

**STRUCTURING THE SALE OF ALCOHOLIC BEVERAGES IN
YOUR HOSPITALITY COMPANY, OR HOW I'VE LEARNED
TO STOP WORRYING AND LOVE THE TABC**

DEWEY A. BRACKIN, *Austin*
Gardere Wynne Sewell LLP

MARCUS SCHWARTZ, JR., *Austin*
Gardere Wynne Sewell LLP

State Bar of Texas
LEGAL ISSUES IN THE TEXAS HOSPITALITY INDUSTRY
November 5-6, 2015
Dallas

CHAPTER 15

TABLE OF CONTENTS

I. ABSTRACT..... 1

II. INTRODUCTION 1

III. QUALIFYING FOR A TABC PERMIT 1

 A. Three-tier Issues 2

 B. Criminal History Issues..... 2

 C. Residency Issues 3

IV. LOCATION, LOCATION, LOCATION 3

 A. Distance Requirements..... 3

 B. Deed Restrictions 4

 C. Zoning Requirements 4

 D. Wet/Dry Areas 4

 E. Permits and Laws Unique o Hotels 5

V. TABC APPLICATION DISCLOSURES 5

VI. MANAGEMENT, SUBLEASE, SERVICE, AND CONCESSION AGREEMENTS..... 6

 A. Management and Service Agreements 6

 B. Sublease and Concession Agreements 7

VII. STRUCTURING ALCOHOL SALES AT HOTELS..... 7

 A. Who Holds the Permit..... 7

VIII. TABC PERMITTING CONSIDERATIONS WHEN A HOTEL IS SOLD 8

 A. Stock Purchase of the BevCo 8

 B. Asset Purchase of BevCo 8

 C. Mergers 9

 D. Permit transfers 9

 E. Conversion and Altering Form of Business Entity 9

ATTACHMENTS 11

STRUCTURING THE SALE OF ALCOHOLIC BEVERAGES IN YOUR HOSPITALITY COMPANY, OR HOW I LEARNED TO STOP WORRYING AND LOVE THE TABC

I. ABSTRACT

Alcoholic beverage sales in Texas are highly regulated by the Texas Alcoholic Beverage Commission (the "TABC") which regulates all phases of the alcoholic beverage industry in Texas. This Article provides a brief introduction to the area of alcoholic beverage regulation as it applies to the hospitality realm, focusing on licensing requirements and how a TABC permit or license may be lawfully obtained and/or utilized while avoiding potential pitfalls in the regulatory scheme surrounding this area of law. Further, because the hotel segment realm can involve multiple entities operating under the same roof, and because the Texas Alcoholic Beverage Code strictly prohibits the unlawful use of a permit by a non-permittee, special care must be taken to ensure lawful conduct by the permittee.

II. INTRODUCTION

The Texas Alcoholic Beverage Code (the "Code") was enacted to exclusively protect against the involvement of criminal elements in alcoholic beverage trafficking.¹ Designed to deter organized crime's involvement with alcohol and the foothold criminals had within the industry following Prohibition, the Code was and is meant to exclusively govern virtually all aspects of alcohol, including the manufacture, sale, distribution, transportation, and possession of alcoholic beverages.² As the Code states, "[w]hile the idealistic motives behind Prohibition were noble, a law enforcement nightmare ensued. Otherwise law-abiding citizens routinely violated the law by buying and consuming alcoholic beverages. The demand for the illegal products created an opportunity for criminal elements to develop a national network for the supply and distribution of alcoholic beverages to the populace."³ To keep out such criminal elements, the Code forbids the sale or possession of alcohol for purposes of sale without a permit or license (hereinafter a "permit")⁴ and maintains strict criteria regarding who may hold a permit.

Permits themselves are considered to be purely personal privileges that are not property, are not subject to execution, and except as expressly authorized, cease on the death of the holder and are not passed by descent or distribution.⁵ Just like other personal privileges such as a driver's license, they may not be transferred or sold in Texas like in other states, and are meant to ensure solely to the benefit of such permittee. A permittee is considered to be the holder of the permit, whether that is an entity or a person, as well as an agent, servant, or employee of that entity or person.⁶ These same persons are termed applicants when applying for a TABC permit⁷.

