

IN THE DISTRICT COURT OF LANCASTER COUNTY, NEBRASKA

COPY

PROJECT EXTRA MILE, THE PUBLIC)
HEALTH ASSOCIATION OF NEBRASKA,)
PRIDE-OMAHA, INC., Nebraska Nonprofit)
Corporations,)
))
and)
))
MARY DOGHMAN,)
))
Plaintiffs,)
))
vs.)
))
NEBRASKA LIQUOR CONTROL)
COMMISSION, and HOBERT RUPE,)
its Executive Director,)
))
Defendants.)

Case No. CI 09-3543

ORDER

This matter came before the court on November 30, 2010, for hearing on the merits of the amended complaint filed by the plaintiffs, Project Extra Mile, the Public Health Association of Nebraska, PRIDE-Omaha, Inc., and Mary Doghman (collectively "Plaintiffs"). Vincent M. Powers appeared for Plaintiffs. Milissa Johnson-Wiles appeared on behalf of the defendants, the Nebraska Liquor Control Commission and Hobert Rupe, its Executive Director (collectively "Defendants"). The court received exhibit 1, the parties' Stipulation of Facts, Exhibits and Issues, as well as exhibits 2 through 17. Arguments were heard, and the matter was taken under advisement. Being fully advised, the court finds and orders as follows:

Facts

Plaintiff Mary Doghman is a natural person and mother of two daughters, who at all times relevant to these proceedings has lived in the State of Nebraska. Mary Doghman is a resident

taxpayer in the State of Nebraska who paid taxes to the state during the preceding year. Project Extra Mile, the Public Health Association of Nebraska, and PRIDE-Omaha, Inc., are Nebraska nonprofit organizations seeking to prevent underage consumption of alcohol.

Plaintiffs have filed this lawsuit challenging the Nebraska Liquor Control Commission's (the "Commission") adoption of 237 N.A.C. § 1-009, "Classification of Alcoholic Liquor," which rule adopted a federal standard by the U.S. Alcohol and Tobacco Tax and Trade Bureau ("TTB") regarding the classification of flavored malt beverages (also referred to as flavored alcoholic beverages or "FABs"). The Commission's rule states:

For the purpose of the classification of flavored malt beverages, the Nebraska Liquor Control Commission shall utilize the same classification as adopted by the Alcohol and Tobacco Trade and Tax Bureau ("TTB") found at 27 CFR Parts 7 and 25 ("Flavored Malt Beverage and Related Regulatory Amendments") which went into effect January 3, 2006. If anyone believes that the determination made by the Commission is in error they may request a declaratory ruling under Chapter 1 003.02.

The Commission is a state agency created pursuant to the Nebraska Liquor Control Act ("the Act"), NEB. REV. STAT. §§ 53-101 through 53-1,122 (Reissue 2004, Cum. Supp. 2008, & Supp. 2009). The Commission's statutory mandate includes the collection of tax on alcoholic beverages imported into and sold within the State of Nebraska. The Commission has the power to regulate all phases of the control of the manufacture, distribution, sale, and traffic of alcoholic liquor, except as specifically delegated in the Act. NEB. REV. STAT. § 53-116 (Reissue 2004). The Commission also has the power to fix by rules and regulation standards of manufacture and labeling of alcohol. NEB. REV. STAT. § 53-117(2) (Reissue 2004). Defendant Hobert Rupe is the Executive Director of the Commission and is named in his official capacity in that position.

The FABs at issue in this case and currently sold in Nebraska are classified under federal TTB regulations as "malt beverages." Under current TTB regulations and the Commission classification, up to 49 percent of the alcohol in FABs may contain flavorings that contain alcohol obtained by distillation. At least 51 percent of the alcohol content must be derived from the beer or malt beverage base. The 51/49 percent rule is restricted by TTB regulations and the Commission classification to a FAB that has a 6 percent or lower total alcohol content. If a FAB has a total alcohol content above 6 percent, then only 1.5 percent of the total alcohol content may

be derived from flavorings containing alcohol obtained by distillation.

To produce these FABs:

brewers brew a fermented base of beer from malt and other brewing material. Brewers then treat this base using a variety of processes in order to remove malt beverage character from the base; i.e., they remove the color, bitterness, and taste that are 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.

(Ex. 4, p. 4). Commonly known FABs are Mike's Hard Lemonade, Smirnoff Ice, and Bacardi Silver. FABs are also referred to as "Alcopops" in addition to "Flavored Malt Beverages."

