

UNITED STATES BANKRUPTCY COURT

DISTRICT OF NEW MEXICO
FILED
12:00 MIDNIGHT

In re:

FURR'S SUPERMARKETS, INC.,
a Delaware corporation,

Debtor.

JUL 25 2001

Case No. 11-01-10779 SA
Chapter 11
DROP BOX
United States Bankruptcy Court
Albuquerque, New Mexico

**DEBTOR'S MEMORANDUM IN SUPPORT OF DEBTOR'S MOTION FOR
ORDER DETERMINING THAT THE DIRECTOR OF
THE NEW MEXICO ALCOHOL AND GAMING DIVISION MAY NOT
CONDITION APPROVAL OF THE TRANSFER OF DEBTOR'S LIQUOR
LICENSES UPON PAYMENT IN FULL TO LIQUOR WHOLESALERS**

On July 10, 2001, Furr's Supermarkets, Inc. ("Debtor"), by counsel, filed its *Motion for Order Determining That the Director of the New Mexico Alcohol and Gaming Division May Not Condition Approval of the Transfer of Debtor's Liquor Licenses Upon Payment in Full to Liquor Wholesalers* (the "Motion") (Doc. #737) in which Debtor requests an order determining that, notwithstanding any provision of the Liquor Control Act of the State of New Mexico ("LCA"), the Director (the "Director") of the New Mexico Alcohol and Gaming Division (the Division") of the Regulation and Licensing Department of the State of New Mexico (the "Department") may not condition his approval of the transfer of the Liquor Licenses to Purchaser or its designees under the approved Sale Motion filed June 1, 2001 (Doc. # 542), upon payment in full to the Liquor Wholesalers (sometimes referred to as the "Wholesalers"). In the Motion the Debtor requests further that the Court's order direct the Director not to so condition approval of

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the transfer of the Liquor Licenses. The underlying facts are set forth in the Motion and are not repeated here.¹

The Liquor Wholesalers filed Objections to the Sale Motion. The Sale Order entered July 3, 2001 (Doc. # 710), in paragraphs 9 and 10, preserved the issues raised in the Liquor Wholesalers' Objections to transfer of the Liquor Licenses. Paragraph 9 of the Sale Order provides,

Except as provided in paragraph 10 of this Order, notwithstanding any non-bankruptcy law, no governmental authority or official shall withhold or delay approval of a transfer of a license or permit because of any outstanding taxes or other liabilities.

Paragraph 10 of the Sale Order provides, in part, that the Liquor Wholesalers' Objections, insofar as they assert any of the identified "Grounds," are not resolved by the Sale Order, and shall be resolved prior to Closing.² The Liquor Wholesalers claim a first priority lien against the Liquor Licenses.³ That matter is at issue in Adversary No. 01-01073S, pending before this Court and is not addressed in the Motion or in this Memorandum.⁴ The subject of the Motion and of this Memorandum is the Liquor Wholesalers' claim that under the Liquor Control Act ("LCA") of the State of New Mexico, specifically §60-6B-3, NMSA 1978 (Repl. Pamp. 1998), the Debtor may not transfer the Liquor Licenses to

¹ Capitalized words are as defined in the Motion unless otherwise stated. Without limiting the scope of the Motion, "transfer, assignment, sale or lease" of the Liquor Licenses is referred to herein as "transfer."

² Pursuant to the Asset Purchase Agreement approved in the Sale Order, Closing is to occur by August 31, 2001. Under certain circumstances, Closing may occur as late as October 1, 2001.

³ Under the Sale Order, any liens the Liquor Wholesalers may have against the Liquor Licenses will attach to the proceeds of sale to the same extent, and in the same order of priority, that such liens (if any) attach to the Liquor Licenses that are transferred. Sale Order, ¶3.

⁴ Similarly, the Wholesaler lien provisions of the LCA are not at issue in the Motion or in this Memorandum and all references to Section 60-6B-3 herein are deemed not to be references to the lien provision of Section 60-6B-3 NMSA 1978 (Repl. Pamp. 1998).

the Purchaser or its designees, without payment in full to the Liquor Wholesalers, regardless of whether the Liquor Wholesalers have liens against the Liquor Licenses, and regardless of the priority of any such liens.⁵

The Debtor asserts three independent but related grounds for the relief it seeks. First, the restriction in Section 60-6B-3 on the sale or transfer of a liquor license (the "Pre-petition Debt Payment Condition"), as applied to pre-petition claims in the bankruptcy context, is irreconcilable with the fundamental priority and distribution provisions of the Bankruptcy Code. Therefore, to the extent Section 60-6B-3 would prevent sale of the Liquor Licenses and distribution of the proceeds in accordance with the Code, it is preempted by the Code.⁶ Second, enforcement of Pre-petition Debt Payment Condition in Section 60-6B-3, violates the automatic stay of 11 U.S.C. §362(a). Third, enforcement of the Pre-petition Debt Payment Condition violates the Code's anti-discrimination provision in 11 U.S.C. §525(a), and is preempted by such provision.

A. This Court has jurisdiction to order the relief requested in the Motion.

⁵ Section 60-6B-3, NMSA 1978 of the Liquor Control Act of the State of New Mexico, provides:

The transfer, assignment, sale or lease of any license shall not be approved until the director is satisfied that all wholesalers who are creditors of the licensee have been paid or that satisfactory arrangements have been made between the licensee and the wholesaler for the payment of such debts. Such debts shall constitute a lien on the license, and the lien shall be deemed to have arisen on the date when the debt was originally incurred.

Debtor is prepared to escrow a sufficient portion of the Sale proceeds to satisfy payment of the Wholesalers' claims, pending the outcome of the adversary proceeding concerning the Wholesalers lien claims. Debtor believes that such an arrangement would constitute satisfactory arrangements under Section 60-6B-3 and permit the Director to approve the transfers of the Liquor Licenses.