Throughout the regulatory structure of the Code and in an effort to prohibit criminal involvement in the industry, the allowance or consent to or use of a permit by another is forbidden.⁸ Generally referred to as 'subterfuge' under the Code, the Legislature has tasked the TABC to prevent any devise, scheme, or plan which surrenders control of a permittee's employees, premises, or business to another and all Code provisions are to be liberally construed to carry out such intent.⁹

What this means in practical effect, is that hiring, firing, choice of alcoholic beverage offerings, sale prices, marketing and all profits from the sale of alcohol must be done and inure to the benefit of the permittee and no other person. As required by the Code, a permittee must have and maintain exclusive occupancy and control of entire permitted premises in every phase of the storage, distribution, possession, and transportation and sale of all alcoholic beverages purchased, stored, or sold on the permitted premises.¹⁰ If it is proven that the use or the exclusive control of a permit is surrendered to another and then the permit is subject to cancellation¹¹ and the person that signed the TABC application to apply for the permit can be found guilty of a felony.¹²

III. QUALIFYING FOR A TABC PERMIT

The TABC may refuse to issue or renew a permit for a litany of reasons. Further, there are different qualifications required depending upon the type of permit or license applied for or held. While there are

⁵ TEX. ALCO. BEV. CODE ANN. §11.03 (West Supp. 2011).

⁶ TEX. ALCO. BEV. CODE ANN. §1.04(11) (West Supp. 2011).

⁷ TEX. ALCO. BEV. CODE ANN. §11.45 (West Supp. 2011).

⁸ TEX. ALCO. BEV. CODE ANN. §11.05 (West Supp. 2011).

⁹ TEX. ALCO. BEV. CODE ANN. §109.53 (West Supp. 2011).

¹⁰ *Id.*

¹¹ TEX. ALCO. BEV. CODE ANN. §§11.61, 61.71 (West Supp. 2011).

¹² TEX. ALCO. BEV. CODE ANN. §101.69 (West Supp. 2011).

¹ http://www.tabc.state.tx.us/about_us/the_organization.asp

² TEX. ALCO. BEV. CODE ANN. §1.06 (West Supp. 2011).

³ TEX. ALCO. BEV. CODE ANN. §6.03(b) (West Supp. 2011).

⁴ TEX. ALCO. BEV. CODE ANN. §11.01(a) (West Supp. 2011).

general requirements such as the permittee or applicant must be of good moral character, is not an alcoholic, and is not a minor¹³, there are several requirements which must be closely looked at within the hospitality industry.

A. Three-tier Issues

Texas adheres to the three-tier system of alcohol regulation. Under this system, manufacturers make the product and sell to wholesalers, who in turn sell to retailers. The retailers then sell to consumers who ultimately consume the product. The Code and TABC require strict adherence to Texas' general policy of preventing overlapping ownership or other prohibited relationship, either directly or indirectly, between the different tiers.¹⁴ This means no permittee or applicant in one tier may:

1. Own or hold, directly or indirectly, an interest in a permittee in another tier;
2. Act or serve as an officer, director, or employee of a permittee in another tier;
3. Own or have an interest in the premises, fixtures, or equipment of a permittee in another tier;
4. Loan or lend credit to a permittee of another tier;
5. Enter into any agreement to control or manage, financially or administratively, directly or indirectly, in any form or degree, the business or interests of a permittee in another tier; or
6. Enter into a profit sharing agreement or any agreement relating to the repurchase of assets or any agreement to effectuate the shipment or delivery of alcohol on consignment with a permittee of another tier.¹⁵

The majority of the hospitality industry will fall into the retailer tier, considered to be the lowest tier of the three tiers. Therefore, no permittee or applicant may own an interest in a permittee of an upper tier member. If the permittee or applicant is an entity, TABC considers the permittee to include all persons having an interest in that permittee or applicant, including all the way up that entity's corporate ownership structure. TABC has no de minimis ownership allowance, therefore if a permittee or applicant has even one share of stock in an upper tier member, then this may result in a three-tier violation

¹³ TEX. ALCO. BEV. CODE ANN. §§11.46, 61.42(West Supp. 2011).

¹⁴ TEX. ALCO. BEV. CODE ANN. §102.01 (West Supp. 2011).

¹⁵ TEX. ALCO. BEV. CODE ANN. §102.01(c)-(i) (West Supp. 2011).

and a permit renewal or application will be refused.¹⁶ Therefore, it is imperative that a hospitality company's owners from top to bottom be thoroughly vetted to ensure there are no tier ownership overlaps.

Overlapping ownership is most commonly found in two instances: 1) where a permittee or applicant has invested in a winery (considered to be a manufacturer) or 2) where a permittee or applicant owns property that is rented to an upper tier member. This latter instance is especially important in the hotel business with the proliferation of real estate investment trusts ("REITs") which can hold interests in permittees or applicants and hold enormous amounts of property which could be rented to an upper tier member such as an urban winery. Yet, it should be noted that a permittee is defined to be a Texas permittee.¹⁷ In other words, if a winery is not permitted in Texas, it cannot be considered a manufacturer under the Code, and there is no ownership prohibition in such winery.

