By E-Mail and By FedEx June 10, 2016

Commissioner José Cuevas, Jr.
Texas Alcoholic Beverage Commission
5806 Mesa Drive, Suite 380
Austin, TX 78731

RE: McLane Company, Inc.

Dear Commissioner Cuevas:

On behalf of McLane Company, Inc., I write to request a meeting with you to discuss concerns about the actions of your staff.

As you know, the three-tier system is the cornerstone of the state's regulation of the alcoholic beverage industry. Properly understood, the three-tier system rightfully forbids any person or entity from controlling or influencing businesses that operate in more than one tier of the industry. But the TABC staff has recently taken the three-tier system to an absurd (and in our view, unlawful) extreme. In the course of defending a recent lawsuit that is now pending before the Texas Supreme Court, the TABC testified that the agency believes it is illegal for any person to own even a single share of stock in more than one tier (the so-called "One Share Rule")—a legal theory that would endanger virtually every licensee, mutual fund, and pension fund in Texas. Naturally, the TABC staff does not actually enforce this absurd rule against all licensees. But that only makes the problem worse: they appear to be selectively enforcing the One Share Rule only against certain applicants, while ignoring blatant violations by others, and for no discernible, principled reason.

We brought our concerns to the attention of your staff, at a meeting on March 18, 2016 with Emily Helm and Sarah Wolfe. In particular, we asked how the TABC could challenge a license to a company like McLane on the basis of the One Share Rule, while granting licenses to similarly situated entities—that is, to other companies that own a similar, or indeed greater, allegedly disqualifying interest. The TABC staff offered no principled reason for this disparate treatment. In sum, we heard nothing from the TABC staff to assuage our serious concerns that this is nothing more than unlawful selective prosecution and discrimination against new applicants for the benefit of politically favored incumbent licensees.

We do not believe that this reflects your vision and philosophy as the Chairman of the Commission. In that spirit, we request a meeting with you, so that we might determine together whether the TABC staff should abandon its One Share Rule—and if not, whether the TABC plans to enforce the One Share Rule consistently, rather than selectively, and thereby usher in an era of de facto Prohibition in the State of Texas. Most importantly, we would like to work with you to learn if there is any principled reason why the TABC would deny a license to one company, while continuing to grant licenses to other companies that have similar (indeed, greater) allegedly disqualifying interests in other tiers—including those who are currently subject to McLane's pending protest involving World Market.

We have included additional information regarding the concerns we hope to discuss with you below. We look forward to the opportunity to meet with you anytime in the next two weeks to determine the best interests of the agency and of the people of our great state.

A. McLane's Permit Application

McLane, a wholly-owned subsidiary of Berkshire Hathaway Inc., is a supply chain company that provides grocery and foodservice solutions to many of the nation's largest convenience stores, mass merchants and chain restaurants. In 2015, McLane distributed over $45 billion of food, beverages, and general merchandise throughout the United States, including in Texas where McLane is headquartered and employs over 3,500 Texans.

McLane distributes alcohol in a number of states, including Georgia, North Carolina, Colorado, and Florida, and desires to distribute alcohol in its home state of Texas. McLane, however, has been unsuccessful in securing a wholesaler permit from the TABC. Specifically, in August 2012, the TABC informed McLane that McLane was not eligible to receive an alcohol wholesaler permit because McLane's parent company, Berkshire Hathaway, owns a small percentage (about 2%) of Wal-Mart Stores, Inc.'s stock. Importantly, Berkshire Hathaway has no control over Wal-Mart's activities.

The TABC challenged McLane's permit application under the TABC's One Share Rule on account of Berkshire Hathaway's investment in Wal-Mart. As articulated by the TABC's Director of Licensing, Amy Harrison, in sworn testimony in the *Cadena* case, the One Share Rule prohibits anyone from owning as little as one share of stock of a company operating in one of the three tiers of the alcoholic beverage industry if that person also owns any shares of another company operating in a different tier—e.g., a person who owns any stock in an alcohol retailer cannot also own any stock in either an alcohol manufacturer or distributor. Ex. A, Harrison Tr. at 58:7-15; *see also Cadena Comercial USA Corp. v. TABC*, 449 S.W.3d 154, 159 (Tex. App.—Austin 2014, pet. granted) (noting that the "TABC . . . took the position that ***even one overlapping share of stock ownership, whether direct or indirect, would violate the statutory tied-house prohibitions***") (emphasis added).

