No. 03-16-00786-CV

In the Court of Appeals for the Third Judicial District Austin, Texas

TEXAS ALCOHOLIC BEVERAGE COMMISSION AND ROBERT SAENZ, IN HIS OFFICIAL CAPACITY AS ACTING EXECUTIVE DIRECTOR OF TEXAS ALCOHOLIC BEVERAGE COMMISSION,

Appellants,

v.

LIVE OAK BREWING CO., LLC; REVOLVER BREWING, LLC; AND PETICOLAS BREWING CO., LLC

Appellees.

On Appeal from the 98th District Court, Travis County

REPLY BRIEF FOR APPELLANTS

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To the Honorable Third Court of Appeals:

Plaintiffs' response confirms that they are not entitled to relief under *Patel* for several reasons. First, Plaintiffs' claims depend on an unfounded expansion of *Patel* to business entities. *Patel* vindicated the fundamental right of an individual to earn a living free from oppressive government interference; it did not weaponize the Texas Constitution for corporate challenges to unwanted business regulations based on policy disagreements.

Second, Plaintiffs' success hinges on the trial court's facial invalidation of section 102.75(a)(7), but that relief is irreconcilable with *Patel*. The *Patel* standard permits only as-applied challenges; it does not apply to facial challenges, the only relief granted by the trial court. *Patel* is a tool for relieving regulatory oppression as applied to specific individuals—a judicial scalpel, not a machete.

Third, even if *Patel* applied and facial relief were available, Plaintiffs nevertheless failed to meet their high burden of proving that the Legislature enacted an unconstitutional statute. Section 102.75(a)(7) is rationally related to the State's legitimate interest in maintaining the vitality of the three-tier system, which prevents tied houses and other problems, and Plaintiffs did not prove that the law operated oppressively as applied to them. Plaintiffs' *Patel* claim rests on their mistaken theory that a statute is illegitimate unless it directly and materially impacts the ultimate ends of the larger statutory framework. With that premise, they seek to lower the bar on all aspects of the *Patel* standard.

Plaintiffs' attempt to portray section 102.75(a)(7) as a product of political cronyism aimed only at enriching distributors is baseless and needlessly disparages the good-faith legislative process that dramatically expanded rights for Plaintiffs and other craft brewers at the expense of distributors and retailers. *Patel* was not intended as a vehicle for litigants to redraw the carefully crafted contours of legislative compromises.

ARGUMENT

I. Plaintiffs' Statement of Facts Is Misleading and Erroneous.

Plaintiffs' explanation of the history and legislation regarding territorial assignments in their statement of facts contains several misleading and erroneous statements that warrant attention.

A. There Is No Long History of Selling Territorial Assignments.

Plaintiffs indicate that selling territorial assignments was common practice, *see* Resp. at 5-9, and "was perfectly legal for nearly 80 years following prohibition," Resp. at 33; *see also* Resp. at 1. Plaintiffs' are wrong. As an initial matter, Plaintiffs cite no case law or provision in the Texas Alcohol Beverage Code (the Code) that ever authorized the sale of territorial assignments. To the contrary, the record shows that TABC has "always operated under the premise that the sale of territorial rights w[as] illegal," even prior to SB 639. CR.309. During the 2013 legislative session, a legislator reached out to TABC to confirm the apparently widespread industry belief that "payment for territorial assignments of brands by a distributor to a manufacturer are not allowed

by Texas law." CR.337. A TABC representative replied that "nothing in the alcoholic beverage code authoriz[es] a manufacturer or brewer to seek payment for territorial rights." CR.336. Another TABC representative stated that TABC could not confirm the legislator's statement because the Code did not address that issue, but stated that it would be helpful to have legislation "that specifically authorizes or prohibits payment for distribution rights." CR.335. It is no surprise, then, that SB 639's author described the bill prohibiting the sale of territorial assignments as a clarification of existing law. CR.312.

What's more, Plaintiffs presented no evidence of any brewer selling territorial rights in the "over eighty years" that they allege it was permitted, *see* Resp. at 1, except for plaintiff Live Oak's testimony that it sold its Houston territory in 2012, CR.166, 176. A single sale in "over eighty years" does not support Plaintiffs' contention that the activity had a long and accepted history.

B. The Challenged Law Was Not Intended to Enrich Distributors; It Was One of Five Bills in a Legislative Package That Largely Favored Craft Brewers.

Plaintiffs assert that SB 639 was a scheme by distributors to enrich themselves. Resp. at 7-9. Not true. SB 639 was one of five bills in a legislative package that was aimed primarily at expanding the rights of craft brewers. *See* Appellant's Br. at 11-13. The five-bill package was an all-or-nothing deal negotiated among brewers, distributors, legislators, and other stakeholders. *See, e.g.*, Elena Schneider, *Beer Distributors, Craft Brewers Reach Deal*, TEXAS TRIBUNE

(March 11, 2013), https://www.texastribune.org/2013/03/11/beer-distributors-craft-brewers-reach-tentative-de/; *see also* CR.268-69 (SB 639); CR.134-35.