⁶ The overriding purpose of the Code is the expeditious and equitable distribution of the assets of the debtor's estate. *Midlantic [National] Bank v. New Jersey Department of Environmental Protection*, 474 U.S. 494, 508, 106 S.Ct. 755, 763 (1986) (Renquist, J. dissenting). The Supremacy Clause mandates that where state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress, state law must yield. See, *Hines v. Davidowitz*, 312 U.S. 52, 67, 61 S.Ct. 399, 404 (1941) and *Perez v. Campbell*, 402 U.S. 637, 652, 91 S.Ct. 1704, 1712 (1971).

Debtor filed the Motion to seek a determination of issues raised in objections to the Sale Motion, which were reserved in the Sale Order for determination pursuant to the procedure subsequently approved by the Court. *See*, Sale Order, ¶10. The Sale Motion is a core proceeding, 28 U.S.C. §157(b)(2)(A). The Court has jurisdiction over the Sale Motion and the Objections pursuant to 28 U.S.C. §§157 and 1334 and 11 U.S.C. §363, and over the necessary parties. Venue is proper under 28 U.S.C. §§1408 and 1409. The Liquor Licenses are property of the estate subject to the jurisdiction of the bankruptcy court.⁷ 11 U.S.C. §541; *In re Hoffman*, 65 B.R. 985 (D.R.I. 1986), *aff'g* 53 B.R. 874 (Bankr. D.R.I. 1985); *In re Terwilliger's Catering Plus, Inc.*, 86 B.R. 937, 939 (Bankr. S.D. Ohio 1988), *affirming* 911 F.2d 1168 (6th Cir. 1990) (a liquor license becomes property of the estate upon the filing of the bankruptcy petition); *In re Del Mission Limited*, 998 F.2d 756, 757 (9th Cir. 1993) (liquor licenses and proceeds therefrom are property of the estate).

B. The United States Bankruptcy Code Preempts the state Liquor Control Act, including §60-6B-3, NMSA 1978, to the extent that it prevents transfer of the Liquor Licenses without first paying the Pre-petition Claims of the Liquor Wholesalers in full.

The United States Constitution provides that “[t]his Constitution, and the Laws of the United States which shall be made in Pursuance thereof; . . . shall be the supreme Law

⁷ The bankruptcy estate is comprised of “all the following property, wherever located and by whomever held: (1) . . . all legal or equitable interests of the debtor in property as of the commencement of the case.” 11 U.S.C. §541(a)(1). The legislative history states that the scope of §541(a)(1) is broad. “It includes all kinds of property, including tangible or intangible property, . . . and all other forms of property currently specified in section 70(a) of the Bankruptcy Act.” H.R. Rep. No. 95-595, p. 367 (1977); S. Rep. No. 95-989, p. 82 (1978), U.S. Code Cong. & Admin. News 1978, pp. 5868, 6323. Section 541(a)(1) “will bring everything of value that the debtor has into the estate.” H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 176 (1977). Code Section 541(a)(1) includes “every conceivable interest of the debtor” in the estate. 3 Norton Bankr. L. & Prac. 2d §51:4.

of the Land and the Judges in every State shall be bound thereby, any thing in the Constitution or Laws of any State to the contrary notwithstanding.” U.S. Const. art. VI, cl. 2 (the “Supremacy Clause”). The United States Constitution provides also that “Congress shall have the power to establish . . . uniform laws on the subject of Bankruptcies throughout the United States.” U.S. Const. Art. 1, §8, cl. 4. “The power of Congress to establish uniform laws on the subject of Bankruptcies . . . is unrestricted and paramount.” *International Shoe Co. v. Pinkus*, 278 U.S. 261, 265, 49 S.Ct. 108, 110, 73 L.Ed. 318 (1929) (state statute governing distribution of property of insolvents for the payment of their debts and providing for their discharge was preempted under the doctrine of field preemption). The court’s function is to “determine whether a challenged state statute ‘stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.’” *Perez v. Campbell*, 402 U.S. 637, 91 S.Ct. 1704 (1971); *Hines v. Davidowitz*, 312 U.S. 52, 67, 61 S.Ct. 399, 404, 85 L.Ed. 581 (1941).

“Pre-emption fundamentally is a question of Congressional intent.” *English vs. General Electric Company*, 496 U.S. 72, 78-79, 110 S. Ct. 2270 (1990). State law is preempted under the Supremacy Clause in three circumstances. *English*, 496 U.S. at 78-79. Those circumstances are: (1) when Congress made its intent known to preempt state law by explicit statutory language; (2) in the absence of explicit statutory language, where Congress “regulates conduct in a field that Congress intended the Federal government to occupy exclusively;” and (3) state law is preempted to the extent it actually conflicts with federal law. *Id.*, at 79. See also *United states v. Vasquez-Alvarez*, 176 F.3d 1294, 1297 (10th Cir. 1999); *Guschke vs. City of Oklahoma*, 763 F.2d 379, 383 (10th Cir. 1995).

“It is well established that federal bankruptcy law preempts state law but only to the extent that the state law conflicts with the federal law.” *Paul v. Monts* 906 F.2d 1468, 1476 (10th Cir. 1990). The Pre-petition Debt Payment Condition of Section 60-6B-3 conflicts with the Bankruptcy Code and is unenforceable under the Supremacy Clause, when applied in the bankruptcy context. Requiring Debtor to pay the pre-petition claims of the Wholesalers’ as a condition to transfer of the Liquor Licenses, even if the claims are unsecured, actually conflicts with fundamental provisions of the Bankruptcy Code: it violates the automatic stay of 11 U.S.C. §362(a); it conflicts with the comprehensive priority and distribution provisions of the Code, found primarily at 11 U.S.C. §§727 and 1129; and it is discriminatory under 11 U.S.C. §525.

