

TEXAS ALCOHOLIC BEVERAGE COMMISSION  
COMMISSION MEETING  
MONDAY, FEBRUARY 25, 2002

The Texas Alcoholic Beverage Commission met on this date in Room 185 at 5806 Mesa Drive, Austin, Travis County, Texas. Members present: John T. Steen, Jr., Member and Gail Madden, Member. Staff present: Rolando Garza, Administrator; Randy Yarbrough, Assistant Administrator; Lou Bright, General Counsel; Jeannene Fox, Director of License & Compliance; Greg Hamilton, Chief of Enforcement and Denise Hudson, Director of Resource Management. Present to receive certificates of service: James Champion, 20 years, McAllen; Robert McGee, 20 years, Texarkana; Michael Sudderth, 20 years, Mineral Wells; Amaro Tijerina, 25 years, Houston and Yvonne Gaydos, 35 years, Compliance. Visitors included: Russell Gregorczyk, Jansen & Gregorczyk; Alan Gray, Licensed Beverage Distributors, Inc.; Mike McKinney, Wholesale Beer Distributors of Texas; Charles E. McGrigg, Wine Institute; Robert Sparks, Licensed Beverage Distributors, Inc.; Dale Szyndrowski, DISCUS, Inc.; Fred Marosko, Texas Package Stores Association; Rick Donley, Beer Alliance and Jay Howard, DISCUS, Inc.

The agenda follows:

1:30 p.m.- Call to order.

1. Recognition of agency employees with 20 or more years of service.
2. Approval of minutes of January 28, 2002 meeting; discussion, comment, possible vote.
3. Administrator's report:
  - a. discussion of staff reports;
  - b. recognitions of achievement;
  - c. discussion of management controls;
  - d. state auditor's update; and
  - e. Survey of Organizational Excellence.
4. Presentation of internal auditor's report on Internal Audit of the Information Resources Department; discussion, comment, possible vote.
5. Consider approval of Revised 2002 Fiscal Year Audit Plan; discussion, comment, possible vote.
6. Fiscal stewardship of agency; discussion, comment, possible vote.
7. Briefing on "flavored beer" products and discussion on the need of a possible rule; discussion, comment, possible vote.
8. Public comment.

Announcement of executive session.

9. Executive session.
  - a. the commission will convene in executive session to confer with the general counsel regarding litigation pending against the agency under the authority of Government Code, §551.071;
  - b. the commission may go into executive session to consult with legal

counsel regarding item number 7 of the agenda pursuant to Texas Government Code, §551.071; and

c. performance evaluation of the administrator.

Continue open meeting.

10. Take action, including a vote if appropriate, on topics listed for discussion under executive session.

11. Adjourn.

The meeting was called to order at 1:30 p.m. by Mr. Steen.

MR. STEEN: I want to call the meeting to order of the Texas Alcoholic Beverage Commission. I will be presiding today. Chairman Shivers had a conflict that was unavoidable; that came up at the last minute.

We want to begin by recognizing employees for their service. I would like to call on Greg Hamilton, our chief of enforcement. Mr. Hamilton?

MR. HAMILTON: Thank you, Commissioner Steen. The first one we have on the list is Randall Brown. He's not present today, but I'll go ahead and read a little bit about him for the record.

Randall Brown, an enforcement agent in Georgetown, joined the Texas Alcoholic Beverage Commission on February 15, 1982. Agent Brown began his career with this agency as an Agent I stationed in Austin. Agent Brown has always shown a great initiative to achieve goals and accomplish work duties. He interacts well with the community, industry and other law enforcement agencies. We congratulate Agent Brown on his 20 years of dedicated service to the TABC and the State of Texas.

Our next one is James Champion. James would you come on up?

James Champion joined the agency on February 15, 1982, as an Agent I in San Antonio. Currently assigned to our McAllen office, Agent Champion is a leader among his fellow agents. He is well versed in the Alcoholic Beverage Code and knowledgeable in marketing practices. As an agent he wears many hats and carries out various assignments without hesitation. Again, we congratulate Agent Champion on his 20 years.

Our next agent, I will refer to him as the "bootleg man," Elliott Ness I would call him. Just recently I saw him in the newspaper. I was in San Antonio, I think it was Super Bowl weekend, and there was this big article. Lo and behold, that's who I see on the front page of the

*San Antonio Express* and he's located in Texarkana. I was wondering if we were looking for him or if he was one of the names that would be at the post office, but he had done some hard work up in Texarkana. I would ask Robert McGee to come forward.

Robert McGee joined the Texas Alcoholic Beverage Commission on February 15, 1982, as an Agent I in the Galveston office. Currently stationed in Texarkana, Agent McGee has held positions in Dallas and Galveston. Agent McGee has long been recognized for his professionalism and dedication to the agency. We congratulate him on his 20 years of dedicated service to the TABC and the State of Texas. And we also have his captain, Captain Baker, here with him.

Our next agent is Michael Sudderth. Michael, would you come forward? He is here with Lieutenant Karen Smith.

Michael Sudderth joined the commission on February 15, 1982, as an Agent I. During his service with the agency, Agent Sudderth has done an outstanding job in the Mineral Wells outpost. He has developed good working relations with other law enforcement agencies as well as members of the alcoholic beverage industry and local officials. We congratulate Agent Sudderth on his 20 years of dedicated service to the TABC and the State of Texas.

