

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW MEXICO

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U.S. BANKRUPTCY COURT
ALBUQUERQUE, N.M.

IN RE:)
)
FURR'S SUPERMARKETS, INC.) Case No. 11-01-10779-SA
a Delaware Corporation,)
)
Debtor.)
)

**DESERT EAGLE'S RESPONSE TO
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 THE DEBTOR'S LICENSES
UPON PAYMENT IN FULL TO LIQUOR WHOLESALERS**

TO THE HONORABLE JAMES C. STARZYNSKI, CHIEF UNITED STATES BANKRUPTCY JUDGE:

The Debtor's motion should be denied. The New Mexico Liquor Control Act creates a comprehensive scheme for regulating the traffic and distribution of intoxicating liquors within the State of New Mexico in a valid exercise of powers reserved to the State under the Twenty-First Amendment to the United States Constitution and in a valid exercise of the State's police powers, which is not pre-empted by the United States Bankruptcy Code. **Desert Eagle Distributing Company of New Mexico, L.L.C.** sets out its response more fully below:

I. The 21st Amendment: The LCA Controls.

Section Two of the Twenty-First Amendment ("21st Amendment") 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."

U.S. CONST. AMEND. XXI § 2. Historically, the 21st Amendment "subordinated Congress' rights

under the Commerce Clause to the power of a State to control, and to control effectively, the traffic in liquor within its borders." *United States v. Frankfort Distilleries, Inc.*, 324 U.S. 293, 300 (1945).

The most recent Supreme Court case addressing the inter-relation between the States' 21st Amendment powers and federal law is *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691 (1984). In *Capital Cities*, an Oklahoma statute prohibited the advertising of alcoholic beverages, except by means of strictly regulated on-premises signs. *Id.* at 695-96. The Oklahoma Attorney General determined that this ban prohibited cable television systems operating in Oklahoma from transmitting or re-transmitting out-of-state commercials for alcoholic beverages. *Id.* The Supreme Court struck down the law and held: "[W]hen a State has not attempted directly to regulate *the sale* or use of liquor within its borders — the core § 2 power — a conflicting exercise of federal authority may prevail." *Id.* at 713 (*emphasis added*). "We hold that when, as here, 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 the times, places, and manner under which liquor may be imported and sold is *not* directly implicated, the balance between state and federal power tips decisively in favor of the federal law, and enforcement of the state statute is barred by the Supremacy Clause." *Id.* at 716 (*emphasis added*).

The Supreme Court employed a two-step analysis for addressing conflicts between federal law and 21st Amendment powers: (1) the court first determined whether the state regulation "squarely" conflicted with "the full purposes of federal law", and (2) the court then determined whether the state regulation was an exercise of the State's "central power" under the 21st Amendment. *Id.* at 716. According to the Supreme Court, the States' "central power" under the 21st Amendment is to regulate "the sale of liquor" with a State and to regulate "the times, places, and

manner under which liquor may be imported and sold” within a state. *Id.* at 713, 716. This brief will first address the second step.

A. Step Two of the 21st Amendment analysis: § 60-6B-3 directly implicates and employs New Mexico’s “central power” under the 21st Amendment.

Assuming for the sake of argument that the LCA “squarely” conflicts with the “full purposes” of the Bankruptcy Code, the LCA is nevertheless an exercise of New Mexico’s “central power” under the 21st Amendment which cannot be pre-empted by Congress. Determining whether the statute in question is an exercise of New Mexico’s “central” 21st Amendment power requires a review of the statute in context. *Id.*; *cf.*, *Perez v. Campbell*, 402 U.S. 637 (1971). If a question of constitutionality is raised, it is a cardinal principal that a court will first ascertain whether a construction of the statute is fairly possible by which a question may be avoided. *Crowell v. Benson*, 285 U.S. 22, 262, 52 S. Ct. 285, 296, 76 L. Ed. 598 (1932). “Moreover, bankruptcy and state law are accommodated by a judicially-created concept of deference to state policies that do not conflict with federal law.” *In re Davis*, 194 F.3d 570 (5th Cir. 1999).