The legislative compromise favored craft brewers. Four of the five bills significantly expanded rights of craft brewers, allowing self-distribution of beer and sale of beer for on-site consumption at the breweries.[1] And far from favoring distributors, as Plaintiffs imply (Resp. at 8), Senator Carona (the author of SB 639) stated that legislators were "going to do our best to get [craft brewers] a product that works" for them. Hearing on S.B. 515, 516, 517, and 518 Before S. Comm. on Bus. & Commerce, 83d Leg., R.S. at 1:20-2:15 (Mar. 5, 2013), http://tlcsenate.granicus.com/MediaPlayer.php?view_id=9&clip_id=745.

Plaintiffs also allege that "[t]he bill was uniformly opposed by brewers," Resp. at 8, but there is ample evidence that the group representing craft brewers' interests in the Legislature did *not* oppose the bill. For example, the record shows that the Texas Craft Brewers Guild (TCBG) agreed to accept passage of SB 639 in exchange for passage of the four pro-craft beer bills (SB 515,

[1] **SB 515**, Act of May 20, 2013, 83d Leg., R.S., ch. 750, 2013 Tex. Gen. Laws 1896 (allows brewpubs to self-distribute beer); **SB 516**, Act of May 20, 2013, 83d Leg., R.S., ch. 533, 2013 Tex. Gen. Laws 1443 (allows small brewers of ale/malt liquor to self-distribute up to 40,000 barrels); **SB 517**, Act of May 20, 2013, 83d Leg., R.S., ch. 534, 2013 Tex. Gen. Laws 1444 (allows small manufacturers of beer to self-distribute up to 40,000 barrels); **SB 518**, Act of May 20, 2013, 83d Leg., R.S., ch. 535, 2013 Tex. Gen. Laws 1446 (permitting small brewers to sell their beer for on-site consumption (up to 5,000 barrels annually)).

516, 517, 518). CR.134-35; *see also* CR.169-70 (explaining that TCBG's legislative committee agreed to SB 639 as part of the five-bill package). The territorial-assignment restriction was expressly contingent on the passage of four pro-craft-brewer bills. CR.269; S.B. 639, Act of May 20, 2013, 83d Leg., R.S., ch. 555, § 2, 2013 Tex. Gen. Laws 1494, 1494-95. And after the bills were enacted, craft brewers were jubilant. Ronnie Crocker, *Debate over SB 639 continues among craft brewers*, HOUSTON CHRONICLE (March 14, 2013), http://blog.chron.com/beertx/2013/03/debate-over-sb-639-continues-among-craft-brewers/. That is far from uniform opposition.

C. Brewers Were Not "Stripped" of Rights or Forced to "Give Away" Anything.

Plaintiffs allege that brewers are forced to "give away" territorial assignments in perpetuity while distributors are free to resell those assignments to another distributor. Resp. at 9. Not true. Plaintiffs do not "give away" anything when they assign territories for distribution. Territorial assignments are a creation and requirement of the three-tier system within which brewers operate. *See* Tex. Alco. Bev. Code § 102.51.

The Code also does not force brewers to assign territories in perpetuity while allowing distributors to re-assign territories with impunity, as Plaintiffs allege. Resp. at 6, 9. To the contrary, the Code presumes that distribution agreements may expire or be cancelled, and that assignments by distributors may require the brewer's approval. *See* Tex. Alco. Bev. Code §§ 102.71, .73,

.74, .77. While the Code requires compensation for cancellation of a distribution agreement or refusal to allow an assignment without "good cause," *id.* § 102.77(a), it recognizes that "good cause" is subject to agreement between the parties, *id.* § 102.77(b). The Code even defines "good cause" as failure to comply with the terms of the agreement. *Id.* § 102.71(6). The Code thus provides boundaries and default rules for contracts between distributors and brewers (not punitive mandates, as Plaintiffs allege) designed to "promote the public's interest in the fair, efficient, and competitive distribution of beer" by ensuring the independence of distributors from brewers. *Id.* § 102.72(a); *see also* Appellants' Br. at 7-11.

D. Plaintiffs' Assertion That the Law Lacks Evidentiary Support Is Deeply Flawed.

Plaintiffs assert that there is no evidence that section 102.75(a)(7)'s territorial-assignment restriction promotes the purposes of the three-tier system, Resp. at 10, but there are several serious flaws in that argument. First, the validity of the law does not depend on whether TABC proved that it was needed to address a problem.[2] The Legislature is not required to wait until trouble occurs before it acts to head off a perceived problem. *See, e.g.*, *Ex parte Morales*, 212 S.W.3d 483, 497 (Tex. App.—Austin 2006, pet. struck & ref'd) (uphold-

[2] The fact that TABC had not received complaints about the sale of territorial assignments does not show that the law lacked evidentiary support, as Plaintiffs contend. *See* Resp. at 11-12, 36-37. Rather, it confirms that the sale of territorial assignments was unheard of until 2012. Indeed, TABC was not aware of any instances of territorial assignments being sold until the issue was raised during the 2013 legislative session. CR.304-05.

ing a law prohibiting sexual relationships between faculty and students because it was rational for the Legislature to think that such relationships would "undermine the school's learning environment").