The Wholesalers contend that Section 60-6B-3 prevents transfer of the Liquor Licenses until the Wholesalers’ prepetition claims are paid in full, notwithstanding the Bankruptcy Code. The United States Supreme Court has found other similar laws invalid in the face of federal bankruptcy law. State legislation that frustrates the full effectiveness of federal law is invalidated by the Supremacy Clause. *Perez*, 402 U.S. 637, 91 S.Ct. 1704 (holding invalid under Supremacy Clause an Arizona statute providing that discharge in bankruptcy does not relieve a debtor from having his driver's license suspended if he fails to satisfy a dischargeable judgment entered against him in an action arising out of operation of a motor vehicle). In *Perez*, the Supreme Court found that the “sole emphasis in the [Arizona statute] is one of providing leverage for the collection of damages . . .” 402 U.S. at 646-647. In *Perez*, the Court refused to uphold a state statute with “a declared purpose to protect judgment creditors 'from financial hardship' by giving them a powerful weapon with which to force bankrupts to pay their

debts despite their discharge.” 402 U.S. at 654. The issue in the case at bar is analogous: the Wholesalers ask this Court to uphold a New Mexico law designed to provide leverage for the Wholesaler’s collection of prepetition claims, whether or not secured, in contravention of the Bankruptcy code’s priority distribution scheme set forth in Code §§ 726 and 1129. The Court should reject the Wholesaler’s position.

Section 60-6B-3 is preempted to the extent it directly conflicts with the Bankruptcy Code. *In re Pompeo*, 195 B.R. 43 (Bankr. W.D. Penn. 1996). The Bankruptcy Code establishes a uniform framework for claim priorities and distribution of assets in bankruptcy. Section 60-6B-3, when applied in this case, would require that the Debtor pay the Wholesalers in full at closing in order to transfer the Liquor Licenses, regardless of any liens claimed by the Wholesalers, or the priority of those liens, contravening the mandate of the Bankruptcy Code. It is antithetical to the fundamental aspects of the Bankruptcy Code to permit state legislatures to undo the work of Congress and create independent priorities, favoring one industry, one company, or even one person, over other creditors. State legislatures “cannot rewrite bankruptcy priorities.” *In re County of Orange*, 191 B.R. 1005, 1017 (Bankr.C.D.Cal.1996) (state statute dictating priority of distribution of property held in trust by debtor county conflicted with, and thus was preempted by Bankruptcy Code). This point is “universally recognized” by the courts and legal scholars.” *Id.* 191 B.R. at 1017, fn. 13, *citing* 3 Collier on Bankruptcy ¶507.02 (15th ed. 1995).

The Tax Cases.

The conflict between the Bankruptcy Code and state statutes that prevent transfer of a liquor license unless prepetition debts are paid is most often fought in the tax arena.

The "tax cases" demonstrate ably that (i) the Bankruptcy Code constitutionally preempts the field of priority and distribution of assets in a bankruptcy case, (ii) state debt collection statutes do not enjoy constitutional protection in the bankruptcy context, and (iii) only by invalidly torturing the state statute and the Bankruptcy Code can the Wholesalers obtain the priority they seek in this case.

A number of courts have addressed issues similar to those in the present matter. The matter calls on the Court to construe carefully the competing laws and the basis from which they derive authority, including the Supremacy Clause, the Bankruptcy Clause, the automatic stay, the police powers exception, and the Eleventh and Twenty-First Amendments. *See, Perez*, 402 U.S. 644-648, 91 S.Ct. 1708-1711.

Several other courts have considered statutes, similar to the one at issue here, that require payment of taxes before a liquor license can be transferred. For example, the Rhode Island District Court held that the statute conflicted with the automatic stay of the Bankruptcy Code because it attempted to give the state's claim priority over those creditors to which the Bankruptcy Code gave precedence. *In re Hoffman*, 65 B.R. 985, 988 (D.R.I. 1986). The court concluded that the statute was merely a "legislative device

compliance with state tax law before a liquor license could be issued or renewed. 82 B.R. 649-650. The Massachusetts liquor commissioner sought to argue that proceeds of the liquor license actually belong to the tax commissioner under a “constructive trust and executory lien” theory.⁸ 82 B.R. 650-651. The court held that the law was in fact a state “debt collection statute” and that applying it would violate the Supremacy Clause to the extent that it interfered with the purposes of the Bankruptcy Code. *Id.*, citing U.S. Const. Art. VI, cl. 2. and *Perez*, 402 U.S. 649.

The Bankruptcy Court in the Western District of Pennsylvania (sitting *en banc*) upon exhaustive analysis, held that Pennsylvania’s claimed, “lien-like” interest in the liquor license was in direct conflict with, and was preempted by, the priority and distribution provisions of the Bankruptcy Code. *Pompeo*, 195 B.R. at 52. There, the chapter 13 trustee filed a motion to sell the debtor’s liquor license. 195 B.R. at 45. Various departments of the Commonwealth of Pennsylvania (Department of Revenue, Liquor Control Board, and Department of Labor and Industry), objected arguing that the trustee could not sell the license under Pennsylvania law unless outstanding taxes were paid. *Id.* The Commonwealth argued that the value of the license to the trustee and the debtor’s estate is only that portion remaining after satisfaction of outstanding taxes. 195 B.R. at 46. The court held the claimed interest preempted to the extent it is asserted in the bankruptcy context. 195 B.R. at 46.

⁸ Within the Ninth Circuit there is a line of cases in which the courts have found a “lien-like” or “proprietary” interest in favor of the state, which “encumbers” the debtor’s liquor license by the amount of taxes owed. See, *In re Professional Bar*, 537 F.2d 339, 340 (9th 1976); *In re Farmers Markets* 792 F.2d 1400 (9th 1986); *In re Petit Auberge Village*, 650 F.2d 192 (9th 1991). The theory is mostly rejected in other jurisdictions and would appear to have no value where an independent basis for a lien existed.

C. Failure of the Director or the N.M. Alcohol and Gaming Division to approve transfer of the Liquor Licenses would violate the automatic stay provided by 11 U.S.C. §362(a) and is not excepted from the stay under 11 U.S.C. §362(b) or otherwise.