Next we have Amaro Tijerina. He is a lieutenant in Houston and joined the agency on September 1, 1976, as an Inspector I in the Edinburg enforcement office. During his many years of service with the agency, Lieutenant Tijerina has been stationed in Victoria, Longview, Corpus Christi, McAllen and Houston. He's a traveling man. We congratulate him on his 25 years of dedicated service to the TABC and the State of Texas.

MR. STEEN: I would like to call on Jeannene Fox, Director of License and Compliance.

MS. FOX: Rueben Ochoa is the next one. We certainly want to congratulate him on his 30 years of service, but he was unable to be here today. He originally started with us in 1969, and if you do that quick mental math you know that doesn't add up to 30. But he was with us until 1982 and took two years away and decided it really wasn't too bad, and he came back in 1984. Very shortly after that he was promoted as supervisor at the ports of entry in Hidalgo. I can say it has been a pleasure to work with him and to continue to work with him. He has really excelled in all his duties. He's always the first

one to adopt and accept and implement new ideas and changes, and we've had a lot of those at ports of entry in the last five or six years. He's done a very good job with our agency.

Yvonne Gaydos. I would like for you to all meet our most senior in tenure employee of the agency. She has 35 years with TABC. She's currently in our compliance department in the excise tax section. I don't know where to begin. Everyone knows Yvonne that has ever worked at the agency, and she certainly is one of our exemplary employees. She probably has three years of sick leave amassed during this time. She's never out and she hardly ever takes vacation, so she's one of these very dedicated employees who makes our work "go." You know, when everyone else may be off at the capitol or visiting in the field, she's one who is always here and working. It's been wonderful to have her, and I think we're going to continue to have her for a few more years. Congratulations.

MR. STEEN: We'll move next to the minutes of the January 28, 2002, meeting.

MS. MADDEN: I move that we adopt them.

MR. STEEN: Second. All in favor, say aye.

MS. MADDEN: Aye.

MR. STEEN: Aye.

Next we have the administrator's report. Mr. Garza.

MR. GARZA: Commissioner Madden, Commissioner Steen, this month I would like to report on the new agent trainee class that we started on Friday. We've spent a lot of time here acknowledging longevity and recognizing our employees. We have twelve agent trainees that started their career track with TABC on Friday. They are going to an in-service academy that will culminate with graduation ceremonies here on March 29<sup>th</sup>. At that time they will be sent out to different district offices across the state. Most of them are going to Houston, one is going to El Paso, a couple to Dallas and Galveston. You'll be seeing those agent trainees at our next meeting here in March. You will have a chance to meet them. I was up here yesterday afternoon, and I'll tell you our training department has them working through weekends, so they are in for a long, arduous task throughout this academy, but they will be welcome additions to our enforcement division.

The other item I would like to report to you centers on our public forums. Ms. Madden, you had a chance to attend the Dallas forum, so you have first-hand knowledge of what we are trying to do at these forums across the state. We have done six of them. Jeannene is the only one who has experienced being at all six of them, and she will eventually wind up attending all eight. We will finalize these forums this week. We will go to Lubbock. I believe Randy will be there with Jeannene and some of the other staff. Then Mr. Steen will finish out Friday in San Antonio, March 1<sup>st</sup>. Then we're going to roll up this information and make it part of our overall strategic plan.

MS. MADDEN: Mr. Garza, I think those forums were great. I think a lot of people got some things out on the table and you all handled everything beautifully.

Mr. Steen, you get a chance to do this pretty quickly, right, in San Antonio?

MR. GARZA: Yes, on Friday. It has been a good cooperative effort between our field staff, and Jeannene's done a lot of legwork organizing these things across the state. I think we are going to garner some pretty good citizen input that will be helpful to the agency as we mold and shape our blueprint for the future.

The last thing I will tell you and you've heard us report to you on the State Auditor's Office and the audit they have been conducting here at TABC. Along with members of the executive staff I had a chance to sit down with them last week for an exit interview. The good news is they are going to issue a management audit letter in lieu of a formal report. I think most of the findings will be very positive and supportive of what we are doing here at the agency. There will be some items, obviously, that they will identify needing some corrective measures and we will address those. Within the next couple of weeks we will get their draft of their report. Management will then sit down and task that report and provide a response to it. So you can expect a pretty comprehensive and definitive update on the state auditor's audit of this agency's enforcement and licensing activities at our March meeting.

MS. MADDEN: Your letter dated February 4<sup>th</sup> of this year on recruitment and hiring policies was really helpful. I was reading it; is it supposed to be an annual letter, because I didn't get one last year when I was going to be confirmed? I would have "killed" for this report. This is a good thing, as Martha Stewart says.

MR. GARZA: It is an annual report that the Human Resources Department, Ms. Rowe, Ms. Escalante, put together for the agency. I believe that it is an annual report, and for whatever reason, we erred in not submitting this report to the board last year. But rest assured you will be receiving this on a regular timely basis. It gives us a chance to take a look at our recruitment and hiring efforts, our retention efforts; to take a look at some of the statistics in terms of workforce diversity. It gives senior management an opportunity to work to target those areas where we have some under-representation. It is a good tool to have in terms of assessing our workforce across the state.

MS. MADDEN: I notice it talks about the fact that we hired 12 percent of African Americans during 2001, but we lost 16 percent. So I guess we'd need to hire smarter. I'm borrowing your words. You always like to say, "Let's do something smarter." So maybe that applies to our hiring methods. Also, I wanted to ask you, and this might be going into the next report, so excuse me if it is, but on the FTE's I was noticing they were under cap. If you go to, let's see there's a page number here, but anyway it's under Denise Hudson's report. We seem to be under the legislative cap and I was wondering what department? Is there a particular department that we are under cap or is it all over the agency?