Placing the wholesaler’s lien in context requires a review of the LCA and its declared policies and purposes. The LCA creates a comprehensive scheme for the regulation of the transportation, importation, delivery, and use of intoxicating liquors in the State of New Mexico. *See* §§ 60-3A-1, *et seq.* NMSA 1978 (1998 Repl., 1999 Supp.). The LCA includes a statement of policy (§ 60-3A-2), exemptions (§ 60-3A-5), delegation and assignment of investigative and enforcement authority (§ 60-3A-6, § 60-3A-7; §§ 60-4B-1 through 4B-7), local option provisions (§ 60-5A-1, § 60-5A-2), licensing requirements for everyone involved in the manufacture, distribution, and sale of liquor (§§ 60-6A-1, *et seq.*), specification of the rights attending a license (§ 60-6A-19), regulation of and limitations upon license transfers (not only in relation to transferees but also in relation to the

geographical area in which the licensee and transferee may operate) (§ 60-6A-19, § 60-6A-20, § 60-6B-3, § 60-6B-4, § 60-6B-10, § 60-6B-11, § 60-6B-12), qualifications of licensees and transferees (§ 60-6B-1, § 60-6B-1.1, § 60-6B-2), report requirements for change of ownership and organization by licensees who are not individuals (§ 60-6B-6), provisions and procedures for expiration, renewal, cancellation, suspension, and revocation of licenses (§ 60-6B-5, § 60-6B-7, § 60-6B-9, §§ 60-6C-1, *et seq.*, § 60-6D-4), education and training of employees (§§ 60-6D-1, *et seq.*), regulation of hours and days of sales (§ 60-7A-1, § 60-7A-2), regulation of importation and exportation (§ 60-7A-3), penalties and forfeitures for unlawful sales (§ 60-7A-4.1), maintenance of transaction records and penalties for failure to comply (§ 60-7A-5), penalties and forfeitures for unlawful possession and manufacture (§ 60-7A-6, § 60-7A-7), regulation of sales to wholesalers (§ 60-7A-8), regulation of terms of sale by wholesalers (§ 60-7A-9, § 60-8A-1), regulation of ownership of retailers and dispensers by wholesalers (§ 60-7A-10; § 60-7A-11.F), regulation of supply and sale, points of sale, labeling and mixing, and concurrent business activities (§§ 60-7A-11, *et seq.*, §§ 60-7B-1, *et seq.*), regulation of employees (§§ 60-6D-1, *et seq.*, § 60-7B-11), anti-competitive provisions (§ 60-8A-1), regulation of terms of sale by a variety of licensees (§ 60-8A-1), invoice regulation and retention (§ 60-8A-3), barring suits and remedies for collection of debts for liquor sold in violation of the LCA (§ 60-8A-5), and franchise regulation (§§ 60-8A-7, *et seq.*).

The LCA provides that, “It is the policy of the Liquor Control Act that the sale, service and public consumption of alcoholic beverages in the state shall be shall be licensed, regulated and controlled so as to protect the public health, safety and morals of every community in the state” § 60-3A-2.A NMSA 1978 (1998 Repl.). “It is the intent of the [LCA] that each person to whom a license is issued shall be fully liable and accountable for the use of the license, including but not limited to liability for all violations of the [LCA]” § 60-3A-2.B NMSA 1978 (1998 Repl.). A citizen has no inherent right to sell intoxicating liquors and the liquor business is

attended with danger to the community and is subject to regulation or prohibition. *Alamogordo Imp. Co. v. Prendergast*, 109 P.2d 254, 45 N.M. 40 (1940).

The LCA regulates the terms of sale between wholesalers and retailers by: allowing only sales for cash or on very short-term credit (§ 60-7A-9); creating priority for wholesaler invoices (§ 60-6B-3); by mandating maintenance of transaction records (§ 60-7A-5); prohibiting wholesalers from owning an interest in retailers, whether direct or indirect, (§ 60-7A-10, § 60-7A-11.F), and vice-versa (§ 60-7A-11.F); prohibiting exclusive contracts and tying arrangements (§ 60-8A-1); declaring non-conforming credit sales to be in violation of the LCA (§ 60-7A-9), raising the prospect of suspension or revocation (§ 60-6C-4); and establishing penalties and forfeitures for violations of the LCA (§§ 60-6C-1, *et seq.*, §§ 60-7A-4.1, *et seq.*). Thus, the LCA establishes a comprehensive scheme for regulating sales of liquor between wholesalers and retailers. Section 60-6B-3 is but one aspect of a comprehensive system of controls. In other states, similar statutory schemes have been construed as (a) regulating “the tied house evil”, (b) protecting wholesalers from being forced to deliver liquor on credit terms in order to obtain or keep a customer, and (c) preventing wholesalers from controlling retailers through extensions of credit. ANNOT. 17 A.L.R.3d 396, 399 (1968 and Supp. 2000).