B. Criminal History Issues

An applicant may be denied a permit if they have been finally convicted or received deferred adjudication for an offense of:

1. Prostitution;
2. Bookmaking;
3. Gambling or gaming;
4. Bootlegging;
5. A vagrancy offense involving moral turpitude;
6. Any offense involving dangerous drugs or controlled substances as defined in the Texas Controlled Substances Act;
7. Any offense involving firearms or a deadly weapon;
8. More than three violations of the Code relating to minors;
9. Violations of the Code resulting in a criminal fine of \$500; or
10. Violations of an individual's civil rights or discrimination against an individual on the basis of race, color, creed, or national origin.¹⁸

Further, the TABC may refuse to issue or renew a permit if five years have not passed since the termination, by pardon or otherwise, of a sentence

¹⁶ See *Cadena v. TABC*, No. 03-13-00262-CV (Tex. App.—Austin Sept. 5, 2014, XXXX re: pet.) (not designated for publication)

¹⁷ TEX. ALCO. BEV. CODE ANN. §1.04(11) (West Supp. 2011).

¹⁸ See generally *TABC Business Packet*, available at <http://www.tabc.state.tx.us/forms/licensing/L-B.doc>.

imposed on an applicant for a felony conviction.¹⁹ Applicants must swear on a TABC application regarding whether such convictions have occurred, therefore is important to determine whether an offense may be a misdemeanor or a felony. A crime in Texas could be a misdemeanor, but the same crime in Colorado could be a felony. TABC will classify the offense according to the local jurisdictional conviction.

Deferred adjudications under the Code are treated differently. For instance, deferred adjudications in minor alcohol-related offenses are considered to be convictions.²⁰ Yet, most offenses that result in deferred adjudications, including felonies, which are later dismissed, are not considered convictions. If a permittee is currently serving deferred adjudication for certain offenses, the TABC has discretion to cancel or deny the permit or application; in deciding same, TABC takes into account the following factors:

1. The extent and nature of the person's past criminal activity;
2. The age of the person at the time of the crime;
3. The amount of time that has elapsed since the person's last criminal activity;
4. The conduct and work activity of the person prior to and following the criminal activity;
5. Evidence of the person's rehabilitation; and
6. Other evidence presented by the person of his or her present suitability, including letters of recommendation.²¹

C. Residency Issues

Gone are the days when only Texas citizens or residents could become permit holders. While many state residency and citizenship requirements are still within the Code, TABC is enjoined from enforcing them.²² Therefore, any United States citizen, assuming the person meets all other qualifications, may obtain a TABC permit. Further, as long as a permittee legally resides and is authorized to work in the United States, the permittee is eligible to hold a TABC permit, assuming the permit will not violate the permittee's immigration status or result in the permittee being illegally in the United States.²³ To

prove the same, such permittee must provide documentation in the form of a visa, resident alien card, work visa, etc. when applying for the permit. If the permit is in the name of an entity, with limited exceptions, the permittee must file a certificate of formation or register to transact business with the Texas Secretary of State.²⁴

IV. LOCATION, LOCATION, LOCATION

Where a business is or will be located will have great effect on whether the business will be able to sell alcoholic beverages and in the manner such sales may be made. Distance requirements, deed restrictions, zoning requirements, and wet/dry issues can play a large role in whether a TABC permit can be issued. Therefore, performing due diligence related to the below matters is highly recommended to ensure a successful and desired alcohol business.

A. Distance Requirements

While there is no statewide prohibition in relation to selling alcohol next to a protected use, the Code gives cities and counties the ability to enact ordinances/regulations which establish 300 foot distance requirements between the retailer and protected uses such as a church, public hospital, private school, public school, day care centers, and child care facilities (collectively "protected uses").²⁵ In some cases for purposes of public and private schools this distance requirement can be extended to 1,000 feet.²⁶ For churches or public hospitals the distance is measured from the front door to the front door, along the property lines of street fronts and in a direct line across intersections.²⁷ For public and private schools, day care centers, and child care facilities the distance is measured in a straight line from the nearest property line of the place of business to the nearest property line of the protected use, and in a direct line across intersections.²⁸

There are though a myriad of exceptions to these distance requirements. For example, a private school

¹⁹ TEX. ALCO. BEV. CODE ANN. §§11.46(a)(2), 61.42(a)(6)(West Supp. 2011).

²⁰ TEX. ALCO. BEV. CODE ANN. §106.071(f)(2) (West Supp. 2011).

²¹ 16 TEX. ADMIN. CODE §33.1 (2015) (Tex. Alco. Bev. Comm'n, Deferred Adjudication).

²² See *Cooper v. McBeath*, 11 F.3d 547 (5th Cir.), cert. Denied, 114 S. Ct. 2675 (1994).

²³ 16 TEX. ADMIN. CODE §33.10(a) (2015) (Tex. Alco. Bev. Comm'n, Citizenship and Status).

²⁴ 16 TEX. ADMIN. CODE §33.10(b) (2015) (Tex. Alco. Bev. Comm'n, Citizenship and Status).