B. McLane's Investigation Into The TABC's One Share Rule

Disappointed with the TABC's decision to deny McLane's permit application, and armed only with the aforementioned sworn ***verbal*** testimony as opposed to any meaningful ***written*** guidance from the agency (or any reference to the One Share Rule within the Texas Alcoholic Beverage Code), in early 2015, McLane began investigating the TABC's One Share Rule and licensing practices to help McLane determine whether to re-apply for a permit. To that end, McLane sent a series of Public Information Act ("PIA") requests to the TABC, in order to better understand the TABC's rationale for denying McLane's permit application. The PIA provides that Texas governmental bodies such as the TABC must promptly produce public information upon request, and establishes a presumption that the requestor receive the public information within ten business days. *See* Tex. Gov't Code § 552.221(a), (d).

McLane's PIA requests sought documents relating to, among other things, the One Share Rule, the TABC's enforcement of the tied-house statutes, and the TABC's permitting decisions relating to publicly-held applicants. While McLane expected to receive the documents it requested promptly, as required by law, it instead encountered significant resistance to its requests and, in many cases, outright refusal to provide the requested information. The TABC, for example, (i) delayed producing any documents responsive to certain McLane PIA requests by up to nine months, (ii) objected to the production of relevant documents based on meritless legal positions that have since been withdrawn, and (iii) improperly sought reconsideration of Attorney General Letter Rulings when reconsideration is not permitted by law (and even after the Attorney General advised the TABC that reconsideration requests are improper).

McLane refrained from taking any legal action in connection with its information requests for nearly a year in the hopes that the TABC would come into compliance with its obligations under the PIA. But, by early 2016, it had become clear to McLane that the TABC seemed to have no intention of complying with its statutory obligations, and McLane had no choice but to file suit against the TABC seeking the production of responsive materials. Regrettably, McLane and the TABC are presently parties

to three different lawsuits concerning McLane's PIA requests, each of which (i) could have been avoided had the TABC complied with its legal obligations to produce public information promptly and (ii) is resulting in a significant waste of McLane and Texas taxpayer resources, especially given that the TABC has retained outside counsel (Jackson Walker) to defend the lawsuits.

Although the lawsuits have prompted the TABC to produce more documents, to this day the TABC's document productions remain severely deficient as the TABC seems to have focused most of its efforts on thwarting McLane's discovery requests (with motions for protective orders), rather than complying with its obligations under the PIA. One would hope that the TABC would have nothing to hide and voluntarily produce its public information in an expeditious fashion—but, unfortunately, the TABC's actions thus far tell a different story.[1]

C. The TABC's Unequal Application Of The One Share Rule And Failure To Act On McLane's One Share Rule Protests

In addition to seeking information pursuant to the PIA, McLane also contacted the TABC to attempt to better understand how companies that are similarly situated to McLane have been able to secure alcohol permits. After all, Amy Harrison testified under oath in the *Cadena* case that the TABC applies a "one share" standard to the Alcoholic Beverage Code's tied-house provisions, and that the TABC, in reviewing applications, "look[s] for any interest, be it direct or indirect" in determining whether there is any improper overlapping ownership of an applicant. *See* Ex. A, Harrison Tr. at 19:4-9; *but see* Ex. B, TABC Fiscal Note Cost Estimate for S.B. 1198 (stating that the TABC would require an additional six full-time employees and over $500,000 each year to implement proposed legislation amending the Code's tied-house provisions to permit cross-tier direct or indirect ownership interests of 5% or less—suggesting that the TABC does not, in fact, "look for any [overlapping] interest, be it direct or indirect"). Based on McLane's investigation, this is not true.

Nearly every (if not every) publicly-traded entity that holds a Texas alcohol permit has owners who have overlapping interests in companies that operate in other tiers of the Texas alcoholic beverage industry. And, it appears that the TABC applies its One Share Rule to certain companies, such as McLane, and refuses to allow their applications for permits, while the TABC turns a blind eye to other companies who are similarly situated.

