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PROPOSED REGULATION
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**BEFORE THE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA**

IN THE MATTER OF THE PROPOSED ADOPTION	}	
SECTIONS 2558, 2559, 2559.1, 2559.3, and 2559.5	}	COMMENTS OF THE CALIFORNIA
OF TITLE 18 OF THE CALIFORNIA CODE OF	}	DEPARTMENT OF ALCOHOLIC
REGULATIONS	}	BEVERAGE CONTROL
	}	
	}	

Pursuant to Government Code § 11346.8, the California Department of Alcoholic Beverage Control (“Department”) submits the following comments to the proposed adoption of the above-captioned regulations governing the treatment and taxation of products known as flavored malt beverages (“FMB’s”) and treated as “beer” under §23006 of the Alcoholic Beverage Control Act (Business and Professions Code [“BPC”] §§23001 *et seq.*) by the Department. The proposed regulations would, for California excise tax purposes, create a rebuttable presumption that these products are distilled spirits as defined in BPC §23005.

HISTORY

Currently, the public policy discussion over FMB’s is front and center at both the state and federal levels. The Legislature passed AB 417 in 2005, which was intended to clarify and codify existing state law. Governor Schwarzenegger vetoed this legislation, specifically noting both that there should be “public debate and serious consideration of the policy issues surrounding this beverage,” and that the veto was “not to suggest that the State’s regulatory administration of flavored malt beverages [i.e. treating them as beer] is flawed.”

Shortly following the veto, a group of alcohol policy advocates filed a Petition for Writ of Mandamus against the Department in the state Court of Appeal, First Appellate District in San Francisco (*Kiley et al. v. Dept. of Alcoholic Beverage Control No. A112671*). The Petition sought to require the Department to classify and treat FMB’s as distilled spirits. The Department filed a response opposing the petition, which response was previously made available to the Board. A copy of the response is attached to these comments as Exhibit 1 and incorporated herein by this reference as if set forth in full.

The Petition was summarily denied by order of the court on March 23, 2006 and the Petitioners filed a timely appeal with the California Supreme Court (Case Number S142281). The Petition for Writ of Review was denied by the Supreme Court on May 24, 2006.

DEPARTMENT’S COMMENTS:

The Department is vested with the “exclusive power, except as herein provided and in accordance with laws enacted by the Legislature, to license the manufacture, importation and sale of alcoholic beverages in this State, and to collect license fees or occupation taxes on

account thereof." Article XX, Section 22 of the California Constitution. The Legislature has established more than 50 different types of licenses authorizing the production, importation, distribution, storage and the retail sale of alcoholic beverages to consumers. The privileges for each of these various license types are limited to specific alcoholic beverage classifications.

The statutory definitions and classifications for "alcoholic beverage," "beer" and "distilled spirits" have remained unchanged for over 50 years. These definitions have not provided clear, unambiguous standards for evolving product development during this time. As the Department stated in its court responses:

"The ABC's position is twofold: (1) ... the ABC has acted properly in treating FMB's as beer; and (2) this public policy discussion is properly before and should be dealt with by the Legislature, and should not be before the court."

Just as this important public policy discussion was improperly before the court, it is equally inappropriate before the Board. It should be noted that although footnote 12 in Exhibit 1 states that "BOE is free to tax products as it deems appropriate," it is not the case that BOE should regulate where there is ambiguity in the law. Where products are clearly defined, it is appropriate for BOE to exercise their regulatory power, but not when clarification is needed from the Legislature.

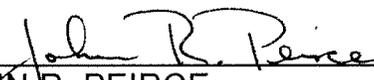
Because the statutes and definitions are ambiguous and potentially subject to multiple and contradictory interpretations, the Department believes that the policy debate and final resolution **should be made by the Legislature**. The Department has argued and continues to believe that it has exercised its discretion relating to the classification of FMB's fairly and reasonably and such determination is within its exclusive authority. A clarification or contrary determination is appropriate for a Legislative resolution so as to ensure that conflicting treatments by two state agencies for a single product not happen. See also Legislative Counsel Opinion #0729803 (Exhibit 2). Contradictory and conflicting treatment and statutory interpretation such as would be caused by the Board's regulatory action would disrupt the orderly marketing of these controlled and regulated products. Such conflicting treatment would also create confusion in the market place and confusion in the law.

The Department urges the Board to articulate its concerns, both relating to the public policy debate as well as the statutory ambiguity and its impact on the collection of taxes, to the Legislature. The Department believes that is where this policy debate properly belongs and any classification contrary to the Department's existing determination should legally be made.

Respectfully Submitted:

STEPHEN M. HARDY, Director
JOHN R. PEIRCE, Chief Counsel

Dated: November 14, 2007



JOHN R. PEIRCE
Chief Counsel
California Department of Alcoholic Beverage Control

EXHIBIT 1

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA
FIRST APPELLATE DISTRICT, DIVISION 2

JOAN KILEY, ET AL.,

Petitioners,

v.

CALIFORNIA DEPARTMENT OF
ALCOHOLIC BEVERAGE
CONTROL,

Respondent.