Plaintiffs contend that since FABs contain alcohol obtained by distillation, FABs are "spirits" under NEB. REV. STAT. § 53-103(2) (Reissue 2004)¹ and the Commission's standard violates that statute as it permits FABs to be treated as "beer" under NEB. REV. STAT. § 53-103(4). The practical consequence being that beer is taxed at a much lower rate by the State of Nebraska than spirits. *See* NEB. REV. STAT. § 53-160(1).

Plaintiffs filed a complaint on September 9, 2009, seeking a declaratory judgment pursuant to NEB. REV. STAT. § 84-911 (Reissue 2008) and a writ of mandamus pursuant to NEB. REV. STAT. § 25-2156 (Reissue 2008). On October 26, 2009, Defendants filed a motion to dismiss pursuant to NEB. CT. R. PLDG. §§ 6-112(b)(1) and 6-1112(b)(6) and argued that Plaintiffs lacked standing. In an Order dated February 24, 2010, Judge Robert R. Otte dismissed Plaintiff's claims for a writ of mandamus and attorney fees, but found that Plaintiffs had standing to seek a declaratory judgment regarding the validity of 237 N.A.C. § 1-009.

Plaintiffs filed an amended complaint on March 1, 2010. Defendants answered on March 18, 2010. Trial was had on October 4, 2010, and the matter submitted to Judge Otte. Subsequently, Judge Otte recused himself and the case was reassigned to this court on November 1, 2010. A hearing was held on November 30, 2010, and the matter was resubmitted to this court. Defendants also renewed their objection to standing and argued that the court lacks subject matter jurisdiction.

¹ In 2010, the Legislature amended NEB. REV. STAT. § 53-103 and renumbered the definitions found in that section. *See* NEB. REV. STAT. §§ 53-103.01 to 53-103.42 (Reissue 2010). In this Order, though, all statutory references to the Act are to the 2004 Reissue versions.

Standard of Review

“Basic civil jurisprudence indicates that the burden of proof in declaratory judgment actions is a preponderance of the evidence and the burden is to be borne by the plaintiff.” *Tipp-It v. Conboy*, 257 Neb. 219, 224, 596 N.W.2d 304, 309 (1999).

Section 84-911 provides that upon a challenge to a rule or regulation adopted by an administrative agency, the issue is whether the rule or regulation “violates constitutional provisions, exceeds statutory authority of the agency, or was adopted without compliance with the statutory procedures.” NEB. REV. STAT. § 84-911 (Reissue 2008). The Supreme Court has held that NEB. REV. STAT. § 84-911 is “a limited statutory waiver of sovereign immunity and confers subject matter jurisdiction for a declaratory judgment concerning the validity of a state agency's rule or regulation.” *Riley v. State*, 244 Neb. 250, 258, 506 N.W.2d 45, 50 (1993).

Analysis

Plaintiffs are not challenging 237 N.A.C. § 1-009 as violating constitutional provisions, nor are they alleging that the rule was adopted without compliance with statutory procedures. (Ex. 1, ¶ 10). The sole issue raised by Plaintiffs is whether the rule exceeds the Commission’s statutory authority.² The Commission defends its rule as within its statutory authority. The Commission also defends this action on the basis that the court lacks subject matter jurisdiction as Plaintiffs lack standing to sue. The court addresses the jurisdictional issue first.

I. Plaintiffs’ Standing

Defendants argue that none of the Plaintiffs have standing to challenge the Commission’s adoption of the TTB standard. This argument has been considered twice before and rejected both times. In a February 24, 2010 Order, Judge Otte found that all Plaintiffs had standing to proceed on their action for declaratory judgment. Judge Otte’s decision was largely based on a previous order of this court in another case, Case No. CI06-3960, involving the same parties and essentially the same allegations as the present case in which this court rejected Defendants’ challenge to Plaintiffs’ standing.

² Plaintiffs, in their Amended Complaint, also asked the court to find that the rule violated NEB. REV. STAT. § 53-174 (Reissue 2004). That statute was repealed by the Legislature in 2010. (Ex. 1, ¶ 13). Therefore, Plaintiffs did not submit any argument on this issue and it will not be considered as the issue is moot.

Having reconsidered Defendants' argument, the court reaches the same conclusion and finds that all Plaintiffs have standing to proceed on their claim for declaratory judgment. The court adopts the reasoning in both Judge Otte's February 24, 2010 Order and this court's Order dated April 9, 2007 in Case No. CI06-3960 and will not restate the analysis here.

II. Validity of Commission's Regulation

Plaintiffs argue that the Commission's regulation, 237 N.A.C. § 1-009, violates the plain meaning of NEB. REV. STAT. § 53-103(2), as the definition of spirits in that statute clearly encompasses FABs. Defendants assert that the Commission's rule is not inconsistent with Nebraska law as FABs fit both the definition of spirits and beer under the Act. Defendants further contend that the Commission's rule is within the statutory authority granted to the Commission by NEB. REV. STAT. §§ 53-116 and 53-117(2).