Second, Plaintiffs' assertion is built on the false supposition that the State must prove that the statute directly advances the ultimate aims of the three-tier system. Not so. Maintaining the balance, strength, and separation of the tiers is critical to maintaining the vitality of the three-tier system and preventing tied houses and other pre-Prohibition problems, which courts have consistently recognized is a legitimate interest. *See infra* at 19-22; Appellants' Br. at 20-23.

With the extensive expansion of the powers of craft brewers at the expense of distributors and retailers, the Legislature had good reason to maintain balance among the tiers by prohibiting the sale of territorial assignments. There is certainly evidence of that concern in the legislative record. In a hearing addressing the numerous pro-craft-brewer bills, for example, Senator Carona (author of the territorial-assignment restriction in SB 639) explained that "when you deal with anything that involves the three tier system, you really have to look at the whole picture," and that while craft brewers' interests "are important . . . there are other interests that also align with the alcohol industry that we have to look after as well if we're going to preserve [the] system that has worked well in the State for many many years." Hearing at 1:20-2:15, *supra* at 6. Furthermore, Live Oak's sale of territorial rights in 2012, CR.166, apparently a first in Texas, CR.304-05, was a significant development that is more

than enough evidence to justify the Legislature's action to address a perceived emerging threat to the three-tier system.

II. Plaintiffs' Attempt to Expand *Patel* Is Unfounded.

Plaintiffs wish to make *Patel* a catch-all constitutional cause of action for corporations to challenge unwanted government regulation, but *Patel* does not support such an expansive interpretation. *Patel* vindicated the fundamental right, secured by article 1, section 19 of the Texas Constitution, of an individual to earn a living free from oppressive government interference. *See Patel v. Tex. Dep't of Licensing & Regulation*, 469 S.W.3d 69, 86-87 (Tex. 2015). The Supreme Court did not (and had no reason to) extend the oppressiveness standard announced in *Patel* to business entities or to facial challenges.

That is not say that Article I, Section 19 does not cover business entities; undoubtedly it does, and the traditional rational-basis test applies. However, *Patel*'s heightened standard does not apply in this case because *Patel* is limited to as-applied challenges to economic regulations that burden an individual's ability to earn a living.

A. *Patel* Protects an Individual's Right to Earn a Living, Not a Business's Interest in Avoiding Unwanted Regulation.

Plaintiffs argue that business entities have long enjoyed the substantive economic liberty interest recognized in *Patel*. They are wrong, and they confuse the general protections of article I, section 19, with the specific interest at issue in *Patel*. There is no doubt that article I, section 19, generally applies to business entities and individuals; the State has never argued otherwise. The

issue in this case is whether the fundamental economic liberty interest recognized in *Patel* also applies to business entities. The answer to that question is no, and none of the cases Plaintiffs cite hold otherwise.[3] Although *Patel* cited some cases that involved businesses in explaining the background for the standard, the Texas Supreme Court did not hold that the particular liberty interest in question applied to business entities. To the contrary, the Court focused on individual rights. *See Patel*, 469 S.W.3d at 73 (noting that individuals brought the challenge); *id.* at 87 (concluding that "Section 19's substantive due course provisions" were intended to protect "individual rights"); *id.* at 91 (holding that the challenged law applied to "the individual Threaders" was unconstitutional).

Of particular significance was *Patel*'s consideration of the Texas Constitution's 1875 amendments after the *Slaughter House Cases* placed "guardianship of non-federal rights of individuals squarely in the hands of the states."

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[3] Plaintiffs are also wrong that the U.S. Supreme Court overturned its prior holdings that refused to recognize substantive economic liberty interests for corporations. *See* Resp. at 17-18. Both cases cited by Plaintiff do not support their argument. One—*Grosjean v. American Press Co.*, 297 U.S. 233 (1936)—*preceded* the Court's decision in *Hague v. Committee for Industrial Organization*, which held that "the liberty guaranteed by the due process clause is the liberty of natural, not artificial, persons." 307 U.S. 496, 527 (1939). The other case cited by Plaintiffs, *First National Bank of Boston v. Bellotti*, 435 U.S. 765 (1978), did not recognize a fundamental economic liberty interest for companies; it was a speech case. *Bellotti* held that the First Amendment protects certain speech regardless whether the speaker is an individual or a company. *See id.* at 777 ("The inherent worth of the speech in terms of its capacity for informing the public does not depend upon the identity of its source, whether corporation, association, union, or individual."); *id.* at 784 ("We thus find no support in the First or Fourteenth Amendment, or in the decisions of this Court, for the proposition that speech that otherwise would be within the protection of the First Amendment loses that protection simply because its source is a corporation that cannot prove, to the satisfaction of a court, a material effect on its business or property.").