Refusal to approve transfer solely due to outstanding prepetition liabilities to the Wholesalers violates the automatic stay.” *In re Kick-Off Inc.*, 82 B.R. 648 (Bankr.D.Mass. 1987), *aff’d*, 1988 WL 123927 (D. Mass 1988) (tax commissioner stayed from enforcing anti-transfer law with respect to liquor license); *In re Nejberger*, 120 B.R. 21, 24 (E.D. Penn. 1990) *aff’d*, 934 F.2d 1300 (3rd Cir. 1991) (liquor board’s refusal to renew liquor license due to nonpayment of taxes was stayed); *In re Hoffman*, 65 B.R. 985 (D.R.I.1986) (enforcement of statute requiring payment of delinquent taxes was stayed); *In re Aegean Fare, Inc.*, 35 B.R. 923 (Bankr.D.Mass.1983) (statute requiring payment of taxes as condition to liquor license renewal was stayed); *In re Farmers Markets*, 792 F.2d 1400, 1404 (9th Cir. 1986) (state’s refusal to transfer liquor licenses constituted an act to collect tax claim in violation of the stay); *See also, In re J.F.D. Enterprises, Inc.*, 183 B.R. 342 (Bankr. D. Mass. 1995) (state’s imposition of restrictions on buyer of liquor license violated automatic stay).

Courts have no difficulty staying enforcement of statutes designed to collect debts on behalf of private parties (such as the one at bar, Section 60-6B-3). *In re Massenzio*, 121 B.R. 688 (Bankr. S.D.N.Y. 1990) (Insurance company filed pre-petition complaint with state insurance department because of debtor’s failure to remit pre-petition

” The automatic stay prevents other actions that may be applicable here. 11 U.S.C. §362(a) provides, in part, that “a petition filed under section 301, 302, or 303 of [Title 11] . . . operates as a stay, applicable to all entities, of (1) the commencement or continuation . . . of a judicial, administrative, or other action or proceeding against the debtor . . . to recover a claim against the debtor that arose before the commencement of the case under this title; . . . (3) any act . . . to exercise control over property of the estate; (4) any act to create, perfect, or enforce any lien against property of the estate; . . . (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title; . . .”

premiums; state insurance department revoked debtor's insurance license post-petition in violation of stay; court held license revocation was not excepted from the stay because it was designed to protect the insurance company's pecuniary interest).

The automatic stay applies to all entities, and all creditors, both public and private.¹⁰ Courts apply the same analysis and hold the automatic stay applicable outside the liquor license area, yet still where other arguably compelling public interests are at stake. Other governmental functions, arguably as important and pervasive as liquor regulation, are also constrained by the automatic stay. Once again, if the measure is for the purpose of debt collection it will be stayed and will not be enforced over Bankruptcy Code preemption. *In re North*, 128 B.R. 592, 600 (Bankr. D. Vt. 1991) (Suspension effective post-petition of chiropractor's license for non-payment of taxes violated automatic stay, and was not excepted from the stay as an enforcement of police or regulatory powers); *In re NextWave Personal Communications*, 244 B.R. 253, 266-267 (Bankr. S.D.N.Y.2000) (automatic cancellation postpetition of FCC licenses due to nonpayment of prepetition debt and postpetition notices in connection with cancellation violated automatic stay and did not qualify for police power exception).

The Ninth Circuit has held that after court approval of the sale of liquor licenses, the state's refusal to transfer the licenses in an effort to obtain payment of delinquent

¹⁰ The effectiveness of the automatic stay is not diminished by 28 U.S.C. § 959(b). That statute provides that a trustee or debtor in possession [among others], "shall manage and operate the property in his possession . . . according to the requirements of the valid laws of the State in which such property is situated, in the manner that the owner or possessor thereof would be bound to do if in possession thereof." 28 U.S.C. §959(b) requires a trustee to manage a business in accordance with State law, as any other person must. This section does not "give a state agency the license to ignore the automatic stay of the Bankruptcy Code in order to enforce state laws." *Hillis Motors, Inc. v. Hawaii Automobile Dealer's Association*, 997 F. 2d 581, 952 (9th Cir. 1993) (State agency's postpetition action to dissolve debtor corporation violated automatic stay, and was not excused under 28 U.S.C. § 959(b), or otherwise). Although it may operate as a policy consideration in favor of granting relief from the automatic stay, if requested. *Id.*

taxes constitutes "an act to collect or recover a claim," in violation of the automatic stay. 11 U.S.C. §362(a)(6). *In re Farmers Markets* 792 F.2d 1400, 1404 (9th 1986); *see, In re Del Mission Limited*, 998 F.2d 756, 757 (9th Cir. 1993) (California's tax authority held to have violated stay by demanding payment of prepetition penalties and postpetition interest on prepetition taxes as a condition of transferring liquor license).

Section 60-6B-3 is not excepted from the automatic stay.

The stay violation committed by requiring payment of prepetition claims as a condition to license transfer is not excepted from the stay under 11 U.S.C. §362(b). *Aegean Fare, Inc.*, 35 B.R. at 928; *In re Kick-Off Inc.*, 1988 WL 123927-2 & 3 (statutes aimed at gaining pecuniary advantage are not excepted from stay); *In re Hoffman*, 65 B.R. at 899-991 (anti-transfer, tax collection statute was not excepted from stay); *In re Pizza of Hawaii, Inc.*, 12 B.R. 796, 799 (Bankr. D. Ha. 1981) (police powers exception did not permit state tax authority to refuse to renew debtor's liquor license unless debtor paid pre-petition delinquent taxes). It is appropriate for the court to direct that the unpaid wholesaler's claims not be considered by the Director for any purpose post-petition, including authorizing transfer of the licenses. *See, In re Nejberger*, 120 B.R. 21, 24 (E.D. Penn. 1990) *aff'd*, 934 F.2d 1300 (3rd Cir. 1991) (ordering liquor control board to renew license rather than enjoining board from refusing to renew because of outstanding tax delinquencies was overly broad).¹¹