²⁵ TEX. ALCO. BEV. CODE ANN. §§109.33, 109.331 (West Supp. 2011).

²⁶ TEX. ALCO. BEV. CODE ANN. §109.33 (West Supp. 2011).

²⁷ TEX. ALCO. BEV. CODE ANN. §109.33(b) (West Supp. 2011). See also *Robinson v. City of Dallas*, 193 S.W.2d 821 (Tex. App.—Austin 1946, rehearing denied); *Ezzell v. TABC*, 528 S.W.2d 888 (Tex. App.—Fort Worth 1975, rehearing denied).

²⁸ TEX. ALCO. BEV. CODE ANN. §§109.33(b), 109.331 (West Supp. 2011)

is only considered a private school for purposes of the Code when it offers a course of instruction for students at least one grade from K-12 and must have more than 100 students enrolled and attending classes.²⁹ Additionally, the 1,000 foot distance for public and private schools does not apply to the off-premise applicant if less than 50% of the gross receipts from the premises, excluding items subject to the motor fuels tax, is from the sale of alcoholic beverages,³⁰ the three hundred (300) foot distance requirement for private schools does not apply if a food and beverage certificate is applied for,³¹ and all distance requirements may be disregarded, save the 1,000 foot public school requirement, on the sale or transfer of a business where there is an existing permit and a new permit is required.³² Further, the Code allows a county or city to allow variances to these distance requirements if the governing body determines that such requirement is not in the best interest of the public, constituted waste or inefficient use of the land or other resources, creates an undue hardship on an applicant, does not serve its intended purpose, is not effective or necessary, or for any reason if a determination is made after consideration of the health, safety, and welfare of the public and the equities of the situation, that the variance is in the best interest of the community.³³

B. Deed Restrictions

Deed restrictions may also prevent the sale of alcohol. Such restrictions may be in the form of a total prohibition on the sale or service of alcoholic beverages, may prohibit just on- or off-premise sales, or may prohibit only a specific subset of alcohol such as spirits. Such deed restrictions are very difficult to remove³⁴ and thus any deed restrictions must be thoroughly vetted to ensure the desired alcohol sales would be permitted when due diligence on a location is conducted.

C. Zoning Requirements

Certain jurisdictions have zoning related requirements that may prohibit alcohol sales. Except as expressly provided by the Code, no regulation,

²⁹ TEX. ALCO. BEV. CODE ANN. §109.33(i) (West Supp. 2011).

³⁰ TEX. ALCO. BEV. CODE ANN. §109.33(f)(2) (West Supp. 2011).

³¹ TEX. ALCO. BEV. CODE ANN. §109.33(h)(1) (West Supp. 2011).

³² TEX. ALCO. BEV. CODE ANN. §109.59 (West Supp. 2011).

³³ TEX. ALCO. BEV. CODE ANN. §109.33(e) (West Supp. 2011).

³⁴ See generally *Ehler v. B.T. Suppenas Ltd.*, 74 S.W.3d 515 (Tex. App.—Amarillo 2002, pet. denied).

charter, or ordinance promulgated by a Texas governmental entity may impose stricter standards on a business required to have a TABC permit than on a similar business that is not required to have a TABC permit.³⁵ What this means is that municipal and county regulations pertaining to alcohol that are not expressly authorized by the Code are preempted.³⁶ Yet, such alcohol discriminatory regulations, charters, or ordinances may be imposed upon a business which will derive more than 75% of the businesses' gross receipts from the on-premise sale of alcoholic beverages³⁷ or if the regulation, charter, or ordinance was enacted on or before June 11, 1987.³⁸ Many jurisdictions in the state have discriminatory zoning requirements that were passed on or before June 11, 1987, which specifically affect the ability to sell alcohol. In many cases, zoning changes, specific use permits, conditional use permits, limited use permits, or some other municipal created zoning exception must be obtained in order to allow alcohol sales. Such requirements vary from jurisdiction to jurisdiction. Some can be granted quickly and administratively by the local zoning officer, while some require large fees and a series of hearings that take place over several months. In most instances, these actions must be undertaken before the permit can even be applied for with the TABC.

D. Wet/Dry Areas

Coming out of prohibition, Texas allowed the local determination of the types of alcoholic beverages that could be sold and how they could be sold by means of local options elections. These elections are held by counties, cities, or individual justice of the peace precincts. This has created the present-day patchwork of wet (meaning able to sell all forms of alcohol and in all ways), dry (meaning no ability to sell any form of alcohol in any way), and damp (meaning able to sell certain forms of alcohol in certain ways) areas throughout the State. While Texas is undoubtedly becoming a wetter state (in 1995 there were 53 dry counties compared to just 7 in May of 2015), there are still many areas in the state which do not allow certain sales of alcohol or limit the way in which alcohol may be sold.³⁹ A common form of wet/dry restriction in the type and way alcohol may be sold is where an area is wet for the legal sale of mixed

³⁵ TEX. ALCO. BEV. CODE ANN. §109.57 (West Supp. 2011).

