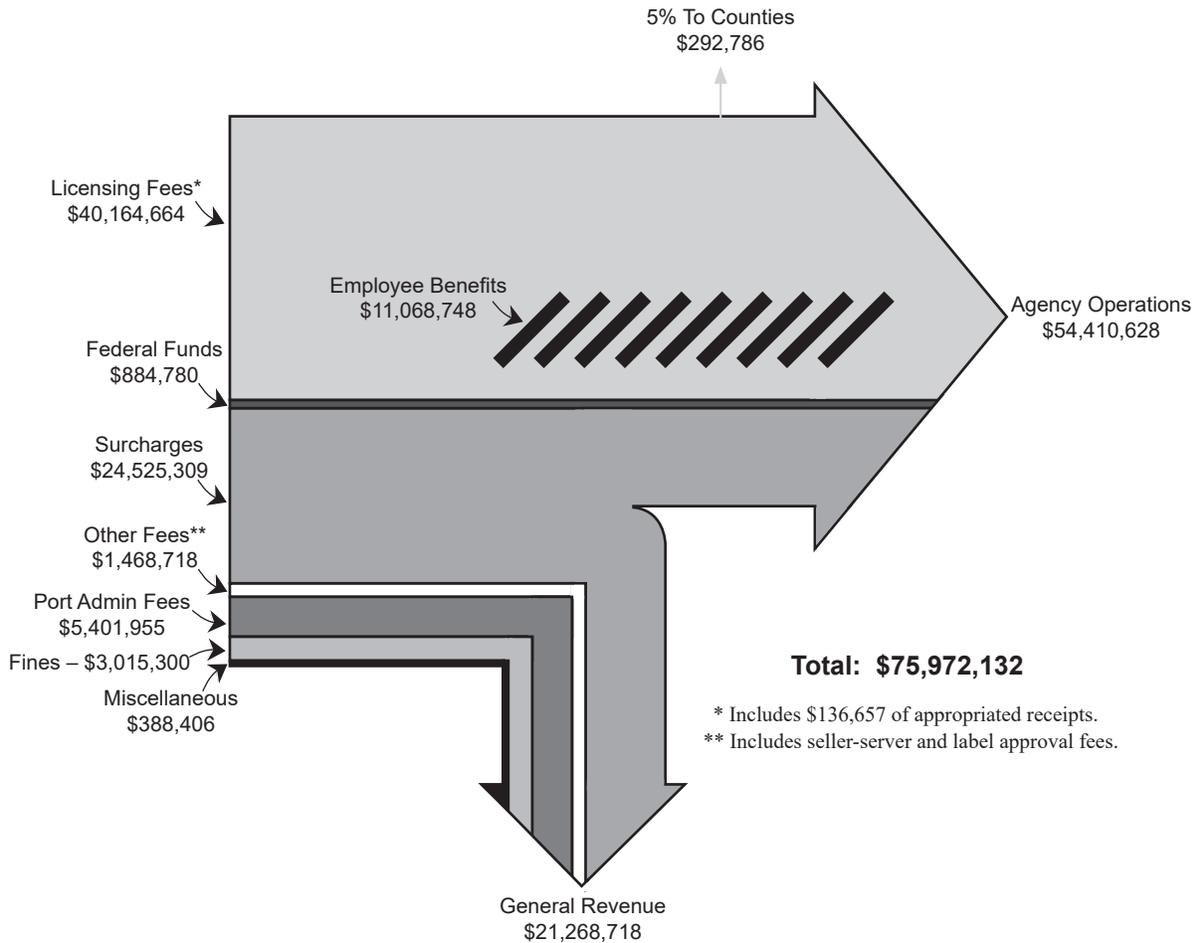
Texas Alcoholic Beverage Commission Expenditures – AY 2017



Historically, the agency has generated revenue through fees in excess of that needed to cover agency expenditures. As shown in the chart on the following page, *Flow of Texas Alcoholic Beverage Commission’s Revenue and Expenditures*, the agency transferred \$21.3 million in excess licensing revenue and other fees and fines to the General Revenue Fund.

TABC’s use of historically underutilized businesses in purchasing goods and services for fiscal years 2015–17 is described in Appendix A.

Flow of Texas Alcoholic Beverage Commission's Revenue and Expenditures – FY 2017



- **Staffing.** TABC employed 582 full-time equivalent positions in fiscal year 2017, including 242 commissioned peace officers. About 23 percent of TABC’s employees work at the agency’s Austin headquarters. The rest work in one of five regional offices, 43 field offices, or 30 international land or sea ports of entry shown in Appendix B. Appendix C compares the percentage of minorities in TABC’s workforce to the statewide civilian labor force for the past three fiscal years.

- **Three-tier system.** After the repeal of Prohibition, Texas adopted a three-tier regulatory system to ensure adequate oversight and financial independence of businesses in each stage of the alcoholic beverage supply chain, from production to retail sales. The textbox, *The Three Tiers*, describes the function of each tier. The three-tier system is intended to prohibit close ties between each tier (i.e. creating “tied houses”) to protect citizens from business practices that can lead to overconsumption and corruption.

The Three Tiers

Upper Tier – Manufacturer. Produce and sell alcoholic beverages to wholesalers and distributors.

Middle Tier – Wholesaler/Distributor. Purchase alcoholic beverages from manufacturers and sell to retailers. The industry term “distributor” generally applies to beer and “wholesaler” to ale, distilled spirits, and wine.

Lower Tier – Retailer. Sell alcohol to consumers.

- **Licensing.** TABC coordinates licensing with counties, cities, and precincts, which control the types of alcohol that may be sold in different locations through local option elections.³ As of May 2018, Texas had six completely dry counties; 55 completely wet counties concentrated along the Texas-Mexico border, in Central Texas, and the Panhandle; and 193 partially wet counties with some restrictions on alcoholic beverages in all or part of the county.⁴

TABC issues 75 different licenses and permits to regulate the alcoholic beverage industry. At the end of fiscal year 2017, nearly 60,000 businesses and individuals, including 615 foreign entities, held more than 130,000 active licenses and permits.

- **Enforcement.** TABC enforces both administrative and criminal laws in the Alcoholic Beverage Code through its law enforcement and audit programs. The *Focus of Enforcement and Audit Functions* textbox describes the differences between the two programs. The agency receives complaints against licensees and initiates its own investigations, and takes action against those in violation of the Alcoholic Beverage Code or commission rule. In fiscal year 2017, TABC received 6,655 complaints from the public. The *TABC Disciplinary Efforts* table provides a high level summary of the agency's overall enforcement efforts in fiscal year 2017.

Law Enforcement. TABC's law enforcement agents are certified peace officers who inspect and investigate retail licensees for public safety violations of the code. In fiscal year 2017, TABC agents conducted 84,503 inspections, undercover operations, minor sales stings, and joint operations with other law enforcement agencies.

The agency uses special units to investigate more complex crimes involving TABC licensees and permittees, such as narcotics trafficking, human trafficking, and money laundering. TABC also has a specially trained response team to assist with state and local emergencies and large public events, such as Hurricane Harvey in Houston and South by Southwest in Austin.

Audit. TABC auditors inspect and audit the financial and business records of licensees and permittees to ensure compliance with the Alcoholic Beverage

Focus of Enforcement and Audit Functions

Law enforcement agents investigate public safety violations at licensed locations:

- Sales or service of alcohol to minors and intoxicated customers
- Sales or service of alcohol after legal hours
- Breaches of the peace in a licensed location resulting in death or serious injury
- Human trafficking, prostitution, and sales of illegal alcohol or drugs

Auditors investigate regulatory violations:

- State excise taxes
- Industry marketing regulations
- Cash and credit payments for alcoholic beverage deliveries
- Signage and tax stamp requirements
- Money laundering, cross-tier relationships, and sales of illegal alcohol

TABC Disciplinary Efforts – FY 2017

Agency Actions	
Administrative cases opened	3,040
Administrative warnings issued	2,374
Summary suspensions of license	670
Criminal cases filed with local jurisdiction	1,589
Criminal warnings issued	267
Penalties Resulting From Administrative Cases	
Suspension or civil penalty	1,754
License cancellation	64
Bond forfeiture or cancellation	13
Warning	2
Penalty restrained (safe harbor)	752

Code's business and financial provisions. In fiscal year 2017, TABC auditors conducted 24,252 inspections and 1,600 audits and filed 624 administrative cases against licensees and permittees. A special audit unit that investigates prohibited cross-tier relationships opened 60 cases and warned, fined, or suspended 21 licensees and permittees in fiscal year 2017.

- **Marketing practices.** TABC regulates marketing and advertising practices to prevent improper cross-tier relationships and excessive promotion of alcohol consumption. These regulations apply to special promotions, sweepstakes, coupons, merchandise giveaways, advertising, signage, special events, and product labels. During the label approval process, TABC also verifies a product's source and alcohol content. In fiscal year 2017, TABC processed 21,659 label applications and 439 industry marketing practices proposals.
- **Excise and import tax collections.** TABC collects the state's excise tax on the "first sale" of alcohol, with six tax rates depending on the type of beverage and its alcohol content.⁵ TABC receives monthly taxpayer reports from distributors and wholesalers, and certain manufacturers who can sell their products directly to retailers or consumers without going through a distributor. TABC received 57,809 excise tax reports in fiscal year 2017.

TABC collects an import tax and administrative fee on alcoholic beverages imported for personal use at 28 ports of entry along the Texas-Mexico border and two Galveston cruise ship terminals. TABC also collects a state tax on imported cigarettes on behalf of the comptroller of public accounts at the same locations. In fiscal year 2017, TABC collected \$1.1 million in alcoholic beverage import taxes, \$614,466 in cigarette import taxes, and \$5.4 million in administrative fees.

- **Education and prevention.** Through federal and state grants, TABC provides public education materials, public safety equipment, and other resources aimed at reducing underage drinking and drunk driving. TABC distributes these materials to high schools, universities, civic groups, and other organizations. In fiscal year 2017, TABC provided training and education to 56,410 individuals and groups.

TABC certifies workers who sell or serve alcoholic beverages and pass a training program offered by one of 62 TABC-approved schools in Texas.⁶ The training is not required, but the state's "safe harbor" law offers an incentive for licensed or permitted businesses to hire certified sellers and servers. Under the law, TABC cannot hold an employer responsible if an employee sells alcohol to a minor or an intoxicated person, provided all of the employer's seller-server staff at that location are certified and meet other requirements. In fiscal year 2017, TABC issued 402,982 seller-server certificates.

- **Office of Professional Responsibility.** In 2007, the Legislature formalized TABC's internal affairs office in statute to ensure consistent, fair, and impartial investigations of alleged employee misconduct.⁷ The office investigates complaints and submits findings and conclusions to the executive director for action. Depending on the nature of the allegation, the office may call on the Texas Rangers, Department of Public Safety, local police, or other law enforcement agencies to assist in an investigation. In early 2018, TABC established a new method for tracking complaints the office receives and reported 79 complaints leading to investigations during fiscal year 2018.

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¹ Chapter 467 (H.B. 77), Acts of the 44th Texas Legislature, 2nd Called Session, 1935.

² This total excludes employee benefits.

³ “Local Option Liquor Elections,” Texas Secretary of State, accessed August 16, 2018, <https://www.sos.state.tx.us/elections/laws/liquorelections.shtml>.

⁴ “Local Option Elections,” Texas Alcoholic Beverage Commission, last updated December 20, 2017, https://www.tabc.state.tx.us/local_option_elections/index.asp.

⁵ “Excise Tax,” Texas Alcoholic Beverage Commission, last updated September 20, 2018, https://www.tabc.state.tx.us/excise_tax/index.asp.

⁶ “Seller Training – Course Providers,” Texas Alcoholic Beverage Commission, last updated September 17, 2018, https://www.tabc.state.tx.us/training_and_certification/approved_seller_training_schools.asp.

⁷ Chapter 68 (S.B. 904), Acts of the 80th Texas Legislature, Regular Session, 2007.

ISSUES

ISSUE 1

Texas Has a Continuing Need for TABC, but a Weak Commission Limits Its Ability to Effectively Oversee and Regulate the Alcoholic Beverage Industry.

Background

The Legislature created the Texas Liquor Control Board in 1935, two years after the repeal of Prohibition. In 1970, the Legislature changed the agency's name to the Texas Alcoholic Beverage Commission (TABC), but its functions have remained largely the same over the years.¹ The commission consists of three public members appointed by the governor who serve staggered six-year terms. The commission typically meets six times per year. As described in the accompanying textbox, statute prohibits commission members and agency employees from having any financial connection to the alcoholic beverage industry.²

TABC seeks to protect the welfare, health, peace, temperance, and safety of Texans by regulating all phases of the alcoholic beverage industry.³ At the end of fiscal year 2017, nearly 60,000 entities and individuals held more than 130,000 TABC-issued licenses and permits.

Prohibited Relationship With Alcoholic Beverage Business

No person can be appointed to or employed by the commission who

- has any financial connection with a person 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.

Findings

Texas has a continuing need to regulate the alcoholic beverage industry.

Texas has a continuing, legitimate need to protect the public from the illegal and irresponsible consumption of alcohol. While the steady increase in the number of alcoholic beverage manufacturers over the last decade has had a positive impact on the Texas economy and state tax collections, increased alcohol sales and consumption also pose public health risks. Problems such as underage drinking, overconsumption, and drinking and driving continue to be important public safety issues. Despite the recent attention on the opioid epidemic in the U.S., alcohol killed more than double the number of Americans than did opioids in 2016.⁴ According to the National Center for Health Statistics, the rate of alcohol-induced deaths across the nation, excluding traffic fatalities and other acute cases, increased by approximately 47 percent between 1999 and 2015.⁵ In 2016, the number of traffic fatalities in Texas totaled 3,776, accounting for a full 10 percent of all fatal traffic accidents in the U.S. Alcohol use contributed to 38 percent of those fatalities, which is higher than the national average of 28 percent and higher than other populous states, including California, Florida, and New York.⁶

Alcohol killed more than double the number of Americans than did opioids in 2016.

Although some improvements to TABC's enforcement efforts are necessary, as discussed in Issue 5 of this report, TABC appropriately focuses on key public safety issues involving regulated businesses, such as selling alcohol to minors and intoxicated individuals, engaging in drug trafficking, and having frequent acts of violence on the premises. In fiscal year 2017, TABC found more than 3,000 public safety violations through complaint investigations, open inspections, undercover operations, and other activities.

TABC is the most appropriate agency to regulate the alcoholic beverage industry.

TABC has specialized expertise in the state's highly complex alcoholic beverage laws.

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. TABC also has specialized expertise in the state's highly complex alcoholic beverage laws. While other agencies could perform these functions, Sunset staff did not find sufficient benefit to warrant transfer of any or all of TABC's functions, as discussed below.

- **Texas Department of Licensing and Regulation (TDLR).** TDLR performs a variety of standard licensing functions through its regulation of nearly 40 professions. While TDLR could perform TABC's licensing functions, the Texas Alcoholic Beverage Code includes many more complex requirements than most standard occupational regulations. TABC has the existing expertise necessary to ensure applicants meet these requirements before receiving a license or permit.
- **Department of Public Safety (DPS) and local law enforcement agencies.** TABC performs a variety of law enforcement functions that might seem like a natural fit for consolidation within the Department of Public Safety (DPS) or that could be performed by local police and sheriff's departments. However, DPS has a number of current responsibilities and struggles with some of its own regulatory functions, as highlighted in that agency's recent Sunset review. Further, local law enforcement agencies do not have the resources or statewide reach to effectively detect and deter violations of the Alcoholic Beverage Code.
- **Comptroller of Public Accounts.** While TABC collects alcoholic beverage excise taxes, the comptroller collects the bulk of all state taxes, including the sales tax and mixed beverage gross receipts tax from bars and restaurants that serve mixed drinks. Although the comptroller could perform TABC's current tax collection functions, costs related to a transfer would likely outweigh any benefits. Further, when TABC audits its taxpayers the agency has the opportunity to find other violations of the Alcoholic Beverage Code that may not have become apparent otherwise, such as evidence of fraudulent business practices or structures.

Constrained by its small size and limited role, the commission fails to adequately oversee and direct agency policy.

- **Small commission size.** The three-member commission structure presents certain challenges. With so few commission members responsible for regulating such a large industry, ensuring the members are fully informed and knowledgeable about the Alcoholic Beverage Code is critical. However, the commission's small size limits members' ability to engage on a more meaningful level given the complexity and nuances of the regulations. Other larger governing boards use subcommittees to allow board members to develop expertise in certain areas of the agency they govern, which helps them make more informed decisions in their important governance and oversight role.

Also, since two members constitute a quorum, an official meeting of the commission occurs any time two members discuss agency business. As a result, the commission risks violating the Open Meetings Act if two members discuss the agency's work without advance posting. In fact, one member cannot even call another member to ask a question about basic business. This is particularly problematic for the current commission since one of the positions has been vacant for more than a year.

- **Overly restrictive conflict-of-interest provisions.** The commission's strict conflict-of-interest provisions are outdated and limit the pool of potential appointees. Current law prohibits any connection to the alcohol industry but does not define this connection, leading to unreasonable conclusions, such as prohibiting a commission member from serving due to owning even one share of an oil company that also sells alcohol in gas station convenience stores.⁷ While the statutory conflict-of-interest provisions serve the Legislature's original intent in 1935 to have an independent agency whose actions would not be influenced by a financial interest in the alcohol industry, the requirements are no longer practical in today's environment of highly complex business structures. Individuals who might be well-qualified to serve on the commission otherwise are prohibited due to even the smallest, most remote relationship to the industry.

The strict requirements are unique among other conflict-of-interest provisions in state law. For example, general state law prohibits agencies from purchasing goods or services above a certain amount from a private vendor if a member of the governing body or other official has a financial interest in the vendor.⁸ However, statute specifies that "financial interest" means the state employee or official owns or controls an ownership interest of at least 1 percent in the vendor and clarifies it does not include a retirement plan or an ownership interest of less than 1 percent.⁹ Some other conflict-of-interest restrictions in the law are even less stringent. For example, members of the Public Utility Commission cannot have an interest as an officer or employee of a public utility or have a financial interest of more than 10 percent in a business the agency regulates.

The commission's small size limits members' ability to engage on a more meaningful level.

Individuals well-qualified to serve on the commission are prohibited due to the most remote relationship to the industry.

- **Failure to adopt needed rules.** One of the key responsibilities of a governing body is adopting rules. Agencies typically clarify and implement the Legislature’s directives through the rulemaking process. The commission has broad rulemaking authority to explain how it will enforce the highly complex and often ambiguous Alcoholic Beverage Code, yet it has not adopted rules in many key areas that would provide transparent, consistent guidance to industry members and establish clear boundaries for allowable activities.¹⁰ The accompanying textbox provides specific examples — some of which are discussed further in other issues in this report — where the commission has failed to adopt rules that would guide its functions and flesh out how it will implement certain provisions.

Current Rulemaking Gaps

- No definition of “an interest” for purposes of enforcing the tied-house provisions
- No clarification of what it means to be “engaged in the alcoholic beverage industry” for purposes of enforcing the tied-house provisions
- No definition of what qualifies as an “excessive discount” from a manufacturer or distributor to a retailer
- No clarification whether private labels for wine and distilled spirits violate the tied-house provisions
- No clarification regarding the requirements and process for protesting licenses and permits

The agency risks engaging in ad-hoc rulemaking.

By not using the formal rulemaking process, the agency risks engaging in ad-hoc rulemaking through administrative decisions. For example, in 2016 Texas’ 4th Court of Appeals ruled that TABC staff’s interpretation prohibiting certain retailers from selling a specific type of alcoholic beverage container was in fact a rule.¹¹ Further, without rules staff interpretations are subject to change when leadership changes, such as the current administration’s recent relaxing of a previous policy prohibiting common tasting rooms for manufacturers of different types of alcoholic beverages. While such changes may be well-intended, the rulemaking process should be used to get formal input, consider the statewide impact, and communicate clear direction to all affected.

While the competing interests of various stakeholders can put TABC in a difficult position, that does not negate the commission’s responsibility as the governing body to ensure adequate rules exist to effectively regulate. In the past, the agency has occasionally tried to pass rules on controversial topics only to be stymied by industry protests. For example, following the agency’s 2007 Sunset review, TABC attempted to develop a penalty matrix for marketing practices violations, but abandoned the effort after receiving significant pushback from industry interests.

- **Failure to engage in key agency decisions.** Being actively involved in the development and approval of an agency’s overarching mission, goals, and strategies for the future is another key duty of a governing body. Historically,

the commission approved the agency's legislative appropriations request, operating budget, and strategic plan. Recently, however, the commission implemented a practice of hearing presentations from staff on these documents but not taking a formal vote to approve or adopt them.

Additionally, as discussed further in Issues 4 and 5 of this report, the commission has no oversight of the agency's final decisions to issue licenses or take enforcement action against a licensee, even in high-profile cases. This lack of attention to key responsibilities further demonstrates the commission's lack of engagement in policymaking and oversight roles.

Lack of attention to key responsibilities demonstrates the commission's lack of engagement.

TABC lacks a transparent approach for engaging stakeholders.

While all agencies should be proactive and transparent in obtaining stakeholder input, TABC has an especially high bar to meet, given the statewide interest from industry members, local governments, and members of the public who are directly affected by the agency's decisions. However, TABC lacks a formal and transparent approach to gathering and using feedback, as described below.

- **Reliance on informal meetings.** Unlike many agencies, TABC has no authority to establish general advisory committees. Advisory committees lend expertise and advice to boards and commissions, which retain final decision-making authority. In lieu of advisory committees, TABC uses several methods to engage stakeholders, including roundtables, summits, workgroups, and individual meetings. However, many of these meetings take place behind closed doors and with select invitees rather than in open, public forums. For example, in the spring of 2018, TABC held four staff-level "legislative session discussions" with industry members, none of which were publicized and included only attendees TABC invited or who happened to hear about the events. These types of informal meetings and discussions are not inherently inappropriate, but appear to be occurring in lieu of open, public dialogue. For example, in the last three years, across 21 regularly scheduled commission meetings, TABC received only six public comments. As mentioned above, TABC has many regulatory topics that could benefit from formal rules. Using advisory committees to solicit open input would ensure transparency and inclusiveness, especially for contentious and controversial topics.
- **Limited commission meeting information.** As a means of promoting transparency and stakeholder engagement, agencies should make information about board deliberations and decisions readily available. Providing board materials, such as staff presentations, either before or at meetings is critical for allowing meaningful participation by the public, yet TABC does not make these materials available. Further, in early 2018 the commission began maintaining audio recordings of its regularly scheduled meetings instead of keeping minutes — something it has done for public hearings on rule proposals since 2012. While this practice is perfectly acceptable, the agency does not post the audio recordings online or make transcripts available, which would provide key information the public needs to understand

Informal stakeholder meetings appear to be occurring in lieu of open, public dialogue.

how and why the commission makes its decisions. Although not in place at the time of this report, TABC indicates it procured new software that will make all these materials publicly available in time for its November 2018 meeting.

Recommendations

Change in Statute

1.1 Continue TABC for 12 years.

This recommendation would continue TABC until 2031 as an independent agency, responsible for regulating the alcoholic beverage industry.

1.2 Expand the Alcoholic Beverage Commission from three to five members.

This recommendation would add two public members to the commission, both appointed by the governor. The new members would serve four-year terms initially and be appointed by November 31, 2019, to stagger with the terms of the existing members. With more members, the commission should consider creating subcommittees to help oversee updates to rules, implementation of the new licensing structure outlined in Issue 2 of this report, and other areas needing greater oversight.