The statutory provisions are inter-related and each provision assists in the exercise and enforcement of a valid, “central” or “core” 21st Amendment power, i.e., regulating and controlling “the sale of liquor” and “the times, places, and manner under which liquor may be imported and sold” within the State of New Mexico. The Debtor focuses on a single provision of the LCA, which restricts transfers if the licensee is not current with wholesalers (§ 60-6B-3). In doing so, the Debtor ignores related LCA provisions which operate hand-in-glove with § 60-6B-3

to regulate the terms of sale between wholesalers and retailers. When considered in context, it is obvious that § 60-6B-3 provides an incentive to retailers to remain current in their transactions with wholesalers in furtherance of the LCA's restriction on credit sales, and also provides the Director with an enforcement mechanism in relation to the LCA's credit sales restrictions. Thus, the Debtor's characterization of the purpose and effect of § 60-6B-3 is inaccurate and/or myopic.

When considered within the warp and woof of the LCA, the purpose and effect of § 60-6B-3, clearly falls within the "central" regulatory power of the 21st Amendment, that is to regulate "sales of liquor" and to regulate "the times, places, and manner" of liquor sales within the State of New Mexico. Regulation of credit sales is a regulation of the terms of sale and undoubtedly qualifies as a regulation of the "manner under which liquor may be . . . sold" or a regulation of "the sale of liquor". Section 60-6B-3 and the related provisions of the LCA directly implicate, employ, and rely upon New Mexico's "central" regulatory power under 21st Amendment. Neither Congress nor the courts have the power to pre-empt or abrogate the exercise of "central" 21st Amendment powers.

B. Step One of the 21st Amendment analysis: § 60-6B-3 does not conflict with the purposes of the Bankruptcy Code.

The assumption that § 60-6B-3 "squarely" conflicts with "the full purposes of federal law" (i.e., the Bankruptcy Code) is faulty. Provisions such as § 60-6B-3, which operate without regard to the licensee's financial condition or insolvency, do not conflict with the purposes of the Bankruptcy Code. *In re Anchorage International Inn, Inc.*, 718 F.2d 1446 (9th Cir. 1983) (where the Ninth Circuit held that a similar provision of the Alaska liquor control act was not pre-empted; it did not create a disguised bankruptcy distribution scheme in conflict with the Bankruptcy Act). A debtor-in-possession takes the debtor's assets as it finds them. *In re Daniel Nejberger*, 934

F.2d 1300 (3rd Cir. 1991). “Although [Bankruptcy Code Section] 541 defines property of the estate, we must look to state law to . . . to stake out its dimensions. See *Butler v. United States*, 440 U.S. 48, 54-55, 99 S. Ct. 914, 917-18, 59 L. Ed. 2d 136 (1979); *In re Roach*, 824 F.2d 1370, 1374 (3rd Cir. 1987) (‘property interests are created and defined by state law’).” *Id.*, at 1302.

Here, the Debtor is possessed of licenses which are transferable only upon certain conditions. If the conditions are satisfied, the Debtor may transfer the licenses. The Bankruptcy Code does not necessarily or as a matter of policy disable or nullify state law transfer restrictions. For instance, state law restrictions on assignment of leases and executory contracts are honored and enforced against a trustee seeking to liquidate a lease or executory contract by assignment.¹ *Cinicola v. Scharffenberger*, 248 F.3d 110, 121 (3rd Cir. 2001). When the debtor assumes an unexpired lease, “it assumes it *cum onere*— the debtor must accept obligations of the executory contract along with the benefits. See *Adventure Resources, Inc. v. Holland*, 137 F.3d 786, 798 (4th Cir.), cert. denied, ___ U.S. ___, 119 S.Ct. 404, 142 L.Ed.2d 328 (1998).” *In re Shangri La, Inc.*, 167 F.3d 843, 849 (4th Cir. 1999). Section 60-6B-3 does not “squarely” conflict with “the full purposes of federal law”.