MR. GARZA: Denise, you can correct me on this. Some of this under cap reporting has to do with the fact we still had not reflected those twelve agent trainees that we hired. We have some in the ports of entry program, I believe. We have two positions that are posted as we speak. In many of those cases we are in the process of going ahead and either submitting the posting or actually getting to the posting and will start narrowing the applicants and screening and interviewing in those positions.

MS. MADDEN: So, are we within what, pretty close to it?

MR. GARZA: Denise, do you know off-hand where we are?

MS. HUDSON: We are about 26 under at the end of January; under the cap.

MS. MADDEN: Is this taking into account what you're saying?

MR. GARZA: That's not taking into account the twelve agent trainees?

MS. HUDSON: No. The twelve will come out of that and then the hires for ports of entry, and there are some licensing positions also.

MR. GARZA: By the end of the third quarter I would tell you that we would probably be very close.

MS. MADDEN: So, I guess my question is, do you feel comfortable with this, with these numbers?

MR. GARZA: Yes, I do. I would tell you my experience has always been that we would rather be under the cap in this area than getting real close. There are certainly agencies that go over. It also gives us a good indication of the fact that we make sure we address those vacancies where we have them and bring them in. As you well know, our hiring process, when it comes to enforcement agents, is an elongated process. It is not a simple task of just posting a position and bringing them in. We have to do a bunch of background checks, medical reports and physicals and things of that nature. We hope to address that starting next year when we are going to have a regularly scheduled posting period for our agent trainees, which I believe will be the month of June. We will post the position for 30 days, then we'll conduct our interviews. So we should get on a regular schedule which will allow us to better dictate that whole FTE count.

MS. MADDEN: Okay, thanks.

MR. STEEN: Mr. Garza, help me on this. Did we ever get a final report on, you were going to look at the promotion procedures?

MR. GARZA: Yes. We did a revamp of a whole promotional process. We had input, Mr. Steen, from throughout the state. We asked the enforcement division, regardless of rank or position, to give us their input on what they thought a promotional process should be like. Part of the results of the survey we did was to have a regularly scheduled period for posting our agent trainee slots, for example. One of the complaints that we heard loud and clear from our staff, for example, was this last posting, which we ran out there for a couple of weeks, three weeks at the max, escaped a lot of people. They didn't hear about it, and they were not able to apply for the position. So we decided, based on the input from our staff, that we would have those posted for 30 days. We also took a look at the criteria that an individual would need to be eligible for consideration to a sergeant position, to a lieutenant position, to the rank of a captain. We have come up with what appears to be an acceptable process for everybody. I would be glad to share that with the board and I apologize for not having sent that to you earlier, but that did result in a revamped, revised process for all promotions in the

enforcement division.

MR. STEEN: So you have finalized it?

MR. GARZA: Yes, sir. With input from staff and it has been shared with the enforcement division. I believe that has been distributed, has it not, to all the enforcement division?

MR. HAMILTON: Yes.

MR. STEEN: Would you provide us with a copy?

MR. GARZA: Yes, sir.

MR. STEEN: Thank you. Anything else?

MR. GARZA: No, sir.

MR. STEEN: The next item on the agenda is presentation of internal auditor's report on Internal Audit of the Information Resources Department.

MR. GREGORCZYK: Good afternoon. This is our first audit we did this fiscal year. The first quarter we started the audit and it has taken until now to get it all finished and through the process. Would you like me to highlight the report or respond to questions? What would your preference be this afternoon?

MS. MADDEN: I read your report and it is very thorough. Actually it is very impressive. You had to really dig for this. I know your recommendation number 10 is about developing a plan to finance a new computer system, if you'll excuse my lay terms. I feel that we have agonized over this I know at least two years, and I'm sure those who came before me have agonized over it prior to that. I'd like to see us make this our top priority because it seems to me we are maxed out on our computer, and if we don't do something about it I think we're going to get ourselves into deep waters here. I know that the legislature has turned us down a couple of times, but I'm willing to knock on doors and meet people and go plead our case. I just think we need to have a united front. I think we're all going to have to lock pinkies and go forward on this as they say. But thank you for your report, I think it is very thorough.

MR. GREGORCZYK: We are certainly aware that you all had looked at that in great detail the last few years. We felt it was something that we had to at least comment on. It is such a critical thing for the agency. Hopefully

you will be able to go forward with it on all fronts.

MR. STEEN: Would you mind elaborating as far as your thoughts on that for the record?

MR. GREGORCZYK: Again, we put it in our report for the record. It is a legacy based system and you've really outgrown the system. At some point you have to have a new system it would seem to me. I don't know how much longer you can patchwork it together. Of course, I think staff is completely aware of this and board members are aware of it too. But again, we didn't want to just gloss over it because you were aware of it because we felt it was important. And if you are not going to be able to get something done, you certainly need a plan for how you are going to continue to try to operate with respect to keeping the patchwork together and adding new data bases. Some of the divisions have actually gone out on their own, the compliance department in particular, and had to develop their own database systems. We hate to see that fragmentation occur if there is any way to avoid it. Again, I'm sort of preaching to the choir, I know, on this whole thing.