1.3 Modernize TABC's conflict-of-interest provisions by defining financial interest to mean 1 percent or more in an alcoholic beverage business.

Under this recommendation, statute would prohibit a TABC employee or commission member from being employed by an alcoholic beverage business, having a financial interest in an alcoholic beverage business, or having a financial connection to someone with a financial interest in an alcoholic beverage business. Following existing general law provisions applying to state agency purchasing, the recommendation would specify that a financial interest exists only if someone owns or controls, directly or indirectly, an ownership interest of at least 1 percent in an alcoholic beverage business, including the right to share in profits, proceeds, or capital gains. This recommendation would further provide that a financial interest does not include a retirement plan, blind trust, insurance coverage, or an ownership interest of less than 1 percent in a corporation. Other conflict-of-interest provisions, such as allowing the child of a TABC employee to be employed by a regulated business, would remain in place.

This recommendation would allow the state to continue protecting against commission members being influenced by a financial interest in the alcohol industry, while modernizing the restrictions to ensure the governor has an adequate pool of qualified applicants for potential appointment in today's complex business environment. Commission members and the executive director would continue to file personal financial statements with the Texas Ethics Commission, which would publicly disclose stocks, mutual funds, and other financial interests that may conflict with fulfilling their duties in the public interest.

1.4 Authorize the commission to establish advisory committees by rule.

Under this recommendation, TABC would be authorized to establish advisory committees subject to the requirements of Chapter 2110 of the Texas Government Code. This recommendation would not require the creation of any specific advisory committee but would authorize the agency to establish committees by rule to meet the changing needs of the agency.

Management Action

1.5 Direct the commission to establish advisory committees to provide expertise for rulemaking and other issues, and to adopt rules regarding standard committee structure and operating criteria.

By January 31, 2020, the commission should establish standing advisory committees to provide external expertise on particular areas of regulation TABC identifies, such as marketing practices. The commission should adopt rules regarding the purpose, structure, and use of its advisory committees, including

- the purpose, role, and goal of the committees;
- size and quorum requirements of the committees;
- composition and representation provisions of the committees;
- qualifications of the members, such as experience or geographic location;
- appointment procedures for the committees;
- terms of service;
- training requirements, if needed;
- the method the agency will use to receive public input on issues considered by the advisory committees; and
- compliance with the requirements of the Open Meetings Act.

Having advisory committees would create more structure around the agency's stakeholder input processes and a more inclusive and transparent process for vetting issues and developing rules.

1.6 Direct TABC to evaluate and address gaps in its rules.

In addition to adopting rules to implement specific recommendations in this report, TABC should undertake a comprehensive review of its rules and identify regulatory requirements and processes in need of additional clarification or explanation. The newly expanded commission could form a subcommittee to review existing rules and identify areas where clarification or other changes are needed. The commission could also consider forming advisory committees, in accordance with the recommendation above, to provide input on especially controversial rules.

Beginning in July 2020, TABC staff should report to the commission at least annually on the agency's progress until all rules have been reviewed and any necessary changes made. After that, TABC should use the existing requirement that agencies review rules at least every four years as an opportunity to scrutinize any rulemaking gaps. Given the complexity of the Alcoholic Beverage Code, TABC must be diligent in its effort to review rules on an ongoing basis. A more robust set of rules would provide clarity to the industry about allowable activities, promote more consistent enforcement, and protect the agency from future legal challenges related to informal agency interpretations.

1.7 Direct TABC to update its rule describing the separation of duties between the commission and executive director.

TABC would need to update its existing rule by December 31, 2020, to specify the commission's role in protests and enforcement decisions, as recommended in Issues 4 and 5 of this report, and in approving key agency documents, including the agency's annual operating budget, legislative appropriations request, and strategic plan. This recommendation would ensure the commission takes a more active oversight role and fulfills its responsibility for establishing agency policies and providing direction.

1.8 Direct TABC to make meeting materials and recordings available online.

This recommendation would direct TABC to make commission packets available to the public on its website at least one day before commission meetings. Further, TABC should make recordings, transcripts, or other documentation of all posted meetings available online, including regularly scheduled meetings, public hearings on rules, and advisory committee meetings.

Fiscal Implication

If the Legislature continues TABC, the agency would continue to need its annual appropriation of approximately \$50 million, which is entirely covered by licensing and other fees the agency collects. Expanding the commission from three to five members would result in minimal additional costs of approximately \$4,000 per year in per diem and travel expenses for two new members.

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¹ "Historical Perspective," Texas Alcoholic Beverage Commission, accessed August 23, 2018, https://www.tabc.state.tx.us/about_us/history.asp.

² All citations to Texas statutes are as they appear on <http://www.statutes.legis.texas.gov/>. Section 5.05(a), Texas Alcoholic Beverage Code.

³ Section 1.03, Texas Alcoholic Beverage Code.

⁴ J.B. Wogan, "The Deadliest Drug," *Governing*, July 2018, 29.

⁵ *Ibid.*

⁶ "Traffic Safety Facts: Texas 2012–2016," National Highway Traffic Safety Administration, accessed August 15, 2018, <https://cdan.nhtsa.gov/STSI.htm>.

⁷ Section 5.05, Texas Alcoholic Beverage Code.

⁸ Section 2261.252(b), Texas Government Code.

⁹ Sections 2261.252(c)–(d), Texas Government Code.

¹⁰ Section 5.31(a), Texas Alcoholic Beverage Code.

¹¹ *EATX Coffee, LLC v. Tex. Alcoholic Beverage Comm'n*, No. 04-16-00213-CV (Tex. App.–San Antonio Dec. 7, 2016) (mem. op.).

ISSUE 2

TABC Cannot Efficiently Regulate the Alcoholic Beverage Industry Without Modernizing the State’s Byzantine Licensing System.

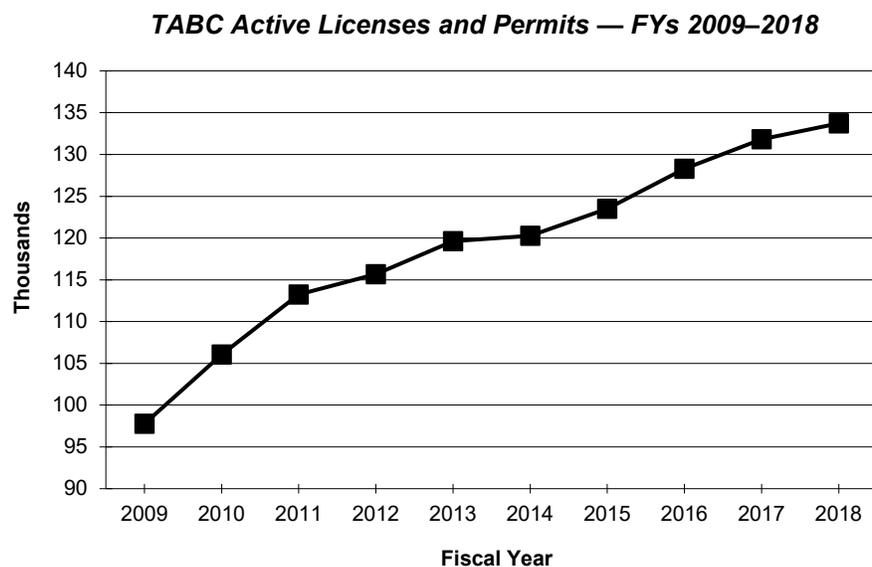
Background

Since the end of Prohibition, the Texas Alcoholic Beverage Commission (TABC) has regulated all aspects of the alcoholic beverage industry through a system of licenses and permits. In accordance with state law, TABC issues *licenses* to manufacture, distribute, and sell beer, and *permits* to do the same for distilled spirits, wine, and ale. Today, nearly 60,000 businesses and individuals hold more than 130,000 licenses and permits.

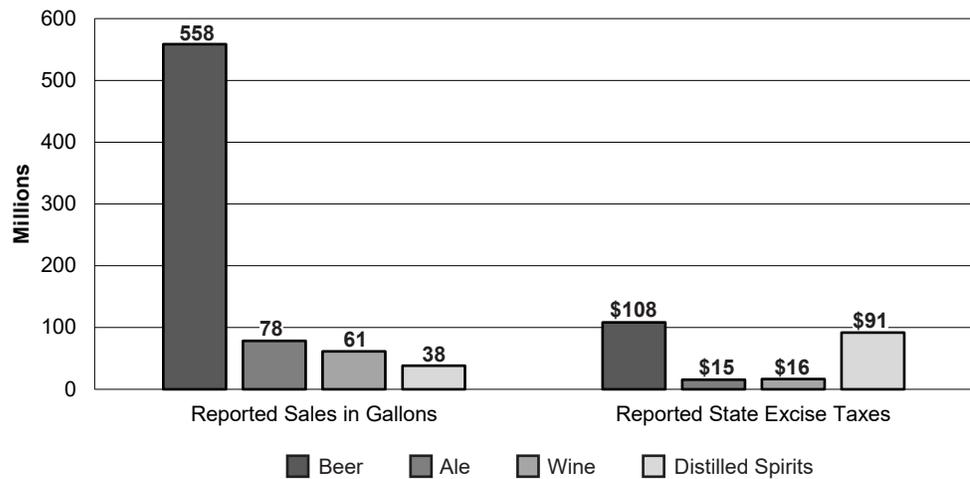
Through local option elections, voters in counties, cities, and precincts decide what kinds of alcohol can be sold in which locations. Over time, Texas has become increasingly “wet,” where some type of alcohol sales are legal, and only six counties remain completely “dry” where no alcohol may be sold.¹

The alcoholic beverage industry has flourished from the increasingly wet areas across the state, resulting in a 37 percent increase in TABC licenses and permits over the past 10 years as shown in the graph, *TABC Active Licenses and Permits*. Alcoholic beverages are a significant source of tax revenue in Texas, totaling \$1.2 billion in fiscal year 2017.² TABC reported \$232 million in state excise taxes alone on more than 736 million gallons of alcohol sold in fiscal year 2017.³ The *Texas Alcoholic Beverage Sales and Excise Taxes* chart on the following page shows the beer industry captures most of the market’s sales and pays the most excise tax.

Since 1977, the Sunset Commission has specialized in evaluating licensing and regulatory agencies with a focus on efficient, effective, and fair regulations that are necessary to protect the public. In evaluating TABC’s licensing system, Sunset staff identified aspects of the system that cause problems for agency staff and have the most significant overall impact on agency and industry operations. Sunset staff generally avoided making value judgements about the various nuanced authority each license or permit grants. Sunset staff also received significant feedback about TABC’s licensing structure from nearly 2,000 regulated businesses responding to an online survey.



Texas Alcoholic Beverage Sales and Excise Taxes – FY 2017³



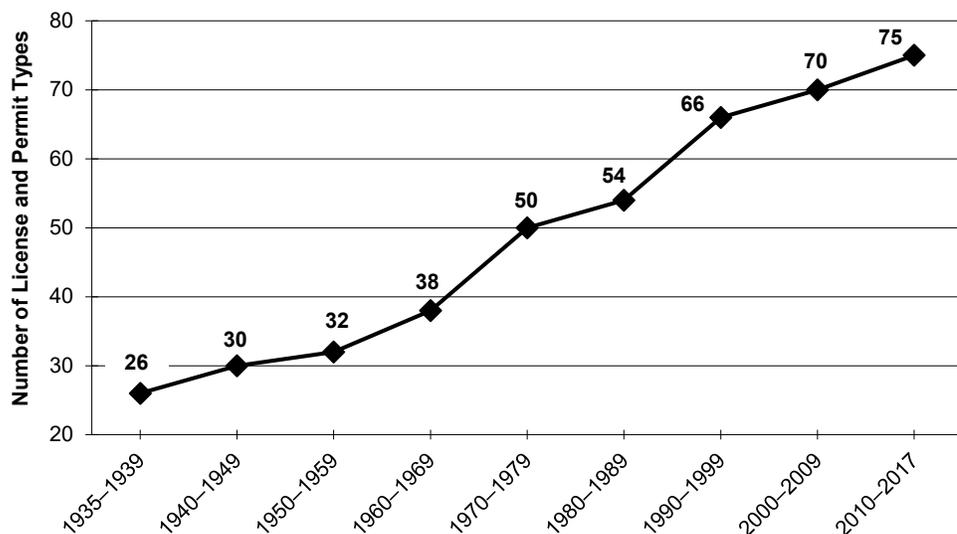
Findings

Having 75 different types of alcoholic beverage licenses and permits is complicated, duplicative, and unnecessary.

The Legislature has taken a piecemeal approach in responding to new business models.

Overall, the Legislature has taken a piecemeal approach in responding to new business models in the evolving alcoholic beverage industry, adding new licenses and permits over time instead of adjusting the authority of existing licenses and permits. As the *Expansion of TABC’s License and Permit Types* chart depicts, the number of different types of licenses and permits has more than tripled since the Legislature passed the original Liquor Control Act in 1935, resulting in today’s overly complex regulatory environment.

Expansion of TABC’s License and Permit Types 1935–2017



- **Excessive layers of licensing.** TABC issues 26 licenses and permits that are subordinate to 19 primary licenses or permits, as defined in the *Licensing Hierarchy* textbox. Businesses with a primary license or permit must get a subordinate license or permit to conduct specific activities. However, 11 of these subordinates are for routine business activities inherent to the primary license or permit's purpose, creating unnecessary layers of licensing with no discernible public safety benefit. For example, businesses must get subordinate permits to transport and store products they manufacture or sell, and hotels must get a subordinate permit to provide guestroom minibars. Regulated businesses held 12,508 of these subordinates in fiscal year 2017.

Licensing Hierarchy

Primary licenses and permits authorize businesses to manufacture, distribute, or sell alcoholic beverages.

Subordinates authorize the primary license or permit holder to conduct specific activities, such as storing and transporting alcohol.

- **Unnecessary regulation of agents.** Agents are employees of manufacturers and distributors and perform routine tasks such as promoting products, taking customer orders, making deliveries, stocking shelves, and setting up marketing displays.⁴ State law holds employers responsible if agents violate the Texas Alcoholic Beverage Code and also requires agents to be individually licensed or permitted. Agents have no required training or qualifications for licensure and TABC does not conduct background checks on agent applicants. They pose little risk to public safety, with TABC taking enforcement action against agents only six times for administrative violations in the last five fiscal years. TABC had 32,736 active agent licenses and permits in fiscal year 2017.
- **Confusing temporary event regulation.** State law has eight licenses and permits authorizing businesses and federally tax-exempt entities to provide alcoholic beverages at temporary events, such as county fairs, festivals, weddings, and fundraisers. In addition to getting a permit, wineries, restaurants, and bars also must apply for a certificate for every wine festival or catering event where they serve alcoholic beverages. This assortment of licenses, permits, and certificates creates a confusing hodgepodge of inconsistent licensing processes and regulations. TABC had 7,651 active temporary event permits and 13,538 wine festival and catering certificates in fiscal year 2017.
- **Duplicative public transportation permits.** State law has four similar permits authorizing passenger buses, airplanes, trains, and excursion boats to purchase, store, and serve alcoholic beverages onboard. The Legislature added each permit incrementally over time, ultimately creating multiple permits to regulate one general type of activity. TABC had 41 active transportation permits in fiscal year 2017.
- **Redundant late hours licenses and permits.** Cities and counties may authorize certain retailers, such as bars and restaurants, to serve alcoholic beverages later than state law typically allows. In addition to local approval, these retailers must get a late hours license or permit from TABC. However, instead of having a single permit to authorize the same late hours at various

Agents pose little risk to public safety.

TABC has a confusing hodgepodge of licenses, permits, and regulations.

businesses, state law creates three separate but nearly identical late hour permits for different types of businesses. TABC had 9,801 late hours licenses and permits in fiscal year 2017.

State law contains 10 outdated or inactive licenses and permits.

- **Obsolete licenses and permits.** As described in the *Obsolete Licenses and Permits* textbox, state law contains 10 outdated or inactive licenses and permits for activities that do not require regulation or that could be regulated through other more commonly used licenses or permits. In fiscal year 2017 TABC had 149 active obsolete licenses and permits; 144 were for industrial and manufacturing businesses not in the alcoholic beverage industry.

Obsolete Licenses and Permits

- Two permits are for businesses that use alcohol in industrial or manufacturing processes unrelated to alcoholic beverages, such as gas and medical supply companies; they are exempt from state excise taxes.
- The obscure wine bottler permit and the local wholesaler permit have three permittees total who could perform the same activities with other more commonly used permits.
- An outdoor billboard permit was only used twice in the past year; billboards could be regulated under other existing TABC laws and rules.
- Five permits and licenses have zero activity.

Having fees divided between statute and rule makes designing a system of surcharges difficult.

- **Unwieldy licensing fee structure.** TABC assesses licensing fees set by state law and surcharges set by rule.⁵ Most statutory fees have not changed in decades, and in 1993 the Legislature authorized TABC to assess surcharges to cover increasing regulatory costs. In fiscal year 2017, TABC collected \$64.7 million in licensing fees and surcharges, exceeding the agency's total operating cost by \$10.3 million. In 1995, TABC began using a formula to estimate regulatory costs for each license and permit when setting the surcharges. However, while TABC has periodically updated surcharges, the agency has not comprehensively or systematically reviewed the surcharges in nearly a decade. As shown in the chart on the following page, *Examples of Variances in TABC Fees and Surcharges*, some licensing fees and surcharges seem illogical compared to similar ones and agency staff could not readily explain or justify how the amounts relate to the agency's current regulatory costs. TABC is responsible for ensuring the overall costs charged to different parts of the industry remain fair and appropriate, but having 75 licenses and permits with the fees divided between statute and rule makes designing a valid and fair system of surcharges difficult, if not impossible.

Examples of Variances in TABC Fees and Surcharges

	License or Permit Type	Statutory Fee	Surcharge	Total
Manufacturers (Upper Tier)	B: Brewer's Permit (ale)	\$3,000	\$576	\$3,576
	D: Distiller and Rectifier's Permit (distilled spirits)	\$3,000	\$350	\$3,350
	BA: Manufacturer's License, First Location (beer)	\$1,500	\$651	\$2,151
	G: Winery Permit (wine)	\$150	\$701	\$851
Distributors (Middle Tier)	BB: General Distributor's License (beer)	\$600	\$701	\$1,301
	W: Wholesaler's Permit (ale, distilled spirits, wine)	\$3,750	\$701	\$4,451
Retailers (Lower Tier)	P: Package Store Permit (ale, distilled spirits, wine)	\$1,000	\$501	\$1,501
	Q: Wine-Only Package Store Permit (ale, wine)	\$150	\$553	\$703

Texas' archaic distinction between beer and ale is irrational and no longer necessary in today's malt beverage market.

The state's outdated, bifurcated approach to regulating malt beverages based solely on alcohol content adds significant, unnecessary regulatory complications. Since the 1930s, Texas has defined *beer* as a malt beverage with 5 percent or less alcohol by volume and *ale* as a malt beverage with more than 5 percent alcohol content by volume.⁶

- **Outdated terminology.** In the alcoholic beverage industry, ale is just one of many styles of beer made in a similar way with similar ingredients, no different than lagers, stouts, porters, and other styles. Beers of any style may have a range of alcohol content levels. For example, the national Brewers Association's 2018 Beer Style Guidelines lists 87 types of ale, 15 percent of which have less than 5 percent alcohol by volume.⁷

Adding to the confusion is the lack of a statutory definition for malt beverage, leaving TABC to regulate flavored malt beverages and non-malt beverages as beer or ale, despite the fact that consumers and some industry members would not consider them either. These "malternatives" include products such as Smirnoff Ice, Mike's Hard Lemonade, and White Claw Hard Seltzer.

- **Uncommon approach.** In today's marketplace, the federal government and most other states have long left the distinction between beer and ale behind. The federal Internal Revenue Code and Alcohol and Tobacco Tax and Trade Bureau, 33 other states, and the District of Columbia regulate beer and ale the same, regardless of their alcohol content. Eight states use the term "malt beverage" in their state laws to regulate ale, beer, and other types of brewed alcoholic beverages.⁸
- **Declining relevance.** As Texas voters have authorized more types of alcohol sales in most of the state, ale has become widely available, eliminating the

The federal government and 33 other states regulate beer and ale the same.

need for separate licensing and regulatory requirements. Most retailers can sell both beer and ale under one permit in 244 wet or partially wet counties. Only 68 local jurisdictions in 34 counties limit alcohol sales to beer for on-premise or off-premise consumption, or both. The textbox, *Survey Comments on Beer and Ale Regulation*, provides an illustrative sample of industry members' opinions about Texas' approach.

Survey Comments on Beer and Ale Regulation

"The terms are confusing to consumers — a beer can be an ale, an ale can be a lager, and a lager can be a beer."

"Clear labeling of alcohol by volume is more effective than the current archaic name designations."

"This law hurts medium to small sized producers that cannot afford multiple types of packaging."

"It's redundant and just adds to the time, efforts, paperwork, and resources."

"This is an archaic rule without any benefit to the public or the industry. Just another waste of time for everyone involved."

Most businesses with a beer license also have a permit for ale.

- **Redundant regulation.** Most businesses with a license to manufacture, distribute, or sell beer also have a permit for ale, as described in the *Regulatory Redundancy: Ale Permits and Beer Licenses* textbox.⁹ In response to the Sunset survey, 76 percent of industry members — a majority in every tier — indicated the regulatory distinction between beer and ale is no longer needed.

Regulatory Redundancy: Ale Permits and Beer Licenses

- 81 percent of beer manufacturers also have a permit to make ale.
- 49 percent of ale brewers also have a license to make beer.
- 57 percent of nonresident beer manufacturers also have a permit to import ale.
- 95 percent of beer distributors also have a permit to distribute ale.
- 98 percent of retailers can sell beer and ale; 79 percent need just one permit to sell both.
- 96 percent of package stores and 98 percent of wine-only package stores have a license to sell beer.

- **Confusing labels.** Unlike distilled spirits and wine, the law does not require malt beverage labels to include the product's alcohol content. Instead, manufacturers can put the word "beer" or "ale" on the label. This nuance is lost on most consumers and many retailers, leaving consumers — and the servers who are responsible for monitoring their consumption in a bar or restaurant — uncertain of the potency of some malt beverages they are drinking. Issue 3 of this report also addresses TABC's unnecessary malt beverage product testing and label inadequacies.

The cumulative effect of the state’s convoluted licensing scheme overwhelms TABC and burdens the industry for no public benefit.

Taken together, the multiple problems within the state’s alcoholic beverage licensing structure create significant negative impacts on TABC and the industry, and confusion for stakeholders and consumers.

- **Effect on TABC.** Industry growth combined with 75 different licenses and permits creates a nonstop flood of applications, reducing TABC’s productivity. The textbox, *Burdens on TABC*, depicts just a few of the many pressure points Sunset staff identified during the review. Beyond the workload increase, the sheer volume of different license and permit types makes it difficult for even the most seasoned TABC staff to understand and explain the details and nuances for all of them. Not surprisingly, less than half of industry members who completed the Sunset survey on TABC agreed agency field staff provide consistent responses to their questions.

Agents account for 25 percent of all active licenses and permits.