C. Result of 21st Amendment of analysis: § 60-6B-3 is not abrogated or pre-empted by the Bankruptcy Code.

In both prongs of the 21st amendment analysis, the LCA prevails. Therefore, § 60-6B-3 is not pre-empted by the Bankruptcy Code. Even if the Court opines that § 60-6B-3 squarely conflicts with the full purposes of federal law, § 60-6B-3 would not be pre-empted; it constitutes the exercise of the “core” or “central” 21st Amendment power.

¹ The Bankruptcy Code does disable transfer restrictions as between a pre-petition debtor and the trustee or debtor-in-possession, so that the debtor’s property may pass to the bankruptcy estate. However, the liquor wholesalers do not here contend that the DIP is not the holder of the licenses in question at this time.

In arguing to the contrary, the Debtor relies upon *In re J.F.D. Enterprises*, 183 B.R. 342 (Bankr. D. Mass. 1995), in which the court held that a provision of the Massachusetts liquor control act was pre-empted by the Bankruptcy Code. However, the Debtor's reliance on *J.F.D. Enterprises* is misplaced. The facts and the particular statutory provisions at issue in *J.F.D. Enterprises* and the related provisions of the Massachusetts act are substantially dissimilar to the LCA provisions at issue before this Court. In *J.F.D. Enterprises*, the buyer of the debtor's liquor license moved for a permanent injunction requiring the Alcoholic Beverage Control Commission ("the ABCC") to remove the buyer's name from the Delinquency List. A wholesaler could nominate a licensee for the Delinquency List by sending a notice to the ABCC certifying that the licensee was more than 60 days past-due. Nomination to the Delinquency List effectively placed the licensee on a statutorily-mandated C.O.D. basis with all wholesalers. The licensees nominated to the Delinquency List were permitted to transfer the license, but a transfer would cause the buyer's name to be substituted for the transferor-licensee's name on the Delinquency List except under certain circumstances. Transfers could be made free of name substitution (i.e., free of Delinquency List restrictions) to court-appointed receivers or to trustees under a voluntary assignment for the benefit of creditors (but not to bankruptcy trustees), with prior approval of the ABCC and notice to other creditors. In *J.F.D. Enterprises*, the buyer wanted its name removed from the Delinquency List. In examining the Delinquency List provision, the court held that the operation of the Delinquency List did not directly regulate the time, place, or manner under which liquor may be sold. *Id.* at 352. In reaching that conclusion, the court noted that the Massachusetts "tied house" justifications for the

Delinquency List provisions would combat “tied house evils” — the “tied” licensee would be removed from the Delinquency List by simply transferring the license to a third party, which the “tied” licensee was freely allowed to do. *Id.* at 350-51. While the court recognized that the substitution provisions may have been intended to prevent the principals of a corporate licensee from escaping Delinquency List consequences by forming an affiliated corporation and transferring the license to the new corporation, the court found that the statutory mechanisms for addressing that problem failed to serve any broad public policy goals. *Id.* at 350-51. The court also felt that the removal of the ABCC’s blanket authority to revoke licenses somehow belied the state’s alleged concern about “tied houses”. Considered in context, the court felt that the statute did not exhibit a serious attempt to avoid “tied houses”.

The LCA provisions differ substantially from those of the Massachusetts statute. The LCA does not contain a delinquency list mechanism. The LCA is designed to place the liquor distribution system on essentially a cash basis. The “tied house” and enforcement provisions of the LCA plainly communicate that avoiding the “tied house evil” continues to be a central objective of the LCA. *See* §§ 60-7A-10; 60-7A-11.F; 60-7A-11.F; 60-8A-1; 60-7A-9; 60-6C-4 NMSA 1978. The LCA bears little resemblance to the Massachusetts statute at issue in *J.F.D. Enterprises*.

Furthermore, in *J.F.D. Enterprises*, the court’s analysis and conclusion are flawed. It seems inconsistent and illogical to recognize, on the one hand, that regulation of the time, place, and *manner* under which liquor may be sold is an exercise of “core” 21st Amendment powers and, in the next breath, to declare that provisions which restrict the licensee to C.O.D. purchases are about “credit” and are not about “core” 21st Amendment powers. *J.F.D. Enterprises, Inc.*, 183 B.R.

at 352. The “core” 21st Amendment power, according to the Supreme Court, authorizes a State to regulate “the *sale* or use of alcoholic beverages within its borders” and to control “the *manner* under which liquor may be sold within a state”. *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. at 713, 716 (emphasis added). It seems indisputable that statutes limiting credit terms and credit transactions directly and intimately regulate “the sale of liquor” and “the manner” of sale. One could hardly imagine a more intimate and direct regulation of “the manner” of sale.² The *J.F.D.* court’s declaration that the Delinquency List provisions are “about credit, not import, transport, and use” [*J.F.D. Enterprises, Inc.*, 183 B.R. at 352] either blindly or patently ignores the authority of the States, under the 21st Amendment, to regulate “the sale of liquor” and “the manner of sale”. For the foregoing reasons, *J.F.D. Enterprises* is not persuasive and should not be followed.