I would say that overall that the IR Department was in very good shape. I've audited the IT shops at various places, Department of Information Resources included, and it looks like to us overall the recommendations we had we didn't feel were any serious problems. We did make some minor recommendations. But overall it looked like to us it was in pretty good shape.

MS. MADDEN: I would like to underscore what you are saying, because I think Mr. Webster and his team have done yeoman service and with a main frame that's what, 17 years old? That's tough. So our hats are off to you, Mr. Webster.

MR. STEEN: Before we leave this subject, Mr. Garza, could you comment on it?

MR. GARZA: The only thing I would say is that Mr. Webster and I talked just this morning, and we are scheduled to visit with Carolyn Purcell over at the Department of Information Resources tomorrow to go over that last request and get some input from her on how we could perhaps go about making a subsequent request next session. I think the overall price on that, Jay, was what, four million dollars, an exceptional item request that we had on revamping that whole system? Everybody I've talked to as I've gone across the state has told me very strongly that this will be a very tight session. Agencies will be asked to pretty much try to get by with what they have. So

we want to be modest in our request and understand the state's financial condition, but I believe we would be remiss if we didn't put in some kind of request to try to address a system that's almost 20 years, I think next year will be 20 years old.

MS. MADDEN: If we could break it down to where it's more manageable, instead of just going out there and saying we need four million dollars. Get bids that are more viable and just do it in a smart way, maybe we would have a better chance. I think knocking on doors of the Senate and the House, the Appropriations Committee. And you're so good at that, Mr. Garza.

MR. GARZA: Randy has volunteered to lock pinkies with you, Ms. Madden.

MS. MADDEN: Well he is fabulous, too. I think we all need to get out there. I think the commission does too, all the commissioners.

MR. YARBROUGH: I think our internal auditor is going to be pretty much echoed by the state auditor in their management report. They read his report and they recognize some of the same things in looking at our licensing system that we need to be looking at; automation to do things better. They do recognize the fact that we have asked for that. Without coming out and blessing a request or anything, they will put it in writing that these are things that we need to be addressing in the future. We would ask them to volunteer to make that recommendation, but I don't think they will be that strong.

MR. GREGORCZYK: Any other questions?

MR. STEEN: The head of this department is Mr. Jay Webster? Mr. Webster, could you come forward? I would like your thoughts on what we've just been talking about.

MR. WEBSTER: I certainly would echo all the support in this area. You know two years ago, during strategic planning, this particular initiative was brought forward. From that idea coming out of strategic planning two years ago, we developed the LAR that we then moved forward with in that rather sizeable project initiative. What we will do in the next strategic planning process in the next few months is really re-evaluate the scope, as Rolando said. Look at where we are, talk with Ms. Purcell and get some guidance from some other parties and really establish a future direction. It is very important that we address our technology and do it on a regular basis. We can't go years and years leaving technology like it is. You can expect your staff to be turned over, and your institutional knowledge essentially

be removed from the agency. That's a big part of our problem. Currently we have staff, whether it is in the user department in licensing, or enforcement, or compliance, who are both familiar with the systems and my staff. As these people either retire or leave, you are left with this very complex system with no one to maintain it or understand it. Not to mention that in itself it has seen its better days, and it is time to look at new technology in the agency. So I totally support this. I thought Russell did an outstanding job in our audit, and I would like to compliment him. It wasn't brought up that the state auditors used all of his working papers that he did on our audit and did not have to expend the hours to look at our business too. I mean getting in there and looking at a lot of details. He saved the state some money.

MS. MADDEN: It's a real compliment to you.

MR. STEEN: Thank you, Mr. Webster. Any other questions?

MS. MADDEN: No.

MR. STEEN: The next item on the agenda is to consider approval of Revised 2002 Fiscal Year Audit Plan.

MR. GREGORCZYK: I had asked that this item be put on. I'm not really ready to bring forth the revision. Other than doing this first audit, we have been in sort of a holding pattern to see what the state auditor was going to focus on because the two audit areas I intended to audit this year were enforcement and licensing, and that's the two areas the state auditor focused on. I'm still somewhat awaiting their final conclusions. We don't want to go back and duplicate any effort there. I have talked to management, and we probably are going to do some work in enforcement. We are going to have a little different scope than perhaps I had initially planned. Mr. Garza would like us to look at the grants management aspect, some of this money flowing in through grants. Mr. Hamilton has asked us to look at performance measures. We probably will be looking at that, but I'm still going to wait until I see what they come up with and will probably come back to you in March with a revised plan for you to consider so we can finish out the year. I would say that the auditor's office did rely on our work in the accounting area that we did last year. They said it did save them a lot of time with respect to the IT audit and the accounting. They probably would have been here a little bit longer had they not relied on that work. So we were pleased that we were able to coordinate with the state auditor. I will bring you a revised audit plan, hopefully, at your March meeting so

we can get on and get our work done.

MS. MADDEN: At the end of the year, do you start over and go to the same departments, or how do you do that?

MR. GREGORCZYK: We will go through a risk assessment again and we'll bring forth to you probably at the last meeting of the fiscal year, a new audit plan for next year. I will also be bringing you a followup on the status of recommendations we made in the prior year. Mr. Steen, you've asked about that at prior meetings. I will be in the next couple of months going into the accounting and ports of entry and looking at where they stand on implementing those audit recommendations. I have been very pleased so far that management has been very receptive, and Mr. Garza says that we are really going to do these things. He is very sincere about that, so I'm sure we will find that many of these things will have been done, hopefully. But that is our process.