Burdens on TABC – Examples

- TABC received 12,438 more applications in fiscal year 2018 than the previous year, and added nearly 12 days to its processing time for in-state original applications over the same period.
- Agent licenses and permits accounted for 25 percent of all active licenses and permits in fiscal year 2017. Turnover in these positions is high, with nearly 24,000 agents failing to renew in the past three years.
- Separate regulations for ale and beer require TABC to process duplicative licenses, permits, and excise tax reports for 5,710 businesses that have both beer licenses and ale permits.
- TABC reviewed more than 5,000 labels and conducted 1,225 in-house laboratory tests in fiscal year 2017 to confirm malt beverage products were correctly identified as a beer or an ale.
- TABC’s outdated information technology systems require staff to re-enter data that field offices collect and businesses submit online, an inefficient task made even more so with 75 licenses and permits and separate beer and ale applications and reports submitted by the same businesses.

- **Effect on the industry.** Throughout the Sunset review, businesses and industry groups voiced frustration with the state’s complicated licensing structure and reported difficulty comprehending and complying with licensing requirements, even for routine business activities. The textbox on the following page, *Burdens on Industry*, illustrates some of the many ways the current approach needlessly increases regulatory headaches. Many alcoholic beverage businesses need multiple licenses and permits to operate. Given TABC’s increased processing time for applications, these businesses face delays that reduce their income and the state’s alcoholic beverage tax revenue. Licensing beer and ale separately is especially burdensome as it complicates manufacturing operations, increases costs, and prolongs the approval process for malt beverages, which typically have a shorter shelf life than distilled spirits and wine.

Licensing delays reduce businesses’ income and the state’s tax revenue.

Burdens on Industry – Examples

- A restaurant with a mixed beverage permit may need up to six additional licenses and permits to carry out basic activities, such as transporting alcohol and serving alcohol at a catered event.
- Many businesses get agent licenses and permits unnecessarily for most or all of their employees, due to uncertainty over who actually needs them.
- A business with a brewer's permit cannot legally brew beer without also getting a manufacturer's license.
- Unlike most retailers, which can sell both beer and ale to consumers with a single permit, package stores and wine-only package stores must get a separate license to sell beer.
- Unlike distilled spirits and wine, beer and ale manufacturers must submit an independent laboratory report or a product sample when seeking approval of a malt beverage label so TABC can verify the alcohol content.
- Some breweries must change their national labels specifically for the Texas market, requiring segregated production runs and increasing labeling, packaging, and shipping costs — a difficult hurdle for smaller producers trying to enter the market.

Brewers cannot legally brew beer.

- **Effect on the public.** The unnecessarily complicated licensing system does not provide enhanced public protection. Because of the complexity, businesses find it more difficult to understand and follow licensing laws and rules. This in turn results in a constant stream of administrative violations that distract TABC's time and attention from investigating more serious public safety issues, such as underage sales or money laundering.

The system also confuses consumers and other key stakeholders, reducing accountability overall. For example, some city and county officials have had trouble interpreting their own local options for alcoholic beverages, sometimes incorrectly certifying to TABC that voters in their area have approved a particular type of business. This situation is not surprising considering the long list of local options never mentions the regulated category of "ale." Instead, options for "beer" authorize beer but not ale, while the option for "beer and wine" also authorizes ale.

Recommendations

The following recommendations are designed to work together to streamline and modernize TABC's licensing structure and reduce operational burdens on the agency and regulatory burdens on the industry without compromising public safety. These changes also would present a unique opportunity for TABC to evaluate its internal licensing processes and information technology resources more broadly and identify areas for improvement and funding requirements to modernize licensing processes. Appendix D shows the ultimate effect of these recommendations in a proposed licensing system that reduces the total number of licenses and permits from 75 to 36 without substantively changing the existing authority for most regulated businesses. Appendix E provides more details about how each recommendation would affect all 75 existing licenses and permits.

Change in Statute

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.

- a. Combine primary and subordinate licenses and permits.** Eleven subordinate licenses and permits that authorize routine business activities, such as transporting or storing alcohol, would be combined with their associated primary license or permit. Businesses would need only a primary license or permit for activities previously authorized by the subordinate; any regulations applicable to the subordinate would transfer to the primary permit or license. For example, statute would authorize package stores to conduct product tastings at their location without a separate tasting permit, but the tasting restrictions, such as limits on sample sizes, would remain.
- b. Eliminate agent licenses and permits.** State law would no longer individually regulate agent employees of manufacturers and distributors but would still govern what the agents can do. This change would remove a substantial burden on TABC by eliminating one-quarter of the licenses and permits it currently processes. Since employers are responsible for their agents' actions, licensing these employees is duplicative and provides no public benefit. This recommendation would require businesses to retain agent employees' employment records for a minimum of four years in the event TABC receives a complaint.
- c. Combine temporary event permits and licenses.** Five temporary event permits for charitable, nonprofit, fraternal, veteran, religious, civic, and political organizations would be combined into a single temporary event permit that standardizes existing authorities for these federally tax-exempt entities. This recommendation also would combine six subordinate temporary event permits for regulated businesses with the associated primary license or permit and would require businesses to provide advance notice to TABC for each event. TABC has rulemaking authority for temporary events and should adopt rules, similar to its recently proposed catering and wine festival rules, to specify which temporary events need prior agency approval, such as large concerts, outdoor festivals, and sponsored events, and which could fall under a file-and-use system that does not require prior approval but does require businesses to notify TABC of an upcoming event, such as a wedding or dinner party.
- d. Combine passenger transportation permits.** Four similar transportation permits would be combined into a single permit for airlines, trains, buses, and passenger boats selling or serving alcohol onboard. Existing statutory requirements and other provisions for each type of transportation would not change. For example, airlines would still be required to purchase wine and distilled spirits from a package store.
- e. Combine late hours licenses and permits.** Three similar late hours licenses and permits would be combined into a single permit for retailers located in areas that have approved extended hours for alcoholic beverage sales.
- f. Eliminate obsolete licenses and permits.** The two permits regulating industrial and manufacturing businesses would be eliminated, given these entities do not make, distribute, or sell alcoholic beverages. The obscure wine bottler and local class B wholesaler permits also would be eliminated, since the three current permittees could perform the same activities with similar more commonly used permits. This recommendation also would eliminate the billboard and electric sign permit, which regulated businesses must obtain for a billboard advertising an alcoholic beverage within 200 feet of a retailer selling that beverage. This separate permit is unnecessary given TABC's existing authority to prohibit

any activity that violates the state's three-tier system. Finally, the recommendation would eliminate five totally inactive licenses and permits, which are described on pages 92–93 in Appendix E.

This recommendation to streamline TABC's licensing system would take effect in two stages to give TABC sufficient time to update rules, procedures, applications, forms, and information technology systems. Effective September 1, 2019, unnecessary and inactive licenses and permits would be eliminated, including those for agents and industrial and manufacturing businesses. All other changes would take effect September 1, 2021, at which time TABC would be required to issue a new permit or license to every regulated business with an existing license or permit that was combined into a newly created one, such as the late hours and public transportation permits. Existing expiration dates would apply to these new licenses and permits to maintain TABC's staggered renewal schedule. Three permittees with a local class B wholesaler permit or wine bottler's permit would be grandfathered until their permit expires, at which time they would apply for a more commonly used permit. For licenses and permits that would acquire subordinate authority, but not otherwise change, TABC would not be required to issue a new license or permit. TABC would assess new fees in accordance with Recommendation 2.3 to existing licenses or permits upon renewal. Any fees paid before the effective date would not be refunded. Any enforcement and audit cases open before the effective date would continue until completion under the terms that existed before the effective date.

This recommendation would direct Sunset staff to work with staff from the Texas Legislative Council and TABC to draft legislation that ensures an orderly implementation and resolves any inconsistencies in statutory provisions when combining or eliminating licenses and permits.

2.2 Modernize Texas' regulation of malt beverages by eliminating distinctions between beer and ale.

This recommendation would eliminate Texas' legal distinction between beer and ale, combining them into a single category of malt beverages, including those made with added flavoring or malt substitutes. As listed below, this recommendation generally would apply the Alcoholic Beverage Code's statutory licensing requirements and regulations for beer to all malt beverages — with three important exceptions relating to payments, protests, and package stores. Because so many malt beverage businesses already have authority for both beer and ale, this recommendation would not significantly disrupt business operations. Businesses with beer licenses would gain authority for ale. With the exception of package stores, businesses with liquor permits that include ale as well as wine or distilled spirits would lose their authority for ale; however, most could apply for a license to continue to have authority for all malt beverages.

The recommendation would include the following key elements:

- a. State excise taxes.** The lower beer excise tax rate would apply to all malt beverages. The state excise tax rate is nearly \$0.194 per gallon for beer and \$0.198 per gallon for ale.¹⁰
- b. Application protests.** All hearings related to protests of malt beverages would be conducted by the State Office of Administrative Hearings, as state law currently provides for ale, instead of by county judges, as state law currently provides for beer. As discussed further in Issue 4 of this report, the county judge process for beer is antiquated and out of step with modern, standardized state practices.
- c. Marketing regulations.** The current more restrictive beer marketing laws and regulations would apply to all malt beverages, since beer accounts for 76 percent of all alcoholic beverages sold in Texas.

- d. **Retail payment oversight.** To align with Issue 3 of this report, all malt beverage payments would be governed by the credit law, as currently applies to ale, instead of by the cash law, as currently applies to beer. Distributors would have the discretion to require retailers to pay cash on delivery for malt beverages. This change would reduce administrative burdens on TABC while preserving the state's interest in preventing long-term indebtedness between tiers of the alcoholic beverage industry.
- e. **Storage.** The current authority for beer manufacturers to store beer anywhere in the state would apply to all malt beverages. Currently, ale manufacturers may only store their products in the county where the permitted manufacturing facility is located.
- f. **Transportation.** The current authority for manufacturers and distributors to transport beer statewide would include all malt beverages. Current transportation regulations for ale vary depending on the type of permit.
- g. **Hours of distribution and sale.** The current authorized hours for distribution and sales of beer would apply to all malt beverages. Currently, beer distributors may deliver beer to retailers at any time except between 1:00 a.m. and noon on Sunday, while wholesalers may not deliver ale on Sunday or on Christmas Day.
- h. **Alcohol content.** To be consistent with other kinds of alcoholic beverages, all malt beverage product labels would be required to display the alcohol content to ensure transparency to consumers and retailers. As long as a state does not prohibit a label from containing the alcoholic beverage content, manufacturers could sell malt beverages with these labels in other states. As also discussed in Issue 3 of this report, TABC would no longer need to test the alcohol content of malt beverage products to determine whether they are ale or beer before allowing them to market, but could continue to spot check products as needed, such as for investigations or complaints.
- i. **Package stores.** Package stores and wine-only package stores would have authority to purchase and sell all malt beverages with one permit instead of two, which is consistent with most other retailers in Texas. This recommendation also would codify an informal TABC policy, in place for several decades, allowing package stores with a local distributor's permit to purchase beer from distributors and distribute it to bars, restaurants, and private clubs.
- j. **Grandfathering local option beer-only locations.** To avoid constitutional conflicts with local option election results, approximately 355 locations — less than 1 percent of the 56,000 alcoholic beverage retailers in Texas — would be grandfathered. These businesses are in areas where voters have approved retail sales of beer but not ale, and they would retain their current authority to sell malt beverages of up to 5 percent alcohol by volume. Distributors would continue to deliver the same products they do today to these businesses. The grandfathered status would be eliminated if local voters approve other alcoholic beverages in a subsequent local option election. TABC implemented a similar approach in 1999 when the Legislature raised the maximum alcohol content of wine sold in most retail stores from 14 percent to 17 percent.¹¹ TABC printed the maximum wine alcohol content authorized on these businesses' permits to prevent any confusion.

To give TABC time to update its rules, procedures, application forms, and information technology systems to implement these complex changes, this recommendation would take effect September 1, 2021. TABC would be required to issue a new license to manufacturing tier businesses with beer licenses or ale permits that would be combined into a newly created license, such as a brewer's license. Existing expiration dates would apply to these new licenses to maintain TABC's staggered renewal schedule. For licenses and permits that are acquiring authority for ale, but not otherwise changing, TABC would

not be required to issue a new license or permit. Businesses with a permit issued before the effective date that would no longer have authority for ale, such as a wholesaler, would be grandfathered until the permit expires. TABC would assess new fees in accordance with Recommendation 2.3 to existing licenses or permits upon renewal. Any fees paid before the effective date would not be refunded. Any enforcement and audit cases that are open before the effective date would continue until completion under the terms that existed before the effective date.

The recommendation also would direct Sunset staff to work with staff from the Texas Legislative Council and TABC to draft legislation that ensures orderly implementation and resolves minor inconsistencies in statutory provisions for beer and ale.

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

This recommendation would eliminate all license and permit fees and the surcharge authority from statute. Instead, statute would require TABC to adopt a single licensing fee for each license and permit in rule by September 1, 2021, in concert with the licensing changes in Recommendations 2.1 and 2.2. TABC also would be required to adopt a policy for periodically reviewing and updating 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. This recommendation should not affect the total revenue TABC currently raises through licensing fees and surcharges.

Fiscal Implication

The recommendations to modernize and streamline the state's alcoholic beverage licensing structure are designed to improve the efficiency of TABC's licensing and regulatory operations and, with the exception of a reduction in excise taxes on malt beverages, should be cost-neutral to the state. Given the significant work that would be needed to implement these complex changes and to regulate the rapidly growing industry after implementation, TABC would need to retain its staffing and licensing resources at least at current levels. TABC would need to make significant changes to its licensing rules and processes, such as developing the new fee structure, updating application forms, communicating licensing changes to regulated businesses, and changing and possibly upgrading information technology systems.

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.¹² 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. While the recommendations have too many variables to precisely estimate their fiscal impact, Recommendation 2.3 is intended to have no negative impact to the General Revenue Fund.

The recommendation to apply the beer excise tax rate to all malt beverages would reduce the state's excise tax revenue by approximately \$350,000 per year. This estimate is based on applying the beer excise tax rate of about \$0.194 per gallon to approximately 79 million gallons of ale taxed in fiscal year 2017. However, this revenue loss likely would be offset by increasing tax revenue from the growing alcoholic beverage industry.

Texas Alcoholic Beverage Commission

Fiscal Year	Loss to the General Revenue Fund
2020	\$350,097
2021	\$350,097
2022	\$350,097
2023	\$350,097
2024	\$350,097

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1 "Local Option Elections," Texas Alcoholic Beverage Commission, accessed August 27, 2018, https://www.tabc.state.tx.us/local_option_elections/index.asp.

2 "Revenue by Source for Fiscal Year 2017," Texas Comptroller of Public Accounts, accessed October 12, 2018, <https://comptroller.texas.gov/transparency/reports/revenue-by-source/>.

3 "Excise Tax," Texas Alcoholic Beverage Commission, accessed September 17, 2018, https://www.tabc.state.tx.us/excise_tax/index.asp. The actual excise tax collected was approximately \$225 million because TABC provides a 2 percent discount for timely payment.

4 All citations to Texas statutes are as they appear on <http://www.statutes.legis.texas.gov/>. Sections 11.72 and 61.86, Texas Alcoholic Beverage Code.

5 Section 5.50(b), Texas Alcoholic Beverage Code; 16 T.A.C. Chapter 33, Section 33.23.

6 Sections 1.04(12) and 1.04(15), Texas Alcoholic Beverage Code. The code's definitions for beer and ale use the measurement of alcohol content by weight instead of the more commonly used alcohol by volume.

7 "Beer Style Guidelines, 2018 Edition," Brewers Association, accessed August 27, 2018, <https://www.brewersassociation.org/resources/brewers-association-beer-style-guidelines/>.

8 The eight states are Kentucky, Massachusetts, North Carolina, Pennsylvania, Rhode Island, South Dakota, Wisconsin, and Wyoming.

9 License and permit data retrieved from the Texas Alcoholic Beverage Commission's public inquiry database in August 2018, <https://www.tabc.state.tx.us/PublicInquiry/Default.aspx>.

10 The actual tax rate for beer is \$0.193548 per gallon.

11 Section 251.81, Texas Alcoholic Beverage Code.

12 Rider 7, page V-4, Article V (S.B. 1), Acts of the 85th Legislature, Regular Session, 2017 (the General Appropriations Act).

ISSUE 3

Over-Regulation of Certain Business Practices Creates Burdens on TABC and the Alcoholic Beverage Industry With Little Public Benefit.

Background

The Texas Alcoholic Beverage Code regulates virtually all aspects of the alcoholic beverage industry in Texas by separating the manufacture, distribution, and sale of beverages into three distinct business “tiers.” As a result, state law requires the Texas Alcoholic Beverage Commission (TABC) to enforce numerous regulations related to a licensee’s business practices and its interactions with businesses in other tiers. These regulations aim to protect consumers from unsafe or misrepresented products and to prohibit close relationships between each tier (i.e., creating “tied houses”) or other practices that might promote excessive alcohol consumption. The textbox, *Key Business Practice Regulations*, summarizes some of these regulations. TABC regularly monitors licensees’ conduct to ensure compliance with these regulations, investigates complaints, and takes disciplinary action against any violations of the code or agency rules.

The Sunset Act requires an assessment of whether regulations could be less burdensome for the agency and businesses and still adequately protect the public.¹ The Legislature enacted many of the regulations in the Alcoholic Beverage Code more than 80 years ago, while modern business practices have continued to evolve. The Sunset review focused on evaluating business practice regulations that take the most TABC staff time or generate the most regulatory and enforcement activity. The review concluded several of these regulations, as currently structured, are overly burdensome for both TABC and the industry without providing a corresponding public benefit.

Key Business Practice Regulations

Product registration and label approval. To sell an alcoholic beverage in Texas, businesses must register the product with TABC and have the product label approved. TABC registers more than 20,000 new alcoholic products (wine, distilled spirits, beer, and ale) each year, as well as several thousand products seeking approval of label revisions.

Payment terms for retail purchases of alcohol. State law sets out specific ways in which retailers pay distributors for different types of alcohol, known as the cash law and credit law.

Outdoor advertising. State law and agency rules dictate how retailers can market their products at their place of business. These restrictions vary by type of alcohol and retail business.

Findings

Texas’ duplicative label approval process delays products from getting to market while creating obstacles to consistent regulation.

Before an alcoholic beverage goes to market in Texas, manufacturers or importers must register every product and, as part of that registration, seek label approval through a mix of federal and state requirements and processes. TABC and two federal agencies — the Alcohol and Tobacco Tax and Trade Bureau (TTB) and the Food and Drug Administration (FDA) — play a role in alcoholic beverage product registration and label approval, as described in the table,

Federal and State Agencies' Involvement in Alcohol Product Registration. State law establishes different registration procedures for malt beverages than for wine and distilled spirits. For malt beverages, TABC staff must process and approve all products, including verifying alcohol content and approving each label or label revision.² In contrast, since 2007 state law has allowed wine and distilled spirits products to follow a more streamlined process, requiring TABC to register products upon the submission of a valid federal Certificate of Label Approval (COLA) from TTB that acts as label approval.³

Federal and State Agencies' Involvement in Alcohol Product Registration

	TABC	TTB	FDA
License/permit required	All manufacturers of malt beverages and importers of wine and distilled spirits	Manufacturers or importers of all alcoholic beverages	N/A
Regulates label content	Only malt beverages	Most malt beverages, wines, and distilled spirits	Only low wines, ciders, and non-grain malt beverages (basic nutritional info only)
Pre-market label approval required	Only malt beverages	Most malt beverages, wines, and distilled spirits (receive a "COLA")	N/A
Pre-market product registration required	All alcoholic beverages	N/A	N/A

- **Duplicative malt beverage approval processes.** Requiring TABC to approve malt beverage labels unnecessarily duplicates the federal COLA process and causes TABC staff to spend significant time reviewing labels a second time for no additional benefit. Texas label requirements are virtually identical to the federal requirements for a malt beverage, as reflected in the *Duplicate Texas and Federal Malt Beverage Label Requirements* textbox.⁴ TABC inspected and approved more than 5,000 malt beverage labels in fiscal year 2017, despite the fact that over 60 percent already held a valid COLA.

Duplicate Texas and Federal Malt Beverage Label Requirements

Must include:

- Brand name
- Name and address of bottler
- Net liquid contents

May not:

- Make false or misleading statements
- Disparage a competitor
- Use obscene or indecent language
- Use geographically distinctive names for products not from that region
- Use government seals, flags, or insignia to indicate government endorsement

Delays. The duplicative label approval process bogs down TABC staff and delays businesses getting their products to market. As shown in the *Label and Registration Application* table on the following page, TABC takes almost a month to approve malt beverage labels. In contrast, TABC staff approve wine and spirits labels in about half that time because those with a federal COLA receive automatic approval. Approval delays can have potentially serious consequences for malt beverage manufacturers, such as a seasonal product not getting to market during its target season. Periodically, TABC must shift employees from other important functions to keep average label approval times for malt beverages from getting any longer.

Label and Registration Application – FY 2017

	Malt Beverages	Wine	Distilled Spirits
Number of applications processed	5,086	13,275	3,298
TABC average days to process applications	29	11	9
Federal TTB days to process COLAs (as of 9/6/18)	7	4	7
Total days to process	36	15	16

Added costs. The duplicative state label approval process also adds unnecessary costs for malt beverage manufacturers, who pay \$25 for each container size registered in Texas even if the label is the same.⁵ Comparatively, the federal COLA is free of charge, and wine and spirits manufacturers pay TABC a single \$25 fee to register all their product sizes.

Texas is an outlier. Most states have simplified state label approval processes for malt beverages. Under federal rules, manufacturers of malt beverages sold across state lines must obtain a federal COLA. Even manufacturers of malt beverages produced and sold only in-state may opt to get a COLA, as a convenience. Therefore, most states either accept the federal COLA as the basis for their state malt beverage label approval or do not require any state approval at all. Sunset staff identified only four other states — Connecticut, Oklahoma, Minnesota, and South Dakota — that, like Texas, require a completely unique state label approval for malt beverages.⁶

- **Unnecessary malt beverage content testing.** As discussed in Issue 2 of this report, Texas law creates added regulatory complexity for TABC and malt beverage manufacturers by distinguishing between beer and ale based solely on alcohol content — an outdated and unnecessary distinction. Statute enforces these definitions in part by requiring each malt beverage product to undergo alcohol content testing during registration, adding additional administrative burdens.⁷ Other than classifying beers and ales, testing malt beverages' alcohol content only serves to monitor products' truth in advertising. TABC finds alcohol content discrepancies in less than 10 percent of the 5,000 products tested each year, many related to misclassification as beer or ale. In comparison, TABC has not tested wine or spirits since 2007 and has not seen an increase in complaints related to false advertising of alcohol content. Mandatory testing of beverages before registration also is unnecessary given TABC's existing authority to test any alcoholic beverage to monitor for false advertising or respond to complaints.⁸
- **Regulatory gaps.** Using the federal COLA helps streamline wine and spirits label approval, but the current approval process creates several other obstacles for TABC to consistently enforce state law.

The duplicative state label process adds unnecessary costs for malt beverage manufacturers.

TABC approves some wines and spirits and then immediately refers them for investigation as illegal products.

No standards for some products. In allowing for the use of federal COLAs for wine and spirits, state law was not updated to account for some products that are not eligible for a federal COLA, such as ciders. TABC has not addressed this gap by rule, instead applying an informal set of guidelines generally aligned with Texas’ malt beverage label requirements. Without formal standards, TABC does not provide a transparent or consistent process for manufacturers of these products to follow.