Furthermore in *J.F.D. Enterprises*, the Court recognized the validity of the holding of *In re G. Heileman Brewing Co.*, 128 B.R. 876 (Bankr. S.D.N.Y. 1991), where court held a state statute that prevented manufacturers from terminating alcohol distribution agreements prevailed over the Bankruptcy Code due to the provisions of the Twenty-First Amendment. *Id.* at 884. If Heileman Brewing is correct, then § 60-6B-3 is protected by the 21st Amendment.

II. The Eleventh Amendment: The Court Has No Jurisdiction to Grant the Relief Sought.

In relation to the Eleventh Amendment (11th Amendment), the Debtor maintains that (a) the wholesalers lack standing, (b) the current proceeding does not qualify as a “Suit”, (c) the State

² One may imagine that a prudent parent would limit (i.e., regulate) the manner in which a child may make purchases by restricting or removing credit card privileges. Parenting experts may even have advised parents to do so. There may, in fact, be individuals in addition to the undersigned who have enacted such regulations in their homes.

of New Mexico has waived its sovereign immunity for purposes of this proceeding, and (d) 11th Amendment immunity does not apply under the *Ex parte Young* doctrine.

The 11th Amendment provides:

“The Judicial power of the United States shall not be construed to extend any suit in law or equity, commenced or prosecuted against one of the United States by citizens of another state, or by citizens or subjects of any foreign state.”

A. The Wholesalers have standing.

The 11th Amendment confirms that each state is a sovereign entity and that “it is inherent in the nature of sovereignty not to be amenable to the suit of an individual without his consent.” *Seminole Tribe v. Florida*, 517 U.S. 44, 116 S.Ct. 1114, 134 L.Ed.2d 252 (1996). As a general rule, a litigant may only assert his own constitutional rights or immunities. *McGowan v. Maryland*, 366 US 420, 428 (1961). However, if a party does not bring an action against a state itself, 11th Amendment immunity applies where the state is “the real party-in-interest.” *Ciba-Geigy Corp. v. Alza Corp.* 804 F.Supp. 614, 618-619 (D.N.J. 1992)(citing *Edelman v. Jordan*, 415 U.S. 651, 663 (1974)). The state is the real party-in-interest when “the judgment sought would expend itself on the public treasury or domain, or interfere with the public administration”, or if the effect of the judgment would be “to restrain the government from acting or to compel it to act.” *Pennhurst State School and Hospital v. Halderman*, 465 U.S. 89, 101 n.11, 104 S.Ct. 900, 79 L.Ed.2d 67 (1984).

Here, the Debtor seeks an order which would restrain the Director of the New Mexico Alcohol and Gaming Division (“the Director”) from acting or which would compel the Director to act. Therefore, New Mexico is the real party-in-interest. The Debtor did not properly join

the Director as party to this contested matter. Therefore, the liquor wholesalers may assert 11th Amendment immunity on behalf of the Director.³