The Nebraska Supreme Court has held that general powers may be conferred upon an administrative agency by means of legislative enactment delegating rulemaking authority to the agency with respect to the details of the legislative purpose. *County Cork v. Nebraska Liquor Control Comm'n*, 250 Neb. 456, 459, 550 N.W.2d 913, 916 (1996). Such powers are not, however, unlimited. In exercising its rulemaking authority, an agency may not employ its power to modify, alter, or enlarge provisions of a statute which it is charged with administering. *City of Omaha v. Kum & Go*, 263 Neb. 724, 731, 642 N.W.2d 154, 160 (2002). "The power to regulate must be exercised in conformity with all the provisions of the act and in harmony with its spirit and expressed legislative intent." *DLH, Inc. v. Nebraska Liquor Control Comm'n*, 266 Neb. 361, 367, 665 N.W.2d 629, 634 (2003). Thus, in order for a rule to be enforceable, it must be consistent with the statute under which the rule is promulgated. *Kum & Go*, 263 Neb. at 731, 642 N.W.2d at 160.

Statutory language is to be given its plain and ordinary meaning, and a court will not resort to interpretation to ascertain the meaning of statutory words which are plain, direct, and unambiguous. *State v. Lamb*, 280 Neb. 738, 744, 789 N.W.2d 918, 925 (2010). If the language of the statute is clear, effect must be given to the statute as written. Moreover, a statute which is clear and unambiguous is not susceptible to construction, regardless of whether the agency's definition is easier to use. *Kum & Go*, 263 Neb. at 733, 642 N.W.2d at 161.

Plaintiffs argue that the plain meaning of spirits as defined in NEB. REV. STAT. § 53-103(2) clearly encompasses FABs, and the Commission’s rule allowing FABs to be treated as beer violates section 53-103(2). The Commission argues that the rule is not inconsistent with the Act because all definitions of alcohol under the Act must be considered in para materia. *See Cox Cable of Omaha v. Nebraska Dep’t of Rev.*, 254 Neb. 598, 604, 578 N.W.2d 423, 427 (1998) (“[W]hen considering a series or collection of statutes pertaining to a certain subject matter which are in para materia, they may be conjunctively considered and construed to determine the intent of the Legislature, so that different provisions of the act are consistent and sensible.”). The Commission argues that FABs also fit the definition of beer as defined in NEB. REV. STAT. § 53-103(4), and thus, the application of the Act to FABs creates a latent ambiguity. Given this latent ambiguity, the Commission asserts that the adoption of the TTB standard cannot be considered inconsistent with Nebraska law.

“Spirits,” as defined in the Act, “means any beverage which contains alcohol obtained by distillation, mixed with water or other substance in solution, and includes brandy, rum, whiskey, gin, or other spirituous liquors and such liquors when rectified, blended, or otherwise mixed with alcohol or other substances.” NEB. REV. STAT. § 53-103(2).

“Beer,” as defined in the Act, “means a beverage obtained by alcoholic fermentation of an infusion or concoction of barley or other grain, malt, and hops in water and includes, but is not limited to, beer, ale, stout, lager beer, porter, and near beer.” NEB. REV. STAT. § 53-103(4).

“Alcoholic liquor,” as defined in the Act,

includes alcohol, spirits, wine, beer, and any liquid or solid, patented or not, containing alcohol, spirits, wine, or beer and capable of being consumed as a beverage by a human being. . . . The act does not apply to . . . (b) flavoring extracts, syrups, medicinal, mechanical, scientific, culinary, or toilet preparations, or food products unfit for beverage purposes, but the act applies to alcoholic liquor used in the manufacture, preparation, or compounding of such products . . . that contains more than one-half of one percent alcohol

NEB. REV. STAT. § 53-103(5).

The Commission argues that, under the TTB standard, a FAB may only be considered a “beer” or “malt beverage” if at least 51 percent of its alcohol is derived from a fermented beer base. Any product which meets the TTB standard will have at least 51 percent of its alcohol

content from fermentation of malt and other materials. Therefore, according to the Commission, such product is “a beverage obtained by alcoholic fermentation of an infusion or concoction of barley or other grain, malt, and hops in water” and clearly a “beer” under Neb. Rev. Stat. § 53-103(4). The Commission further points out that the Act treats alcohol from nonbeverage flavors differently than other types of alcohol, by providing that the Act “does not apply to . . . flavoring extracts . . . or food products unfit for beverage purposes.” NEB. REV. STAT. § 53-103(5). Thus, the Commission contends, the Act recognizes an inherent distinction between the alcohol in nonbeverage flavors versus the alcohol in a distilled spirit beverage product, and this indicates that FABs were not contemplated by the Act when the definitional sections were adopted.