No state authority to disallow certain products. By requiring TABC to accept federal COLAs for wine and spirits without any exceptions, state law does not give TABC needed flexibility to deny approval in the rare situation that a product’s label passes federal standards but still violates Texas law. This required automatic approval has resulted in the unintended consequence of TABC approving some wines and spirits and then immediately referring them for investigation as illegal products. For example, TABC must accept and approve wine it considers to be a “private label” product — one produced exclusively for or under the control of a retailer — despite the agency’s position that private labels violate Texas’ tied-house provisions. Courts have affirmed TABC’s authority to prohibit malt beverages with private labels, but because state law requires TABC to approve wine and spirits with a valid COLA, the agency believes it lacks the same authority to deny these beverages.⁹

The antiquated state law requiring retailers to buy beer with cash inserts TABC into daily business transactions without an ongoing state purpose.

As part of the state’s three-tier system for regulating alcohol, TABC monitors business transactions between retailers and distributors to prevent indebtedness that could cause undue influence between them. For beer transactions, the Alcoholic Beverage Code requires retailers to pay distributors upon delivery with cash, check, or electronic funds transfer.¹⁰ In contrast, state law regulates retailers’ purchases of ale, wine, and distilled spirits through a credit law that sets out regular payment deadlines twice a month.¹¹ The textbox, *Key Elements of Cash and Credit Laws*, summarizes these laws and TABC’s approach to enforcement.

Key Elements of Cash and Credit Laws

Cash law: Retailers must pay distributors for beer with cash, check, or electronic funds transfer upon delivery. Each time a retailer fails to pay with cash or writes a “hot” check, the licensee violates the law. TABC issues up to six warnings to licensees who violate the cash law in a 12-month period, initiating formal administrative action on the seventh violation. TABC staff issues a letter for each violation and visits licensees after the third violation to provide education about the cash law. Retailers with unresolved cash violations can continue to purchase beer from distributors.

Credit law: Retailers may purchase ale, wine, and distilled spirits using credit transactions, but with strict credit terms that require prompt payment at set dates twice a month. Failing to pay all invoices due during the payment period is a violation under the law. TABC places violators on a delinquent list, which prohibits them from purchasing from any wholesaler until all debts are paid. Similar to cash violations, TABC allows retailers six infractions before taking formal administrative action.

- **Administrative burden.** Because of the effort required to monitor and enforce the cash law, licensees often refer to TABC as the industry's bill collector. The time and attention TABC staff dedicate to cash law violations siphons off resources that could be directed toward more critical tasks, such as conducting tax audits or new business inspections. In the last five years, cash law has consistently ranked as the most frequent violation agency staff identified, far outpacing other violations largely due to the sheer number of cash transactions TABC monitors. Unlike credit violations, cash law violations occur each time a retailer fails to pay a single invoice, resulting in the agency investigating cash law violations far more frequently than credit law violations, as reflected in the *Cash and Credit Violations* table. A retailer under the cash law may continue to purchase beer from other distributors, or even the same distributor, despite having outstanding cash violations. This loophole further encourages repeat violations the agency must monitor and enforce.

Cash and Credit Violations — FYs 2015–2017

	FY 2015	FY 2016	FY 2017
Cash law violations	4,488	4,525	4,608
Credit law violations	2,355	2,457	2,408

- **Unnecessary to protect public safety.** TABC oversight of each beer invoice payment in cash is not necessary to protect the public or fulfill the state's interest in regulating the three-tier system. Cash payment requirements date back to the end of Prohibition when lawmakers were concerned about beer manufacturers extending lines of credit to retailers and using the resulting debt to control the retailer's actions and potentially encourage excessive drinking and illegal conduct. However, in the modern era, cash law violations do not correspond to any notable increase in other violations or increased risk to public safety. In the past five years, the most common violation committed by retailers also violating the cash law was failure to post required notices. As shown in the table, *Results of Cash Violations*, the roughly 4,500 cash violations each year produced less than 200 license suspensions or fines and almost no license cancellations.

Results of Cash Violations — FYs 2015–2017

	FY 2015	FY 2016	FY 2017
Total violations found / informal warning letters sent	4,488	4,525	4,608
Formal warnings issued	395	580	537
Suspensions or civil penalties assessed	175	157	181
License cancellations	2	0	2

- **Credit law could better protect the state's interests.** The state's credit law — applicable to all other alcohol sales, including ale — is designed to sufficiently protect against a retailer becoming indebted to a manufacturer or distributor, without making each failure to pay a violation that requires agency action. In fact, a key protection against such indebtedness under the credit law is conspicuously absent from the cash law — under the credit law, a retailer cannot purchase more alcohol until all debts are paid. TABC staff take action immediately against a licensee found to be purchasing alcohol while on the delinquent list.

However, TABC’s enforcement of the credit law may dilute its effectiveness by encouraging repeat violations. TABC staff has implemented a policy — outside its existing, formal penalty matrix — of issuing warning letters for a licensee’s first six credit law violations each year before taking administrative action on the seventh. In 2017, only 167 licensees were responsible for the entirety of the 2,408 credit law violations, averaging over 14 violations per licensee. TABC issued only 36 suspensions and fines related to those violations.

Excessive outdoor advertising restrictions for certain retail businesses create enforcement burdens with no public benefit.

Outdoor Advertising Sign Restrictions

Retail stores, except those serving mixed beverages, may generally post only one sign outside their premise. The sign:

- may include only the words “beer,” “wine,” or “liquor” depending on the type of business, and the words “to go” if applicable
- may not include descriptive words like “cold” beer or “Texas” wine
- may not include name or insignia of any alcohol brand
- may not have font larger than 12 inches in height

The Alcoholic Beverage Code includes numerous advertising and marketing rules ostensibly designed to prevent unethical business practices that could encourage overconsumption. As part of these regulations, state law puts special restrictions on the outdoor signs a subset of retail businesses may display, described in the textbox, *Outdoor Advertising Sign Restrictions*.¹² However, state law does not extend these restrictions to all retailers, calling into question the public safety benefit of such regulations. Mixed beverage permit holders, typically bars and restaurants that sell liquor by the drink, are not subject to most outdoor advertising restrictions despite selling beverages with the highest alcohol content.¹³ These establishments can display any number of outdoor signs and may advertise anything except the price of the alcohol being served.¹⁴

- **Administrative burden.** TABC staff spend valuable time enforcing the Alcoholic Beverage Code’s archaic signage regulations, which consistently rank among the most frequent violations TABC cites each year. In fiscal year 2017, TABC cited 164 cases of outdoor advertising violations. During the Sunset review, TABC and stakeholders identified confusion and frustration in the industry about how to comply with these rules. Given the frequency with which retailers violate the regulations, TABC recently adopted a policy to first give warnings to allow businesses to come into compliance, but the public safety benefit of such regulations is still questionable.

Advertising cold beer and brand names are no longer novel attractions that induce consumers to buy a drink.

- **Unnecessary to protect public safety.** Restrictions on outdoor signs come from a bygone era when the use of descriptions or brand names could serve as an inducement to increased consumption — such as “cold” beer being a novel attraction that would draw a consumer to buy a drink. Today, refrigerated displays and brand name alcohol are standard throughout the industry and available widely at retail locations across the state. Numerous other laws and rules prohibit misleading, slanderous, or obscene statements and prohibit manufacturers or distributors from providing advertising benefits to retailers (in violation of the three-tier system), making overly prescriptive regulations of the signs themselves unnecessary.¹⁵

Recommendations

Change in Statute

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

This recommendation would create a single, consistent process for all alcohol product registration and label approval, eliminating redundancies while helping prevent products not compliant with Texas law from getting to market. The recommendation would make the following changes to statute:

- a. Eliminate state approval of malt beverage labels and adopt the federally approved COLA instead.**
This recommendation would eliminate the duplicative state approval process by requiring all malt beverage manufacturers wanting to register and sell a product in Texas to get a federal COLA. Statute would require TABC to implement a process for accepting the COLA as part of the application for product registration. By adopting the federal label approval for malt beverages, Texas' process for approving labels would be consistent across all alcoholic beverages, whether produced in Texas or imported from outside the state. Out-of-state manufacturers would no longer need their product's label reviewed by two separate agencies and both in-state and out-of-state manufacturers would see a benefit from reduced time for label approval and registration of their products, as well as a reduction in state fees.
- b. Require TABC to adopt rules governing the label and registration requirements for all products ineligible to receive a federal COLA.** TABC would consider both federal alcohol label requirements and FDA nutrition label requirements as a basis for the rules, which would clearly identify the standards TABC would use to approve non-COLA products, such as ciders, for sale in Texas. This recommendation would provide clarity to the regulated industry and provide a framework for TABC staff to use as the industry evolves and businesses introduce new alcoholic beverage products into the market.
- c. Eliminate statutorily mandated alcohol content testing requirements for malt beverage registration.** TABC would continue to be authorized under other existing statutory authority to test any alcoholic beverage to prevent fraud and ensure public safety. TABC could adopt rules developing a regular testing program should it determine such a program is necessary in the future.
- d. Authorize TABC to deny label approval and registration for any product that has received a COLA but still violates Texas laws.** This authority would allow TABC to prevent products from being approved for sale in Texas if TABC finds their sale would create a public safety concern, create a cross-tier violation, or otherwise violate the Alcoholic Beverage Code.

TABC should update its existing label and registration rules by December 31, 2020, to reflect the streamlined process for label approval and registration. These changes would reduce redundant bureaucratic processes for TABC staff, allowing more time to focus on areas of greater risk. In addition, industry members would benefit from lower costs and faster service to get their products to market in Texas.

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

This recommendation would remove the state from the business of collecting unpaid bills for the alcohol industry by eliminating the statutory requirement that retailers' beer purchases from a distributor be paid for by cash, check, or electronic funds transfer. Instead, such transactions would be regulated by the existing credit law, which allows retailers to purchase all other types of alcohol on very short-term

credit. This recommendation would remove TABC staff from having to monitor daily transactions and instead allow the agency to focus on the state's interest in preventing long-term indebtedness by retailers. To give TABC time to modify its internal systems for tracking violations and to allow industry members to make any needed adjustments to business operations, the recommendation would take effect September 1, 2020.

Market participants would remain able to negotiate payments in cash as part of their contracts, as well as other standard terms, such as payment schedules and late fees. Allowing retailers and distributors to choose between cash payments or short-term credit would give businesses greater flexibility and control to enter into contracts matching their individual needs. For example, while distributors may currently sell ale to retailers on credit, some choose to require cash payments as part of their contracts and would be able to continue doing so under this recommendation. Transitioning to credit terms for all alcoholic beverage sales to retailers would also ease unnecessarily burdensome restrictions on the industry by reducing the number of violations created by each missed invoice payment. Unlike the current cash law, failing to pay an invoice but correcting the matter a few days later would not be considered a violation under credit law.

3.3 Eliminate overly restrictive outdoor advertising requirements.

This recommendation would remove statutory restrictions regarding the content, appearance, and display of outdoor advertising for alcohol at all retail locations.¹⁶ Instead, this recommendation would require TABC to adopt reasonable rules by December 31, 2019, governing alcohol-related outdoor advertising for all retail businesses, similar to current rules for mixed beverage permittees. Other statutory prohibitions against a manufacturer benefiting a retailer through advertisements would remain in effect. This recommendation would have no effect on separate provisions regarding the location of billboards and outdoor advertisements somewhere other than a licensed premise, but Issue 2 of this report includes a recommendation related to permits for billboards advertising alcoholic beverages.¹⁷ The recommendation would reduce unnecessary restrictions on the type, verbiage, and size of signs a business may display and free TABC from inspecting licensed premises for compliance with those restrictions, while still allowing the agency to prohibit advertisements that violate other provisions of the Alcoholic Beverage Code and present greater potential for public harm.

Management Action

3.4 Direct the commission to update its existing penalty guidelines to strengthen enforcement against licensees who violate the credit law.

In conjunction with recommendations in Issue 5 for the commission to complete its schedule of sanctions, the commission should also update its existing penalty guidelines for enforcing credit law violations and, in doing so, review the current policy of issuing six warnings before taking administrative action against a licensee violating payment regulations. Having the commission adopt a schedule of sanctions for credit law violations as part of its formal penalty matrix would engage commission members in overseeing and directing the agency's enforcement approach. To discourage businesses from abusing the benefits of credit terms through repeated violations, TABC should consider reducing the number of warning letters it issues before taking action against a violator. While stronger enforcement of credit regulations may increase the number of disciplinary actions TABC pursues in the short term, doing so may deter future violators more effectively and would ultimately better uphold the state's interest in preventing long-term debt, penalize repeat bad actors who generate the majority of violations, and eliminate TABC's oversight of each individual beer invoice.

Fiscal Implication

These recommendations would have a negative fiscal impact of \$88,825 to the state. The recommendation to transition to a federal COLA-based malt beverage registration process would reduce the number and amount of fees collected from malt beverage applications. In fiscal year 2017, licensees paid a \$25 fee for 3,553 additional sizes of a malt beverage product beyond the first size being approved. Under a COLA-based approval process, licensees would only be required to pay a single \$25 fee, regardless of container size, resulting in an estimated loss of \$88,825 annually. Reducing regulatory burdens that have little, if any, public protection value would allow TABC to better focus its time and resources on functions that have a direct, positive impact on public safety.

Texas Alcoholic Beverage Commission

Fiscal Year	Loss to the General Revenue Fund
2020	\$88,825
2021	\$88,825
2022	\$88,825
2023	\$88,825
2024	\$88,825

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¹ All citations to Texas statutes are as they appear on <http://www.statutes.legis.texas.gov/>. Sections 325.011 and 325.0115, Texas Government Code.

² Section 101.67, Texas Alcoholic Beverage Code.

³ Section 101.671, Texas Alcoholic Beverage Code.

⁴ The only Texas label-related requirements not addressed by federal rules are those regarding alcohol content, as federal label rules defer to state rules for including alcohol content on a label, and Texas' regulations concerning tier separation, which can impact what may appear on a beverage label.

⁵ 16 T.A.C. §45.85.

⁶ Sunset staff compared label requirements for the 32 alcohol "licensing" states, but did not compare the label approval and registration process for the 18 alcohol "control" states.

⁷ Section 101.67, Texas Alcoholic Beverage Code.

⁸ Section 5.38, Texas Alcoholic Beverage Code.

⁹ *Tex. Alcoholic Beverage Comm'n v. Mark Antony Brewing, Inc.*, No. 03-16-00039-CV (Tex. App.—Austin October 13, 2017) (mem. op.).

¹⁰ Section 102.31, Texas Alcoholic Beverage Code.

¹¹ Section 102.32, Texas Alcoholic Beverage Code.

¹² Sections 108.52(c), (d), (f), (h), Texas Alcoholic Beverage Code.

¹³ Section 108.07, Texas Alcoholic Beverage Code.

¹⁴ 16 T.A.C. §45.105.

¹⁵ Sections 102.07, 102.12, 102.14, 102.15, and 102.16, Texas Alcoholic Beverage Code.

¹⁶ Sections 108.52(c), (d), (f), (h), Texas Alcoholic Beverage Code.

¹⁷ Sections 108.52(a), (b), (e), (g), (i), (j), Texas Alcoholic Beverage Code.

ISSUE 4

TABC's Protest Process Needs A Complete Overhaul to Meet Basic Transparency, Accountability, and Fairness Standards.

Background

The Texas Alcoholic Beverage Code envisions a process whereby certain local officials and the public can challenge the issuance or renewal of a beer *license* or distilled spirits, wine, or ale *permit* if they believe a business would pose a risk to public safety.¹ Individuals challenge the license or permit by protesting the business' application. Protests occur for a variety of reasons — individuals may not want a bar in their community, the local police department may consider the location a nuisance, or communities may be concerned about the proximity of a school to a convenience store that sells alcohol. Staff of the Texas Alcoholic Beverage Commission (TABC) also protest applications, typically when an applicant has a history of enforcement actions or the application reveals relationships between retailers, manufacturers, and distributors that could violate the state's three-tier system.

TABC usually receives protests after an applicant submits a new or renewal application for a license or permit. The accompanying textbox provides a high-level overview. In fiscal year 2017, only about 180 of 43,000 applications had an associated protest.² The vast majority of protest cases are typically resolved without a hearing by the applicant withdrawing, the protestor withdrawing, or the parties settling the matter through mediation. If the protest proceeds to a hearing, the venue varies depending on the type of license or permit the applicant is seeking. In fiscal year 2017, a total of 22 cases proceeded to a hearing — nine with county judges and 13 at the State Office of Administrative Hearings (SOAH). Applicants can appeal the hearing decision to different district courts depending on the license or permit, but this rarely happens — only one case progressed to this point in fiscal year 2017.

TABC Protest Process Basics

1. Applicant submits an application for an alcohol license or permit
2. External party or TABC staff protest the application
3. Protest may be resolved without a hearing
4. Venues for protest hearings vary
 - County judge of the county where the applicant's premises is located hears beer-related protests
 - SOAH hears all other protest cases

The Sunset Commission has a long history of evaluating and identifying problems in licensing and regulatory processes. Sunset staff assess these processes against basic government standards of transparency, accountability, and fairness, among others. As described on the following page, overall, Sunset staff concluded TABC's protest process is unnecessarily convoluted, inconsistent, confusing for applicants and those protesting, and difficult for the agency to administer.

Findings

Unclear statute and no rules prevent a basic understanding of how to participate in or administer TABC’s alcoholic beverage license and permit protest process.

The most fundamental expectation of any government regulation is clear, understandable standards to guide consistent administration and fair treatment of the regulated population. The Alcoholic Beverage Code provides no uniform standards defining a protest or who can formally protest an application, and although TABC has adopted a policy outlining the basic requirements for who can protest when, it has failed to adopt rules to govern the process and set clear expectations for all parties involved. For example, statute gives local officials, including city councils and chiefs of police, the right to “protest” any *permit* application, but only certain *license* applications.³ Statute also allows any person to “contest” a license application, but with no clear indication as to whether or how that is different than a protest.⁴ These inconsistent and confusing provisions could result in a local official being able to protest a distilled spirits, wine, or ale manufacturer, but not a beer manufacturer. Without clear statute or rules, staff interpretations on how to implement the provisions are subject to change when leadership changes, such as when the current TABC administration scaled back a previous internal policy that allowed any member of the general public to protest any application. TABC also attempts to resolve some protests through mediation, and although SOAH’s rules govern the general process, TABC has no rules or policies about the circumstances under which it may offer mediation or the roles and responsibilities of the agency, applicants, and protestors in that process.

In comparison, other agencies with similar processes provide clear expectations to all involved and make information about the process available publicly. For example, the Texas Commission on Environmental Quality details each phase of the process for challenging an environmental permit in rule and on its website.⁵

Neither the commission nor staff are fully accountable for application decisions, undermining due process and responsible oversight.

Having a clearly defined regulatory process with definite decision points establishes the basic rights for regulated individuals affected by an agency’s decisions, and final actions by agency governing bodies or staff, as appropriate, provide clear lines of accountability and oversight. The protest process fails to meet this basic standard. Neither TABC staff nor the commission fully assume responsibility or accountability for the agency’s actions during the protest process. For example, if TABC staff believe an applicant has a conflict that violates the state’s three-tier system, the agency protests the application instead of simply denying the application, which it is clearly authorized to do. Of the 180 protest cases closed in fiscal year 2017, TABC staff initiated nearly 83 percent.

No uniform standards defining a protest or who can protest exist.

The agency protests applications instead of simply denying them.

This approach leads to concerns regarding an applicant's due process rights if the agency never actually issues an official, formal decision. Notably, this scenario played out in 2012 when McLane Company Inc. voluntarily withdrew its application in response to TABC staff protesting it.⁶ When McLane later sued the agency in federal district court, TABC asserted the company lacked standing to sue in part because the company had not suffered any observable hardship since TABC had not technically taken any formal action to deny its application.⁷ While TABC never denied the company due process, had the agency taken formal action to deny instead of protest the application, the company may have had clearer standing to pursue legal action.

Further, the commission has neglected its oversight role by delegating even the most high-profile protest decisions to staff. For example, in early 2018, following an external protest of a renewal permit for California-based distributor Core-Mark Midcontinent Inc., a SOAH judge issued a proposal for decision that TABC not renew the permit.⁸ However, despite being a historic decision for the agency that clarified how it will implement certain tied-house provisions, the deputy executive director, not the commission or even the executive director, rejected the judge's proposal and issued the agency's final decision to renew the permit.⁹ While the commission has authority to delegate its decision-making authority on contested cases, relinquishing a decision of this import, one that sets a significant policy precedent for the agency and has a major impact on licensees, shows a complete disregard or lack of understanding for the critical oversight role governing bodies have and should exercise in executive agencies.

The commission delegated the high-profile Core-Mark decision to staff.

Non-standard hearings risk treating applicants unfairly.

Overall consistency within an agency's regulatory processes helps promote fairness by ensuring individuals and businesses regulated by the agency are treated the same way. Generally, hearings on state regulatory matters should follow the uniform standards set forth in the Administrative Procedures Act (APA) designed to allow for due process and establish clear expectations for both the agency and the industry it regulates. Additionally, SOAH handles hearings for almost all state licensing agencies, offering a consistent standard of independence and professionalism in carrying out the hearings process.

The involvement of county judges in making TABC application decisions is an archaic remnant dating back to before the repeal of Prohibition, when beer was legal and regulated at the local level. The two separate hearings venues for protests of beer-related versus all other alcoholic beverage license and permit types has no rational basis and creates the potential for inconsistent hearings processes and rulings. The table on the following page highlights key differences between the protest hearings conducted at SOAH and by county judges. Although TABC does not comprehensively analyze the decisions of SOAH judges versus those of county judges, the agency reports situations where the two adjudicators came to different decisions based on similar facts. Having different processes for the multiple alcoholic beverage license and permit types needed to operate in today's modern business environment also

Involvement of county judges in application decisions is an archaic remnant of Prohibition.

creates the potential for absurd regulatory situations. For example, technically under the law, a grocery store — which commonly seeks both a beer license and liquor permit from TABC — could have two separate protest hearings at different venues.