Case Number: A112671

**ANSWER TO PETITION FOR WRIT OF MANDATE;
MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT
THEREOF**

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MEMORANDUM OF POINTS AND AUTHORITIES
IN OPPOSITION TO PETITION FOR WRIT OF MANDATE

INTRODUCTION

There is no doubt that tremendous societal challenges exist with respect to consumption of alcohol by minors. Vast resources, both public and private, are devoted to researching and addressing these challenges. The California Department of Alcoholic Beverage Control (“ABC”) is on the front line of such issues, ensuring a fair and balanced regulation of the manufacture, distribution and sale of alcoholic beverages within this State. In so doing, the ABC works closely with policy advocates and prevention groups, including petitioners herein, as well as local law enforcement agencies throughout California in the efforts to reduce the incidence of underage drinking. The ABC also works with all of its stakeholders and the Legislature in developing appropriate public policy in the regulation of alcoholic beverages.

Currently, the public policy discussion over flavored malt beverages (“FMB’s”) is front and center at both the state and federal levels. As pointed out by petitioners, the Legislature last year passed AB 417, which was intended to clarify and codify existing state law. Governor Schwarzenegger vetoed this legislation, specifically noting both that there should be “public debate and serious consideration of the policy issues surrounding this beverage,” and that the veto was “not to suggest that the State’s regulatory administration of flavored malt beverages is flawed.” Assembly Bill 417 is now back before the Legislature for consideration of a veto over-ride. Meanwhile, several legislators have made it publicly clear that they intend to pursue legislation that would classify these products as distilled spirits; and the Senate Governmental Organizations Committee has scheduled hearings to continue the public discussion and address the very question posed by this Petition: “Flavored Malt Beverages: Are They

Beer or Distilled Spirits?” (Hearing scheduled for February 14, 2006; Request for Judicial Notice (“RJN”) exh. 4, ABC-011¹.)

The same public policy debate has been recently before the Alcohol and Tobacco Tax and Trade Bureau (“TTB”), the federal agency that regulates alcoholic beverages. Indeed, following extensive regulatory review, including some 16,500 public comments, new regulations in this area went into effect on January 3, 2006. These regulations now resolve any conflict over the source of the alcohol in FMB’s at the federal level—up to 49% of the alcohol content of FMB’s may come from the addition of “flavors and other nonbeverage ingredients” for such products to continue to be classified as beer. (27 CFR § 25.15; see, also, TTB Final Rule², RJN exh. 7.)

Despite relatively recent changes in marketing practices—in particular distilled spirits branding of FMB’s—these products have been around for a long time. In its Final Rule, the TTB noted that it, and its predecessor agency (Bureau of Alcohol, Tobacco and Firearms—“ATF”), has allowed brewers to use alcohol-flavoring ingredients, without limitation, for “many years”. According to some commenters, the use of nonbeverage flavorings in FMB’s have been regularly and routinely authorized by the ATF/TTB since as far back as the 1950’s. (See TTB Final Rule, “Fairness and Notice Issues,” RJN exh. 7, ABC-038.)

By opposing this Petition, the ABC in no way seeks to diminish the good work of petitioners or others in the very important area of underage drinking, or to minimize this issue. However, the Petition fails to recognize the complexities of

¹ The exhibits attached to the ABC’s Request for Judicial Notice are BATES stamped ABC-001 through ABC-073 .

² The Department of the Treasury, Alcohol and Tobacco Tax and Trade Bureau “Flavored Malt Beverages and Related Regulatory Amendments (2002R-044P); Final Rule,” was published in the Federal Register on Monday, January 3, 2005.

the issue and attempts to shift the policy debate from the Legislature to the courts. The ABC's position is twofold: (1) a Writ of Mandate cannot issue as the ABC has acted properly in treating FMB's as beer; and (2) this public policy discussion is properly before and should be dealt with by the Legislature, and should not be before the court.

I.

THE ABC HAS ACTED PROPERLY IN TREATING FMB's AS BEER UNDER CALIFORNIA LAW

Contrary to petitioners' contention otherwise, FMB's do not fit neatly into either the definition of "distilled spirits" or "beer" in current California law. As such, the ABC has acted properly in treating such products as beer. In fact, this court has held that the ABC has great discretion in interpreting provisions of the Alcoholic Beverage Control Act.³

A court may issue a writ of mandate "to compel the performance of an act which the law specially enjoins, as a duty resulting from an office, trust, or station." The prerequisites for traditional mandamus are a "clear, present and usually ministerial duty upon the part of the [agency]" and a "clear, present and beneficial right in the petitioner to the performance of that duty." (*Loder v. Municipal Court* (1976) 17 Cal.3d 859, 863.) Petitioners are unable to establish

³ As this court stated in *Department of Alcoholic Beverage Control v. Alcoholic Beverage Control Appeals Bd.* (2002) 100 Cal.App.4th 1066 at 1073, "[t]he discretion legally vested in an administrative body, such as the Department, is broad and inclusive and is not subject to judicial control when exercised within its legal limits. (*Walsh v. Kirby* (1974) 13 Cal.3d 95, 103 [118 Cal.Rptr. 1, 529 P.2d 33]; *Martin v. Alcoholic Bev. etc. Appeals Bd.* (1959) 52 Cal.2d 287, 295 [341 P.2d 296].) However, deference to the Department's interpretation of the Act is not unlimited. It is subject to review and intervention by the Board and the courts in the event that the Department acts in an arbitrary and capricious manner, or in a manner which is not in conformity with the spirit of the law. (*Walsh v. Kirby, supra*, 13 Cal.3d at p. 106.)"