Id. at 83. The Court concluded that "Section 19's substantive due course provisions undoubtedly were intended to bear at least some burden for protecting individual rights that the United States Supreme Court determined were not protected by the federal Constitution." *Id.* at 87. That holding confirms that only the rights of individuals, not business entities, were in view because corporations are not covered by the privileges and immunities clause. *See Grosjean*, 297 U.S. at 244 ("A corporation, we have held, is not a 'citizen' within the meaning of the privileges and immunities clause.").

Patel articulated the standard for individuals seeking to vindicate their fundamental right to earn an honest living free from oppressive and arbitrary government regulations. As Justice Willett explained in his concurrence, "Liberty is not *provided* by government; liberty *preexists* government. It is not a gift from the sovereign; it is our natural birthright. Fixed. Innate. Unalienable." *Patel*, 469 S.W.3d at 92–93 (Tex. 2015). Contrast the innate liberty of individuals with the innate limitations of business entities created under state law: "A corporation has no more powers than are granted expressly or by implication from its charter, which is dependent upon the law of the state authorizing the creation of corporations, and prescribing their powers, duties, and liabilities." *Sabine Tram Co. v. Bancroft*, 40 S.W. 837, 839 (Tex. Civ. App. 1897, writ ref'd); *cf. Upjohn Co. v. United States*, 449 U.S. 383, 389–90 (1981) (describing a corporation as "an artificial creature of the law, and not an individual"); *Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 348 (1985) ("As an inanimate entity, a corporation must act through agents."); *id.*

at 349 (noting that "when control of a corporation passes to new management, the authority to assert and waive the corporation's attorney-client privilege passes as well"). Thus, neither the holding of *Patel* nor its philosophical and jurisprudential underpinnings support Plaintiffs' attempt to extend fundamental economic liberty interests to business entities.

B. Plaintiffs Failed to Establish the Facial Invalidity of Section 102.75(a)(7) Under *Patel*.

In response to Plaintiffs' facial challenge under *Patel*, the trial court ruled that section 102.75(a)(7) facially violates the due course of law provision in article I, section 19 of the Texas Constitution. CR.576-78. Plaintiffs do not dispute that they did not meet their burden under a facial challenge, but instead urge that it is "wrong and irrelevant" to argue that *Patel* applies to only as-applied challenges. Resp. at 18. They are mistaken.

1. *Patel* adopted an as-applied standard that is incompatible with facial challenges.

Patel applies to "an as-applied challenge to an economic regulation statute under Section 19's substantive due course of law requirement," 469 S.W.3d at 87, not to facial challenges. The Court could not have been clearer that it was adopting a standard limited to "*as-applied* substantive due course challenges to economic regulation statutes" in *Patel*. *Id.* (emphasis added); *see also id.* (explaining that the standard requires assessment of the "actual, real-world effect" of a law "as applied to the challenging party"); *id.* at 89 (applying "the second prong of the as-applied standard"); *id.* at 91 (stating that the standard

is based on earlier standards "for considering as-applied substantive due process claims"). Nowhere in *Patel* did the Court contemplate or approve of facial challenges.

Even if the Texas Supreme Court hadn't expressly limited *Patel* to as-applied claims, the *Patel* standard is fundamentally incompatible with facial challenges. *Patel* addresses a law's "actual, real-world effect as applied to the challenging party," a fact-intensive inquiry that "will in most instances require the reviewing court to consider the entire record, including evidence offered by the parties." *Id.* at 87. In a facial challenge, however, courts "consider the statute as written, rather than as it operates in practice." *FM Props. Operating Co. v. City of Austin*, 22 S.W.3d 868, 873 (Tex. 2000). This is because the plaintiff must prove that the "statute, by its terms, always operates unconstitutionally." *Tenet Hosps. Ltd. v. Rivera*, 445 S.W.3d 698, 702 (Tex. 2014).

2. The scope of *Patel* is relevant because the trial court granted only facial relief and Plaintiffs failed to establish the facial invalidity of Section 102.75(a)(7).