Inconsistent TABC Protest Hearings

SOAH	County Judge
Administered by an administrative law judge licensed to practice in Texas	Administered by a county judge (or delegate) who may not be an attorney
Regularly conducts contested case hearings	May not have experience conducting contested case hearings
Issues proposals for decision that are typically thorough and summarize the facts of the case and testimony	Issues orders that tend to be boilerplate and do not discuss specific facts of the case or testimony
TABC can affirm, modify, or reverse the proposal for decision	Orders are presumably final unless TABC finds new grounds on which to disqualify an applicant

The bifurcated hearings process contains other oddities that violate statewide APA standards. For example, the Alcoholic Beverage Code requires anyone conducting a protest hearing to provide the general public with an opportunity to testify and to consider the testimony in the decision-making process — a feature not found in standard administrative hearings.¹⁰ Also, statute does not provide a consistent venue for applicants to appeal the denial of a license or permit, which risks inconsistent decisions about who is awarded a license or permit.¹¹

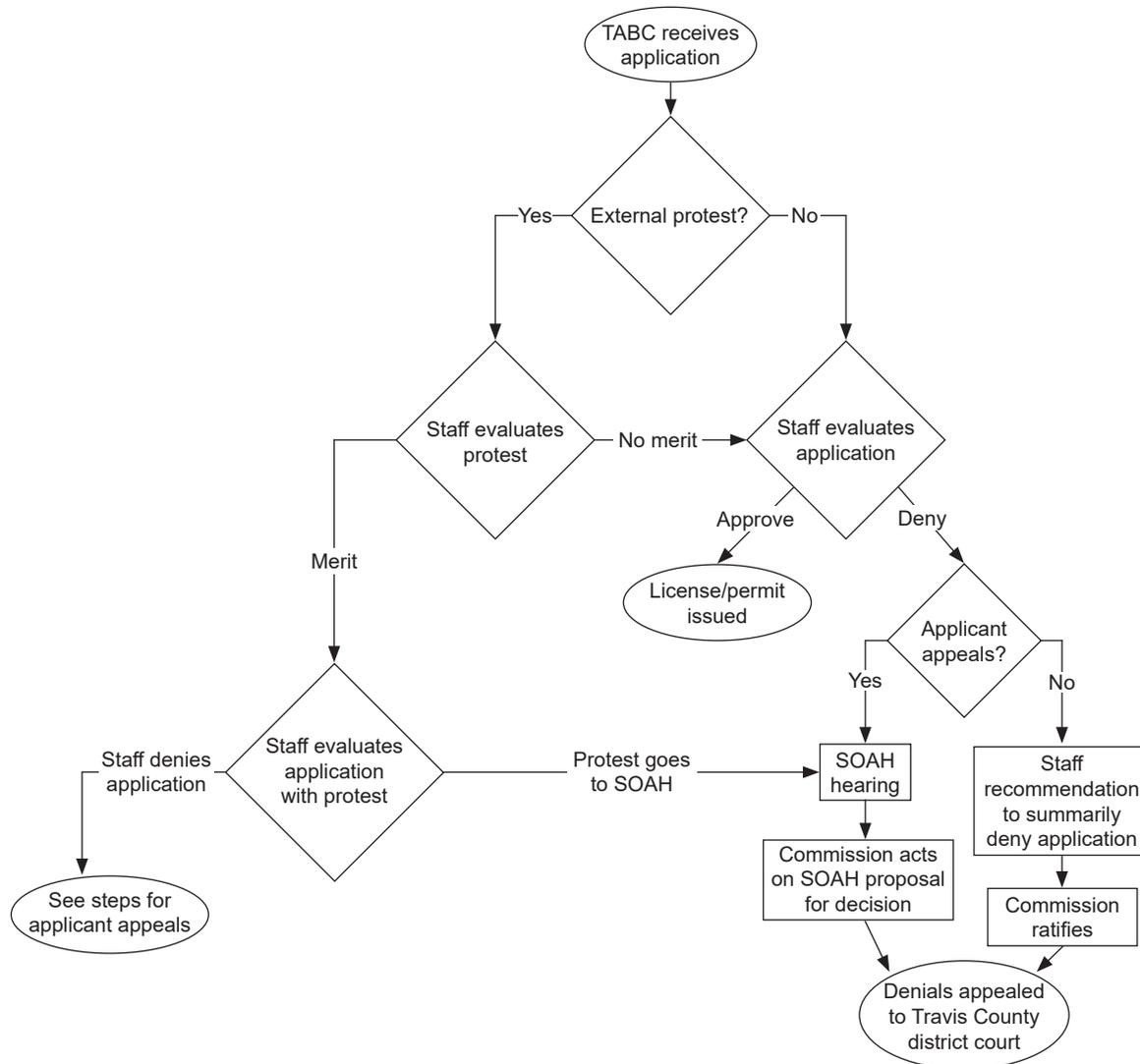
Recommendations

Change in Statute

4.1 Restructure TABC’s protest process to align with best practices, improving consistency and accountability for applicants and TABC.

This recommendation would restructure TABC’s alcoholic beverage license and permit application approval and protest processes to be more in line with standard practices for state agencies. The flowchart on the following page depicts the proposed process. The recommendation would outline the protest process in statute with the following key components:

- **Initial decision by TABC staff.** Statute would require TABC staff to make an initial determination to approve or deny applications that are not associated with an external protest. Staff would no longer protest applications internally. For applications associated with an external protest, TABC staff would evaluate the protest and either deny the application or, if the issue cannot be settled, set it for a hearing at SOAH, as discussed further below.
- **Clear rights to protest.** Local officials would be authorized to protest any license application in addition to their current authority to protest any permit application. Statute would maintain and clarify the existing authority for the general public to protest certain retail applications. TABC would be authorized to adopt rules to allow members of the public to protest applications in other situations it determines appropriate.



- All hearings at SOAH.** Statute would specify that all appeals of TABC decisions to deny an application, regardless of the type of license or permit, would be heard at SOAH. If TABC receives an external protest of an application and determines the protest has merit, staff would consider the application in light of the protest and evaluate whether the application should be approved or denied. If, but for the protest, TABC staff would approve the application, the case would go to SOAH for a hearing. If a protested application results in a SOAH hearing, SOAH would be authorized to request information from TABC. Unless directly involved in a protest, the general public would not be involved in a SOAH hearing.
- Commission approves final decisions.** Statute would require the commission to formally approve the final decision on all applications, including taking final action on all proposals for decision from SOAH. The commission would be authorized to delegate approvals of licenses and permits to staff, but would be required to take final action to deny an application.
- Appeals to Travis County district court.** In accordance with the APA, applicants could appeal the commission's final decision to deny a license or permit to district court in Travis County. Having all appeals heard in Travis County promotes consistent decisions by avoiding a district court in one

part of the state approving a license or permit while a court in another part of the state denies a similar license or permit. Further, all appeals of Travis County district court decisions go to the 3rd Court of Appeals, which has significant expertise in administrative law and helps ensure a uniform body of case law for Texas agencies.

TABC should adopt rules by December 31, 2020, to implement and detail each phase of the new protest process, including reasonable timelines, roles and responsibilities of all involved parties, any potential avenues for mediation or informal dispute resolution, and how the general public can participate in the process. This recommendation would also direct Sunset staff to work with staff from the Texas Legislative Council and TABC to draft legislation that ensures an orderly implementation and resolves any inconsistencies in statutory provisions when establishing the proposed protest process.

Establishing a uniform protest process for all applicants would help ensure applicants are treated fairly and promote more consistent decisions. A clear and streamlined approach would also make the protest process easier for applicants, local officials, and the general public to participate in and clearly understand.

Management Action

4.2 Direct TABC to clearly inform applicants of their due process rights.

In notices to applicants about the status of their license or permit application, TABC should provide clear information about their rights to appeal should the commission deny their application or the applicant voluntarily withdraw the application. This recommendation would ensure applicants know their rights and the consequences of their own actions should they choose to withdraw from the application process.

Fiscal Implication

This recommendation would not have a significant fiscal impact to the state or TABC. With only a handful of protests heard each year by county judges, having SOAH conduct all protest hearings would not result in a significant increase in SOAH's existing workload. Having the commission approve final licensing and permitting decisions would not result in any increased costs to TABC as the commission could approve decisions in bulk through a consent agenda or other mechanism, similar to other licensing agencies.

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- ¹ All citations to Texas statutes are as they appear on <http://www.statutes.legis.texas.gov/>. Sections 11.393(e)(5), 11.41(a), 61.31, 61.32, and 61.382(e)(5), Texas Alcoholic Beverage Code.
 - ² Sections 61.31 and 11.015, Texas Alcoholic Beverage Code.
 - ³ Sections 11.41(a) and 61.32(c), Texas Alcoholic Beverage Code.
 - ⁴ Section 61.39, Texas Alcoholic Beverage Code.
 - ⁵ Texas Commission on Environmental Quality, “Overview: Public Participation in Environmental Permitting—for Applications Filed before Sept. 1, 2015,” accessed August 29, 2018, https://www.tceq.texas.gov/agency/decisions/participation/permitting-participation/pub_part.html.
 - ⁶ Complaint, *Tex. Assoc. Bus. v. Tex. Alcoholic Beverage Comm’n*, No. 1:16-cv-00789 (W.D. Tex. June 27, 2016).
 - ⁷ Defendant’s Motion to Dismiss Plaintiff’s Complaint, *Tex. Assoc. Bus. v. Tex. Alcoholic Beverage Comm’n*, No. 1:16-cv-00789-SS (W.D. Tex. August 5, 2016).
 - ⁸ State Office of Admin. Hearings, *Application for Renewal of Core-Mark Midcontinent, Inc.*, Docket No. 458-17-1235 (Sep. 8, 2017) (proposal for decision).
 - ⁹ Tex. Alcoholic Beverage Comm’n, *Renewal Application of Core-Mark Midcontinent, Inc.*, Docket No. 641578 (Mar. 14, 2018) (order).
 - ¹⁰ Sections 5.435(a)–(b), Texas Alcoholic Beverage Code.
 - ¹¹ Sections 11.67, 32.18, and 61.34, Texas Alcoholic Beverage Code.

ISSUE 5

Several TABC Enforcement Practices Do Not Follow Common Standards, Limiting Regulatory Efficiency and Effectiveness.

Background

The Texas Alcoholic Beverage Commission's (TABC) mission includes protecting public safety by deterring and detecting violations of the Texas Alcoholic Beverage Code.¹ TABC staff regularly investigate and adjudicate violations of state law and TABC rules, including through audits of licensee records, open inspections of licensed premises, and undercover operations. As described further in the *Focus of Enforcement and Audit Functions* textbox, TABC's law enforcement agents are peace officers who investigate violations related to public safety issues, while civilian audit staff investigate violations of the numerous financial, marketing, and other regulatory restrictions in the law.

In fiscal year 2017, TABC staff performed a combined 108,626 inspections of licensed premises and 1,600 audits. Because many violations carry both administrative and criminal penalties, TABC frequently takes disciplinary action against licensees and also files criminal charges with local district attorneys' offices. TABC filed 1,589 criminal cases in fiscal year 2017, while also opening 3,040 administrative cases that resulted in 1,754 suspensions or fines along with 64 license cancellations.

The Sunset Commission has a long history of evaluating licensing and regulatory agencies to determine whether they perform their functions in the most effective, fair, and efficient manner. Over the course of more than 40 years, the Sunset Commission has completed more than 110 licensing agency reviews. Sunset staff has documented standards in reviewing licensing and enforcement functions to guide future reviews of licensing agencies. While these standards provide a guide for evaluating a licensing program's structure, they are not intended for blanket application. Sunset staff continues to refine and develop standards, reflecting additional experience and different or changing needs, circumstances, or practices in licensing agencies. The following material reflects the application of these standards to help refocus the agency's enforcement efforts to provide fairer and more effective oversight of the alcoholic beverage industry.

Focus of Enforcement and Audit Functions

Law enforcement agents investigate public safety violations at licensed locations:

- Sales or service of alcohol to minors and intoxicated customers
- Sales or service of alcohol after legal hours
- Breaches of the peace at a licensed location resulting in death or serious injury
- Human trafficking, prostitution, and sales of illegal alcohol or drugs

Auditors investigate regulatory violations:

- State excise taxes
- Industry marketing regulations
- Cash and credit payments for alcoholic beverage deliveries
- Signage and tax stamp requirements
- Money laundering, cross-tier relationships, and sales of illegal alcohol

Findings

TABC's high annual inspection quota does not effectively target businesses posing the greatest public safety risk.

Inspections of low-risk businesses draw focus and resources away from higher-risk locations.

A licensing agency should have the authority and flexibility to evaluate the public safety risk licensees pose and focus staff time and resources on those representing the greatest risk. While statute does not require TABC to conduct regular inspections of licensed locations, a non-statutory performance measure set by the Legislative Budget Board requires TABC to inspect nearly 80 percent of all locations across Texas each year. Although TABC has developed a risk-based approach to its audit and law enforcement activities, as directed by statute, this performance measure limits the agency's ability to fully prioritize the most significant public safety concerns.

To meet this measure, TABC staff conduct about 36,000 inspections of lower-risk locations each year, drawing focus and resources away from higher-risk locations, such as those with a history of selling alcohol to minors. The high inspection quota also results in agency staff inspecting some businesses multiple times while others go years without an inspection. More than 100 businesses have gone at least three years without an inspection and some as long as a decade. Further, high-volume, untargeted inspections produce few violations; typically, TABC staff find a violation in just 1 percent of inspections. In contrast, when TABC law enforcement agents conduct undercover operations targeted at specific, high-risk locations, they find violations in 10 to 20 percent of inspections.

TABC lacks tools needed to effectively and consistently penalize those violating the Alcoholic Beverage Code.

TABC cannot tailor penalties to fit the circumstances of the offense.

- **Businesses can select penalties.** Licensing agencies typically have the authority to select a disciplinary penalty that fits the facts and circumstances of an administrative violation. Except for a narrow group of serious public safety violations, such as selling alcohol to minors, statute requires TABC to offer most businesses that violate the law a choice between having their license or permit suspended for a period of time or paying a fine.² With this restriction, for the majority of violations, TABC cannot tailor the penalty to fit the circumstance of the offense to adequately discourage future violations. For example, TABC cannot choose the appropriate penalty for licensees being intoxicated while operating their business or for knowingly misrepresenting an alcoholic beverage sold to the public. Similarly, while TABC staff generally require license holders engaging in temporary events to pay a fine for violations, the authority to do so is unclear. For example, technically under current law a caterer could choose suspension as a penalty and simply schedule events around the suspension, thereby largely escaping negative impact from the penalty.

- **Businesses can profit from violations.** A licensing agency should be able to assess fines that are sufficient to appropriately deter violations of the law. TABC cannot consider the profits a business earns from violating the code when assessing fines, allowing some businesses to profit more from violating the law than following it, even when caught. As described in the accompanying textbox, statute prohibits TABC from considering various economic factors about a business when assessing a fine to prevent it from penalizing a business simply based on its size and wealth.³ TABC has interpreted this provision to also prohibit it from considering profits earned *from a violation* when assessing fines. Being unable to consider profits businesses earn from prohibited activities limits TABC's ability to assess fines that appropriately correspond to the nature and seriousness of violations.

Economic Factors TABC Cannot Consider When Assessing Fines

- Volume of alcoholic beverages sold
- Overall receipts
- Taxes paid
- Financial condition of the licensee

- **Incomplete penalty guidelines.** A licensing agency should establish a set of guidelines, such as a penalty matrix, that links specific types of violations to specific penalties or penalty ranges and provides for aggravating and mitigating factors. Such guidelines help ensure disciplinary actions correspond to the nature and seriousness of the offense, and promote consistency in applying sanctions to similar types of violations. Despite statute requiring TABC to adopt a schedule of sanctions for violations of state law or rule, the agency has failed to adopt a schedule that addresses all regulatory violations.⁴ While TABC has a penalty matrix for major regulatory infractions and public safety violations, it has no formal guidelines for violations of marketing and business practices regulations, such as a retailer buying alcoholic beverages from another retailer instead of a distributor or collusion between a manufacturer and retailer to influence prices. TABC staff has developed informal internal guidelines for disciplining these violations based on prior cases, but these guidelines are dependent on staff's institutional memory and are not transparent.

Some businesses profit more from violating the law than following it.

- **Insufficient authority to temporarily suspend a license.** Licensing agencies should have authority to act quickly to temporarily suspend a license to protect the public. Most Texas licensing agencies, for professions ranging from doctors, pharmacists, and dentists to electricians, barbers, and massage therapists, have clear authority to suspend a license when necessary to prevent continuing threats to the public welfare. In contrast, TABC may only suspend a license without holding a full administrative hearing if the business no longer qualifies for the license, such as by losing a required bond. For public safety concerns, the executive director may only suspend a retail license for seven days, and only for investigative purposes, if a shooting, stabbing, or murder has occurred at the location and there is a likelihood of subsequent violence.⁵ Temporary suspension authority acts as a standard tool for agencies to prevent harm to the public. In addition, statute typically balances use of this authority with an oversight

TABC lacks sufficient authority to suspend a license to prevent continuing threats to public welfare.

process to prevent abuse. For example, state law sets out a strict process for the Department of Licensing and Regulation's use of suspension orders, including requiring a hearing before the State Office of Administrative Hearings within 10 days of issuing the emergency suspension.⁶

TABC must open a separate enforcement case if a licensee fails to comply with a prior disciplinary order.

- **Violating an agency order carries no penalty.** The authority to take action or deny license renewals if a licensee fails to comply with an agency's disciplinary order bolsters an agency's enforcement efforts and encourages licensees to comply. TABC issued more than 1,800 disciplinary orders in fiscal year 2017, but the agency lacks clear authority to take disciplinary action or deny license or permit renewals based on an applicant's failure to comply with those orders. Without clear authority to sanction noncompliance, TABC must instead open another separate enforcement case on the original violation, which requires additional staff time and resources and allows noncompliant licensees to continue operating.

Other aspects of TABC's enforcement process do not follow standard practices and weaken oversight.

- **Inappropriate public inclusion in disciplinary hearings.** Generally, hearings on state regulatory matters should follow the uniform standards set forth in the Administrative Procedures Act, which are designed to allow for due process and establish clear expectations for both the agency and the industry it regulates. The Alcoholic Beverage Code includes a unique feature, not found in standard administrative hearings, requiring anyone conducting a disciplinary hearing to provide the general public with an opportunity to testify and to consider the testimony in the decision-making process.⁷ The public typically engages in TABC's enforcement process by filing a complaint, very rarely appearing at a disciplinary hearing. Allowing individual members of the public to insert themselves into such a formal proceeding disrupts standard judicial and administrative procedures and is unnecessary.
- **Lack of commission oversight of decisions.** An agency's governing body should approve final enforcement decisions to ensure knowledge of staff decisions and provide appropriate oversight of staff operations. However, the commission has delegated its decision-making authority for all enforcement decisions to the executive director, including adopting final orders following contested case hearings.⁸ With no active role in the enforcement process, the commission cannot stay abreast of trends in the industry, identify recurring problems or issues, consider the broader policy implications of decisions, ensure licensees and permittees are treated fairly, and generally set the course for the agency.

With no active role in the enforcement process, the commission cannot ensure licensees are treated fairly.

Recommendations

Change in Statute

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.

Statute would require TABC to physically inspect every regulated location in the state, but in a reasonable period of time established by the commission in rule. The commission should adopt rules defining a minimum inspection period by January 31, 2020. TABC should work with the Legislative Budget Board to reduce its current performance target to inspect 80 percent of regulated locations each year. This recommendation would give TABC flexibility to prioritize its inspection efforts based on the greatest risks to the public, while also keeping regulated locations from falling through the cracks and going a decade without any inspection.

5.2 Remove the requirement that TABC offer licensees a choice between a suspension or fine and, instead, authorize TABC to determine the appropriate penalty for each violation.

This recommendation would remove the requirement that TABC offer licensees and permittees a choice of penalty for most violations of the Alcoholic Beverage Code. As currently allowed for public safety violations, TABC would be authorized to choose the appropriate penalty based on the circumstances of the individual violation. This standard authority would allow TABC to structure penalties to discourage repeat violations.

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

This recommendation would allow TABC to consider evidence regarding whether and how much a business profited from violating the law when determining the appropriate penalty to both punish and deter such a violation. Statute would continue to prohibit TABC from considering economic factors unrelated to the violation, including overall volume of alcoholic beverages sold, overall receipts, taxes paid, or the financial condition of the licensee. Allowing TABC to consider a business's profits from violating the law would ensure TABC can effectively penalize a licensee for illegal behavior, so that violating the code and paying a fine does not become simply a cost of doing business.

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

This recommendation would add standard licensing agency authority to allow TABC's executive director to temporarily suspend any license or permit if the agency finds continued operations would constitute a continuing threat to public welfare, such as engaging in human trafficking or organized crime. To guide the use and review of this authority, statute would prescribe a process similar to the one established for the Texas Department of Licensing and Regulation, including a requirement that TABC hold a hearing on the temporary suspension at the State Office of Administrative Hearings within 10 days of issuing the suspension order. Each suspension order issued by TABC would be required to specify the duration of the order, which could not exceed 90 days.

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.

This recommendation would specify in statute that noncompliance with a commission order is a violation of the Alcoholic Beverage Code, allowing TABC to take disciplinary action against a licensee or permittee for noncompliance. TABC could also deny a licensee's renewal application based on the failure to comply with the commission's order. These changes would provide a common tool to incentivize timely compliance with state law and better protect consumers.

5.6 Remove the nonstandard requirement allowing the public to testify at TABC disciplinary hearings.

This recommendation would eliminate the highly unusual provision that allows individual members of the public to insert themselves into formal hearings on enforcement matters. The public would continue to have opportunities to provide input to the commission, such as by submitting complaints and providing comments at commission meetings.

5.7 Require the commission to make final determinations on most enforcement and disciplinary actions.

This recommendation would ensure the commission provides sufficient oversight of the agency's enforcement efforts by issuing the final decision on disciplinary actions. The commission would approve or reject agreed orders developed by staff and take final action on all proposals for decision from the State Office of Administrative Hearings. To avoid unnecessary delays in more serious cases, the commission would be authorized to delegate authority to the executive director to enter into final orders when a business voluntarily agrees to have its license or permit cancelled. As is standard for many licensing agencies, the commission could choose to approve multiple final orders in a single vote, such as by approving a list of agreed orders. Greater involvement by the commission in enforcement decisions would provide better oversight to ensure staff apply disciplinary decisions fairly and consistently.

Management Action

5.8 Direct TABC to complete its schedule of sanctions to account for all regulatory violations.

This recommendation would direct TABC to complete its penalty matrix by December 31, 2020, by adopting a schedule of sanctions for all regulatory violations of the Alcoholic Beverage Code. Establishing a comprehensive matrix would help ensure disciplinary actions relate appropriately to the nature and seriousness of the offense, and promote consistency in applying sanctions to similar types of violations. Adopting the matrix in rule would also give the regulated industry an opportunity to provide input on potential penalties and the commission an avenue to set agency policy regarding enforcement actions.

Fiscal Implication

These recommendations would not have a significant fiscal impact to the state or TABC. Clarifying TABC's inspections timeline should reduce staff time and resources spent on untargeted inspections, which TABC could use to conduct more targeted inspections and enforcement activities. Allowing TABC to choose between a fine and suspension, and to assess those fines based on a licensee's profits from violating the code, may result in increased penalty revenue; however, the actual increase in revenue

would depend on case-specific implementation and cannot not be estimated. Recommendations requiring the commission to approve final disciplinary actions and adopt a penalty matrix could be accomplished with existing resources.

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¹ All citations to Texas statutes are as they appear on <http://www.statutes.legis.texas.gov/>. Section 5.31(b), Texas Alcoholic Beverage Code.

² Section 11.64, Texas Alcoholic Beverage Code.

³ Section 11.641, Texas Alcoholic Beverage Code.

⁴ Section 5.362, Texas Alcoholic Beverage Code.

⁵ Section 11.61(d), Texas Alcoholic Beverage Code.

⁶ Section 51.3511, Texas Occupations Code.

⁷ Section 5.435, Texas Alcoholic Beverage Code.

⁸ Section 5.34, Texas Alcoholic Beverage Code.

ISSUE 6

The High Cost of Collecting Alcohol Import Taxes at the Border Outweighs the Negligible Public Safety Benefit.