¹¹ In *Kick-Off*, the bankruptcy court recognized that the statutes requiring a tax clearance ("notification of good standing") have the purpose and effect of giving the tax collector "significant leverage." 82 B.R. at 649-650. This is "proper outside of bankruptcy," the court noted. "When bankruptcy ensues, however, payment of debts comes within the sweep of the Bankruptcy Code." 82 B.R. at 650. "Taxes," the court observed, at that time, were "given seventh, not first, priority" under Code §507, and debts secured by a lien are governed by §506. The state statute "ignores all this," and is invalid under the Supremacy Clause because it is inconsistent with the Bankruptcy Code. *Id.*

Nonrenewal of a liquor license based solely upon failure to pay prepetition taxes is not within the police and regulatory powers excepted from the automatic stay and thus is prohibited by the automatic stay. *Agean Fare*, 35 B.R. at 928; *see J.F.D. Enterprises*, 183 B.R. at 351 (refusal of state liquor agency to remove buyer of license from delinquency list violated automatic stay and was not a valid exercise of police or regulatory power); *In re Nejberger*, 112 B.R. at 722 (the police powers exception issue was not preserved on appeal); *In re Pizza of Hawaii, Inc.*, 12 B.R. 796,799 (Bankr. D. Ha. 1981) (police powers exception did not permit state tax authority to refuse to renew debtor's liquor license unless debtor paid pre-petition delinquent taxes).

Courts routinely find that enforcement of state statutes requiring payment of prepetition taxes as a condition to license renewal is not a proper exercise of the states' police powers but rather merely an attempt to collect taxes. Enforcement of such statutes is not exempted from the automatic stay under 11 U.S.C. §362(b)(4) ("the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power"). As stated by the *Hoffman* court, "when a nonfederal sovereign acts for a pecuniary purpose, its initiatives must be automatically stayed, notwithstanding the narrow, police powers exception found at 11 U.S.C. § 362(b)(4).

Governmental units cannot, merely by invoking the nominal exercise of their police or regulatory powers, circumvent the "prophylaxis afforded to debtors and creditors alike by federal bankruptcy law." *Hoffman*, 65 B.R. 985, 988. The *Hoffman* court found that the statute at issue there "on its face in no way pertains to public safety, health, or welfare." *Id.*, at 989. It is a "revenue measure, a method of collecting

delinquent taxes – no more, no less”. As such, the court stated, the law “snuggly fits the description of pecuniary legislation of the sort that will not be excepted from the automatic stay.” *Id.* “If the law looks like a revenue collection measure and operates like a revenue collection measure, the chances are excellent. that, when all is said and done, it is indeed a revenue collection measure.” *Id.* 989. The *Hoffman* court rejected both the Ninth Circuit analysis, after lengthy examination, and the Twenty-First Amendment argument. *Hoffman*, 990-993. Both arguments failed under the court’s conclusion that the statute is what it seems to be; “a legislative device designed to foster the collection of delinquent debts.” *Id.* The police powers exception to the automatic stay is “intended to be given a narrow construction in order to permit governmental units to pursue actions to protect the public health and safety and not to apply to actions by a governmental unit to protect a pecuniary interest in property of the debtor or property of the estate”, 124 Cong. Rec. H11092 (Daily ed. Sept. 28, 1978; S17409) Daily ed. Oct. 6, 1978.

As the Vermont bankruptcy court observed in *North*, courts must find balance between deferring to unsupported claims that actions serve the public safety, health, and welfare, on one hand, and on the other, demanding proof to avoid self serving declarations; the “balance against deference shifts in favor of demanding proof of the public safety purpose when it is obvious the plain purpose is to serve a pecuniary interest.” *North*, 128 B.R. at 602. The police powers exception will not apply in a licensing context where the questioned action seeks to “enhance pecuniary interests such as payments of taxes or fulfillment of some other monetary requirement as a prerequisite for license renewal.” *North*, 128 B.R. at 601.

The district court in Massachusetts held that city of Boston's refusal to renew a liquor license because the debtor owed state taxes violated the automatic stay. *In re Aegean Fare, Inc.* 35 B.R. 923 (D. Mass. 1983). The Massachusetts court applied *Perez* concluding that there is a "distinction between governmental actions which are aimed at obtaining a pecuniary advantage ... and those actions which represent a direct application of the unit's police or regulatory powers." *Aegean Fare*, 35 B.R. 927. The former are stayed; the latter are not. *Id.*

In *Hoffman*, the district court concluded that Rhode Island's law requiring payment of delinquent taxes prior to transfer of a liquor license was a revenue collection measure which, as a pecuniary type of legislation, did not fall within the "police regulatory power" exception to the automatic stay. *In re Hoffman*, 65 B.R. 985 (D.R.I. 1986), affirming 53 B.R. 874 (Bankr. D.R.I. 1985); 11 U.S.C. § 362(b)(4); *see also, In re Pub Dennis*, 126 B.R. 903, 905 (Bankr. R.I. 1991) (the automatic stay prevents state tax administrator from objecting to the proposed sale of a liquor license on the ground of unpaid taxes).

The exception under Section 362(b)(4) is "very limited" and applies to permit governmental units to pursue actions to protect the public health and safety and not to actions to protect a "pecuniary interest" in property of the debtor or of the estate. *Shimer v. Fugazy*, 114 B.R. 865, 873 (Bankr. S.D.N.Y. 1990) (FCC was stayed from rendering any administrative cancellation of radio call sign license). As in *Shimer* and *NextWave* (*supra*, p. 11), the law that Wholesalers seek to enforce (Section 60-6B-3) relates exclusively to the "pecuniary interest" of the Wholesalers. As the *Kick-Off* court observed with respect to a similar Massachusetts law requiring tax compliance, Section 60-6B-3 has

“nothing to do the promotion of safety or order in the sale of alcoholic beverages. It is a debt collection measure, pure and simple.” *Kick-Off*, 82 B.R. 650.

D. Failure of the Director or the N.M. Alcohol and Gaming Division to approve transfer of the Liquor Licenses due to the Prepetition Debt Payment Condition would violate 11 U.S.C. §525.