³⁶ See *Dallas Merchants and Concessionaire's Association v. City of Dallas*, 852 S.W.2d 789 (Tex. 1993).

³⁷ TEX. ALCO. BEV. CODE ANN. §109.57(d)(2) (West Supp. 2011).

³⁸ TEX. ALCO. BEV. CODE ANN. §109.57(c) (West Supp. 2011).

³⁹ http://www.tabc.state.tx.us/local_option_election/index.asp

beverages in restaurants by food and beverage certificate holders. What this wet/dry election option does is to allow sales of all alcohol for on-premise consumption but only in restaurants, not bars. This is enforced through the food and beverage certificate which requires food service to be the primary business of the applicant and the offering of at least eight (8) meal entrees.⁴⁰ Some cities require reports on non-alcohol sales for food and beverage certificate holders and the Comptroller compares sales tax receipts to mixed beverage taxes collected to ensure compliance with the same. Under state law, at least 50% of the revenue from an entire premise must be from non-alcoholic beverages. Room sales are included as non-alcoholic beverage revenue.⁴¹ If alcohol sales percentages are too high, the Comptroller will alert TABC and TABC will refuse to renew the permit.

E. Permits and Laws Unique to Hotels

A hotel is defined by the Code to be an establishment where travelers are furnished food and lodging for payment, which operates a regular dining room constantly frequented by customers each day, and which has at least 10 adequately furnished and separate rooms which can accommodate overnight stays either in the course of usual and regular travel or as a residence.⁴² There are many considerations regarding how to sell alcohol in a hotel and the Code provides many options unique to such an establishment. For instance, a hotel can have a bar, a restaurant, a package store, a gift shop, and minibars in each room, all which sell alcohol and all which operate under separate TABC permits.

Unique to hotels is an understanding that people will and should be free to bring their own personal effects to their hotel room. This can include alcohol and the Code generally prohibits a person from bringing alcohol onto the premise of an alcohol retailer.⁴³ For these purposes, hotels do not typically license their entire grounds under a TABC permit. Instead, the grounds of a hotel can be diagrammed whereby certain rooms and areas are covered by one or more TABC permits.⁴⁴ The diagramming of a hotel must be done with care in order to prevent persons from bringing alcohol onto a TABC permitted premises. In practice, this means that a gift shop will

hold an off-premise permit selling beer and wine which only covers that area of the gift shop. A restaurant will hold a mixed beverage permit which only covers the seating area and/or bar where customers will be served. A ball room might not be desired to be a permitted area so that individual catering companies can bring, sell, and serve alcohol at wedding receptions or other events. Individual rooms are typically not permitted (or only the actual minibar portion of the room will carry a permit).

V. TABC APPLICATION DISCLOSURES

When a TABC application is filed certain corporate or company disclosures are required. If the applicant is a person or a single entity and all officers, directors, managers, members, partners, joint venturers, trustees, beneficiaries, and/or shareholders (hereafter "disclosed persons") are actual persons (not entities), then disclosures are relatively simple. Yet, when the permittee involves a corporate chain, disclosures can become quite complicated as the corporate chain and the disclosed persons at each level of the corporate chain must disclose and detail certain information in its application. For an actual person, this can include disclosure of personal information, employment history and residential addresses for the past five years, as well as the personal information of their spouse and any individuals over the age of eighteen that reside in the same residence. Further, if a person has not lived in Texas for the past year, the person may be required to provide TABC with a certified criminal background check from the Federal Bureau of Investigations or the state police of every state the person has lived in the previous five years. If the person has lived in Texas for the past year, no criminal background check is required.

Disclosure requirements also differ based upon the type of permit sought. Generally, for off-premise consumption permits (i.e., grocery stores, convenience stores, or gift shop permits), in addition to the basic business information (trade name and address of the location, etc.), the applicant must disclose whether it is within certain distances of churches, public hospitals, and public and private schools. On-premise locations (i.e., hotels, bars, restaurants, etc.) must disclose this same information as well as distances to day care centers and child care facilities.

For a mixed beverage permit, which allows for sales of beer, wine, and spirits, an applicant must disclose:

1. The name and residential address of the lessor of the premises;

⁴⁰ 16 TEX. ADMIN. CODE §33.5 (2015) (Tex. Alco. Bev. Comm'n, Food and Beverage Certificate).

⁴¹ TEX. ALCO. BEV. CODE ANN. §28.18 (West Supp. 2011).

⁴² TEX. ALCO. BEV. CODE ANN. §1.04(8) (West Supp. 2011).