such a clear, present or ministerial duty on the part of the ABC to act as claimed. As such, the Writ of Mandate must necessarily fail.

a. **What are FMB's?**

According to the TTB:

“Flavored malt beverages are brewery products that differ from traditional malt beverages such as beer, ale, lager, porter, stout, or malt liquor in several respects. Flavored malt beverages exhibit little or no traditional beer or malt beverage character. Their flavor is derived primarily from added flavors rather than from malt and other materials used in fermentation. At the same time, flavored malt beverages are marketed in traditional beer-type bottles and cans and distributed to the alcohol beverage market through beer and malt beverage wholesalers, and their alcohol content is similar to other malt beverages—in the 4-6% alcohol by volume range.

“Although flavored malt beverages are produced at breweries, their method of production differs significantly from the production of other malt beverages and beer. In producing flavored malt beverages, brewers brew a fermented base of beer from malt and other brewing materials. Brewers then treat this base using a variety of processes in order to remove malt beverage character from the base. For example, they remove the color, bitterness, and taste generally associated with beer, ale, porter, stout, and other malt beverages. This leaves a base product to which brewers add various flavors, which typically contain distilled spirits, to achieve the desired taste profile and alcohol level.

“While the alcohol content of flavored malt beverages is similar to that of most traditional malt beverages, the alcohol in many of them is derived primarily from the distilled spirits component of the added flavors rather than from fermentation.”

(TTB Final Rule, “Background Information,” RJN exh. 7, ABC-030-031.)

Title 27, Code of Federal Regulations, Section 25.15, subdivision (b) (“Materials for the production of beer”) states, in part: “You may use flavors and other nonbeverage ingredients containing alcohol in producing beer. Flavors and

other nonbeverage ingredients containing alcohol may contribute no more than 49% of the overall alcohol content of the finished beer.” It is apparent from this language that the TTB considers the flavoring components used in FMB’s to be “nonbeverage products”—i.e., they are not fit for human consumption. There is no reason why the ABC may not take the TTB’s findings at face value, nor have petitioners shown any abuse of discretion by the Department in using the TTB’s findings for guidance.

What FMB’s are not is simply a mixed drink—with finished distilled spirits products simply being added to a malt beverage base. What that means is that one does not create a FMB by simply adding a shot of vodka or rum to a malt beverage base. Indeed, the TTB has clearly and consistently stated that “the mere addition of distilled spirits or other alcohol to beer or malt beverages” is not sanctioned by either the Internal Revenue Code or the Federal Alcohol Administration Act, but that it has “historically allowed flavors, including flavors containing alcohol, to be added to these products.” (TTB Final Rule, “Standard for Added Alcohol and Alcohol From Fermentation,” RJN exh. 7 ABC-032.) To fit within the California and the federal definitions of beer, a FMB may derive up to 49% of its alcohol content from nonbeverage ingredients, which may include a flavoring product.

The corollary to this, of course, is that a FMB may also derive its entire alcohol content from the malting process.⁴ In fact, in its Final Rule, the TTB noted comments from Anheuser-Busch as follows: “It [Anheuser-Busch] is

⁴ It is noteworthy that the Petition does not identify the actual source of alcohol content for any FMB. As far as the ABC or this court knows, the products referenced in the Petition (such as Smirnoff Ice, Bacardi Silver or Skyy Blue; Petition, Mosher Decl. ¶ 12) do not derive any of their alcohol content from added distilled flavorings.

capable of producing FMBs under the 0.5% standard⁵] and is preparing to do so. The brewer stated that its brew masters have already developed reformulated products that will be indistinguishable from the current FMB products they produce and sell.” (TTB Final Rule, “Comments Supporting the 0.5% Standard,” RJN exh. 7, ABC-041; emphasis added.)^{6 7}

b. California definitions:

California law does not have a specific statutory definition of FMB’s. Petitioners would have this court believe that existing definitions are clear and that such products are unequivocally distilled spirits. This is simply not accurate and glosses over the far more complex reality.

Business and Professions Code Section 23004 defines “alcoholic beverage” as follows: “‘Alcoholic beverage’ includes alcohol, spirits, liquor, wine, beer, and every liquid or solid containing alcohol, spirits, wine, or beer, and which contains one-half of 1 percent or more of alcohol by volume and which is fit for beverage purposes either alone or when diluted, mixed, or combined with other substances.”

Business and Professions Code Section 23005 defines “distilled spirits” as follows: “‘Distilled spirits’ means an alcoholic beverage obtained by the distillation of fermented agricultural products, and includes alcohol for beverage

⁵ The initial regulation proposed by the TTB would have set the level of alcohol content derived from flavorings or other nonbeverage ingredients at 0.5%. During the rule-making process, the TTB evaluated both the 0.5% standard and the 49/51 standard, which was ultimately adopted.

⁶ Anheuser-Busch is the producer of the Bacardi Silver line of FMB’s.