MR. STEEN: Thank you very much. And let me just say I think you are doing a great job for us.

MR. GREGORCZYK: Thank you. I appreciate that.

MR. STEEN: We appreciate your help.

The next item is fiscal stewardship of the agency. Ms. Hudson?

MS. HUDSON: Yes, sir. This month we looked at the legislative caps, and we seem to be doing very good on those. We are under all of our caps. We also looked at recycled products, and there, again, we are doing very good on meeting the state's requirements to buy recycled paper and paper products. We also included the *Compact with Texans*. Claire has worked hard to update that document. And in the next newsletter we will be sending out a customer service survey that will look at our performance in those areas of customer service. We should have those to report back to you on.

MR. STEEN: Do you have further questions?

MS. MADDEN: No, that was a very good report.

MR. STEEN: Thank you very much.

Now we move to a briefing on flavored beer products and discussion on the need of a possible rule. That's Mr. Yarbrough.

MR. YARBROUGH: Commissioner Steen, Commissioner Madden, let me briefly go through how we got here today, and then I've got in your book under tab number seven some scans of labels we've had submitted to us, and then I'll make some recommendations for your consideration.

Several years ago, we began to get into the new category of product-flavored beers. Beer is defined under the Alcoholic Beverage Code as a subset of malt beverages. It is defined as a malt beverage containing one-half of one percent or more of alcohol by volume and not more than four percent of alcohol by weight and shall not be inclusive of any beverage designated by label or otherwise by any other name than beer. When we get into alcohol percentages and so forth I'll try to talk just in layman's terms because I have to rely on our chemist, Janet Meisenheimer, to keep me straight on the difference between weight and volume and how you calculate those. I've had to go back and relearn some of my high school and college chemistry because I had forgotten most of that. We began to get some of these products that kind of fit into an unknown category several years ago. Some of these, for example, were Zima, which was a beer that Coors came out with. Initially, it was talked about as a clear beer or a malt beverage with natural flavors. They call it a clear malt. We had no particular category for this, but ATF began to look at this, and we got label approval on this as we have subsequently on all of these products. The Bureau of Alcohol, Tobacco and Firearms looks at the labels; they test product samples. They even get formulas of products that are submitted to them that they look at and review and make sure they meet certain standards of identity. When this started coming out, they issued a ruling, ATF Ruling 96-1, which I've put in your books, and where I've highlighted they talk about this as a new type of product. They are not sure exactly where that fits in. They said that "flavored malt beverages' have varied and diverse characteristics which distinguish them from traditional malt beverages. Further, these characteristics are so diverse that the demarcations between 'flavored malt beverages' and distilled spirits or wine products are becoming increasingly blurred and undefined."

"In order to prevent the consumer deception that can arise from the lack of distinction between these 'flavored malt beverages' and similar wine and distilled spirits products, and in order to determine the parameters of the use of flavoring materials containing alcohol, AFT has decided to undertake rulemaking in the near future. This rulemaking will consider the prohibition, restriction, or limitation on the use of such flavoring materials at any stage in the production of

malt beverages.”

That all seemed well and good, but that rulemaking never got off the ground, has kind of floundered along and nothing has been done on the federal level until just in the last month when they announced in their newsletter of February 1, 2002, after we had made some inquiries with ATF that this was becoming a problem in the market place, they again are talking about rulemaking. That is a very cumbersome and long aspect, and we feel like we might need to move quicker than that. In their last bulletin, they “*Held*, a malt beverage under the FAA Act may only contain alcohol which is the result of alcoholic fermentation at the brewery.”

And they “*Held further*, pending completion of rulemaking, ATF will allow the continued production or importation of fermented beverages which contain alcohol not solely the result of alcoholic fermentation at the brewery if: (1) they are - ‘flavored malt beverages’ which contain not more than six percent alcohol by volume in the finished product; or (2) they are ‘flavored malt beverages’ containing in excess of six percent alcohol by volume in the finished product and derive not more than 1.5 percent of their overall alcohol content from alcohol added through the use of alcoholic flavoring materials.”

Now that was the question we had. Was there a tolerance that was used? When we started talking to ATF, looking at their bulletins, we found that if you had ale or malt liquor - and you have an example up there, I think, in front of you, Mr. Steen, that large bottle is ale - it is over what we would consider to be beer. It is over four percent by weight, so that’s ale or malt liquor. If it’s over six percent by volume, then it has a limit of not more than one and one half percent of that total alcohol coming from flavorings. But ATF seems to have left off any type of tolerance if it’s below six percent or if it falls into the beer category. So what we have found in asking ATF investigators is that some of these products have a trace of alcohol from flavoring, others have 90 percent plus of their alcohol coming from a flavoring and no longer from beer. So our question is at what point does beer lose its characteristics as beer? Is this really something else?

Now the reason we got to this, first of all we used to have wine coolers. We had ready-to-drink spirit coolers or premixed drinks and then the flavored beers came along. There are several business reasons which makes the industry want to do this. One is the tax level; beer is taxed at a lower level than other products.

Second, is the distribution level, where beer can be distributed and sold in convenience stores and grocery stores, where you don't worry about the wet/dry elections. Most places are wet for beer before they would be for wine or for spirits. And so it provides the broadest distribution network for that.