To test the TABC's application of its One Share Rule, on February 5, 2016, McLane submitted a Protest to the TABC relating to four retailer permits held by World Market. *See* Ex. C, McLane's World Market Protest. The Protest demonstrated how World Market's owners (through World Market's parent company, Bed Bath & Beyond) violate the One Share Rule by owning stock in companies operating in all three tiers. As examples:

- Vanguard Group, Inc. owns $600 million of World Market (retailer) stock, $75 million of Core-Mark Holding Company, Inc. (wholesaler) stock, and $600 million of Brown Forman Corp. (manufacturer) stock;
- FMR LLC owns $575 million of World Market (retailer) stock, $13 million of Core-Mark (wholesaler) stock, and $400 million of Molson Coors Brewing Co. (manufacturer) stock;
- State Street owns $450 million of World Market (retailer) stock, $25 million of Core-Mark (wholesaler) stock, and $1 billion of Molson Coors and Brown Forman (manufacturers) stock; and

[1] Materials produced to McLane thus far show that TABC officials provide preferential treatment to favored companies in the industry, regularly accept gifts from industry players, and improperly use taxpayer funds.

- JP Morgan Chase & Co. owns $400 million of World Market (retailer) stock, $11 million of Core-Mark (wholesaler) stock, and $400 million of Molson Coors (manufacturer) stock.

Ex. C at 3-7.

While McLane does not agree with the TABC's One Share Rule, at a minimum the TABC must apply the rule in an even-handed manner and, as such, McLane requested that the TABC either change its interpretation of the law or refuse to renew World Market's permits. *Id.* at 7.[2] But to date—over four months later—the TABC has refused to act on McLane's Protest. As with McLane's PIA requests, it seems as if the TABC intends to either delay or outright refuse to address McLane's concerns. Even though McLane provided the TABC with publicly available SEC filings that demonstrate World Market's violations of the One Share Rule, the TABC, on March 29, 2016, stated that its investigation "might take 6 months or even longer." Ex. D, TABC's March 29, 2016 Letter to McLane at 1.

World Market is by no means the only One Share Rule violator that has received permits from the TABC. As another example, San Francisco-based Core-Mark—one of McLane's primary competitors—is in violation of the One Share Rule, as it has many investors who also hold shares in retailers and manufacturers. As examples, publicly available SEC filings show that:

- Vanguard owns 7.1% of Core-Mark (distributor), 9% of World Market (retailer), and 7% of Molson Coors (manufacturer);
- FMR owns 1.1% of Core-Mark (distributor), 6.2% of World Market (retailer), and 3.1% of Molson Coors (manufacturer); and
- State Street owns 1.8% of Core-Mark (distributor), 5.2% of World Market (retailer), and 3.2% of Molson Coors (manufacturer). *See generally* Ex. E, McLane's Core-Mark Protest.

Yet the TABC has granted Core-Mark permits to distribute alcohol in Texas, despite its obligation to discover and enforce the tied-house prohibitions contained in the Code. *See Cadena*, 449 S.W.3d at 171 (stating the TABC has the authority and duty "to discover all [cross-tier] violations and to enforce the statute against all violators, especially those arising from investments in mutual funds, defined contribution and benefit plans, and private equity or hedge funds").[3]

Finally, the absurdity of the One Share Rule is perhaps most evident when one considers that the State of Texas and all TABC employees themselves violate the rule. The Code prohibits all TABC employees from "ha[ving] any financial connection with a person engaged in an alcoholic beverage business", "hold[ing] stocks or bonds in an alcoholic beverage business", or "ha[ving] a pecuniary interest in an alcoholic beverage business." Tex. Alco. Bev. Code § 5.05(a). Despite this, all TABC employees participate in the Texas Employees Retirement System. *See, e.g.*, Tex. Const. art. XVI, § 67(b)(2)-(3);

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[2] The TABC has been explicit about the One Share Rule applying to hedge funds and investment funds that have overlapping interests. *See* Ex. F, TABC's *Cadena* Brief On the Merits at 58 ("If a hedge fund or investment firm acquired 5% of the shares of both a manufacturer and a retailer, for example, the investment manager could pressure the retailer for discounts, shelf space, or other favorable treatment for the manufacturer's product. While some may argue that cross-tier influence and vertical integration are acceptable (or even desirable) business practices as a general matter, the Legislature has determined otherwise for the alcoholic-beverage industry.").