⁷ The fact that FMB’s may be readily produced with the alcohol content being wholly derived from the fermentation process also dispels the notion that the mere formulation of these products (and consequently the ABC’s classification of them) is somehow the cause of or contributing to the high incidence of underage drinking as urged by petitioners.

use, spirits of wine, whiskey, rum, brandy, and gin, including all dilutions and mixtures thereof.”

Business and Professions Code Section 23006 defines “beer” as follows: “‘Beer’ means any alcoholic beverage obtained by the fermentation of any infusion or decoction of barley, malt, hops, or any other similar product, or any combination thereof in water, and includes ale, porter, brown, stout, lager beer, small beer, and strong beer but does not include sake, known as Japanese rice wine.”

Taken together, and assuming that some of the FMB’s in question actually derive more than 0.5% of their alcohol by volume from some nonbeverage ingredient which is itself a distilled product, these definitions reveal that some, but not all, FMB’s are something of a hybrid beer product. Petitioners contend that the final five words of Section 23005—“all dilutions and mixtures thereof”—resolve the question without further inquiry. However, it is not that simple. Since Section 23006 defines beer as “any alcoholic beverage obtained by the fermentation of any infusion or decoction” (emphasis added), it is inclusive of all products that are produced by fermentation, even if such products include ingredients that are not themselves fit for beverage purposes (or, as the TTB puts it, “nonbeverage ingredients”, such as flavoring additives). In contrast, the definition of “distilled spirits” does not refer to “any alcoholic beverage.” Rather, it merely refers to “an alcoholic beverage.” As such, this definition is not inclusive, and can reasonably be interpreted to presuppose that the product itself, even without diluting or mixing it with any other product, is fit for beverage purposes.

Indeed, the same conclusion was reached by the TTB following much debate and comment on the subject. Although not identical, the definitions of

“beer” (or “malt beverage”) and “distilled spirits” in federal law are very similar to those in California law.⁸ The TTB noted that “[b]oth the definition of ‘beer’ under IRC [Internal Revenue Code] section 5052⁹] and the definition of ‘malt beverage’ under the FAA [Federal Alcohol Administration] Act focus on fermentation as the source of alcohol in these products.” (TTB Final Rule, “Statutory Definitions,” RJN exh. 7, ABC-049.) While finding that Congress did not intend to allow products that derive the majority of their alcohol content from the distilled spirits components of added flavors, the TTB further noted that “[a]t the same time neither statutory definition explicitly excludes beverages that contain alcohol in addition to that produced during their fermentation.” (Id.)

⁸ 27 CFR § 7.10 defines “malt beverage” as: “A beverage made by the alcoholic fermentation of an infusion or decoction, or combination of both, in potable brewing water, of malted barley with hops, or their parts, or their products, and with or without other malted cereals, and with or without the addition of unmalted or prepared cereals, other carbohydrates or products prepared therefrom, and with or without the addition of carbon dioxide, and with or without other wholesome products suitable for human consumption. Standards applying to the use of processing methods and flavors in malt beverage production appear in § 7.11.”

27 CFR § 25.11 defines “beer” as: “Beer, ale, porter, stout, and other similar fermented beverages (including saké and similar products) of any name or description containing one-half of one percent or more of alcohol by volume, brewed or produced from malt, wholly or in part, or from any substitute for malt. Standards for the production of beer appear in § 25.15.”

27 CFR § 5.11 defines “distilled spirits” as: “Ethyl alcohol, hydrated oxide of ethyl, spirits of wine, whisky, rum, brandy, gin, and other distilled spirits, including all dilutions and mixtures thereof, for nonindustrial use. The term ‘distilled spirits’ shall not include mixtures containing wine, bottled at 48 degrees of proof or less, if the mixture contains more than 50 percent wine on a proof gallon basis.”

⁹ IRC Section 5052 defines “beer” as: “For purposes of this chapter (except when used with reference to distilling or distilling material) the term beer means beer, ale, porter, stout, and other similar fermented beverages (including sake or similar products) of any name or description containing one-half of 1 percent or more of alcohol by volume, brewed or produced from malt, wholly or in part, or from any substitute therefor.”

The bottom line here is that the classification of a specific product as either a beer or a distilled spirit is not merely a matter of looking at one single ingredient used in the production of the beverage to the exclusion of all else. It is reasonable for the ABC to look at the base product to determine if the majority of the product was obtained by either fermentation or distillation. It is also reasonable for the Department to look at whether the fermented product is a “beverage” and whether the distilled portion is a “nonbeverage” in determining the classification of alcoholic products. Finally, it is reasonable for the ABC to look to the federal regulations for guidance or aid in grappling with these complex definitional issues.

II.

THE TUX CASES ARE NOT HELPFUL

Petitioners rely heavily on *Tux Ginger Ale Co., Ltd. v. Davis* (1936) 12 Cal.App.2d 73 and *People v. Tux Winery Company* (1937) 21 Cal.App.2d 586 in support of their overly simplistic evaluation of the definitional dichotomy. These cases are not particularly helpful in determining the classification of FMB’s.