⁴³ See TEX. ALCO. BEV. CODE ANN. §28.06 (West Supp. 2011).

⁴⁴ See TEX. ALCO. BEV. CODE ANN. §11.49(B) (West Supp. 2011).

2. The name and address of the lessee of the premises;
3. The amount of monthly rental on the premises and the date of expiration of the lease;
4. Whether the lease or rental agreement includes furniture and fixtures;
5. Whether the business is to be operated under a franchise and, if so, the name and address of the franchisor;
6. The name and address of the accountant of the business;
7. A list of all bank accounts, including account numbers, used in connection with the business; and
8. Any information required by the TABC relevant to the determination of all persons having a financial interest of any kind in the granting of the permit.⁴⁵

Many of these requirements are also required of off-premise and other on-premise permit applications. In addition, for both on- and off-premise permit applications information related to other businesses within the same premises, the terms of any concession, service or management agreement, sales data for alcoholic beverage sales, food sales, and all other sales, source of financing information, and information related to distances to residential addresses or neighborhood associations must be disclosed.

VI. MANAGEMENT, SUBLEASE, SERVICE, AND CONCESSION AGREEMENTS

Management and service agreements spell out the terms on which one entity will perform certain management functions and services related to the permittees business for the another entity which holds a TABC permit. Concession and Sublease agreements grant a permittee the right to operate at the location of another. Each of these agreements are common in the hospitality industry but special care must be taken in how such agreements are drafted and the actions undertaken by the respective parties as they relate to the business of purchasing, serving, and selling alcohol.

A. Management and Service Agreements

It is common for a variety of reasons for members of the hospitality industry to hold or apply for a TABC permit through a standalone entity typically referred to as a beverage company ("BevCo"). The BevCo is separate from the main operating entity ("OpCo"). The OpCo is typically the employer at the

location who runs the day-to-day operations. These entities may be part of the same corporate umbrella and share the same officers, managers, or directors, or they may be entirely separate entities with no common officers, managers, or directors. In instances where the BevCo has no employees, it will enter into a service agreement or a management and service agreement with the OpCo in order for its alcohol business to be conducted. Pure service agreements are rare and management and service agreements are much more common. Such management agreements typically dictate that the OpCo will perform the duties of accepting, preparing, serving, and selling alcohol on behalf of the BevCo, supply employees for the same, maintain the books and records required by law and for tax reporting purposes, and other such duties to be provided.

Special care must be taken in drafting management and service agreements so that no subterfuge takes place. It is critical that the BevCo at all times retains exclusive control of its business and the purchase, handling, selling, and serving of alcoholic beverages. This means the BevCo must purchase the alcohol, select the alcohol that is to be served, set the prices and the standards of operation, and that all alcohol revenue must be placed on the books of the BevCo even though the OpCo may initially accept payment for the alcohol. The OpCo and its employees are effectively considered to be agents and/or employees of the BevCo when such employees undertake alcoholic beverage related work and as much the BevCo should retain the right to hire and fire employees accordingly. The costs of the purchase of alcoholic beverages should be borne by the BevCo. In exchange for the services and management provided, the OpCo may charge the BevCo a fee, based upon a flat fee, a percentage of gross sales, or a combination of the two. In no case may the fee be based upon net profit and the fees may not be at such a level (including any sublease or concession agreement fees) that all profits are taken away from the BevCo.

An example of this and how such an arrangement is examined for subterfuge purposes is *TABC v. Good Spirits, Inc.*⁴⁶ Albertson's wished to sell beer and wine at its locations but was unable to at the time because it was an out of state corporation and did not qualify under the Code to hold such a permit. Albertson's approached Thomas C. Reynolds, a Texas resident, with the idea of forming Good Spirits in order for Good Spirits to apply and be granted TABC permits at Albertson's locations. Naturally, Mr.

⁴⁵ TEX. ALCO. BEV. CODE ANN. §28.03 (West Supp. 2011).

⁴⁶ *TABC v. Good Spirits*, 616 S.W.2d 411 (Tex. App.—Amarillo 2002, pet. denied)

Reynolds at the time had no experience selling alcoholic beverages. The arrangement was nonetheless agreed to and Good Spirits was funded through a bank loan guaranteed by Albertson's. Mr. Reynolds and another individual owned 53% of the company and 100% of the voting stock, and Albertson's held 47% of the company and 0% of the voting stock.

Under the agreement, Good Spirits sold alcoholic beverages within Albertson's seamlessly without any sectioned off area. It paid Albertson's 4 ½% of its gross sales to sublease the premises, 1 ½% under a service contract, and a certain flat fee to utilize Albertson's employees to stock the shelves and coolers. Good Spirits employed the manager and two assistant managers of Albertson's at the location in question as well as Mr. Reynolds. It was not obligated to employ Albertson's employees and retained the right to hire and fire all employees. Good Spirits utilized its own checking account to pay for the alcoholic beverages. Per the agreement, Albertson's provided purchase and sales records, bank statements, filing of all tax returns, weekly sales reports, payment of license fees, payment of invoices, and provided quarterly reports and financial statements. Good Spirits made a net profit of approximately 7% of sales but never paid a dividend to its stockholders.