Background

State law limits the amount of alcohol individuals can bring into the state for personal use and requires those importing beverages into Texas to pay an import tax as well as a \$3 administrative fee.¹ As shown in the *Import Maximums and Tax Rates* table, when the import tax is combined with the administrative fee, the total amount collected ranges from \$3.25 to \$5.50 per container, depending on the type and quantity of alcohol. The Texas Alcoholic Beverage Commission (TABC) implements these provisions through its Ports of Entry Program. The agency's civilian tax compliance officers operate 28 tax collection stations along the Texas-Mexico border plus at two cruise ship terminals, as shown in Appendix B, where they collect the taxes and enforce the import limits.

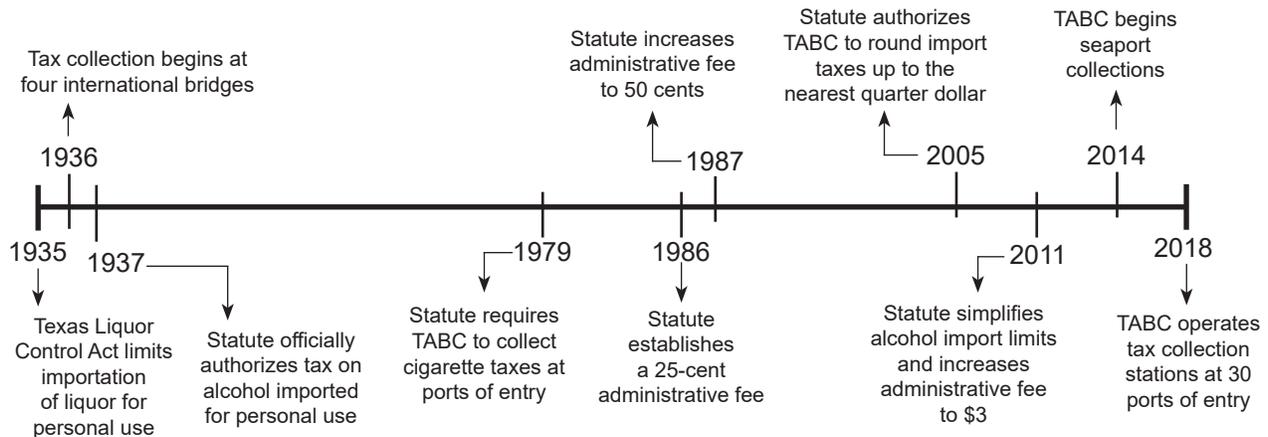
Import Maximums and Tax Rates

Import Maximum		Tax Rate	Administrative Fee	Total Cost Per Container
Distilled Spirits	1 Gallon	Gallon \$2.50	\$3.00	\$5.50
		Half Gallon 1.25	3.00	4.25
		Quart 0.75	3.00	3.75
		Fifth 0.50	3.00	3.50
		Pint 0.50	3.00	3.50
		Half Pint 0.25	3.00	3.25
		Miniatures 0.25	3.00	3.25
Wine	3 Gallons	Gallon \$0.75	\$3.00	\$3.75
		Fifth 0.25	3.00	3.25
Malt Beverages	24 12-oz Containers	24 12-oz Containers \$0.50	\$3.00	\$3.50
		12 12-oz Containers 0.25	3.00	3.25
		6 12-oz Containers 0.25	3.00	3.25
Cigarettes	None	Pack \$1.50	None	\$1.50

As depicted in the timeline on the following page, Texas' Ports of Entry Program began in 1936 with tax collection stations at Brownsville, Eagle Pass, Laredo, and El Paso, and has expanded over the years. Although state law requires the comptroller of public accounts to collect most state cigarette taxes, as a matter of convenience, in 1979, the Legislature required TABC employees already collecting alcohol taxes at ports of entry to also collect cigarette taxes.² State law imposes a \$1.50 per pack tax on cigarettes imported from other countries, but unlike alcohol, does not expressly limit the number of cigarettes that can be imported for personal use and does not require an administrative fee.³

In fiscal year 2017, TABC taxed almost 1.8 million alcohol containers, collecting \$1.1 million in alcohol taxes and \$5.4 million in administrative fees, and also taxed approximately 400,000 packs of cigarettes, collecting roughly \$600,000 in cigarette taxes. TABC operates the program with 115 tax compliance officers and four executive and management staff.

Texas Ports of Entry Program History



Findings

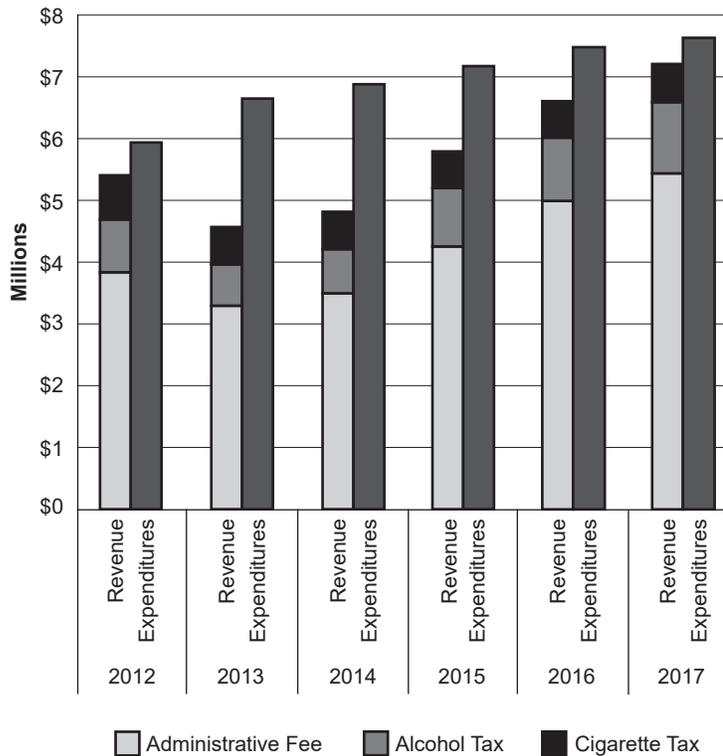
Collecting taxes on alcohol and cigarettes imported for personal use is a poor return on investment for the state.

- Taxes and administrative fees do not cover program costs.** The Ports of Entry Program is not self-sufficient, nor has it ever been. Even considering total revenue — alcohol and cigarette taxes combined with administrative fees — the program had a combined net deficit of almost \$7 million over the last six fiscal years. Although alcohol tax revenue has risen slightly, cigarette tax revenue has decreased every year and neither has made the overall operations profitable.

The ports program had a deficit of almost \$7 million over the last six years.

In 2011, the Legislature increased the administrative fee for alcohol tax collection from \$0.50 to \$3, citing the program’s lack of self-sufficiency.⁴ However, even with the higher administrative fee, revenue has not kept up with operational costs, as shown in the *Ports of Entry Revenue and Expenditures* graph on the following page. In the six years since raising the fee, total program revenue averaged \$5.8 million per year while program costs averaged \$6.9 million. Adding collection stations at the Galveston cruise ship terminals in 2014 helped increase revenue, but in the years since, even with the administrative fee, revenue has continued to fall short of paying for the program.

**Ports of Entry Revenue and Expenditures
FYs 2012–2017**



- **Repeal of another inefficient alcohol tax.** Texas recently repealed an alcohol tax that imposed a high administrative burden for little revenue in return. In 2015, the Legislature repealed the 5 cent per serving tax on alcoholic beverages sold on passenger airplanes and trains.⁵ Before its repeal, airlines were entitled to a refund for the portion of the tax paid on beverages sold outside of Texas airspace, causing TABC to refund most of the taxes collected.

The program’s fee structure and operating rules are not fair or transparent to taxpayers, undermining basic good government principles.

- **Administrative fee increases the tax rate.** Charging a fee to pay a tax creates a fundamental policy problem because the fee effectively increases the tax rate. In the case of the Ports of Entry Program, the \$3 administrative fee can be more than 10 times the amount of the tax. Charging a fee to fund tax collection is not transparent public policy and Sunset staff could not identify another instance of the state imposing a fee specifically to fund the collection of a tax. While the fee helps support TABC’s enforcement of import limits, unlike a license fee or other user fee that provides a service or other benefit to the user, this fee provides no discernable benefit to the consumer.

*The
administrative
fee can be 10
times the amount
of the import tax.*

TABC has not adopted rules to justify its current tax rates and fees.

- **Unclear law and no rules.** State law does not clearly define the alcohol import tax amount or how TABC should collect the administrative fee, and TABC has interpreted both in internal agency policy without the benefit of a more transparent rulemaking process. In particular, TABC has not adopted rules to justify its current import tax rates for wine and spirits, which unlike beer and ale, do not explicitly tie to alcohol excise taxes in law.⁶ Further, TABC charges the \$3 administrative fee on every imported container without clear authority to do so, as state law does not indicate whether the administrative fee is per container or per transaction.

For cigarettes, state law requires the comptroller and TABC to adopt rules for cigarette tax collection at ports of entry.⁷ Although the comptroller adopted rules, TABC did not, and since 2003, the comptroller's rules have envisioned an interagency contract between the two agencies that never materialized.⁸

TABC's presence at ports of entry adds negligible public safety benefits beyond what U.S. Customs and Border Protection already provides.

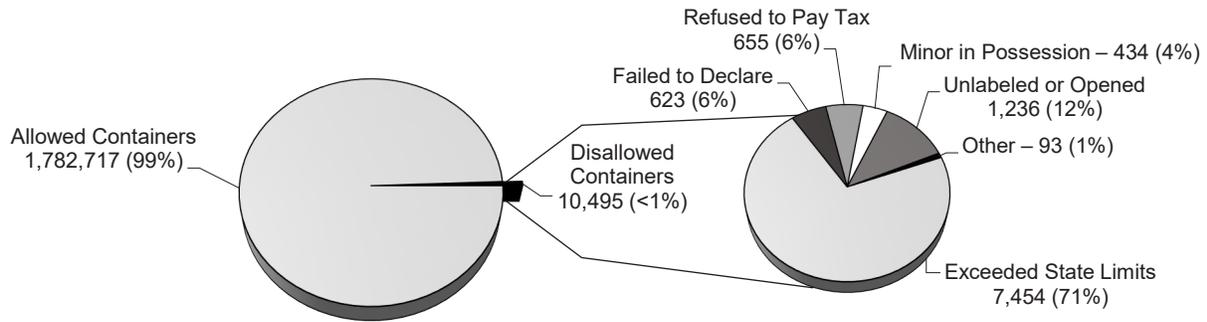
- **TABC is not primarily responsible for public safety at ports of entry.** TABC leases space adjacent to U.S. Customs and Border Protection's ports of entry, where U.S. Customs officers are responsible for identifying and seizing illicit material before it enters the country. Customs processes individuals crossing the border, then refers those with alcohol or cigarettes to TABC tax compliance officers who collect state alcohol and cigarette taxes. Over the last three years, U.S. Customs officers at Texas ports of entry seized a total of 10,233 kilograms of methamphetamine, 1,293 kilograms of heroin, 9,737 kilograms of cocaine, and 284,300 kilograms of marijuana.⁹ Unlike U.S. Customs officers, TABC's tax compliance officers are civilians, not law enforcement officers, and lack authority to search or seize. Therefore, when public safety issues arise, TABC's tax compliance officers rely on the federal customs officers. For example, if a TABC tax compliance officer thinks an alcoholic beverage container looks suspicious, the officer immediately reports it to U.S. Customs for proper inspection and action.¹⁰

TABC disallowed less than 1 percent of alcohol containers that passed through ports of entry.

- **TABC's regulatory focus has minimal public safety value.** Although TABC claims the Ports of Entry Program helps stop potentially dangerous alcoholic beverages from coming into Texas, most of the containers TABC disallows result from individuals trying to exceed the allowed amount of alcohol. As shown in the *Disallowed Alcohol Containers* pie chart on the following page, out of almost 1.8 million containers that passed through the ports of entry in fiscal year 2017, TABC's tax compliance officers disallowed less than 1 percent. Of that small percentage, more than three-quarters simply exceeded the legal limits or chose to abandon their alcohol rather than pay the tax. Of all the alcohol containers TABC disallowed over the last six years, only two contained illicit drugs. Although a handful of

containers TABC disallows are unlabeled or opened, possibly presenting a small public safety risk, TABC does not test these containers to determine whether the substance is dangerous. Anecdotally, TABC reports most of these containers are bottles of homemade alcohol.

Disallowed Alcohol Containers – FY 2017



Total Containers: 1,793,212

- Weak and inconsistent TABC enforcement.** 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. TABC is not always present when border crossing stations are open, creating a significant regulatory gap. For example, TABC staffs only three stations 24 hours every day; at the other stations, U.S. Customs processes travelers before TABC arrives in the morning and after TABC leaves for the day. At some stations, TABC only appears occasionally, on a spot-check basis. Further, because TABC has no presence in international airports, air travelers are not asked to declare imports according to state limits or pay state alcohol or cigarette taxes at all. Finally, TABC does not physically inspect bottles at the Port of Galveston or consistently enforce the law during peak travel times at its other locations, such as during winter holidays.

Compliance with alcohol import laws is on the honor system.

Attempting to strengthen the program’s public safety value would likely force TABC to charge beyond what people are willing to pay.

To strengthen the Port of Entry Program’s public safety value by more fairly and consistently enforcing import limits, TABC would need significant additional resources, meaning the agency would either need to charge an even higher administrative fee or tax more alcohol containers. In an effort to increase revenue by taxing more containers, TABC explored establishing tax collection stations at Texas’ international airports. In early 2018, TABC conducted a 30-day trial at Austin’s airport, collecting approximately \$6,300 in taxes and fees. However, the agency spent approximately \$24,000 for the pilot — nearly four times the amount of revenue collected. TABC estimated that taxing alcohol

at the much busier Houston Intercontinental and Dallas-Fort Worth airports could increase revenue substantially, but would require 30 to 40 more staff, plus leasing and equipment costs. Ultimately, logistical problems at the airports caused TABC to put its plans to tax air travelers on hold.

Alternatively, TABC's only other option is to request the Legislature increase the administrative fee. However, at some point, the fee would be higher than people would bear. At that point, they would likely abandon their alcohol at TABC's tax collection stations rather than pay an exorbitant fee to bring it into Texas, and TABC would collect less revenue, increasing the program's deficit.

No other state physically collects taxes or enforces limits on alcohol on the U.S.-Mexico border.

Texas is the only state on the U.S.-Mexico border that spends state resources to regulate alcohol import limits for personal use or collect import taxes. While not its primary focus, U.S. Customs' publicly stated policy is to enforce state laws limiting the amount of alcohol that may be brought in without a license, even when state law is more restrictive than federal regulations.¹¹ Accordingly, the other southern border states rely on U.S. Customs to monitor and enforce their regulations relating to alcohol importation. At its discretion, U.S. Customs also enforces separate federal regulations that prevent an individual from importing large quantities of alcohol for commercial or resale purposes, and collects federal taxes for amounts exceeding duty-free limits.¹²

Recommendation

Change in Statute

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

This recommendation would eliminate the tax on alcohol imported for personal use and the associated administrative fee. By extension, this recommendation would eliminate TABC's Ports of Entry Program, as the agency would no longer have a need to place tax compliance officers at ports of entry. Considering TABC's overall cost of physically collecting alcohol taxes at the border compared to the revenue collected, eliminating the tax would save the state money without significantly sacrificing any regulatory or public safety benefit.

The recommendation would maintain current state limits on how much alcohol individuals can import for personal use to provide U.S. Customs a tool to enforce Texas' limits at its discretion, in addition to its ongoing role to monitor alcohol imports for compliance with federal regulations and taxes. In accordance with its primary mission, U.S. Customs would continue searching travelers, investigating suspicious containers, and seizing illicit substances that pose a genuine threat to public health and safety.

Because state law requires TABC employees who collect taxes on alcoholic beverages at ports of entry to also collect taxes on cigarettes, this recommendation would also eliminate TABC's role in collecting cigarette taxes. The cigarette tax would remain in law and jurisdiction for its collection would revert to the comptroller of public accounts.¹³

Fiscal Implication

Overall, this recommendation would result in an estimated net savings to the state of approximately \$421,000 per year, based on fiscal year 2017 revenues and expenditures.

Repealing the tax on alcohol imported for personal use and its administrative fee would result in an annual loss of approximately \$6.5 million to general revenue. Additionally, assuming the comptroller would choose not to expend resources to collect the cigarette tax at the border, the state would see a loss of \$194,000 to general revenue and a loss of \$420,000 to the Property Tax Relief Fund, as a portion of the cigarette tax collections are deposited to the latter.¹⁴

However, these losses would be offset by annual savings of \$7.6 million in operating costs associated with closing TABC's 30 tax collection stations, including 119 positions and associated benefits, \$243,000 in lease expenses, and \$659,000 in indirect costs.

Texas Alcoholic Beverage Commission

Fiscal Year	Savings to the General Revenue Fund	Loss to the General Revenue Fund	Loss to the Property Tax Relief Fund	Change in FTEs
2020	\$7,578,238	\$6,737,506	\$420,000	-119
2021	\$7,578,238	\$6,737,506	\$420,000	-119
2022	\$7,578,238	\$6,737,506	\$420,000	-119
2023	\$7,578,238	\$6,737,506	\$420,000	-119
2024	\$7,578,238	\$6,737,506	\$420,000	-119

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¹ All citations to Texas statutes are as they appear on <http://www.statutes.legis.texas.gov/>. Section 107.07, Texas Alcoholic Beverage Code.

² Section 111.001, Texas Tax Code; Sections 154.021 and 154.024, Texas Tax Code; H.B. 1955, 66th Texas Legislature, Regular Session, 1979.

³ Section 154.021, Texas Tax Code, sets a tax rate of \$1.41 per 20-cigarette pack and Section 154.024 applies that tax to persons importing small quantities of cigarettes into Texas from foreign countries and permits TABC to round the tax up to the nearest quarter of a dollar, resulting in a \$1.50 tax per pack.

⁴ Bill Analysis, H.B. 1936, 82nd Texas Legislature, Regular Session, 2011.

⁵ H.B. 1905, 84th Texas Legislature, Regular Session, 2015.

⁶ Sections 201.02, 201.41, and 203.02, Texas Alcoholic Beverage Code.

⁷ Section 154.024(c), Texas Tax Code.

⁸ 34 T.A.C. Section 3.101

⁹ Methamphetamine data includes crystal methamphetamine. U.S. Customs and Border Protection Office of Field Operations Select Drug Seizures, prepared August 7, 2018.

¹⁰ Texas Alcoholic Beverage Commission, *TABC Ports of Entry Procedure Manual* (Austin: Texas Alcoholic Beverage Commission, 2017), 33.

¹¹ "Customs Duty Information," U.S. Customs and Border Protection, official website of the Department of Homeland Security, last modified May 31, 2017, <https://www.cbp.gov/travel/international-visitors/kbyg/customs-duty-info>.

¹² Ibid.

¹³ Section 111.001, Texas Tax Code.

¹⁴ The comptroller estimated fiscal year 2018 revenue to the Property Tax Relief Fund at \$1.591 billion. Comptroller of Public Accounts, *Certification Revenue Estimate 2018–2019, Revised July 2018* (Austin: Comptroller of Public Accounts, 2018), 10.

ISSUE 7

TABC's Statute Does Not Reflect Standard Elements of Sunset Reviews.

Background

Over the years, Sunset reviews have included a number of standard review elements from direction provided by the Sunset Commission, from statutory requirements added by the Legislature to the Criteria for Review in the Sunset Act, or from general law provisions imposed on state agencies. This review identified changes needed to conform the Texas Alcoholic Beverage Commission's (TABC) statutes to standard Sunset language generally applied to all state agencies and to address the need for the agency's required reports. Sunset staff also performed a newly required assessment of cybersecurity practices.

- **Sunset across-the-board provisions.** The Sunset Commission has developed standard language that it applies across the board to all state agencies reviewed unless a strong reason exists not to do so. These provisions reflect an effort by the Legislature to place policy directives on agencies to prevent problems from occurring, instead of reacting to problems after the fact. These provisions also reflect review criteria contained in the Sunset Act designed to ensure open, responsive, and effective government.
- **Reporting requirements.** The Sunset Act establishes a process for the Sunset Commission to consider if reporting requirements of agencies under review need to be continued or abolished. The Sunset Commission has interpreted these provisions as applying to reports required by law that are specific to the agency and not general reporting requirements that extend well beyond the scope of the agency under review. Reporting requirements with deadlines or that have expiration dates are not included, nor are routine notifications or notices, posting requirements, or federally mandated reports.
- **Person-first respectful language.** The Sunset Act directs the Sunset Commission to evaluate each agency's statute for compliance with the Legislature's person-first respectful language initiative and make recommendations for appropriate statutory revisions, such as replacing terms like "handicapped" with "persons with disabilities."¹
- **Cybersecurity.** The 85th Legislature tasked the Sunset Commission with assessing cybersecurity practices for agencies under review.² The assessment of TABC's cybersecurity practices focused on identifying whether the agency complied with state requirements and industry cybersecurity best practices. Sunset staff did not perform technical assessments or testing due to lack of technical expertise, but worked closely with the Department of Information Resources to gather a thorough understanding of the agency's technical infrastructure.

Findings

TABC's statute does not reflect updated requirements for commission member training.

TABC's statute contains the standard across-the-board Sunset recommendation requiring training for commission members, but does not include newer requirements for agency staff to create a training manual for all commission members or specify that the training must include a discussion of the scope of and limitations on the commission's rulemaking authority.

TABC's only statutorily required report is no longer needed.

In 2007, the Legislature strengthened TABC's enforcement authority over businesses selling and serving alcohol after the legally allowed hours and required the agency to report to the Legislature before each session on the number of establishments with prohibited-hours violations.³ The report has served its original purpose to provide specific information about a new area of enforcement and is no longer needed. TABC tracks all enforcement activity and violations and makes that information publicly available, further reducing the need to separately report on this narrow aspect of the agency's overall enforcement efforts.

TABC's after-hours report has served its original purpose.

TABC's statute does not use appropriate language when referring to persons with disabilities.

The Texas Alcoholic Beverage Code contains language inconsistent with the person-first respectful language initiative in three sections.⁴ TABC's Sunset bill should revise these statutes to use person-first respectful language.

The commission should continue to implement state cybersecurity requirements and industry best practices.

Sunset staff found no issues relating to TABC's cybersecurity practices that require action by the Sunset Commission or the Legislature, and communicated the results of this assessment directly to the agency.

Recommendations

Change in Statute

7.1 Update the standard across-the-board requirement related to commission member training.

This recommendation would require TABC to develop a training manual that each commission member attests to receiving annually, and require existing commission member training to include information about the scope of and limitations on the commission's rulemaking authority. The training should provide clarity that the Legislature sets policy, and agency boards and commissions have rulemaking authority necessary to implement legislative policy.

7.2 Discontinue the requirement for TABC to prepare a limited report on after-hours violations.

This recommendation would remove the requirement for TABC to report to the Legislature on certain enforcement efforts related to prohibited-hours violations. Statute would still require TABC to track statistics and trends of every type of enforcement activity, report the information to the commission, and make it available to the public.

7.3 Update the agency's statute to reflect the requirements of the person-first respectful language initiative.

This recommendation would direct the Texas Legislative Council to revise TABC's statutes in three places to conform to the person-first respectful language requirements found in Chapter 392, Texas Government Code.⁵

Fiscal Implication

These recommendations would not have a fiscal impact to the state or TABC.

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¹ All citations to Texas statutes are as they appear on <http://www.statutes.legis.texas.gov/>. Section 325.0123(b), Texas Government Code.