While the Court appreciates the Commission’s arguments, the plain language of NEB. REV. STAT. § 53-103(2) defining spirits clearly encompasses FABs. FABs do contain a fermented beer base and could, arguably, fit within the definition of beer under the Act. Section 53-103(2), however, is clear that “*any* beverage which contains alcohol obtained by distillation, mixed with water or other substance in solution” is a “spirit” under the Act. NEB. REV. STAT. § 53-103(2) (emphasis added). The inclusion of the word “any” in the statute is clear and the definition of spirits unambiguously applies to any beverage containing alcohol obtained by distillation. It is undisputed that FABs contain alcohol obtained by distillation and it matters not that the alcohol obtained by distillation is in the form of “flavorings” added to the malt base.

The Commission argues that regardless of whether FABs are “spirits” within the meaning of NEB. REV. STAT. § 53-103(2), the Commission’s rule is within the statutory authority granted by NEB. REV. STAT. §§ 53-116 and 53-117(2).

Section 53-116 provides: “The power to regulate all phases of the control of the manufacture, distribution, sale, and traffic of alcoholic liquor, except as specifically delegated in the Nebraska Liquor Control Act, is vested exclusively in the commission.”

Section 53-117(2) provides, in relevant part, that the Commission has the power, function, and duty:

To fix by rules and regulations the standards of manufacture of alcoholic liquor not inconsistent with federal laws in order to insure the use of proper ingredients and methods in the manufacture and distribution thereof and to adopt and promulgate rules and regulations not inconsistent with federal laws for the proper

labeling of containers, barrels, casks, or other bulk containers or of bottles of alcoholic liquor manufactured or sold in this state.

The Commission contends that the TTB rule regarding FABs is a standard of manufacture for those products. The rule provides that up to 49 percent of a FAB's total alcohol content (of up to 6 percent) can contain flavorings and other nonbeverage ingredients containing alcohol obtained by distillation; 51 percent must come from the brewing process. The rule also sets forth standards for labeling. Therefore, the argument goes, the Commission's adoption of the TTB rule is clearly within the Commission's broad statutory authority under NEB. REV. STAT. §§ 53-116 and 53-117(2).

The Court recognizes that NEB. REV. STAT. § 53-117(2) indicates that the Legislature intended for the Commission to adopt rules and regulations that are consistent with federal laws with respect to standards of manufacture and labeling. The Commission's rule, however, does not apply only to standards of manufacture and labeling. The rule classifies FABs according to the TTB standard for *all* purposes, including taxation. As to taxation, the Act provides:

For the purpose of raising revenue, a tax is imposed upon the privilege of engaging in business as a manufacturer or a wholesaler at a rate of thirty-one cents per gallon on all beer; . . . and three dollars and seventy-five cents per gallon on alcohol and spirits manufactured and sold by such manufacturer or shipped for sale in this state by such wholesaler in the course of such business.

NEB. REV. STAT. § 53-160(1).

The Act clearly provides for different tax treatment of beer and spirits. While the Commission may have the authority to adopt the TTB standard for FABs for purposes of standards of manufacture and labeling, the Act does not allow the Commission to adopt a regulation that treats a product that clearly fits within the definition of spirits as beer for purposes of taxation. The language of NEB. REV. STAT. § 53-103(2) is clear that "any beverage which contains alcohol obtained by distillation, mixed with water or other substance in solution" is a spirit and must be taxed accordingly under NEB. REV. STAT. § 53-160(1).


Accordingly, the court concludes that the Commission's rule regarding FABs, 237 N.A.C. § 1-009, exceeds the statutory authority granted to the Commission under the Act. The court recognizes that the question of how to classify FABs is a question wrought with many public

policy concerns and is one best left to the Legislature. As the law currently stands, though, FABs are clearly spirits under the Act and must be taxed as such.

IT IS, THEREFORE, ORDERED, ADJUDGED AND DECREED that the Nebraska Liquor Control Commission's regulation, 237 N.A.C. § 1-009, is declared illegal and void insofar as it attempts to classify FABs for taxation purposes. Judgment is hereby entered in favor of Plaintiffs and against Defendants. Costs are taxed to Defendants.

DATED this 14th day of February, 2011.

BY THE COURT:



John A. Colborn
District Court Judge

cc: Vincent M. Powers, Attorney for Plaintiffs
Milissa Johnson-Wiles, Attorney for Defendants