In *Tux Ginger Ale*, in a two page opinion devoid of any useful factual details or substantial analysis, the court held that Tux’s products, which are identified only as being “a combination of wine, alcohol, flavoring and water, with the added alcohol being three times as much as the wine,” were properly classified as distilled spirits rather than wine. It is unknown whether the source of the “added alcohol” was a finished distilled spirit in its own right (such as vodka) or was grain neutral spirits or was some flavoring agent produced by distillation. Interestingly, in reaching its conclusion, the court did not even cite in the opinion the definition of distilled spirits, holding simply that “[n]either by the terms of the Liquor Control Act nor by legal definition, nor by common understanding of the word, can the beverages in question here be fairly or properly designated as wines.”

In *Tux Winery*, in a similarly compact decision with little detailed analysis, the court found certain pre-mixed cocktails, identified as “Bourbon High Ball,” “Old Fashion,” “Highball,” and “Lime Fizz,” to fall within the definition of distilled spirits. In referring back to its earlier *Tux Ginger Ale* opinion, the court held that “[t]he beverages in question were subject to the tax on distilled spirits, since, not being wine and admittedly containing brandy or its equivalent, they came within the definition of distilled spirits. . . .” In this case, the “alcohol” components were identified as either “alcohol” (again without identification of source) or “Fruit Spirit”, and appear to be the only source of alcohol content in the drinks.

It appears that both of the *Tux* cases involved products in which the alcohol content was primarily or exclusively derived from a finished distilled spirits product and not from “nonbeverage” ingredients. Neither case dealt with the formulation of products with a fermented base that include flavoring or other nonbeverage ingredients and thus they do not assist in determining the far more complex policy issues surrounding FMB’s.

III.

THE CURRENT PUBLIC POLICY DISCUSSION **IS PROPERLY IN THE LEGISLATURE**

In support of their position, petitioners, in part, rely upon the recently passed-but-vetoed Assembly Bill 417. The analysis and Governor’s veto message on AB 417 establish that this bill was proposed to clarify existing state law, not to radically alter the definition of beer to include products that do not currently qualify as beer:

“According to the author, this bill simply clarifies existing law and would bring California into conformity with federal regulations.”

(Assembly Analysis of AB 417, RJN exh. 1, ABC-003.)

“This bill would codify current law and practice to treat flavored malt beverages as a malt beverage product consistent with federal standards of identity, which 49 of the 50 states follow. [¶] I am taking this action to allow a full discussion of the issues surrounding flavored malt beverages, not to suggest that the States [sic] regulatory administration of flavored malt beverages is flawed.”

(Governor’s Veto Message AB 417, RJN exh. 2.)

The fact that AB 417 specifically states that it is to clarify existing law does not infer any specific intent of the Legislature—other than the law would remain the same. (*Martin v. California Mut. B. & L. Assn.* (1941) 18 Cal.2d 478, 484.) Currently, AB 417 is back before the Legislature for consideration of a veto override. (RJN exh. 3.) This particular measure is by no means a dead issue and may resolve the very same issues presented by the Petition. In addition, recent publicity surrounding the filing of the instant Petition has included comments from several legislators of their intent to pursue legislation classifying FMB’s as distilled spirits. (RJN exh. 5.) Finally, the Senate Governmental Organizations Committee has scheduled a hearing on February 14, 2006, to review the debate and public policy issues surrounding FMB’s—“Flavored Malt Beverages: Are They Beer or Distilled Spirits?” (RJN exh. 4, ABC-011.) All of the competing rhetoric on the subject of FMB’s demonstrates two important facts: (1) the issue is not nearly as clear as claimed by petitioners; and (2) this is a public policy debate that is properly before the Legislature.

Additionally, petitioners rely on the Attorney General's recent pronouncement of his current opinion¹⁰ regarding the status of FMB's. However, the Attorney General's current position contradicts his prior public statement on the subject. In an August 24, 2004, letter from a number of State Attorneys General, including California Attorney General Bill Lockyer, the TTB was urged "to act as quickly as possible to complete rulemaking and to implement rules for Flavored Malt Beverages (FMBs)." The reason for such urgency was that:

"States have struggled with the conflict between the holding in ATF 96-1 and the continued approved labeling of FMBs that derive the majority of their flavorings from distilled spirits. Several States have strict statutory definitions of distilled spirits and malt beverages. Under these statutes, the types of beverages currently labeled as FMBs would be required to be labeled as distilled spirits. However, States have been hesitant to reclassify beverages labeled as FMBs as distilled spirits within their individual borders. [¶] . . . We ask you to act with all due diligence in promulgating a final rule that delineates how much of the alcohol content of a FMB must be derived from fermentation at the brewery and how much may be derived from alcohol added through the use of flavored alcohol. The adoption and enforcement of such a rule is critical to ensure that these beverages are consistently taxed, licensed and distributed from state-to-state, and that consumers are protected from deceptive labeling."

(August 24, 2004, letter from State Attorneys General, RJN exh. 6.)