TABC had initially allowed 7 permits to be granted but refused to issue an 8th permit as it deemed Good Sprits to be a subterfuge corporation for Albertson's and that Good Spirits did not maintain exclusive occupancy and control of the business in violation of the Code. Good Spirits appealed the matter to district court which overturned the TABC order. TABC then appealed the order to the appellate court which affirmed that TABC's order was arbitrary. The rationale given by the Court was that although both corporations worked in close conjunction pursuant to their agreements and operations, nothing in the record showed anything except that Good Spirits was operating independently and free of Albertson's control.

B. Sublease and Concession Agreements

Sublease and concession agreements in the realm of alcohol are very similar in nature and are commonly associated with hotels and stadiums. Each is designed such that in exchange for allowing the permittee to operate at a location, the holder of rights to the property is paid a fee. The main difference is that in subleases the furniture, fixtures, and equipment is typically owned by the permittee, whereas in concession agreements, the furniture, fixtures, and equipment is not owned by the permittee but is instead

owned by another entity, usually the hotel or stadium owner. Both typically involve and contemplate an existing or concurrent lease granted to a third party. For purposes of this Article, they are treated as the same.

While these agreements do not lend themselves readily to subterfuge arrangements when compared to management and service agreements, the sublease and/or concession fee must be structured in such a way that it is based upon a flat fee, a percentage of gross sales, or a combination of the two. Just as with management and service agreements, sublease and concession agreement fees cannot be paid based upon net profit and the agreements (including any management or service agreements) cannot be written to extract all profits from the permittee.

VII. STRUCTURING ALCOHOL SALES AT HOTELS

A. Who Holds the Permit

The majority of hotel operations have a hotel owner and management company enter into a hotel management agreement, whereby the hotel owner engages the management company to manage the business on behalf of, and provides employees to, the hotel owner. This is in a similar fashion to alcoholic beverage management and service agreements. For performing these duties, the management company typically receives a fee in the form of a percentage of the gross revenue of the location, which is typically about 3%.

In a hotel selling alcoholic beverages, all alcoholic beverage revenues should go on the books of the permit holder, who in turns pays all the alcohol taxes, costs of goods, and permit fees; the hotel owner receives room and food revenues on its books; the management company then gets its traditional fee. Hotel management agreements typically contemplate that alcohol sales will be made, but may not dictate exactly how the alcohol business at the hotel will be structured.

To keep with the general idea (and as typically structured in hotel management agreements) that the revenues from the business will inure to the hotel owner, and that the management company will be paid a percentage of such revenues, ideally the alcohol permittee/applicant BevCo would be a subsidiary of the hotel owner entity. Under this scenario, the permittee would have a management and services agreement with the management company and operate under a concession agreement with the hotel owner entity. This arrangement allows all alcohol revenues

to remain on the books of the permittee and profits can flow up the corporate chain to the hotel owner.

Due to the extensive disclosure requirements of the TABC required for disclosed persons, some hotel owners prefer that the management company obtain the permit; thus, the hotel owners and their officers/managers/directors do not have to disclose their personal information, and avoid the need to be fingerprinted, and submit criminal background checks from the FBI or state police. Other reasons why a management company may be chosen to hold the permit can include liability concerns, religious prohibitions, or because of management company experience in owning and operating alcoholic beverage permittees. In these instances, the permittee will be owned by the management company and the management company would be required to obtain the permit. As with the first scenario, the permittee would have a separate alcoholic beverage management agreement with the hotel management company parent; the management company subsidiary will operate under a concession agreement with the hotel owner entity. In this scenario though, all alcohol profits will flow up the corporate chain to the management company, not the hotel owner.

A visual representation of the flows of revenue in the hotel scenarios described above with a mixed beverage permit, management and services agreement, and concession agreement is attached hereto as Exhibit A.