So if I could step you through a couple of these labels, you can look at how this has generally matured over the last five or six years. As I mentioned, Zima, which is a Coors' product, was a clear malt. On the top of the label, even though you can't read it, you'll see where I've highlighted. It says "Beer in Texas." We do require the utilization of the word "beer" to meet our statutory definition. Somewhere on the label it must say "beer" or "flavored beer," and we've been very lenient on that, and we haven't stipulated a type size. We haven't stipulated where on the label. It could be on the front of the label, the back of the label, on the neck of the label. Somewhere though it had to say "beer" or "flavored beer." Their comment on the face of the label said "malt beverage with natural flavors" and then, as I said, on the neck of the label "Beer in Texas."

The next page you have in your book is one of the things that has all of a sudden made a difference. Smirnoff Ice is a product that's a little bit different. It's brewed by Guinness United Distillers and Vintners. Smirnoff Ice is using a well known distilled spirits name. We don't think there is anything inherently bad about that - a name is a name. It is known throughout the country in their distilled spirits form, but this is a flavored beer, as you see just above the government warning label. They say it's a premium malt beverage with "natural flavors." There is no mention of distilled spirits or any type of distilled spirits. There were some complaints we got from other brewers, comparing products, saying there is no vodka in this product. Well, nowhere on the face of the label does it say vodka. There is the thought that because of the Smirnoff name that the public might be lead to believe that Smirnoff Ice contained vodka. In fact, in Europe it is manufactured with distilled spirits in it.

What we have learned though in looking back, and we asked the question of ATF - if it's got alcohol in it and where is it from, how does that relate to this? ATF has said you can't put, as I read earlier in their bulletin, distilled spirits in a beer. However, their ruling essentially says if your flavorings have any alcohol, even if they are from distilled spirits, then that flavoring can be added to the beer. So they are allowing what they can't do directly to essentially be done indirectly. But on the face of this we just have a

product. It has been very successful in the market place. It has grown to a huge amount, approximately 30 percent to 40 percent of the flavored beer market. In the last year it has grown to that. It has been very successful.

MR. STEEN: You're talking about Smirnoff Ice?

MR. YARBROUGH: Smirnoff Ice.

MR. STEEN: Tell me again, Mr. Yarbrough, what's in it.

MR. YARBROUGH: It is a malt beverage with flavorings. Some of those flavorings contain alcohol. Now, we have requested from the different breweries the composition or makeup of their product. This information is proprietary to those companies, and they furnished it to us under protection under the Open Records Act that is not able to be disclosed. The same way they do to ATF. We have just started looking at those. Some of them are broad ranges, but what we have been able to ascertain, most all of these have flavorings that contain alcohol. The flavorings themselves may contain alcohol with 70 to 80 percent of the flavor being alcohol.

MR. STEEN: What's an example of that?

MR. YARBROUGH: Well, it would say a natural citrus flavor manufactured by such and such flavor house, which may also be a distillery, and it will say 85.2 percent alcohol. That's what we get. They send those to ATF. They do not send samples of those flavorings to us. They have sent us copies of the results from ATF, but we can request those if need be. The major breweries - Budweiser, Coors, Miller and the people from UDV - have sent us the information that we have asked for. A number of the others have not yet. Some are still working. If we are unable to get those we may have to subpoena that information or we may have to go back and ask for some more specific information. We had asked ATF to provide it for us. Their lawyers are still looking at our request. We haven't been able to get any information from them.

MR. STEEN: But on the Smirnoff Ice we know....

MR. YARBROUGH: I have a composition.

MR. STEEN: You just can't talk about it.

MR. YARBROUGH: Yes, that is correct.

The next product would be an Anheuser Busch product. That is Tequila Beer. It used some language for the first time; a distilled spirit name appeared on it. It says "Beer with Blue Agave Nectar and a Natural Flavor of Imported Tequila and Lime." We had some discussions about this and some concerns about some advertising that went on the end of last year. Anheuser Busch was willing to pull that advertising because we were concerned that the flavor of imported tequila and the way they were advertising that may have given the impression that they were adding tequila into it. Again, we asked them the question, "Are you adding tequila to the product?" They said no. At that time we were taking ATF's word on what these flavors and compositions were. We did not recognize that distilled spirits might be used as part of that flavoring ingredient.

We are getting into the next products on the next two pages. One of them came out Monday of last week. Bacardi Silver. This is also an Anheuser Busch product. In conjunction with Bacardi they have on here "Premium Malt Beverage with the Natural Flavors of Bacardi Rum and Citrus." Again, you have to almost get your English teacher to tell you when it says the flavors of Bacardi Rum or if it's putting Bacardi Rum in there. It does say "flavored beer." And the next page, Blue Skyy, which is a Miller product that is either coming out this week or possibly next week. I haven't heard any official announcement. I think some of the distributors already have it. If you'll notice on the side of that it says, "Malt Beverage with Natural Flavors Containing Vodka." If you are using vodka - maybe this is where the Smirnoff people came in and didn't use any of this statement - normally they have been saying the "flavor of" Bacardi Rum, the "flavor of" tequila, well even though vodka drinkers tell me they can taste the difference in the flavors of vodka, it is defined as having no color, no taste so you can't have the "flavor of" vodka if it doesn't have any flavor to speak of. So we have this one, and there have been some concerns. Some states have actually turned down this label because they read that "natural flavors containing vodka" as saying that it actually has vodka in it. We have looked at some of the flavoring in there and would indicate that the flavoring is made with some vodka in it.