This letter from the California Attorney General and his counterparts in 27 other states is instructive in two important respects. First, it illustrates that many states, including California, look to the federal regulations for guidance in classifying alcoholic beverages, and that this is a widely accepted and reasonable practice. As a practical matter, this is in large part the result of a need for consistent taxation, licensing and distribution of alcoholic beverages, as well as

¹⁰ This "opinion" is not a formal Attorney General Opinion, but is rather a statement of the Attorney General's position, made in letters to the ABC and the State Board of Equalization.

the fact that the TTB requires submission of statements of processes or formulas for approval and has access to sophisticated laboratories for analysis of products, and thus can determine the source of alcohol content in alcoholic beverages (something the ABC does not have the resources or expertise to do). Second, the letter demonstrates that these Attorneys General clearly contemplate the inclusion of some alcohol from flavoring ingredients while still considering FMB's to be beer.

The Petition raises complex public policy arguments, involving the intersection of ambiguous definitions, appropriate regulation of alcoholic beverages, and underage drinking. Governor Schwarzenegger has invited all interested parties to the table, and the Legislature is exploring all of the issues surrounding FMB's. It would be absolutely appropriate for this court to defer to the Legislature to resolve such complex policy issues.¹¹

IV.

TAXATION IS A RED HERRING

Prior to 1955, the California State Board of Equalization ("BOE") was responsible for all aspects of the regulation, licensing and taxation of the manufacture and sale of alcoholic beverages in California. Commencing on January 1, 1955, and pursuant to a Constitutional amendment (Cal. Const., Art.

¹¹ See, for example, *Coors Brewing Co. v. Stroh* (2001) 86 Cal.App.4th 768 (the Legislature is the proper forum for policy arguments on availability of sweepstakes to promote alcoholic beverages in California); and *People v. Drew* (1978) 22 Cal.3d 333, 355 (judicial restraint proper when issue currently under review by Legislature; superceded by statute on other issues as explained in *People v. Wilder* (1995) 33 Cal.App.4th 90); and *Desert Healthcare Dist. v. PacifiCare FHP, Inc.* (2001) 94 Cal.App.4th 781, 796 ("Where a UCL action would drag a court of equity into an area of complex economic policy, equitable abstention is appropriate. In such cases, it is primarily a legislative and not a judicial function to determine the best economic policy.").

XX, Sec. 22), the California Department of Alcoholic Beverage Control was given “the exclusive power, except as herein provided and in accordance with laws enacted by the Legislature, to license the manufacture, importation and sale of alcoholic beverages in this State, and to collect license fees or occupation taxes on account thereof.” (*Id.*) In addition, Business and Professions Code Section 23051 states, in part:

“On and after January 1, 1955, the department shall succeed to all of the powers, duties, purposes, responsibilities, and jurisdiction now conferred on the State Board of Equalization under Section 22 of Article XX of the Constitution and this division, except the power to assess and collect such excise taxes as are or may be imposed by law on account of the manufacture, importation, and sale of alcoholic beverages in this State, which shall remain the exclusive power of the State Board of Equalization. [¶] All other laws heretofore or hereafter applicable to the State Board of Equalization with respect to alcoholic beverages, except as to excise taxes, shall hereafter be construed to apply to the department.”

Moreover, while the definitions of beer, wine and distilled spirits are found in the ABC Act (Bus. & Prof. Code §§ 23000, *et seq.*), and are incorporated by reference into the Revenue and Taxation Code (Rev. & Tax Code § 32002), neither statute either empowers or authorizes the ABC to direct BOE how to classify any product for taxation purposes.¹² Since the ABC has no authority to assess excise taxes on alcoholic beverages, this issue raised in the Petition is irrelevant.¹³

¹² Indeed, BOE has, in the past, simply deferred to the ABC’s classification of products (see, Petition, Mosher Decl., exh. P). Such deference is not required by law, and BOE is free to tax products as it deems appropriate.

¹³ While it is perhaps obvious, it is noted that BOE is not a party to this action.

CONCLUSION

The court should summarily deny the Petition for Writ of Mandate. Petitioners have failed to establish a “clear, present [or] ministerial duty” on the part of the ABC to act as demanded. In contrast, the definition of FMB’s is a subject that fits well within the ABC’s Constitutionally granted discretion. The ABC’s position is well reasoned as California law defines “beer” as any alcoholic beverage derived from fermentation—exactly the process by which FMB’s are made. As such, the ABC has not abused its discretion.

Moreover, this is a subject of immediate interest to the California State Legislature. Assembly Bill 417, Governor Schwarzenegger’s veto message of it and the current consideration of veto over-ride, the scheduling by the Senate Governmental Organizations Committee of a hearing on the very subject of this Petition, and the public comments of other elected officials all demonstrate that this is a matter of significant public policy. Such issues are properly addressed by the Legislature and this court should defer to the legislative process to resolve them.

Respectfully Submitted:

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MATTHEW D. BOTTING
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Dated: January 26, 2006

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Certificate of Word Count:

According to the word processing program with which the foregoing Answer to Petition for Writ of Review was created, the body of the Answer contains 4,631 words, exclusive of the Table of Contents and Table of Authorities, but inclusive of footnotes.

I hereby certify that the foregoing is a true and correct statement.