VIII. TABC PERMITTING CONSIDERATIONS WHEN A HOTEL IS SOLD

A. Stock Purchase of the BevCo

While a TABC permit is a personal privilege that may not be sold or transferred, the equity of an entity that holds TABC permits may be purchased. This thereby allows the personal privilege to be exercised by a new set of owners without the need to apply for a new TABC permit. This procedure allows for the uninterrupted sales of alcohol at the hotel. The Code has strict requirements to permit such a transaction. Written notice must be provided to the Commission prior to any substantial change of control. A substantial change of control occurs when more than 50% of the interest changes hand.⁴⁷ Once the pre-closing notice is made, within ten days after the closing, the new officers, directors, shareholders, management company, concession grantor, etc., must

be disclosed to the Commission.⁴⁸ Should any of the new officers, directors, or shareholders, be deemed to be disqualified, the TABC may institute action to cancel the existing permit or deny its renewal.⁴⁹

The business considerations to be considered when acquiring a BevCo are similar to any other equity purchase transactions. That is, the Buyer must be cognizant of all tax liens, debts, contingent dram shop liability, etc, that may affect the BevCo, as the liabilities, as well as the assets and personal privileges will pass to the Buyer at closing.

B. Asset Purchase of BevCo

Since the TABC permit is not transferable, the purchase of the existing permit-holders assets (usually just the alcoholic beverage inventory and possibly the FFE) will require the Buyer to obtain a new, original, TABC permit from the Commission. Depending on the local jurisdictional requirements, this process can take from six weeks to six months. Often, the hotel closing will occur prior to the time the new application is granted. To ensure the seamlessness of alcoholic beverage sales during this period, it is common to use an interim beverage agreement, also known in Texas as a temporary concession agreement (“TCA”).

Under a TCA, the existing permit holder agrees to keep its permits in place and allow the Buyer or its affiliate to manage the alcoholic beverages business in the interim period until Buyer’s permit issues. During this period, all the alcoholic beverages remain under title to the current permittee; all the sales inure to the current permittee, and the current permittee is responsible for all taxes and payment of the cost of goods. The current permittee can pay a concession fee to the new hotel owner and a management fee to the new hotel management company. This arrangement must be reported to TABC by the current permittee within ten days of its effective date.⁵⁰ Any new lessors/sub-lessors, concession grantors, and management companies officers’ personal information must be also disclosed. Only once the Buyer or its affiliate complete the application process and are granted new permits may the transfer of the alcoholic beverage inventory be consummated pursuant to a bill of sale or otherwise. A complete inventory of the alcoholic beverage must be taken upon the sale and a

⁴⁷ TEX. ALCO. BEV. CODE ANN. §28.04(d)(2)(B) (West Supp. 2011).

⁴⁸ 16 TEX. ADMIN. CODE §41.48 (2015) (Tex. Alco. Bev. Comm’n, Changes Relating to Control).

⁴⁹ TEX. ALCO. BEV. CODE ANN. §28.04(e) (West Supp. 2011).

⁵⁰ 16 TEX. ADMIN. CODE §41.48 (2015) (Tex. Alco. Bev. Comm’n, Changes Relating to Control).

notarized copy of the inventory must be provided to the TABC.⁵¹

Under this procedure, the FEIN of the new entity may differ from that of the former entity.

C. Mergers

Depending on the structure of the transaction, it may be possible to merge the current permit holding entity into a new entity without the need to obtain a new, original permit from the TABC. The Code's merger provisions require that the two merging entities be 'sister companies' owned at least 90% each by the same parent. Alternatively, 'original parents and child' entities may merge; that is, that parent company that is surviving held an interest in merged former-permit-holding entity since the inception of the TABC permits.⁵²

D. Permit transfers

It may be possible to transfer an existing TABC permit to another location to utilize at a new location. Generally, the privileges under a TABC permit are limited to the address to which it is granted.⁵³ However, a permit can be transferred to another location if all the requirements of an original application are met.⁵⁴

E. Conversion and Altering Form of Business Entity

The type of legal entity holding the permit may be changed for tax or other corporate purposes. This may be done pursuant to the Texas Business Organizations Code⁵⁵ for both domestic and foreign entities or as allowed by TABC.⁵⁶ If done pursuant to the Business Organizations Code, a plan of conversion and any new officers, etc. must be filed with the TABC. It is required that the FEIN of the entity remains the same

The form of the business entity may be changed pursuant to the Code so long as the new entity is identical in ownership to the former business entity.⁵⁷

⁵¹ 16 TEX. ADMIN. CODE §41.3 (2015) (Tex. Alco. Bev. Comm'n, Sale after Cancellation or Expiration of License or Permit).

⁵² TEX. ALCO. BEV. CODE ANN. §6.03(1) (West Supp. 2011).

⁵³ TEX. ALCO. BEV. CODE ANN. §11.06 (West Supp. 2011).

⁵⁴ TEX. ALCO. BEV. CODE ANN. §11.08 (West Supp. 2011).

⁵⁵ TEX. BUS. ORG. CODE ANN. §10.101 (West Supp. 2011).

⁵⁶ See generally TABC *Business Packet for Reporting Changes*, available at <http://www.tabc.state.tx.us/forms/licensing/BusinessReport.pdf>.

⁵⁷ TEX. ALCO. BEV. CODE ANN. §11.12 (West Supp. 2011).