Plaintiffs do not dispute that they sought facial invalidation of section 102.75(a)(2), and they do not seriously dispute that they failed to meet their burden under the facial challenge. *See* Resp. at 18-19. Nor could they, as they never alleged (much less demonstrated) that section 102.75(a)(7) is unconstitutionally oppressive for all brewers, including large brewers like MillerCoors or Anheuser-Busch InBev. *See, e.g.*, CR.84 (arguing that the law "unduly burdens craft brewers"). Plaintiffs did not even attempt to establish that

section 102.75(a)(7) is unconstitutionally oppressive to all craft brewers. They did not show, for example, that section 102.75(a)(7) applies oppressively to craft brewers that supported the legislation or had already entered territorial assignments without receiving compensation. *See* CR.170 (speculating that a craft brewer on the legislative committee of the TCBG did not oppose the statute because "he had already given up all of his distribution rights"). That is fatal to their facial challenge. *Rivera*, 445 S.W.3d at 702 (requiring proof that the law operates unconstitutionally in every application).

Plaintiffs attempt to dodge this problem by arguing that they also sought as-applied relief, Resp. at 18-19, and that "the facial/as-applied distinction only matters as to the scope of the remedy," Resp. at 19. But that does not solve their problem. First, Plaintiffs cite no authority for their argument that the facial/as-applied distinction concerns only the scope of the remedy under Texas law. In any event, viewing the facial/as-applied distinction through the remedy lens does not lower the burden of proof borne by Plaintiffs. Otherwise, the facial standard would be meaningless, swallowed up by the as-applied standard.

Plaintiffs cite the U.S. Supreme Court's decision in *Citizens United v. Federal Election Commission*, 558 U.S. 310 (2010), for their remedy argument, Resp. at 19, but as that case made clear, a facial remedy may be appropriate only when the plaintiff has established its entitlement to that broad relief. *See id.* at 331 (explaining that the plaintiff's claim ultimately challenged the facial validity of the statute at issue), *id.* at 336 (explaining that "a statute which

chills speech can and must be invalidated *where its facial invalidity has been demonstrated*." (emphasis added)); *id*. at 376 (Roberts, C.J., concurring) (noting that the plaintiff satisfied its burden under the facial and as-applied standards).

Here, Plaintiffs only attempted to prove that the statute was oppressive as applied to them, but the trial court facially invalidated section 102.75(a)(7). The judgment therefore is not supported by Texas law or the record and must be reversed.

III. Plaintiffs Failed to Meet *Patel*'s "High Burden" for Invalidating Section 102.75(a)(7).

Even if *Patel* applied in this case, Plaintiffs are not entitled to relief because they failed to satisfy either prong of the standard.

It bears repeating that invalidating a duly enacted law under *Patel* is not easily done. The Texas Supreme Court commanded that "Courts must extend great deference to legislative enactments, apply a strong presumption in favor of their validity, and maintain a high bar for declaring any of them in violation of the Constitution." *Patel*, 469 S.W.3d at 91; *see also id*. at 87 (explaining that the standard includes a presumption that "legislative enactments are constitutional," and imposes "a high burden on parties claiming a statute is unconstitutional").

To overcome that high burden, a plaintiff must prove that either (1) the statute fails rational-basis review because either the purpose or the effect on

the plaintiff "could not arguably be rationally related to a legitimate governmental interest," or (2) the actual effect of the statute on the plaintiff "is so burdensome as to be oppressive in light of[] the governmental interest." *Id.* at 87. Notably, proving that a law is "oppressive" is not an easy task; even "harsh" and "unreasonable" statutory burdens do not rise to the level of being unconstitutionally "oppressive." *Id.* at 90.

Plaintiffs appear to misunderstand the *Patel* standard, arguing that traditional rational-basis review "squarely conflicts" with the standard adopted in *Patel*. Resp. at 20. But the *Patel* standard expressly incorporates the rational-basis test. *Compare Patel*, 469 S.W.3d at 87 (requiring a plaintiff to prove "the statute's purpose could not arguably be rationally related to a legitimate governmental interest") *with, e.g., Mayhew v. Town of Sunnyvale*, 964 S.W.2d 922, 938 (Tex. 1998) (per curiam) (holding that the inquiry under rational-basis review is "whether the enacting body could have rationally believed at the time of enactment that the ordinance would promote its objective"). Evidence is not relevant to the *purpose* inquiry of the rational-basis test in *Patel*, whereas Plaintiffs must prove that the "actual, real-world *effect* as applied" to them "could not arguably be rationally related to [the] governmental interest." *Patel*, 469 S.W.3d at 87 (emphasis added). Requiring plaintiffs to prove that the as-applied effect bears no arguable rational relationship to a legitimate governmental interest grounds the standard in the particular factual scenario, it does not relax the rational-basis standard.

Plaintiffs also assert that *Patel*'s omission of the word "conceivable" from its articulation of the rational-basis standard was intended to ease the standard, Resp. at 23-24, but that is not a fair reading of *Patel*. A "conceivable" rational basis and an "arguable" rational basis (the term used in *Patel*) are just two articulations of the same, highly deferential standard. *Compare* definition of *Arguable*, Collins English Dictionary 106 (12th ed. 2014) (defining "arguable" as "capable of being disputed" and "capable of being supported by argument"), *with* definition of *Conceivable*, Collins English Dictionary 419 (12th ed. 2014) (defining "conceivable" as "capable of being understood, believed, or imagined").