Bankruptcy Code § 525 provides, in part, that “a governmental unit may not deny, revoke, suspend, or refuse to renew a license, permit, charter, franchise, or other similar grant to, condition such grant to, [or] discriminate with respect to such a grant against . . . a person that is or has been a debtor under this title . . . solely because such debtor is or has been a debtor under this title . . . or has not paid a debt that is dischargeable in the case under this title . . .” Code § 525 codifies the result in *Perez*. A state would frustrate the bankruptcy process if it were permitted to deny property rights, privileges, or other interests because a prepetition debt went unpaid. *Perez*, 402 U.S. at 652. Although *Perez* typically has been applied in the tax collection/license transfer arena, it is equally applicable to the present case. As in the present case, the conflicting state law in *Perez* had the purpose of collecting prepetition, third party debts. The Supreme Court held the state statute to be contrary to the federal bankruptcy laws and unenforceable under the Supremacy Clause. 402 U.S. at 654.

Under Code §525, the Court has authority to enjoin discriminatory conduct, even if a state proceeding is not automatically stayed.¹² *In re William Tell II, Inc.*, 138 B.R. 327, 330 (N.D. Ill. 1983) (upholding bankruptcy court’s determination that denial of renewal of liquor license was discriminatory under Code § 525); *see also, Matter of*

¹² See also, 11 U.S.C. §105(a): “The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.”

Anderson, 15 B.R. 399 (Bankr.S.D.Miss. 1981) (state commission not allowed to refuse to renew liquor license due to outstanding prepetition taxes). Critical to an application of Code §525 is a determination of whether the state's conduct is discriminatory. *Id.* In *William Tell*, the bankruptcy court found that the Liquor Control Commission discriminated against the debtor because the primary purpose for revoking and not renewing debtor's liquor license was debtor's failure to pay taxes. 38 B.R. at 331. The court found also that the liquor commission "made the validity of Tell's license conditional on the payment of taxes." *Id.* The court reasoned that since the tax liability was dischargeable "within the meaning of § 525," the liquor commission's denial of renewal of the license was improperly discriminatory. *Id.* In the present case, under Section 60-6B-3, the only grounds the Director could use to deny approval of transfer to the Purchaser would be the outstanding prepetition debt to the Wholesalers. *See*, Section 60-6B-3. To do so would violate Code § 525.

E. The relief requested in the Motion does not violate the Eleventh Amendment to the United States Constitution.

Wholesalers do not have standing to raise the State's rights under the Eleventh and Twenty-First Amendments. *McGowan v. Maryland*, 366 U.S. 420, 428 (1961) (litigant may only assert its own constitutional rights or immunities); *Ford v. West*, 222 F.3d 767, 774 (10th Cir. 2000 (same)); *Smith v. Private Industry Council of Westmoreland and Fayette Counties, Inc.*, 622 F. Supp. 160, 166 (W.D. Pa. 1985) (non-profit corporation lacked standing to challenge federal law on basis of Eleventh Amendment).

Core bankruptcy proceedings, such as this one, do not implicate the Eleventh Amendment, as there is no suit against the state. *Chandler v. Oklahoma ex rel. Oklahoma*

Tax Comm'n (In re Chandler), 251 B.R. 872, 876 (10th Cir. BAP 2000) (“Although the issue is not squarely before us, existing law indicates that if a monetary recovery or dispossession of assets from a State are not sought in a contested matter, a suit does not exist and, therefore, the Eleventh Amendment does not apply”); *In re Sun Healthcare Group, Inc.* 245 B.R. 779 (Bankr. D. Del. 2000) (entry of D.I.P. financing order, which prohibited state exercise of setoff rights, did not violate Eleventh Amendment).

State of New Mexico has Waived Sovereign Immunity on this Issue, in this Case.

The Eleventh Amendment does not bar the relief requested in the Motion because the State of New Mexico has waived sovereign immunity in this case, or at least with respect to this issue. The New Mexico Taxation and Revenue Department (“TRD”) filed a proof of claim and actually participated in the determination of the issues now before the Court.¹³ TRD participated in the process leading to approval of the Sale to Fleming, and in the Sale Order agreed to the following: (i) TRD agreed not to assert successor liability against the Purchaser with respect to any state tax or other liability of the Debtor (Sale Order ¶3(a)); (ii) TRD agreed not to assert that the Court has no power to order the transfer the Liquor Licenses without requiring payment of state taxes (Sale Order ¶3(b)), and agreed instead to assert a claim solely to the Sale proceeds; and (iii) TRD agreed that no governmental authority or official shall withhold or delay approval of a transfer of a license or permit because of any outstanding taxes or other liabilities (Sale Order ¶9).¹⁴

¹³ The State of New Mexico Taxation and Revenue Department filed in early April 2001, a Proof of Claim in the amount of \$1 million for prepetition taxes and filed an Amended Proof of Claim on or about April 17, 2001, in the amount of approximately \$3.9 million, also for prepetition taxes.

¹⁴ Sale Order ¶9 is “subject to ¶10” which preserves the Wholesalers arguments. However, the Wholesalers do not have standing to raise the Eleventh Amendment, as discussed below.

The Taxation and Revenue Department's participation binds the State of New Mexico for purposes of waiver of Eleventh Amendment immunity.¹⁵ A state is one governmental entity for purposes of claims of sovereign immunity and waivers thereof. *In re Straight*, 143 F.3d 1387 (10th Cir. 1998), *cert den.*, 525 U.S. 982, 119 S.Ct. 446 (1998). In *Straight*, The Wyoming Department of Transportation ("WDOT") "decertified" the debtor postpetition as a "disadvantaged business enterprise" alleging that the debtor had "lost the ability to control the financial capacity" of her firm. 143 F.3d at 1389. In response, the Debtor filed a motion for an order to show cause and a contempt citation under 11 U.S.C. §§362 and 525. *Id.* The court ordered WDOT to reinstate the debtor's status as a disadvantaged business enterprise and to pay fees and costs. *Id.* On appeal of a subsequent order approving the amount of fees and costs, WDOT asserted sovereign immunity under the Eleventh Amendment and that the Bankruptcy Court had no jurisdiction over it. *Id.* The Tenth Circuit Court of Appeals held that that the court had jurisdiction because two other state agencies had filed proofs of claims in the case. 143 F.3d at 1389-1390. The court held that for purposes of 11 U.S.C. §106(b) analysis, the state and its many departments comprise a unified entity and one "governmental unit." 143 F.3d at 1390-1391. The appellate court held further that the requirement under Section 106(b) that the claim against the state and the state's claim arise out of the "same transaction or occurrence" is met if they both arise from operation of the "debtor's business." 143 F.3d at 1392. The court held that the Supreme Court's decision in *Seminole Tribe v. Florida*, 517 U.S. 44, 116 S.Ct. 1114 (1996), does not impact Section

¹⁵ 11 U.S.C. §106(b) provides that a "governmental unit that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose."