² Section 325.011(14), Texas Government Code.

³ Section 5.61, Texas Alcoholic Beverage Code.

⁴ Sections 11.46(9), 61.71(23), and 61.74(a)(12), Texas Alcoholic Beverage Code.

⁵ Ibid.

APPENDICES

APPENDIX A

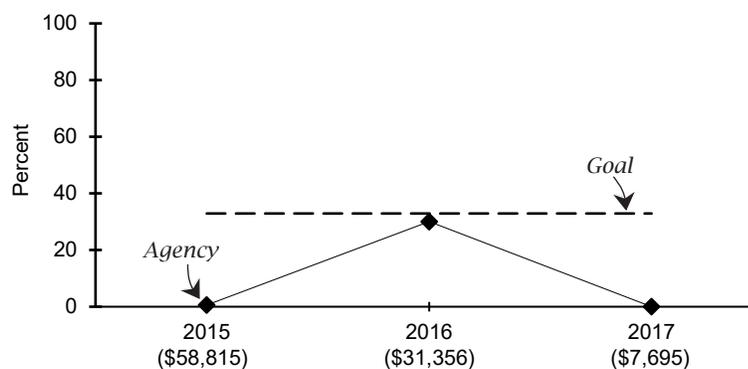
Historically Underutilized Businesses Statistics 2015 to 2017

The Legislature has encouraged state agencies to increase their use of historically underutilized businesses (HUBs) to promote full and equal opportunities for all businesses in state procurement. The Legislature also requires the Sunset Commission to consider agencies' compliance with laws and rules regarding HUB use in its reviews.¹

The following material shows trend information for the Texas Alcoholic Beverage Commission's (TABC) use of HUBs in purchasing goods and services. The agency maintains and reports this information under guidelines in statute.² In the charts, the dashed lines represent the goal for HUB purchasing in each category, as established by the comptroller's office. The diamond lines represent the percentage of agency spending with HUBs in each purchasing category from 2015 to 2017. Finally, the number in parentheses under each year shows the total amount the agency spent in each purchasing category.

TABC failed to meet the state's goal for HUB spending in the special trade and other services categories each year from fiscal year 2015 to 2017. During the same period the agency exceeded goals for HUB spending for professional services and had mixed success in meeting goals in the commodities category. The commission does not have any spending in heavy construction or building construction categories.

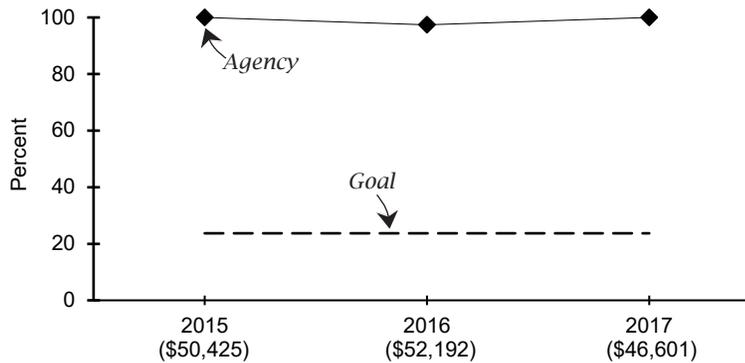
Special Trade



The agency failed to meet the state goal for HUB spending in the special trade category in each of the last three fiscal years, but had little spending in this category.

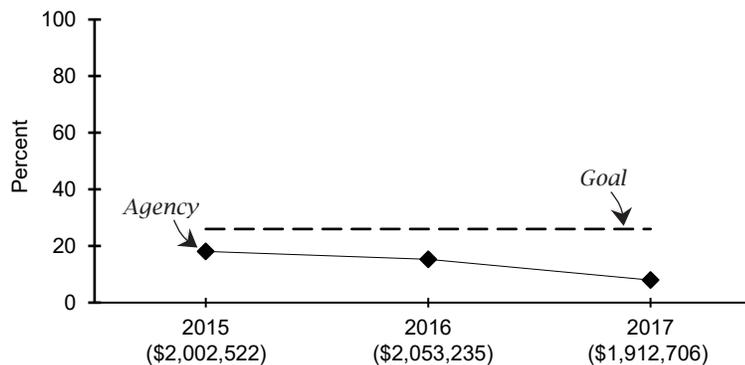
Appendix A

Professional Services



The agency exceeded the state goal for HUB spending for professional services in each of the last three fiscal years.

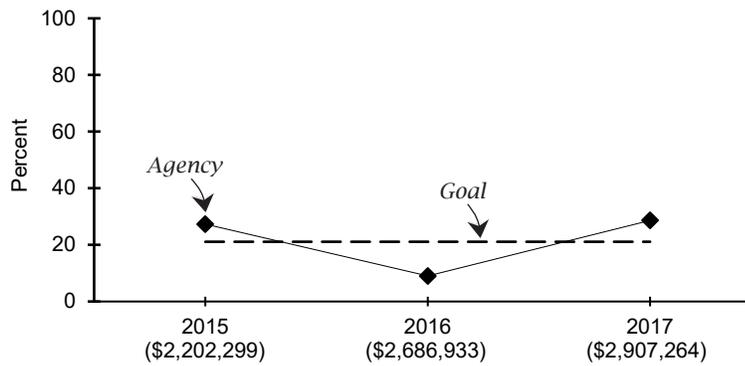
Other Services



The agency fell below the purchasing goal for other services for each of the last three fiscal years. The agency cites the use of the comptroller’s Statewide Procurement Division managed term contract for agency fleet and maintenance expenses as a reason for falling short of this goal. Additionally, many of the agency’s information technology contracts through the Department of Information Resources are not with HUBs.

Appendix A

Commodities



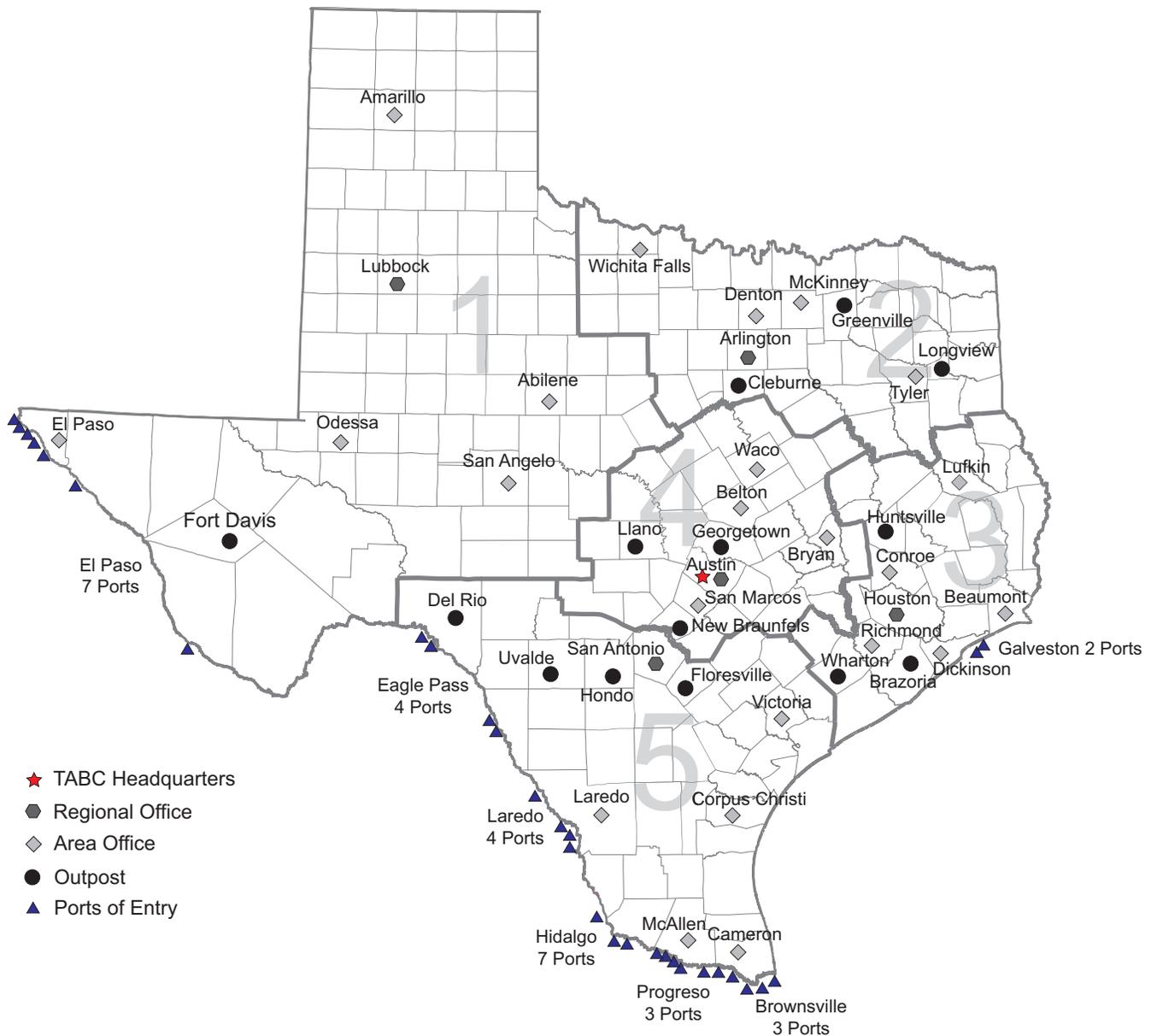
The agency exceeded the state goal for HUB spending for commodities in fiscal years 2015 and 2017, but did not meet the state goal in fiscal year 2016.

¹ All citations to Texas statutes are as they appear on <http://www.statutes.legis.texas.gov/>. Section 325.011(9)(B), Texas Government Code.

² Chapter 2161, Texas Government Code.

APPENDIX B

Texas Alcoholic Beverage Commission Offices

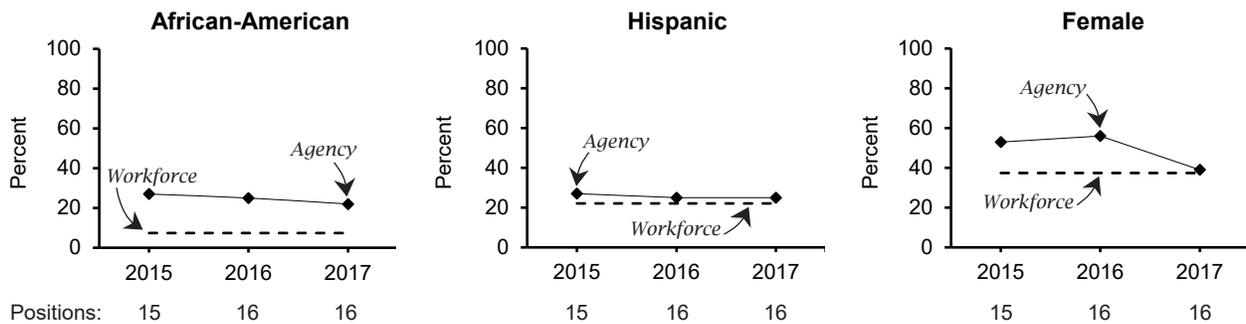


APPENDIX C

Equal Employment Opportunity Statistics 2015 to 2017

In accordance with the requirements of the Sunset Act, the following material shows trend information for the employment of minorities and females in all applicable categories by the Texas Alcoholic Beverage Commission.¹ The agency maintains and reports this information under guidelines established by the Texas Workforce Commission.² In the charts, the dashed lines represent the percentages of the statewide civilian workforce for African-Americans, Hispanics, and females in each job category.³ These percentages provide a yardstick for measuring agencies' performance in employing persons in each of these groups. The diamond lines represent the agency's actual employment percentages in each job category from 2015 to 2017. With the exception of protective services, in categories where the agency has the most employees, it generally met or exceeded the civilian workforce percentages. The service/maintenance category had too few employees to conduct a meaningful comparison to the overall civilian workforce.

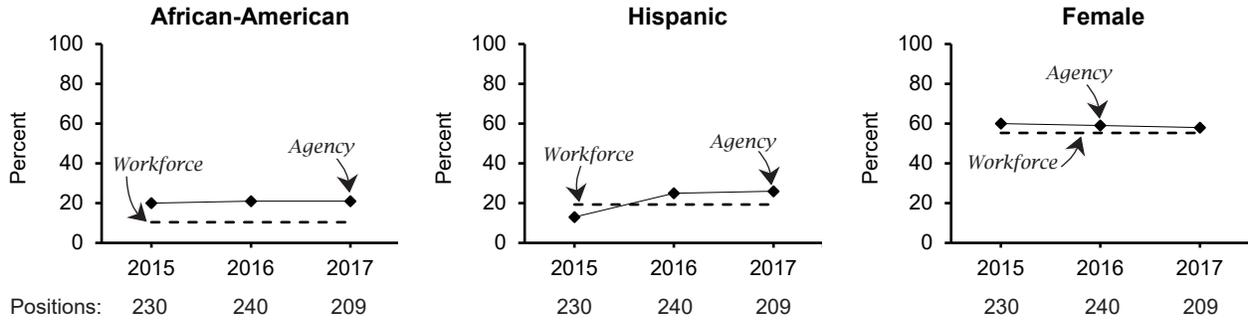
Administration



The agency exceeded the statewide civilian workforce percentages for African-Americans, Hispanics, and females in each of the last three fiscal years.

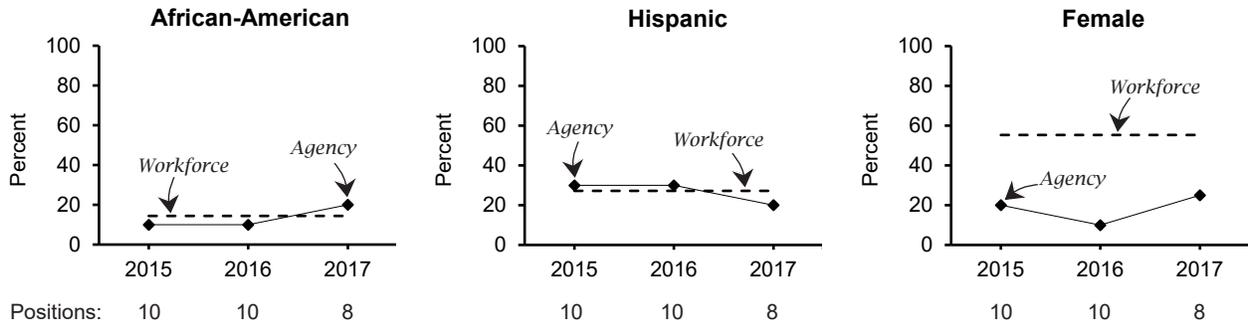
Appendix C

Professional



The agency exceeded the statewide civilian workforce percentages for African-Americans and females in each of the last three fiscal years, and fell short of the statewide percentage for Hispanics only in 2015.

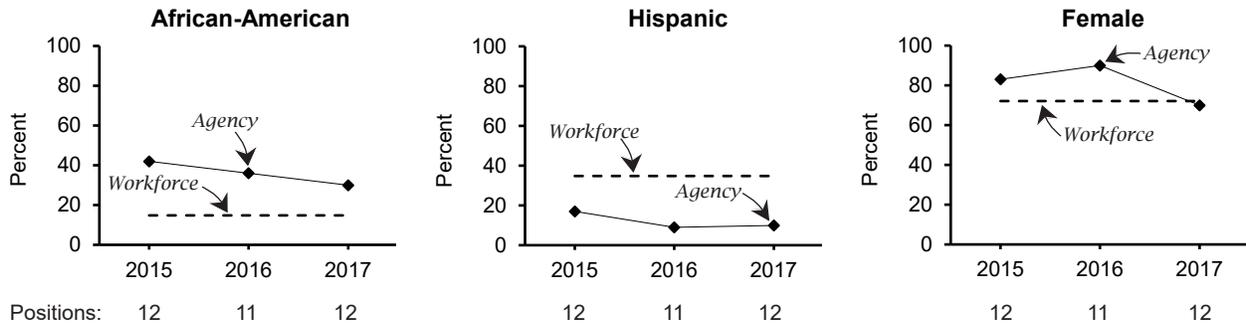
Technical



The agency fell short of statewide civilian workforce percentages for females in each of the last three fiscal years. The agency has been close to the statewide percentage for African-Americans and Hispanics in each of the last three fiscal years.

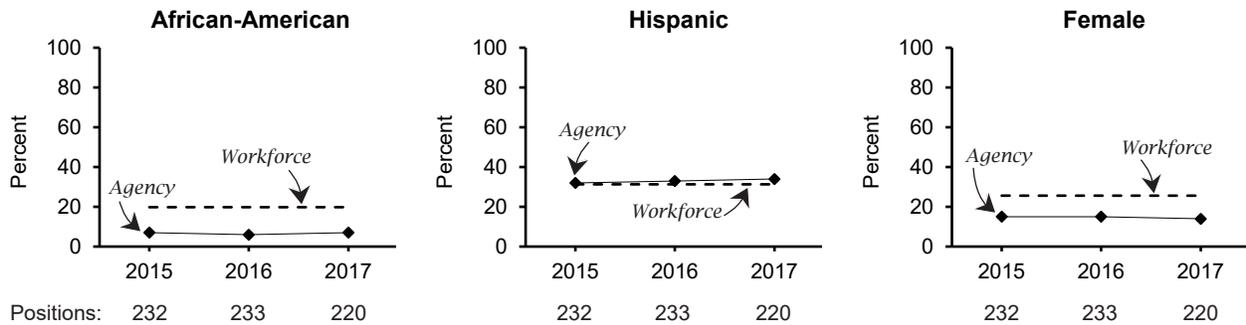
Appendix C

Administrative Support



The agency exceeded statewide civilian workforce percentages for African-Americans in each of the last three fiscal years. The agency exceeded statewide percentages for females in fiscal years 2015 and 2016, but fell slightly below in 2017, and failed to meet the statewide percentage for Hispanics in any year.

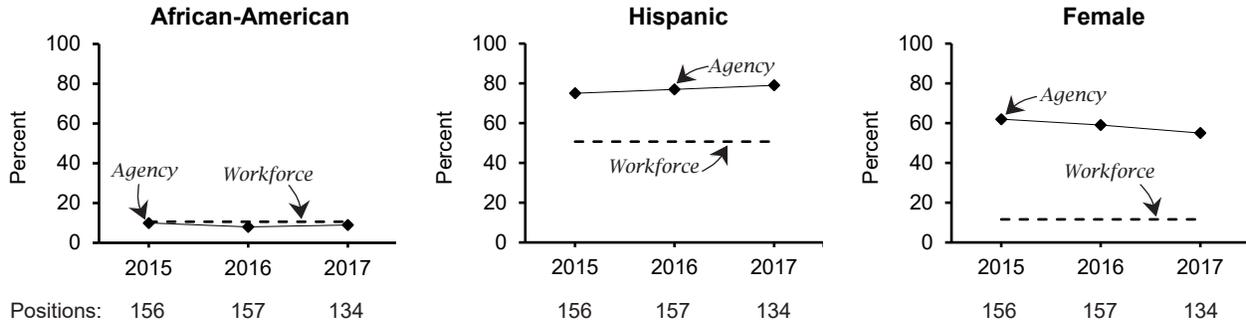
Protective Services



The agency failed to meet statewide civilian percentages for African-Americans and females in each of the past three fiscal years. The agency met or exceeded statewide civilian workforce percentages for Hispanics in each of the past three fiscal years.

Appendix C

Skilled Craft



The agency exceeded statewide civilian workforce percentages for Hispanics and females, but fell slightly below statewide percentages for African-Americans every year.

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¹ All citations to Texas statutes are as they appear on <http://www.statutes.legis.texas.gov/>. Section 325.011(9)(A), Texas Government Code.

² Section 21.501, Texas Labor Code.

³ Based on the most recent statewide civilian workforce percentages published by the Texas Workforce Commission.

APPENDIX D

Proposed TABC Licensing Structure

The following chart describes the proposed licensing structure resulting from adoption of Recommendations 2.1 and 2.2. The proposed licensing structure would have 36 licenses and permits (27 primary and 9 subordinate). Most of these currently exist. The current statutory authorizations would not change unless noted otherwise in the recommendations.

Upper Tier: Proposed Primary Licenses and Permits	Proposed General Authority	Proposed Subordinate
Brewer's License (B)	Brewers could manufacture malt beverages. This new license combines beer and ale manufacturing authority into one license, including self-distribution for small breweries.	Brewer's Self-Distribution License (DA); only for small breweries currently defined in statute Regional Forwarding Center Permit (FC)
Distiller's and Rectifier's Permit (D)	Distillers could manufacture distilled spirits.	Regional Forwarding Center Permit (FC)
Winery Permit (G)	Wineries could manufacture wine.	Regional Forwarding Center Permit (FC)
Nonresident Brewer's License (BS)	Out-of-state brewers could import malt beverages. This new license combines beer and ale manufacturing authority into one license for out-of-state malt beverage brewers.	Regional Forwarding Center Permit (FC)
Nonresident Seller's Permit (S)	Out-of-state sellers could import distilled spirits and wine.	Regional Forwarding Center Permit (FC)
Manufacturer's Agent's Warehousing Permit (AW)	Manufacturer's agents could store malt beverages imported from Mexico for export out of Texas.	None

Middle Tier: Proposed Primary Licenses and Permits	Proposed General Authority	Proposed Subordinate
General Distributor's License (BB)	General distributors could distribute malt beverages.	Branch Distributor's License (BC)
Wholesaler's Permit (W)	Wholesalers could distribute distilled spirits and wine.	Regional Forwarding Center Permit (FC)
General Class B Wholesaler's Permit (X)	General Class B wholesalers could distribute wine.	Regional Forwarding Center Permit (FC)
Out-of-State Winery Direct Shipper's Permit (DS)	Out-of-state wineries could ship wine direct to consumers.	None

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Lower Tier: Proposed Primary Licenses and Permits	Proposed General Authority	Proposed Subordinate
Mixed Beverage Permit (MB)	Bars and restaurants could sell distilled spirits, malt beverages, and wine for consumption on the permitted premises.	Brewpub License (BP) Food and Beverage Certificate (FB) Late Hours Permit (LH) Temporary Event Certificate (TC)
Mixed Beverage Restaurant Permit (RM)	These restaurants would continue to be required to have a food and beverage certificate and could sell distilled spirits, malt beverages, and wine for consumption on the permitted premises.	Brewpub License (BP) Food and Beverage Certificate (FB) Late Hours Permit (LH) Temporary Event Certificate (TC)
Package Store Permit (P)	Package stores could sell distilled spirits, malt beverages, and wine for consumption off the permitted premises. Package stores with a local distributor's permit could distribute these beverages to bars, restaurants, and private clubs.	Local Distributor's Permit (LP)
Passenger Transportation Permit (PT)	Airlines, buses, excursion boats, and trains could sell and serve distilled spirits, malt beverages, and wine for consumption onboard.	None
Private Club Beer and Wine Permit (NB)	Private clubs could serve malt beverages and wine for consumption on the permitted premises, including in dry areas.	Food and Beverage Certificate (FB) Late Hours Permit (LH) Temporary Event Certificate (TC)
Private Club Exemption Certificate (NE)	Fraternal and veteran organizations as currently defined in statute would continue to be exempt from specific fees and statutory provisions for private clubs.	Food and Beverage Certificate (FB) Late Hours Permit (LH) Temporary Event Certificate (TC)
Private Club Registration Permit (N)	Private clubs could serve distilled spirits, malt beverages, and wine for consumption on the permitted premises, including in dry areas.	Food and Beverage Certificate (FB) Late Hours Permit (LH) Temporary Event Certificate (TC)
Retail Dealer's Off-Premise License (BF)	Retail dealers could sell malt beverages for consumption off the licensed premises. Grandfathered licensees in beer-only local option areas could sell malt beverages up to 5 percent alcohol by volume.	None
Retail Dealer's On-Premise License (BE)	Retail dealers could sell malt beverages for consumption on the licensed premises. Grandfathered licensees in beer-only local option areas could sell malt beverages up to 5 percent alcohol by volume.	Brewpub License (BP) Food and Beverage Certificate (FB) Late Hours Permit (LH) Temporary Event Certificate (TC)
Temporary Event Permit (TE)	Federally tax-exempt organizations could sell, serve, and auction alcoholic beverages at a temporary event where locally authorized.	None

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Lower Tier: Proposed Primary Licenses and Permits	Proposed General Authority	Proposed Subordinate
Wine and Beer Retailer's Off-Premise Permit (BQ)	Wine and beer retailers could sell malt beverages and wine off the permitted premises.	None
Wine and Beer Retailer's Permit (BG)	Wine and beer retailers could sell malt beverages and wine on and off the permitted premises.	Brewpub License (BP) Food and Beverage Certificate (FB) Late Hours Permit (LH) Temporary Event Certificate (TC) Waterpark Permit (WP)
Wine-Only Package Store Permit (Q)	Wine-only package stores could sell malt beverages and wine for consumption off the permitted premises.	None

Other Licenses and Permits	Proposed General Authority	Proposed Subordinate
Bonded Warehouse Permit (J/JD)	Third-party facilities could store distilled spirits and wine for manufacturers and distributors.	None
Carrier's Permit (C)	Carriers could deliver distilled spirits, malt beverages, and wine direct to consumers.	None
Promotional Permit (PR)	Promotional businesses could conduct product tastings on behalf of manufacturing tier licensees and permittees at retail locations.	None
Third-Party Local Cartage Permit (ET)	Third-party delivery companies could deliver distilled spirits and wine on behalf of other regulated businesses.	None

APPENDIX E

Impact of Recommendations 2.1 and 2.2 on Current TABC Permits and Licenses

The following charts describe how Recommendations 2.1 and 2.2 to modernize TABC's licensing structure would affect current licenses and permits.