A. Plaintiffs Failed to Prove That Section 102.75(a)(7) Lacks a Rational Basis.

Plaintiffs attack the rational basis for section 102.75(a)(7) on three fronts. They argue that (1) bolstering the three-tier system is not a legitimate government interest because it is "a means to an end, not an end in itself," Resp. at 25-29; (2) the real purpose for section 102.75(a)(7) was to enrich distributors at the expense of brewers, Resp. at 29-32; and (3) the law's effect does not rationally support the three-tier system, Resp. at 32-38. Each argument lacks merit.

1. Ensuring the vitality of the three-tier system is a legitimate governmental interest.

Plaintiffs assert that revising the three-tier system to ensure its continued vitality is not a legitimate government interest. *See* Resp. at 25-29. That argument is baseless, and they cite no cases for support.

As already explained, ensuring the continued effectiveness of the three-tier system is unquestionably a legitimate interest. *See* Appellants' Br. at 20-23. Time and again, courts and the Legislature have recognized the importance and validity of the three-tier system in preventing the reemergence of the tied house and other problems. *See id.* The United States Supreme Court has consistently deemed the three-tier system "'unquestionably legitimate.'" *Granholm v. Heald*, 544 U.S. 460, 466 (2004) (quoting *North Dakota v. United States*, 495 U.S. 423, 432 (1990)). The Texas Supreme Court recently noted with approval that the three-tier system is concerned "not only with preventing paradigmatic, pre–Prohibition tied houses, but also with 'related practices' that might negatively affect public health and safety." *Cadena Comercial USA Corp. v. TABC*, No. 14-0819, 2017 WL 1534052, at *6 (Tex. Apr. 28, 2017). This Court has likewise recognized the State's legitimate interest in the three-tier system. *See, e.g.*, *Neel v. Tex. Liquor Control Bd.*, 259 S.W.2d 312, 316 (Tex. Civ. App.—Austin 1953, writ ref'd n.r.e.) (affirming the government's legitimate interest in "prevent[ing] the evils of the 'tied house,'" which is the aim of the three-tier system); *Cadena Comercial USA Corp. v. TABC*, 449 S.W.3d 154, 163 (Tex. App.—Austin 2014, pet. granted)

(noting that the three-tier system "aid[s] Texas in the regulation and control of alcohol consumption, and prevents companies with monopolistic tendencies from dominating all levels of the alcoholic beverage community" (internal quotation marks omitted)). Other courts have held the same. *See, e.g.*, *Aug. A. Busch & Co. v. TABC*, 649 S.W.2d 652, 654 (Tex. App.—Texarkana 1982, writ ref'd n.r.e.) (recognizing "the public interest is served by the prohibition of vertical integration within the alcoholic beverage industry"); *S.A. Disc. Liquor, Inc. v. TABC*, 709 F.2d 291, 293 (5th Cir. 1983) (explaining that the three-tier system is intended to "avoid the harmful effects of vertical integration in the intoxicants industry" and to "prevent[] companies with monopolistic tendencies from dominating all levels of the alcoholic beverage industry"); *Actmedia, Inc. v. Stroh*, 830 F.2d 957, 965 (9th Cir. 1986) (acknowledging a State's "'substantial' interest in exercising its twenty-first amendment powers and regulating the structure of the alcoholic beverage industry").

Statutory updates to the three-tier system, like section 102.75(a)(7), are not simply regulations for regulation's sake that lack a legitimate purpose, as Plaintiffs argue. Resp. at 25-26. Rather, they revise the three-tier system to ensure that it remains viable, enforceable, and effective amidst an ever-changing business, economic, and statutory landscape. That is a legitimate government interest.

Prohibiting the sale of territorial assignments supports the three-tier system by maintaining strict separation between the manufacturing and distribu-

tion tiers, which advances the aim of preventing tied houses and other problems in numerous ways. *See* Appellants' Br. at 24-26. Plaintiffs' own response illustrates the merit of section 102.75(a)(7) in a hypothetical that contrasts a distribution agreement (barred by the law) that includes a direct injection of cash by a distributor into a brewer's business with a distribution agreement (allowed by the law) that provides for the distributor to invest in the distributor's own business. *See infra* at 25-26.