I added some of the others that we have already had so that you can kind of get an example of some of the things that are out here. Because it's not just these products, but other things like the hard lemonades, which if you read real carefully you see "Lemon Clear Malt Beverage with other Natural Flavors." Then on the neck label they have "Flavored Beer" on the Mike's Hard Lemonade. Bartles

and James Raspberry Daiquiri Flavored Malt Cooler, we don't have any wine coolers specifically. They still make some, but we don't have many in the market place as I have already described. You notice on this one, the "Flavored Beer" is up at the top, right by the screw-off cap. Wraps around the cap, when you take the cap off, the "Flavored Beer" comes off, too, and is no longer on the label. We have approved this label though.

The next one is one I just put in there, because all it says is "Sublime Raspberry...contains alcohol." Then it says it's made with real alcoholic beverages, made with real fruit and natural flavors. It is a flavored beer.

Then the last page and the one that you have up there is Hooch Lemon Citrus. It's a malt beverage with natural flavors. I just wanted to point out, because in Texas that four percent by weight, which translates roughly into 5.2 percent by volume makes this an ale. You'll notice in small letters up on the top of the label, you can read "ale" there to point out that this is not a beer. It cannot be sold in a location that is wet for beer only or a license that allows the sale of beer only.

Our concerns are twofold. One is that the consumer cannot tell what they are getting. In discussions the other day with a trade journal, we were talking for a good while and the reporter said, "I can't figure all this stuff out." And I said that's the same concern most of the regulators have, and if we can't figure it out - the people who are supposed to be experts - how's the consumer supposed to know what he is buying? So we are trying to determine that. The other thing we are looking at and think needs to be clarified is what are these products? As I said, there are some that are clearly some beer with flavors in them. There are others with a little bit of beer with a whole lot of flavors and water added to them to keep them down below the five percent alcohol level and we're not sure that they still meet the standards of identity for beer. We're not necessarily opposed at all in any way, shape or form to a flavored malt beverage or a flavored beer, but we're not sure that we have a standard.

What I would propose, and I come asking you today, is that we can begin sitting down with industry, drafting up language that we think would meet this product in a responsible way, that the consumers would well know what they are purchasing, they wouldn't be misled in any way, and that we could be assured that the standards of identity would be standard enough that these products could fit in without such a broad range. As I said, we've got a standard under ATF for these high alcoholic beverages, but no standard whatsoever if it is flavored beer with less than six percent

by volume. We think there needs to be some sort of standard there with no idea what that should be, but at least something that we can all live with and play on a level playing field.

In conclusion, Mr. Garza gave me an email this morning that he got in doing some research over the weekend. If we want to look at where this is going, it says, "Leave it to the British to think of this one." Europe is a little bit ahead of us in this product. It says, "Chocolate beer. And don't forget raspberry beer. And three other decidedly non-beer flavors." That's what is hitting the grocery stores in Great Britain in June of this year, aimed at a specific market of the females. It said according to the BBC, chocolate lager is made from a unique blend of malts and special barley that has a vanilla edge. The raspberry drink is more acidic and uses fresh fruit. They are even bottled for women in champagne-style bottles. It seems like there is no market that somebody's not willing to fill here. But we think there needs to be some better standards. If we are going to look for new products introduced into the market place, we need to make sure the public knows what they are getting. That would be our thrust that we start sitting down with industry, invite them all to the table, that we look at our standards of identity and see what needs to be changed to clearly identify these products and to ensure the protection of the public. After all, I think that is the responsibility of the Alcoholic Beverage Commission - to protect the public - and that would be the vein in which we are doing this. There have been some other side issues that have come up over the last years which might be addressed along the way, but we think these are the primary reasons we would like to move forward. I have talked to a number of other states. They are also interested and would be welcome to come and work with us in this project. We have also invited ATF if we are going to have any of these meetings. We said we'd love to have them come and give us advice and sit in with us. We don't want to have 50 different approval standards throughout the country, but we seem to be so far ahead of everybody else on this, we would be the ones that people are looking at to move forward at this time.

I'd be happy to answer any questions you might have.

MS. MADDEN: What do you need from us? Do you need a motion?

MR. YARBROUGH: I think the way the commission has handled it in the past is that you have taken action in a motion form to let us move ahead on a rule so we wouldn't be doing something out on our own. So I would be asking for a motion that we could proceed with the development of rules to bring back to you then in some sort of draft form before we would do anything else. Obviously if we come back with something you think is untenable, no further action would need to be taken on

your part. But we would just like it to have your permission to move ahead on this project.

MR. STEEN: Ms. Madden, I had talked to Mr. Garza about this earlier and just something to consider is whether we want to wait to take action until the next meeting when Chairman Shivers would be here.

MR. YARBROUGH: The only thing I would ask is...

MR. STEEN: So he would have the opportunity to read this presentation and we would have his input.

MR. YARBROUGH: We are seeing more and more products introduced every day. That is the only concern that we have at least to begin working on this. We don't anticipate that we would even have any drafts to come back to you with within 60 days, because it will take that long for us to get people together and start discussing it. We certainly don't want to keep Chairman Shivers out of the loop in any way, shape or form on this.

MR. STEEN: You feel like we could go ahead and take the action to move forward?

MR. YARBROUGH: Just to move forward and then we will bring to you and submit to you in advance any drafts that you could rule up or down before we would even begin the formal rulemaking process, before we would publish. Because we'd come back to you with a request to publish in the *Texas Register*.