MATTHEW D. BOTTING
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EXHIBIT 2

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October 25, 2007

Honorable Greg Aghazarian
Room 4167, State Capitol

TAXATION OF ALCOHOLIC BEVERAGES - #0729803

Dear Mr. Aghazarian:

You have asked whether the State Board of Equalization has the authority to interpret the terms "distilled spirits," "beer," and "wine" for purposes of the Alcoholic Beverage Tax Law (Pt. 14 (commencing with Sec. 32001), Div. 2, R.& T.C.).

I. Regulation and Taxation of Alcoholic Beverages in California

By way of background, Section 22 of Article XX of the California Constitution¹ vests in the state the exclusive right and power to regulate alcoholic beverages, and vests in the Department of Alcoholic Beverage Control (hereafter the department) the authority to exercise the state's licensing powers as well as the exclusive power to collect license fees and occupation taxes imposed in connection with that authority. The section further requires the State Board of Equalization (hereafter the board) to assess and collect those excise taxes as the Legislature may impose in connection with alcoholic beverages. In pertinent part, Section 22 of Article XX reads as follows:

"SEC. 22. The State of California ... shall have the exclusive right and power to license and regulate the manufacture, sale, purchase, possession and transportation of alcoholic beverages within the State

"The Department of Alcoholic Beverage Control shall have the exclusive power ... to license the manufacture, importation and sale of alcoholic beverages in this State, and to collect license fees or occupation taxes on account thereof.

¹ All further article references are to the California Constitution, unless otherwise indicated.

"The State Board of Equalization shall assess and collect such excise taxes as are or may be imposed by the Legislature on account of the manufacture, importation and sale of alcoholic beverages in this State.

* * *

As can be seen, the exclusive fee and taxing power vested in the department by Section 22 of Article XX is expressly limited to only those license fees or occupation taxes imposed in connection with the manufacture, importation, or sale of alcoholic beverages. In a separate provision, Section 22 of Article XX expressly requires the board, rather than the department, to assess and collect any excise taxes imposed by the Legislature on the manufacture, importation, or sale of alcoholic beverages in the state. Because this requirement to assess and collect excise taxes applies to the board, rather than the department, it is our view that the excise taxes subject to this requirement are to be distinguished from those license fees or occupation taxes that the department is required to collect.

Pursuant to those provisions of Section 22 of Article XX that vest in the state the exclusive power to license and regulate alcoholic beverages, the Legislature enacted the Alcoholic Beverage Control Act (Ch. 1 (commencing with Sec. 23000), Div. 9, B.& P.C.; hereafter the act) that establishes the department as the entity of state government responsible for the proper administration and enforcement of state laws with respect to alcoholic beverages (see Secs. 23049 and 23051, B.& P.C.). The department's responsibilities under the act include, among other things, the implementation of alcoholic beverage licensing and license fee provisions (see generally Ch. 3 (commencing with Sec. 23300), Div. 9, B.& P.C.).

In accordance with those provisions of Section 22 of Article XX that expressly require the board to assess and collect excise taxes, the Alcoholic Beverage Tax Law (Pt. 14 (commencing with Sec. 32001), Div. 2, R.& T.C.; hereafter the ABT Law) generally imposes a tax at specified rates per gallon on all beer, wine, and distilled spirits sold in this state (Secs. 32151 and 32201, R.& T.C.).² Revenues derived under the ABT Law are deposited in the Alcohol Beverage Control Fund for transfer to the General Fund upon order of the Controller (see Secs. 32501 and 32502). Section 32010 provides that the taxes imposed under the ABT Law are in lieu of all local impositions of tax on the sale of alcoholic beverages, except for local sales or transactions taxes that apply in general to the sale and use of tangible personal property. Section 32451 authorizes the board to prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement of the ABT Law.

II. Does the State Board of Equalization, as the agency required to assess and collect excise taxes on distilled spirits, beer, and wine under the Alcoholic Beverage Tax Law, have the authority to interpret the terms "distilled spirits," "beer," and "wine" for purposes of that law?

² All further section references are to the Revenue and Taxation Code, unless otherwise indicated.

Administrative agencies, such as the board, have only those powers that have been conferred on them, expressly or by implication, by the Constitution or statute (*City and County of San Francisco v. Padilla* (1972) 23 Cal.App.3d 388, 400). An administrative agency, therefore, must act within the powers conferred upon it by law and may not validly act in excess of those powers (*Ibid.*). After the Legislature has declared its policies and provided adequate primary details for the exercise of the power, it may expressly confer on administrative agencies the power to "fill up the details" by enacting rules and regulations to promote the purposes of the legislation and carry it into effect (*California Employment Com. v. Butte County Rice Growers Assn.* (1944) 25 Cal.2d.624, 632). Administrative constructions, however, may not vary or enlarge the terms or conditions of the legislative enactment or compel that to be done that lies without the scope of the statute (*Knudsen Creamery Co. v. Brock* (1951) 37 Cal.2d 485, 492-493).

Section 32002, in the ABT Law, provides that the definitions that govern the construction of that law are found both in Chapter 1 (commencing with Section 32001) of Part 14 of Division 2, contained in the ABT Law, and in Chapter 1 (commencing with Section 23000) of Division 9 of the Business and Professions Code, contained in the act. Chapter 1 (commencing with Section 32001) defines in the ABT Law the terms "sale," "tax," and "taxpayer" (see Secs. 32003, 32004, and 32005). All other definitions affecting the construction of the ABT Law, including the definitions of different types of alcoholic beverages, are found in the act in Chapter 1 (commencing with Section 23000) of Division 9 of the Business and Professions Code, which, as stated above, is administered by the department rather than the board.