106(b), which merely codifies existing “equitable circumstances” under which a state “can choose to preserve its immunity by not participating in a bankruptcy proceeding or to partially waive that immunity by filing a claim. The choice is left to the state.” 143 F.3d at 1392.

Eleventh Amendment immunity does not apply under *Ex parte Young* doctrine.

In the Motion, Debtor requests an order determining that the *Director* may not condition his approval of the transfer of the Liquor Licenses upon payment in full to the Liquor Wholesalers. Basically, Debtor seeks to prevent a state official from interfering with the sale, in contravention of the Bankruptcy Code. Debtor’s requested relief is excepted from any Eleventh Amendment bar under the *Ex parte Young* doctrine.¹⁶ *Ex parte Young*, 209 U.S. 123, 28 S.Ct. 441 (1908); *In re Ellett*, 243 B.R. 741 (9th Cir. 1999) (Eleventh Amendment did not bar debtor’s action against state tax official for injunction preventing tax collection).

The Eleventh Amendment does not bar a federal court injunction to stop state officials from enforcing state laws that violate the United States Constitution. *In re Crook*, 966 F.2d 539, 542 (10th Cir. 1992) *cert. den.*, *Commissioner of Land Office of Oklahoma v. Crook*, 506 U.S. 985, 113 S.Ct. 491 (1992). The *Ex parte Young* doctrine

¹⁶ In *Ex parte Young*, shareholders of a railroad company filed suit and obtained a preliminary injunction against a State Railroad Commission and the state’s attorney general (Mr. Edward T. Young) to enjoin enforcement of state prescribed rates. *Ex parte Young*, 209 U.S. at 129-133, 28 S. Ct. 441. Believing the injunction violated the Eleventh Amendment, the attorney general sought and obtained a state court writ commanding the company to adopt the rates. *Id.* at 133-134. The federal court held the attorney general in contempt; he was taken into custody and filed a petition for writ of *habeas corpus* with United States Supreme Court. The Supreme Court dismissed his petition holding that, even though states are protected by sovereign immunity, actions can be brought against state officials in their representative capacity if they are violating federal law. 209 U.S. at 168; *See Seminole*, 517 U.S. 72, fn. 16, 116 S. Ct. 1114 (*Ex parte Young* is “most notable avenue for insuring state compliance with bankruptcy and other federal laws).

allows a suit against a state official to go forward where the suit seeks prospective relief in order to end a continuing violation of federal law. *Ellett*, 243 B.R. at 744.

Ex parte Young does not apply only to “on going” violations of federal law. *Pacific Gas and Electric Co. v. California Public Utilities Commission, et. al.*, 263 B.R. 306, 315 (Bankr. N.D. Cal. 2001). The Supreme Court makes clear in *Ex parte Young* that the “threatened commencement” of suits was regarded as sufficient to authorize an injunction. *Ex parte Young*, 209 U.S. at 158, 28 S. Ct. 441. In the *PG & E* case, the plaintiff alleged that planned actions (an accounting decision resulting in a rate freeze) was sufficiently threatening to justify an injunction, and the court agreed. *P G & E*, 263 B.R. at 315. The Court held that the debtor was entitled to a ruling on whether the automatic stay applies and whether the court will enjoin the threatened violations. *PG & E*, 263 B.R. at 316. Any attempt to enforce debtor’s obligations in disregard of the bankruptcy stay would constitute a wrongful act of the type contemplated in the teachings of *Ex parte Young*. *Crook*, 966 F.2d at 543.

F. Transfer of the Liquor Licenses without first paying the Liquor Wholesalers in full does not violate the Twenty First Amendment to the United States Constitution.

Section 2 of the Twenty-First Amendment to the Constitution provides that “the transportation or importation into any State, Territory or possession of the United States for delivery or use therein of intoxicating liquors in violation of the laws thereof, is hereby prohibited.” The power of the states to regulate the transportation and use of liquor under the Twenty-First Amendment, however, is not absolute. As the Supreme

Court has explained, "the Amendment does not license the States to ignore their obligations under other provisions of the Constitution."¹⁷

Accordingly, state laws that violate the Commerce Clause are routinely overturned, notwithstanding the fact that they touch on the sale of liquor.¹⁸ The Supreme Court has explained that

To draw a conclusion . . . that the Twenty-First Amendment has somehow operated to 'repeal' the Commerce Clause wherever regulation of intoxicating liquors is concerned would . . . be an absurd oversimplification. If the Commerce Clause had been pro tanto 'repealed,' then Congress would be left with no regulatory power over interstate or foreign commerce in intoxicating liquor. Such a conclusion would be patently bizarre and is demonstrably incorrect.¹⁹

Courts have reached the same conclusion with respect to the Bankruptcy Clause, holding that just as "the Twenty-First Amendment has not repealed the Commerce Clause, so has it also not repealed the Bankruptcy Clause."²⁰

When a state statute involving alcohol conflicts with a federal statute, the question is whether the state's interests are so "closely related to the powers reserved by the

¹⁷ *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691, 712 (1984).

¹⁸ See, e.g., *Brown-Forman Distillers v. New York State Liquor Authority*, 476 U.S. 573 (1986); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984); *Cal. Retail Liquor Dealers Assoc. v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980).