[3] While it is true that Berkshire Hathaway's approximately 2% ownership interest in Wal-Mart equates to millions of shares, such ownership percentage is in line with—or less than— other entities' ownership interests that the TABC ignores. For example, Vanguard and State Street are owners of Core-Mark (a distributor) and each owns more shares of Wal-Mart (a retailer) than Berkshire Hathaway does. *See* Ex. I, NASDAQ Institutional Ownership (WMT Stock).

Tex. Gov't Code § 812.003(a), (c). Yet, the Texas Employees Retirement System presently holds over one billion dollars of cross-tier investments, including but not limited to investments in retailers such as Chevron, Costco, Darden Restaurants, Kroger, Safeway, Target, Wal-Mart; and manufacturers such as Anheuser-Busch InBev, The Boston Beer Company, Brown-Forman, Constellation Brands, Diageo, Heineken and Molson Coors. *See* Ex. G, Employees Retirement System Investment Records. And the Teacher Retirement System of Texas has another $1.7 billion in cross-tier investments across the three tiers (over $1.6 billion in the retailer tier, over $400,000 in the wholesaler tier, and over $100 million in the manufacturer tier). Ex. H, Teacher Retirement System Investment Records. As such, the State of Texas as well as all TABC employees are in violation of the TABC's One Share Rule.

D. McLane Requests Cooperation

McLane wishes to work cooperatively with the TABC in connection with McLane's efforts to become an alcohol distributor in its home state of Texas. McLane is hopeful that, with the assistance of the Commissioners, the TABC will adopt a more reasonable interpretation of the Code's tied-house provisions, and communicate that interpretation clearly so that McLane and other potential applicants can understand the standards and rules that will apply to their applications. With all due respect, the TABC's current interpretation of the Code's tied-house provisions does not make legal or practical sense for the citizens of the state, because taken to its necessary and logical conclusion, the TABC's One Share Rule would result in de facto prohibition in Texas. Furthermore, the unequal application of the One Share Rule (discussed above) favors certain companies (e.g., Core-Mark) while keeping McLane—a Texas company and significant Texas employer—out of the market.

Many states—such as Arkansas, Kansas, Kentucky, Michigan, New York and Maryland—have interpreted their tied-house statutes to prohibit only controlling or significant interests that result in influence amongst the tiers. There is no evidence that the problems tied-house statutes were meant to address are more prevalent in those states than in Texas. And McLane already distributes alcohol in many states without any adverse effects.

Texas has built a legacy of championing free market enterprise. The actions of the TABC staff, through the inconsistent application of the One Share Rule, endanger Texas' business-friendly climate. McLane urges the TABC to abandon its erroneous One Share Rule and adopt a "control or influence" standard with respect to the tied-house provisions—i.e., overlapping ownerships are only prohibited when they result in a member of one tier controlling or influencing a member of another tier.[4] Alternatively, the TABC should adopt a standard whereby small amounts of ownership interests, such as Berkshire Hathaway's interest in Wal-Mart, are not considered or outcome determinative in the application process. Indeed, in the past, the TABC applied a "5% rule" under which it did not consider ownership interests in the application process if such interests were less than 5%. *See* Ex. J. Implementing either of these alternatives would allow McLane to obtain its wholesaler permit and benefit Texas consumers, retailers, and manufacturers (particularly small manufacturers, such as craft brewers) by creating a more competitive marketplace. If the TABC refuses to reject its One Share Rule, the TABC must enforce it against all industry participants in an equal manner. No other option exists under the law.

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Finally, please let us know when you are available for a meeting to discuss McLane's concerns. In the meantime, McLane respectfully requests that the Commissioners instruct the TABC's officials to

[4] *See, e.g., Neel v. Texas Liquor Control Bd.*, 259 S.W.2d 312, 316 (Tex. Civ. App.—Austin 1953, writ ref'd n.r.e.) ("The term 'tied house' has been frequently used to describe the relationship between a wholesale and retail liquor dealer under conditions giving the wholesaler practical control over the business of the retailer. . . . [O]ne result of such control could be the creation of a monopoly for certain brands of liquors as well as dictating prices.").

comply with their obligations under the PIA to produce public information in a prompt manner, and timely address McLane's Protests under the Code.

Sincerely,

W. Grady Rosier

Enclosures

cc: Governor Greg Abbott
Lt. Governor Dan Patrick
Speaker Joe Straus
Commissioner Steven M. Weinberg
Commissioner Ida Clement Steen