MS. MADDEN: I so move that we begin the process.

MR. STEEN: Second.

Is there any discussion? All in favor, say aye.

MS. MADDEN: Aye.

MR. YARBROUGH: Thank you.

MR. STEEN: Mr. Yarbrough, before we leave this, are all these products we have up here, they're all being sold now in Texas?

MR. YARBROUGH: Those products have all been approved for sale in Texas with exception of the Sky Blue, the blue bottle, which has been approved but the label on that one is not the same as the one in the book. We asked Miller Brewing Company to change the label, as did ATF, because if you'll notice there on the side it has a separate line that says, "containing vodka." We asked that they put that on

the same line as “natural flavors” so at least it is a modifier of the natural flavors. They have complied with that. I think they are doing that nationwide. But the rest of them are already being sold and that one, if it is not this week, will be in the next week to 10 days.

MR. STEEN: What about this one called Mike’s Hard Lemonade? Who makes that?

MR. YARBROUGH: That is made, I believe, by Mark Anthony Brands. That was in your book. The Mark Anthony Group. I’m not personally familiar with the company. I am familiar with their attorney. They have outside counsel out of the Washington area. I’ve been in some discussions with him regarding some of this. We have not received anything back from them yet, so I don’t know the composition of that product.

MR. STEEN: You can buy this now?

MR. YARBROUGH: Yes, sir. You can buy that. If you’ll notice the empty bottle next to it is flavored tea with the orange label. That looks in the convenience store or grocery store cold box just like tea. As I said, there are some related issues here regarding whether there is confusion. Could kids get this? In fact, we have had a criminal case that was dismissed because of some of these, like the raspberry label that I showed in here that are brightly colored, and a clerk was charged with sale to a minor. Her defense in criminal court was that she just assumed a number of kids had been coming in and buying fruit drinks, and she thought that’s what this was. A judge bought that argument and dismissed the criminal case against the clerk.

There are some issues that may be more of an issue of how somebody may be advertising the product. We haven’t seen, what I would say, is outlandish advertising for the products. Anyone can argue, though, if you are targeting the 21 to 25 year old market, there are also going to be some people under the age of 21 who are going to be enamored with that.

MR. STEEN: This had to be submitted to us, this label?

MR. YARBROUGH: That is correct.

MR. STEEN: And who approved this label?

MR. YARBROUGH: The Marketing Practices Department upstairs, Allen Johnson and our chemist Janet Meisenheimer. They test them for alcohol content and that they meet the standards that we have on the books. Like I said, we require them to have “flavored beer” or have

“beer” on the label somewhere. And that’s one of the concerns we have. Maybe it should be more prominent; be required to be on the face of the label. If not, at least, in a way that the consumer isn’t mistaken that they picked up a lemonade as opposed to...

MR. STEEN: When we are approving the label, are we just saying that what it says is in there is, in fact, in there or are we actually approving that someone that’s got a malt beverage product could label it Mike’s Hard Lemonade? Are we approving that part of it?

MR. YARBROUGH: We are approving all of it.

MR. STEEN: I didn’t know this was being sold. But you look at a product like this that looks like lemonade, you can see the color of it and it says Mike’s Hard Lemonade.

MR. YARBROUGH: You have to read really carefully to tell that is an alcoholic beverage. That is one of our concerns, but it meets our standards of identity. We think we need to look at those and see if those standards need to be modified....

MR. STEEN: Well, how does this meet our standards of identity?

MR. YARBROUGH: In that we require it to say “beer.” It actually is beer. ATF looks at the formulation, that it is made from a malt base. We have relied on their certification on these standards of identity. That’s why I said until just recently, since the first of the year, it has come to our attention that they have allowed such deviations. I mean if you just took a beer and stripped the color out and you added water and lemon flavoring you’d have what they might call Mike’s Hard Lemonade. The concern now is the other things that are in there, too. So we have two issues. Should it more clearly say beer, like we talk about in trade practices and different things? Equal billing with the hard lemonade and say “beer” so nobody is mistaken? Or, is the public sufficiently given notice as to what this is, so you don’t have kids, you don’t have people who are just going in to buy lemonade get this and find out it is something else?

MR. STEEN: Just a reaction, but I think “beer” ought to be in large letters with “lemonade” in small letters. You have to really look to find the “flavored beer” on there.

MR. YARBROUGH: Certainly. That’s one of the first things we suggested should be on the table for discussion. Maybe in a more prominent location on the label. Thank you.

MR. STEEN: Ms. Madden, do you have a question?

MS. MADDEN: No. Thank you.

MR. STEEN: Thank you, Mr. Yarbrough.

We now move to public comment. Do we have anybody signed up to speak? What's the procedure for that? Would I have something up here?

MR. YARBROUGH: Normally, you would or you can call for anybody in the audience.

MR. STEEN: Anybody?

The commission will now go into a closed, executive session to confer with the general counsel regarding litigation pending against the agency under the authority of Government Code, §551.071, and to evaluate the performance of the administrator.

The commission convened in executive session at 2:25 p.m. and reconvened in open meeting at 4:25 p.m.

MR. STEEN: The commission meeting of February 25, 2002, is now back in open session. During executive session no votes were taken, no final decisions were made.

Do I hear a motion for adjournment?

MS. MADDEN: I so move.

MR. STEEN: Second.

Meeting is adjourned.

The meeting adjourned at 4:26 p.m.