¹⁹ *Hostetter v. Idlewild Liquor Corp.*, 377 U.S. 324, 331-332 (1964).

²⁰ *In re J.F.D. Enterprises, Inc.*, 183 B.R. 342, 352 (Bankr. D. Mass. 1995); see also *In re Elsinore Shore Associates*, 66 B.R. 708, 714 (Bankr. D.N.J. 1986). Section §60-6B-3 is the type of state liquor statute described by the court in *J.F.D. Enterprises*: It is a statute about

credit, not about import, transport and use. It is a tool used to ensure payments for liquor wholesalers and, as such, squarely conflicts with the priority scheme of the Bankruptcy code. And in this case, the operation of the statute conflicts with the effective administration of the assets of the estate. As the Twenty-First Amendment has not repealed the Commerce Clause, so has it also not repealed the Bankruptcy Clause. The Twenty-First Amendment is inapplicable to the resolution of the dispute here presented.

In re J.F.D. Enterprises, Inc., 183 B.R. 342, 352 (Bankr. D. Mass. 1995).

Twenty-First Amendment that the regulation may prevail notwithstanding that its requirements directly conflict with express federal policies."²¹ "When . . . a state regulation squarely conflicts with the accomplishment and execution of the full purposes of federal law, and the state's central power under the Twenty-First Amendment of regulating, times, places and manner under which liquor may be imported and sold is not directly implicated, the balance between state and federal power tip decisively in favor of federal law, and enforcement of the state statute is barred by the Supremacy Clause."²²

In re G. Heileman Brewing Co., Inc.,²³ a case the Wholesalers cited in objections to the Sale Motion, is illustrative of the kind of case that implicates the core concerns of the Twenty-First Amendment. The statute at issue in that case directly involved the transport of liquor, since the Debtor was attempting to terminate a distribution agreement in violation of Oregon law. The bankruptcy court held that, as a result of the Twenty-First Amendment, the debtor was bound to follow the Oregon law, notwithstanding section 365 of the Bankruptcy Code.

The New Mexico statute at issue here, on the other hand, does not implicate the interests protected by the Twenty-First Amendment.²⁴ As the *J.F.D. Enterprises, Inc.* court recognized, these types of statutes are

²¹ *Cooper v. McBeath*, 11 F.3d 547, 555 (5th Cir. 1994).

²² *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691, 715-16 (1984).

²³ 128 B.R. 876 (Bankr. S.D. N.Y. 1991); accord *North Dakota v. United States*, 495 U.S. 423 (1990) (state's liquor labeling and reporting requirements were within core powers granted by Twenty-First Amendment).

²⁴ Apparently the Wholesalers are willing to argue that Section 60-6B-3, despite being a simple debt collection provision, was enacted pursuant to the Twenty-First Amendment and deserves extraordinary protection. See Objection to Sale Motion filed by New Mexico Beverage Company, et al. (Doc. 621), on June 20, 2001. In *Perez v. Campbell*, the Supreme Court rejected an analogous, and similarly disingenuous argument about Arizona's "financial responsibility law," which provided that until a judgment arising from an auto accident was paid the debtor's driving privileges would be suspended, even after discharge of the

about credit, not about import, transport and use. It is a tool used to ensure payments for liquor wholesalers and, as such, squarely conflicts with the priority scheme of the Bankruptcy Code.²⁵

The Ninth Circuit has similarly rejected the notion that a state can use its power to regulate alcohol sales to elevate the claims of one set of creditors – liquor vendors – over the claims over other creditors, holding that doing so took too much advantage of the "purely coincidental" connection to liquor.²⁶

Accordingly, the Court should reject the Liquor Vendors' attempt to cloud the present matter with the Twenty-First Amendment.

CONCLUSION

The Debtor requests that the Court to determine:

(a) The Bankruptcy Code pre-empts §60-6B-3, NMSA 1978, or any other provision of the Liquor Control Act of the State of New Mexico, insofar as such statute precludes or restricts the Director from approving the transfer of the Liquor Licenses to Purchaser or its designees without payment in full to the Liquor Wholesalers.

(b) If the Director were to condition his approval of the transfer of the Liquor Licenses to Purchaser or its designees upon payment in full to the Liquor

judgment in bankruptcy. *Perez*, 402 U.S. at 641-642. The Court rejected the proposition that the purpose of the anti-discharge provision was "deterrence of irresponsible driving" (as had been found in the previously controlling cases struck down by *Perez*), 402 U.S. 652-653, and instead recognized that the "sole emphasis" of the law was "providing leverage for the collection of damages." *Perez*, 402 U.S. at 646-647. Similarly, no genuine argument can be made that Section 60-6B-3 is anything but a statute with the sole purposes of aiding private debt collection.

²⁵ *In re J.F.D. Enterprises, Inc.*, 183 B.R. at 352 (footnote omitted); see also *In re Hoffman*, 65 B.R. 985 (D.R.I. 1986) (tax administrator's attempt to require the debtor to pay the pre-petition taxes before liquor license could be transferred violated automatic stay, state statute was purely pecuniary in nature).

²⁶ *United States v. Stone (In re Stone)*, 6 F.3d 581, 585 (9th Cir 1993).

Wholesalers, the Director (and the Department and Division) would violate Bankruptcy Code §362(a).²⁷

(c) If the Director were to condition his approval of the transfer of the Liquor Licenses to Purchaser or its designees upon payment in full to the Liquor Wholesalers, the Director (and the Department and Division) would violate Bankruptcy Code §525.

The Debtor requests that the Court issue an order directing the Director not to so condition approval of the transfer of the Liquor Licenses.

WHEREFORE, the Debtor asks the Court to grant the relief requested in the Motion.

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²⁷ As stated in the Motion, the Debtor is not asking the Court to determine in this contested matter whether the Director would be subject to damages individually for a willful violation of the automatic stay, if the Director were to condition his approval of the transfer of the Liquor Licenses to Purchaser or its designees upon payment in full to the Liquor Wholesalers, but reserves the right to assert such a claim for damages in a separate proceeding.

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