With regard to administration of the act, Section 25750 of the Business and Professions Code requires the department to prescribe those rules as may be necessary or proper to carry out the purposes and intent of Section 22 of Article XX, and to enable it to exercise the powers and perform the duties conferred upon it by that section of the California Constitution or by the act (see Sec. 25750, B.& P.C.). Section 22 of Article XX also expressly grants the department the "exclusive power" to enforce the provisions of the act. The act itself is an exercise of the police powers of the state for the protection of the safety, welfare, health, peace, and morals of the people of California (Sec. 23001, B.& P.C.). We think, therefore, that because the department is granted the "exclusive power" to enforce the provisions of the act by Section 22 of Article XX and, by extension, the authority to promulgate rules necessary to carry out the purposes and intent of Section 22 of Article XX (Sec. 25750, B.& P.C.), the department's interpretations of the terms within the act are effective for both that act and the ABT Law, which incorporates, by reference, definitions contained within the act. Case law under the act places the order of priority regarding jurisdiction over the act as follows: the California Constitution, any legislative action to the extent that it does not conflict with the Constitution, and finally actions taken by the department, through rules and regulations, to the extent that those rules and regulations do not conflict with the preceding legal authorities (*Harris v. Alcoholic Beverage Control Appeals Bd.* (1964) 228 Cal.App.2d 1, 11). Further, the department's interpretations of the act are granted deference by the courts (*Department of Alcoholic Beverage Control v. Alcoholic Beverage Control Appeals Bd.* (2005) 128 Cal.App.4th 1195, 1205).

The board, in contrast, has more limited administrative authority with regard to alcoholic beverages. As stated above, the board is only required to assess and collect those excise taxes as the Legislature may impose in connection with the manufacture, importation, and sale of alcoholic beverages in this state. In general, the ABT Law imposes an excise tax on a per gallon or other volume basis on the sale of beer, wine, or distilled spirit beverages and it is clear, in our opinion, that the objective of the ABT Law is the production of revenue (see Secs. 32151, 32201, and 32220). The board does not independently classify taxpayers or beverages for purposes of the ABT Law. Instead, the board relies on the department's classification of licensees in the department's administration of the act in order to identify and register taxpayers and, in turn, the board relies on the department's identification and classification of alcoholic beverages in its administration and collection of the alcoholic beverage tax with regard to those taxpayers (A.B. 417, 2005-06 Reg. Sess.; BOE Publication No. 92, January 2004). Moreover, generally speaking, the board does not act as a policing agency with regard to those items upon which the board administers a tax without legislative authority to do so (*Humane Society of the United States v. State Bd. of Equalization* (2007) 152 Cal.App.4th 349, 362).

As stated above, Section 32451 authorizes the board to prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement of the ABT Law. In light of the limited purposes of the ABT Law, and its reliance upon definitions of alcoholic beverages set forth in the act, it is our view that the board may classify specific alcoholic beverages as "beer," "wine," or "distilled spirits" in furtherance of the ABT Law only within the scope of those terms as set forth in the act, and as interpreted by the department. In this connection, the board has adopted regulations that classify alcoholic beverages in conformity with this principle; those regulations are both consistent with the treatment and definition of a particular alcoholic beverage under the act while implementing the excise tax imposed on a particular type of alcoholic beverage.³

It is our opinion, therefore, that in light of the limited authority of the board with regard to alcoholic beverages, and the reliance within the ABT Law on definitions contained within the act, as administered by the department, that, while the board may interpret the terms "distilled spirits," "beer," and "wine" for purposes of the ABT Law, it must do so in a manner that is consistent with the act.

³ For example, Section 2555 of Title 18 of the California Code of Regulations provides that bitters, Chinese liquors, and other products that bear a closure or other device, as provided for by a specified federal regulation, shall, for excise tax purposes, be deemed to be distilled spirits (18 Cal. Code Regs. 2555). This is consistent with the classification of these types of alcoholic beverages under the act (see Secs. 23395 and 23398, B.& P.C. (specifying that bitters are classed as distilled spirits for taxing purposes)). In addition, Section 2557 of Title 18 of the California Code of Regulations, provides the necessary information on the implementation of the ABT Law with regard to powdered distilled spirits.

In conclusion, in light of the foregoing, the State Board of Equalization may, for purposes of the Alcoholic Beverage Tax Law (Pt. 14 (commencing with Sec. 32001), Div. 2, R.& T.C.), interpret the terms "distilled spirits," "beer," and "wine" only in a manner consistent with the definition of those terms as set forth in statute, as validly interpreted by the Department of Alcoholic Beverage Control. The State Board of Equalization may not, however, interpret the terms "distilled spirits," "beer," and "wine" in a manner that is inconsistent with the Department of Alcoholic Beverage Control's valid interpretation of those statutes.

Very truly yours,

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Legislative Counsel

By *Vanessa S. Bedford*
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VB:pjt