Recommendation 2.1: Streamline the state's alcoholic beverage licensing system by combining and eliminating various licenses and permits.

a. Combine primary and subordinate licenses and permits.

Subordinate License/Permit	Original Fee	Enacted	Reference	Active 8/31/17	Recommendation's Impact and Affected Primary License/Permit
Beverage Cartage Permit (PE)	\$191	1971	Chapter 44	7,849	<p>Restaurants and private clubs could transport alcoholic beverages.</p> <ul style="list-style-type: none"> • Mixed Beverage Permit (MB) • Mixed Beverage Restaurant Permit (RM) • Private Club Registration Permit (N) • Private Club Beer and Wine Permit (NB) • Private Club Exemption Certificate (NE)
Importer's License (BI)*	\$318	1949	Chapter 67	137	<p>Manufacturers and general distributors could import beer and transport it on commercial carriers.</p> <ul style="list-style-type: none"> • Manufacturer's License (BA) • General Distributor's License (BB)
Importer's Carrier's License (BJ)*	\$242	1949	Chapter 68	16	<p>Manufacturers and general distributors could import beer and transport it on vehicles they own or lease.</p> <ul style="list-style-type: none"> • Manufacturer's License (BA) • General Distributor's License (BB)

* Identifies licenses and permits affected by both Recommendation 2.1 and 2.2.

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Subordinate License/Permit	Original Fee	Enacted	Reference	Active 8/31/17	Recommendation's Impact and Affected Primary License/Permit
Local Cartage Permit (E)	\$262	1935	Chapter 43	1,190	<p><i>These businesses could carry out these activities without a separate subordinate license or permit.</i></p> <p>Package stores, wine-only package stores, and local distributors could transport alcoholic beverages.</p> <ul style="list-style-type: none"> • Package Store Permit (P) • Wine-Only Package Store Permit (Q) • Local Distributor's Permit (LP)
Minibar Permit (MI)	\$4,350	1985	Chapter 51	72	<p>Hotels with a bar or restaurant could provide guestroom minibars.</p> <ul style="list-style-type: none"> • Mixed Beverage Permit (MB) • Mixed Beverage Restaurant Permit (RM)
Nonresident Brewer's Permit (U)*	\$3,376	1961	Chapter 13	386	<p>Nonresident sellers could import ale.</p> <ul style="list-style-type: none"> • Nonresident Seller's Permit (S)
Package Store Tasting Permit (PS)	\$226	1993	Chapter 52	1,961	<p>Package stores and wine-only package stores could conduct product tastings at their permitted location.</p> <ul style="list-style-type: none"> • Package Store Permit (P) • Wine-Only Package Store Permit (Q)
Private Carrier's Permit (O)*	\$312	1935	Chapter 42	839	<p>Brewers, distillers, general Class B wholesalers, wholesalers, wineries, and wine bottlers could transport alcoholic beverages.</p> <ul style="list-style-type: none"> • Brewer's Permit (B) • Distiller's and Rectifier's Permit (D) • General Class B Wholesaler's Permit (X) • Wholesaler's Permit (W) • Wine Bottler's Permit (Z) • Winery Permit (G)

* Identifies licenses and permits affected by both Recommendation 2.1 and 2.2.

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Subordinate License/Permit	Original Fee	Enacted	Reference	Active 8/31/17	Recommendation's Impact and Affected Primary License/Permit
Private Storage Permit (L)*	\$402	1935	Chapter 45	35	<p><i>These businesses could carry out these activities without a separate subordinate license or permit.</i></p> <p>Brewers, distillers, general Class B wholesalers, wineries, and wine bottlers could store alcoholic beverages in their own warehouse.</p> <ul style="list-style-type: none"> • Brewer's Permit (B) • Distiller's and Rectifier's Permit (D) • General Class B Wholesaler's Permit (X) • Wholesaler's Permit (W) • Wine Bottler's Permit (Z) • Winery Permit (G)
Public Storage Permit (K)*	\$402	1935	Chapter 45	20	<p>Brewers, distillers, general Class B wholesalers, wineries, and wine bottlers could store alcoholic beverages in a regulated public warehouse.</p> <ul style="list-style-type: none"> • Brewer's Permit (B) • Distiller's and Rectifier's Permit (D) • General Class B Wholesaler's Permit (X) • Wholesaler's Permit (W) • Wine Bottler's Permit (Z) • Winery Permit (G)
Winery Storage Permit (GS)	\$402	1993	Chapter 45	3	<p>Wineries could store wine in their own storage facility in a dry county.</p> <ul style="list-style-type: none"> • Winery Permit (G)

* Identifies licenses and permits affected by both Recommendation 2.1 and 2.2.

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b. Eliminate agent licenses and permits.

Agent License/Permit	Original Fee	Enacted	Reference	Active 8/31/17	Recommendation's Impact
Agent's Permit (A)*	\$114	1935	Chapter 35	15,274	<p><i>These licenses and permits no longer would exist.</i></p> <p>Agents of businesses that manufacture or distribute alcoholic beverages no longer would be licensed or permitted. Existing statutory provisions that regulate agent activities and hold employers responsible for agents' actions would remain in statute.</p>
Agent's Beer License (BK)*	\$114	1961	Chapter 73	15,647	
Distiller's Agent's Permit (DK)	\$114	2013	Chapter 15	171	
Manufacturer's Agent's Permit (T)	\$114	1943	Chapter 36	1,644	

c. Combine temporary event permits and licenses.

Temporary Event Permit: Tax-Exempt Entities	Original Fee	Enacted	Reference	Active in FY 2017	Recommendation's Impact
Auction Permit (CA)	\$25	1997	Chapter 53	253	<p><i>TABC would have one temporary event permit for all federally tax-exempt entities.</i></p> <p>These permits would be combined into a single permit authorizing federally tax-exempt entities to sell and serve alcoholic beverages at temporary events. The entities currently defined in statute include nonprofit corporations and charitable, political, civic, fraternal, and religious groups. Local options for the event's location would determine the types of alcoholic beverages authorized.</p> <p>Where statutory provisions differ, the new permit would standardize them and authorize the least restrictive one. For example, some permits are daily while others are two, three, four, or 10 days, so the statute would authorize up to 10 days. Some entities can raise money by auctioning alcoholic beverages, and the recommendation would provide this authority to all permittees. TABC has authority to adopt rules for temporary events.</p>
Daily Temporary Mixed Beverage Permit (TB)	\$251	1971	Chapter 30	1,004	
Daily Temporary Private Club Permit (TN)	\$276	1989	Chapter 33B	72	
Temporary Special Three-Day Wine and Beer Permit (SB)	\$231	1993	Chapter 27B	1,908	
Temporary Wine and Beer Retailer's Permit – Historical Preservation Organizations (HP)	\$231	1973	Chapter 27A	11	

* Identifies licenses and permits affected by both Recommendation 2.1 and 2.2.

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Temporary Event License/Permit: Retail Businesses	Original Fee	Enacted	Reference	Active in FY 2017	Recommendation's Impact
Caterer's Permit (CB)	\$1,278	1971	Chapter 31	1,793	<p><i>These businesses no longer would get a separate license or permit to sell alcoholic beverages at temporary events; TABC has authority to adopt rules requiring advance approval or notice.</i></p> <p>These permits would be combined into the currently authorized primary licenses and permits. Specific provisions would remain in statute. TABC has authority to adopt rules for temporary events.</p> <ul style="list-style-type: none"> • Mixed Beverage Permit (MB) • Mixed Beverage Restaurant Permit (RM) • Private Club Registration Permit (N) • Private Club Beer and Wine Permit (NB) • On-Premise Retail Dealer's License (BE) • Wine and Beer Retailer's Permit (BG) • Winery Permit (G)
Caterer's Certificate	None			11,068	
Daily Temporary Mixed Beverage Permit (TB)	\$251	1971	Chapter 30	1,004	
Daily Temporary Private Club Permit (TN)	\$276	1989	Chapter 33B	72	
Temporary License (BH)	\$231	1935	Chapter 72	2,314	
Temporary Wine and Beer Retailer's Permit (HP)	\$231	1973	Chapter 27A	11	
Winery Festival Permit (GF)	\$378			296	
Festival Certificate	None	2009	Chapter 17	2,470	

d. Combine passenger transportation permits into a single permit.

Transportation Permit	Original Fee	Enacted	Reference	Active 8/31/17	Recommendation's Impact
Airline Beverage Permit (AB)	\$4,727	1971	Chapter 34	28	<p><i>TABC would have one permit for all transportation businesses that serve alcoholic beverages to their passengers.</i></p> <p>The permits would be combined into a single passenger transportation permit for airlines, passenger buses, passenger trains, and excursion boats currently authorized in statute to sell and serve alcoholic beverages to their passengers. Statutory provisions for each transportation type would not change.</p>
Passenger Bus Permit (PB)	\$1,000	2017	Chapter 48A	2	
Passenger Train Beverage Permit (PT)	\$1,602	1985	Chapter 48	3	
Wine and Beer Retailer's Permit – Excursion Boat (V)	\$813	1955	Chapter 25	8	

* Identifies licenses and permits affected by both Recommendation 2.1 and 2.2.

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e. Combine late hours licenses and permits into a single permit.

Late Hours License/Permit	Original Fee	Enacted	Reference	Issued FY 2017	Recommendation's Impact
Mixed Beverage Late Hours Permit (LB)	\$627	1971	Chapter 29	7,939	TABC would have one permit authorizing businesses to have extended hours where authorized locally.
Private Club Late Hours Permit (NL)	\$1,850	1969	Chapter 33	304	The license and permits would be combined into a single late hours permit authorizing bars, restaurants, and private clubs to sell alcoholic beverages as currently authorized in statute: between 1:00 a.m. and 2:00 a.m. on Sunday and between midnight and 2:00 a.m. on other days. Statutory provisions requiring businesses to be in an area that has approved late hours would not change.
Retail Dealer's On-Premise Late Hours License (BL)*	\$827	1957	Chapter 70	1,558	

f. Eliminate obsolete licenses and permits.

Obsolete License/Permit	Original Fee	Enacted	Reference	Active 8/31/17	Recommendation's Impact
Industrial Permit (I)	\$381	1935	Chapter 38	135	These unnecessary and obsolete licenses and permits would be eliminated to streamline TABC's licensing structure.
Local Industrial Alcohol Manufacturer's Permit (LI)	\$527	1979	Chapter 47	9	Industrial and manufacturing businesses that do not manufacture, distribute, or sell alcoholic beverages no longer would be regulated by TABC.
Local Class B Wholesaler Permit (LX)*	\$801	1973	Chapter 21	2	The two businesses that currently have this permit could apply for the more commonly used general Class B wholesaler permit, which authorizes similar activities and currently costs \$450 more.
Wine Bottler's Permit (Z)	\$1,052	1937	Chapter 18	1	The only business that has this permit could apply for a winery permit, which authorizes similar activities and currently costs \$201 less.
Billboard Permit	None	1977	Chapter 108	2	TABC could ensure retailers are not benefiting from another tier's advertisements using its existing rulemaking and enforcement authority.

* Identifies licenses and permits affected by both Recommendation 2.1 and 2.2.

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Obsolete License/Permit	Original Fee	Enacted	Reference	Active 8/31/17	Recommendation's Impact
Local Distributor's License (BD)*	\$851	1935	Chapter 65	0	<p><i>These unnecessary and obsolete licenses and permits would be eliminated to streamline TABC's licensing structure.</i></p> <p>These have no active licensees or permittees so eliminating them would help streamline TABC's licensing structure without affecting the industry. Other licenses or permits in the proposed new licensing structure would regulate similar activities and could be used instead.</p>
Manufacturer's Warehouse License (MW)*	\$1,153	1993	Chapter 62	0	
Market Research Packager's Permit (MR)	\$327	1985	Chapter 49	0	
Storage License (SL)	\$602	1997	Chapter 75	0	
Wine and Beer Retailer's Permit for Railway Dining, Buffet or Club Cars (Y)	\$613 per car	1935	Chapter 25	0	

Recommendation 2.2: License and regulate all malt beverages consistently.

Combined Beer License/ Ale Permit	Original Fee	Enacted	Reference	Active 8/31/17	Recommendation's Impact
Brewer's Permit (B)*	\$3,576	1935	Chapter 12	122	<p><i>Licenses and permits for businesses that manufacture beer or ale would be combined into one license for malt beverages.</i></p> <p>These would be combined into a single brewer's license to manufacture malt beverages.</p>
Manufacturer's License (BA)*	\$2,151-\$17,451	1935	Chapter 62	61	
Brewer's Self-Distribution Permit (DA)	\$750	2013	Chapter 12A	85	<p>These would be combined into a single brewer's self-distribution license for small manufacturers as currently defined in statute.</p>
Manufacturer's Self-Distribution License (DB)	\$750	2013	Chapter 62A	36	

* Identifies licenses and permits affected by both Recommendation 2.1 and 2.2.

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Combined Beer License/ Ale Permit	Original Fee	Enacted	Reference	Active 8/31/17	Recommendation's Impact
Importer's License (BI)*	\$318	1949	Chapter 67	137	Licenses and permits for businesses that manufacture beer or ale would be combined into one license for malt beverages. These subordinate licenses would be combined with the new primary brewer's and general distributor's licenses, authorizing them to import and transport malt beverages. These would be combined into a single nonresident brewer's license to import malt beverages.
Importer's Carrier's License (BJ)*	\$242	1949	Chapter 68	16	
Nonresident Manufacturer's License (BS)	\$2,076	1961	Chapter 63	338	
Nonresident Brewer's Permit (U)*	\$3,376	1961	Chapter 13	386	

License with Beer Authority	Original Fee	Enacted	Reference	Active 8/31/17	Recommendation's Impact
Agent's Beer License (BK)*	\$114	1961	Chapter 73	15,647	Licenses with authority for beer but not ale would be expanded to include all malt beverages. Beer agents could work for businesses that make or distribute all malt beverages, including beer and ale.
Branch Distributor's License (BC)	\$851	1937	Chapter 66	63	General distributors' branch locations could distribute all malt beverages, including beer and ale.
Brewpub License (BP)	\$1,426	1993	Chapter 74	180	Beer-only bars and restaurants with a brewpub license could manufacture and sell all malt beverages, including beer and ale.
General Distributor's License (BB)*	\$1,301	1935	Chapter 64	86	General distributors could distribute all malt beverages, including beer and ale.
Local Distributor's License (BD)*	\$851	1935	Chapter 65	0	Local distributors could distribute all malt beverages, including beer and ale.
Retail Dealer's Off-Premise License (BF)	\$673	1937	Chapter 71	5,662	Off-premise retail dealers could sell all malt beverages, including beer and ale.
Retail Dealer's On-Premise Late Hours License (BL)*	\$827	1957	Chapter 70	1,558	On-premise retail dealers could sell all malt beverages, including beer and ale, during extended hours.

* Identifies licenses and permits affected by both Recommendation 2.1 and 2.2.

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License with Beer Authority	Original Fee	Enacted	Reference	Active 8/31/17	Recommendation's Impact
Retail Dealer's On-Premise License (BE)	\$853-\$2,553	1935	Chapter 69	871	<i>Licenses with authority for beer but not ale would be expanded to include all malt beverages.</i>
Temporary License (BH)*	\$231	1935	Chapter 72	2,314	On-premise retail dealers could sell all malt beverages, including beer and ale. On-premise retail dealers and wine and beer retailers could sell all malt beverages, including beer and ale, at temporary events within their county limits.
Permit with Ale Authority	Original Fee	Enacted	Reference	Active 8/31/17	Recommendation's Impact
Agent's Permit (A)*	\$114	1935	Chapter 35	15,274	<i>Most permits with authority for ale and wine or distilled spirits but not beer would lose their authority for ale.</i> Agents no longer could work for businesses that manufacture or distribute ale, but could still work for those that manufacture or distribute distilled spirits and wine.
Bonded Warehouse Permit (J)	\$436	1935	Chapter 46	9	Bonded warehouses no longer could store ale but could still store distilled spirits and wine.
General Class B Wholesaler's Permit (X)*	\$1,251	1935	Chapter 20	82	General Class B wholesalers no longer could distribute ale but could still distribute distilled spirits and wine, and could apply for a general distributor's license to distribute malt beverages.
Local Cartage Permit for Third-Party Delivery Companies (ET)	\$262	1935	Chapter 43	4	Third-party delivery companies no longer could deliver ale but could still deliver distilled spirits and wine on behalf of regulated businesses.
Local Cartage Permit (E)*	\$262	1935	Chapter 43	1,190	Package stores, wine-only package stores, and local distributors with a local cartage permit no longer could transport ale but could still transport distilled spirits and wine.
Local Class B Wholesaler Permit (LX)*	\$801	1973	Chapter 21	2	Local Class B wholesalers no longer could sell ale but could still sell wine.

* Identifies licenses and permits affected by both Recommendation 2.1 and 2.2.

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Permit with Ale Authority	Original Fee	Enacted	Reference	Active 8/31/17	Recommendation's Impact
Local Distributor's Permit (LP)	\$652	1971	Chapter 23	744	Most permits with authority for ale and wine or distilled spirits but not beer would lose their authority for ale. Package stores with this subordinate permit could purchase all malt beverages from distributors for distribution to local bars, restaurants, and private clubs, as currently allowed by TABC.
Nonresident Seller's Permit (S)*	\$676	1943	Chapter 37	3,035	Nonresident sellers no longer could import ale but could still import distilled spirits and wine, and could apply for a nonresident brewer's license to import malt beverages.
Package Store Permit (P)*	\$1,501	1935	Chapter 22	2,611	Package stores no longer would need a separate beer license to sell all malt beverages to consumers.
Private Carrier's Permit (O)*	\$312	1935	Chapter 42	839	Wholesalers no longer could transport ale but could still transport distilled spirits and wine.
Private Storage Permit (L)*	\$402	1935	Chapter 45	35	Wholesalers and general Class B wholesalers no longer could store ale but could still store distilled spirits and wine in their own storage facilities.
Public Storage Permit (K)*	\$402	1935	Chapter 45	20	Third-party storage facilities no longer could store ale but could still store distilled spirits and wine for manufacturers and distributors.
Wholesaler's Permit (W)*	\$4,451	1935	Chapter 19	221	Wholesalers no longer could sell ale but could still sell distilled spirits and wine, and could apply for a general distributor's license to distribute malt beverages.
Wine-Only Package Store Permit (Q)*	\$703	1935	Chapter 24	2,802	Wine-only package stores no longer would need a separate beer license to sell all malt beverages to consumers.

* Identifies licenses and permits affected by both Recommendation 2.1 and 2.2.

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Recommendations 2.1 and 2.2 would not affect these licenses and permits.

Unaffected Permit/License	Original Fee	Enacted	Reference	Active 8/31/17
Food and Beverage Certificate (FB)	\$776	1995	Chapter 25, 28, 32, 69	10,161
Bonded Warehouse Permit, Dry Area (JD)	\$436	1993	Chapter 46	0
Carrier's Permit (C)	\$312	1935	Chapter 41	545
Manufacturer's Agent's Warehousing Permit (AW)	\$2,151	2007	Chapter 55	13
Out-of-State Winery Direct Shipper's Permit (DS)	\$526	2005	Chapter 54	1,471
Promotional Permit (PR)	\$976	2005	Chapter 50	77
Regional Forwarding Center Permit (FC)	\$2,278	1999	Rule 35.6	50
Water Park Permit (WP)	\$60	2017	Chapter 56	0
Wine and Beer Retailer's Permit (BG)	\$903-\$2,553	1935	Chapter 25	9,916
Wine and Beer Retailer's Off-Premise Permit (BQ)	\$673	1973	Chapter 26	19,133

* Identifies licenses and permits affected by both Recommendation 2.1 and 2.2.

APPENDIX F

Staff Review Activities

During the review of the Texas Alcoholic Beverage Commission (TABC), Sunset staff engaged in the following activities that are standard to all Sunset reviews. Sunset staff worked extensively with agency personnel; attended commission meetings; met with staff from key legislative offices; conducted interviews and solicited written comments from interest groups and the public; reviewed agency documents and reports, state statutes, legislative reports, previous legislation, and literature; researched the organization and functions of similar state agencies in other states; and performed background and comparative research.

In addition, Sunset staff also performed the following activities unique to this agency:

- Attended sessions of TABC's agent academy training
- Attended a stakeholder roundtable discussion in Waco
- Toured and interviewed staff at TABC's Austin and Houston field offices
- Accompanied Houston field staff on open inspections of regulated bars, restaurants, package stores, and other alcohol retailers
- Observed TABC operations at ports of entry in Laredo and Galveston
- Observed an audit case settlement briefing
- Toured a distributor and a wholesaler facility
- Conducted a survey of current TABC licensees and permittees
- Interviewed officers with U.S. Customs and Border Protection, Office of Field Operations
- Interviewed staff from the comptroller of public accounts, State Office of Administrative Hearings, and office of the attorney general

Sunset Staff Review of the *Texas Alcoholic Beverage Commission*

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