Plaintiffs also contend that statutory components of the three-tier system, like section 102.75(a)(7), are illegitimate unless each directly and measurably advances the ultimate purpose of the system. Resp. at 25-26. That is wrong for at least two reasons. First, assessing a statutory provision's impact in isolation violates the well-established rule that courts "consider the context and framework of the entire statute and meld its words into a cohesive reflection of legislative intent." *Cadena*, 2017 WL 1534052, at *5; s*ee also, e.g.*, *Helena Chem. Co. v. Wilkins*, 47 S.W.3d 486, 493 (Tex. 2001) (holding courts "must always consider the statute as a whole rather than its isolated provisions"); Tex. Gov't Code § 311.021(2) (statutes are enacted with the presumption that "the entire statute is intended to be effective"). Plaintiffs' myopic approach fails to account for statutory context, and many provisions in the three-tier system—including those pro-craft-brewer provisions that Plaintiffs championed—might appear unfair to other members of the industry if assessed in isolation.

Second, a statute need not directly and measurably advance the ultimate purpose of the larger regulatory scheme to have a legitimate purpose. A statue's validity turns on "whether the enacting body could have rationally believed at the time of enactment that the ordinance would promote its objective," not on its "ultimate effectiveness." *Mayhew*, 964 S.W.2d at 938; *see also Limon v. State*, 947 S.W.2d 620, 628 (Tex. App.—Austin 1997, no pet.) (Under rational-basis review, statutes "are set aside only if they are based solely on reasons entirely unrelated to the pursuit of the State's goals and only if no grounds can be conceived to justify them.").

Plaintiffs' theory was repudiated by this Court a half-century ago in *Neel*. The Court rejected the plaintiff's argument that the challenged three-tier provision lacked a sufficient relationship to preventing a tied house, reasoning that the statute deterred conduct that could undermine the three-tier system, "thus encouraging the legislative policy which the statute proclaims." *Neel*, 259 S.W.2d at 317. The same holds true for section 102.75(a)(7).

2. Section 102.75(a)(7) was just one component of a legislative package that expanded rights of craft brewers; it was not a "naked transfer of wealth" to distributors.

Plaintiffs argue that the real purpose for section 102.75(a)(7) was a "naked transfer[] of wealth" aimed at "[e]nriching distributors at the expense of brewers." Resp. at 1, 29. Plaintiffs' assertion of bare political favoritism cannot be squared with the facts. Section 102.75(a)(7) was part of a five-bill, all-

or-nothing legislative package negotiated among brewers, distributors, legislators, and other stakeholders that largely *favored* craft brewers. *See supra* at 5-7; Appellants' Br. at 11-13. Senator Carona, chairman of the Senate Business & Commerce Committee and author of SB 639, explained that legislators wanted to help craft brewers while ensuring that the three-tier system remained effective. *See* Hearing at 1:20-2:15, *supra* at 6.

Plaintiffs' cynical perspective was not shared by other craft brewers. Far from viewing the legislation as pure economic protectionism for distributors, leaders in the craft-brewing industry hailed the legislative package as "a victory for Texas craft brewers." Crocker, *supra*, at 7; *see also* Shelby Cole, *Craft Brewers Celebrate New Beer Laws*, TEXAS TRIBUNE (Feb. 7, 2014), https://www.texastribune.org/2014/02/07/craft-brewers-celebrate-new-beer-laws/ (reporting that "[t]he Texas Craft Brewers Guild predicts the new laws will have an enormous economic impact in Texas").

Plaintiffs' only basis for their argument of improper purpose is an email indicating that a lobbyist for distributors proposed the legislation. *See* Resp. at 8. Even if that were true, though, it does not establish that the Legislature's intent was to enrich distributors. It is common practice for lobbyists to advocate for legislation on behalf of their clients, and craft brewers themselves employed lobbyists to promote their favored bills. *See* CR.136. As one of the Plaintiffs admitted in describing the process, "We had several bills, I think it was—there were four of them, that we wanted to see happen, and the [distrib-

utors] had their one, which was 639." CR.169. If legislation could be invalidated on rational-basis review simply because a lobbyist supported it or was involved in the process, few statutes would remain on the books.

Plaintiffs do not dispute this legislative history; they simply ignore it because it does not fit their narrative. Plaintiffs gained much in the 2013 legislative package and lost nothing (as they failed to establish that selling territorial assignments was ever permitted under the Code). Section 102.75(a)(7) was no more a "naked transfer of wealth from brewers to distributors" than the four pro-craft-brewer bills—allowing them to self-distribute their beer and sell directly to customers for on-site consumption—were "naked transfer[s] of wealth" from distributors and retailers to brewers.

3. Plaintiffs failed to show that section 102.75(a)(7)'s actual effect on them could not arguably be rationally related to a legitimate governmental interest.

Plaintiffs also failed to prove that the effect of section 102.75(a)(7) as applied to them "could not arguably be rationally related to" the governmental interest. *See Patel*, 469 S.W.3d at 87. Rather than attempt to meet that difficult burden, Plaintiffs target a lower standard of their own creation: "[d]oes evidence show that the law's actual, real world effect actually advances [the government's] interest?" Resp. at 32. Plaintiffs' proposed test finds no support in *Patel*, which requires the plaintiff to prove that there is no *arguable* rational relationship between the statute's effect and a legitimate governmental interest. *Patel*, 469 S.W.3d at 87. Plaintiffs' relaxed standard would be a dramatic

and troubling reduction in judicial deference to legislative decisionmaking. Plaintiffs also improperly attempt to shift the burden of proof to the State. *See* Resp. at 32-33. It is not the State's burden, however, to establish the statute's validity because there is a "strong presumption" that the law is constitutional. *See Patel*, 469 S.W.3d at 91.

Plaintiffs' contract hypothetical, Resp. at 35-36, does not demonstrate the irrationality of section 102.75(a)(7). Rather, it highlights the policy choices that are inherent in shaping and managing the boundaries of the three-tier system. Plaintiffs' policy arguments should be presented to the Legislature, not the Court.

Regardless, Plaintiffs are wrong that there is no meaningful difference between a distributor making a large cash payment for distribution rights ("Contract A") and a distributor's agreement to build warehouses and purchase trucks to secure a brewer's territorial assignment ("Contract B"). *See* Resp. at 35-35. In fact, Plaintiffs' hypothetical demonstrates the merit of section 102.75(a)(7). Plaintiffs' Contract A (which section 102.75(a)(7) prohibits) amounts to a distributor's direct cash investment in the brewer's business,[4] whereas Contract B reflects a distributor's investment in the distributor's own business. Section 102.75(a)(7) thus promotes the strict separation of tiers while not unduly interfering with commerce between the tiers.

[4] Plaintiffs admitted as much, explaining that cash from the sale of territorial assignments was "important to brewers because it provides them with needed capital to independently invest in, and grow, their own businesses. CR.176 (75:16–76:4); CR.253–54 (¶¶ 3, 6)." Resp. at 7.

Applying the proper standard, the real-world effect of section 102.75(a)(7) as applied to Plaintiffs is to prevent them from selling territorial assignments to distributors. Plaintiffs do not dispute that. Prohibiting the sale of territorial assignments is rationally related to the State's interest in maintaining the vitality of the three-tier system and thereby preventing tied-house and other problems, as Plaintiffs' own hypothetical shows. That is easily enough to satisfy rational-basis scrutiny under *Patel*.

B. Plaintiffs Failed to Prove That Section 102.75(a)(7) Is So Burdensome to Them That It Is Unconstitutionally Oppressive.

Plaintiffs also failed to establish that section 102.75(a)(7) is unconstitutionally oppressive as applied to them. As with other elements of *Patel*, Plaintiffs misstate *Patel*'s oppressiveness standard, contending that oppressiveness "is not a high threshold requirement." Resp. at 38. That directly conflicts with *Patel*'s holding that the standard includes a presumption that "legislative enactments are constitutional," and imposes "a high burden on parties claiming a statute is unconstitutional." 469 S.W.3d at 87; *see also id.* at 91 ("Courts must extend great deference to legislative enactments, apply a strong presumption in favor of their validity, and maintain a high bar for declaring any of them in violation of the Constitution."). Plaintiffs' argument also can't be squared with the Court's explanation that even "harsh" or "unreasonable" statutory burdens are not unconstitutionally "oppressive." *Id.* at 90.

Plaintiffs assert that section 102.75(a)(7) is oppressive because it "imposes massive financial burdens" in exchange for no governmental benefit. Resp. at 39-40. That is wrong for all the reasons detailed in the opening brief, including that Plaintiffs are not required to make any territorial assignments due to their size (and have not, for the most part), and that Plaintiffs failed to establish that their territorial assignments have any actual value. *See* Appellants' Br. at 28-31.

Plaintiffs go so far as to assert that the burden imposed by section 102.75(a)(7) is "plainly *greater* than the burden in *Patel*." Resp. at 41. Hardly. Section 102.75(a)(7) may interfere with how Plaintiffs wish to raise capital for their business, but it undisputedly has not prevented Plaintiffs from operating or expanding their businesses. The law challenged in *Patel*, however, imposed crushing educational requirements on eyebrow threaders, who were entire shut out from practicing their trade and earning a living until they completed onerous and largely irrelevant training. *Patel*, 469 S.W.3d at 88-90. Plaintiffs' burden under section 102.75(a)(7) is small, particularly in comparison to the complete industry barrier to entry imposed on the *Patel* plaintiffs.

* * *

Patel does not apply in this case, but even if it did, Plaintiffs failed to meet their high burden under that standard. Under either rational-basis review or *Patel*'s oppressiveness standard, Plaintiffs failed to establish that, as applied to them, section 102.75(a)(7) violates the due course of law guarantee of article I, section 19 of the Texas Constitution.

Prayer

The Court should reverse the trial court's judgment and dismiss Plaintiffs' lawsuit with prejudice.

Respectfully submitted.

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Certificate of Service

On July 12, 2017, this document was served electronically on all counsel for Appellees, via electronic filing system and counsel's e-mail address.

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