B. This is a “Suit” for purposes of the 11th Amendment.

The 11th Amendment, by its terms bars a “Suit” against the state. In an effort to structure a means to eliminate or limit the States’ 11th Amendment immunity in bankruptcy proceedings, a few courts have suggested that a bankruptcy proceeding is not a “Suit” within the meaning of the 11th Amendment. Only one case has actually held that a bankruptcy proceeding is not a “Suit”. *State of Maryland v. Antonelli Creditors Liquidated Trust*, 123 F.3d 777 (4th Cir. 1997). The no-suit theory, however, is suspect in light of two cases indicating that pursuit of any claim or demand constitutes a “Suit”. *Cohens v. State of Virginia*, 19 U.S. 264 (1821); *State of Missouri v. Fiske*, 290 U.S. 18 (1933). Furthermore, there does not appear to be a case holding that a contested matter is not a Suit. Contested matters appear by definition to qualify as Suits. Federal Rule of Bankruptcy Procedure 9014 governs contested matters. The rule is intended to “govern litigation in contested matters”. FED. R. BANKR. P. 9013, Committee Note. “Whenever there is an actual dispute, other than an adversary proceeding, before the bankruptcy court, the litigation to resolve that dispute is a contested matter.” *Id.* Absent the Lenders and the wholesalers agreement to address the Debtor’s motion as a contested matter in order to expedite its consideration, the Debtor would have had to raise the issue through an adversary proceeding, under FED. R. BANKR. P. 7001 (7) or (9). Therefore, this contested matter would qualify as a “Suit” against the state for purposes of the 11th Amendment.

³ Since the filing of the Debtor’s motion, the Attorney General of the State of New Mexico, on behalf of the Director, has entered a special appearance in this matter asserting its 11th Amendment and 21st Amendment immunities. Therefore, the standing issue may be moot.

C. The State has not Waived Immunity.

The Debtor suggests that the State of New Mexico waived sovereign immunity under the provisions of 11 U.S.C. § 106(b) when the New Mexico Taxation and Revenue Department (“TRD”) filed a Proof of Claim and actually participated in the sale motion. [The Debtor’s Motion, p. 18.] In light of *Seminole Tribe of Florida v. Florida*, Congress may not employ its Article I authority, specifically the bankruptcy clause, to circumvent the 11th Amendment’s restriction of federal jurisdiction. *In re Creative Goldsmiths*, 119 F.3d 1140, 1146 (4th Cir. 1997). *In re Creative Goldsmiths* held that “Congress’ effort to abrogate the state’s 11th Amendment immunity through its 1994 enactment of 11 U.S.C. § 106(a) is unconstitutional and ineffective.” *Id.* at 1147. “Because 11 U.S.C. § 106(a) purports to abrogate state immunity also for Section 106(b), our analysis likewise applies to Section 106(b).” *Id.* The Court went on to hold, under *Seminole*, that § 106(b) is also unconstitutional (independent of § 106(a)) because it purports to deem a waiver sovereign immunity for the State, which has the effect of abrogation. *Id.*; *cf. United States v. Nordic Village Inc.*, 503 US 30, 34 (1992). The court’s theory was that, in § 106(b), Congress attempts unequivocally to dictate the circumstances under which states would have no immunity from private suits in a federal court. *Id.* While Congress is authorized to describe actions which, as a matter of constitutional law, constitute a waiver of 11th Amendment immunity, Congress has no power to abrogate the states’ immunity by creating “deemed” waivers. *Id.* Other courts have reached the same conclusion. *See Sacred Heart Hospital of Norsetown v. Commonwealth of Pennsylvania*, 133 F.3d 237, 243 (3rd Cir. 1998); *Department of Transportation and Development v. PNL Asset Management Company*, 123 F.3d 241, 244-245 (5th Cir. 1997); *Mitchell v. Franchise Tax Board, State of California*, 209 F.3d 1111, 1119 (9th Cir. 2000); *United States Department of Treasury v. Gosselin*, 252 B.R. 854 (Bankr. D. Mass. 2000).

The Tenth Circuit held the filing of proofs of claim by two state agencies, the Wyoming Department of Employment and the Wyoming Workers' Safety and Compensation Division, resulted in a waiver by the State of Wyoming, under § 106(b), as to the claims asserted by the debtor against another state agency, the Wyoming Department of Transportation, arising out of the same transaction or occurrence out of which the other agencies proofs of claim arose. *In re Straight*, 143 F.3d 1387 (10th Cir. 1998), *cert denied*, 119 U.S. 446 (1998). The Tenth Circuit also disagreed with the *Creative Goldsmiths* decision that § 106(b) is unconstitutional after *Seminole Tribe*, finding that the Fourth Circuit's discussion of § 106(b) was dictum. *Id.* at 1392.

Under the *Straight* holding, the relevant inquiry would be whether the Debtor's request for relief against the Director arises out of the same transaction or occurrence out of which the proof of claim filed by the New Mexico Department of Taxation and Revenue arose. The transaction or occurrence giving rise to the TRD's proof of claim was non-payment of taxes. The transaction or occurrence giving rise to the Debtor's claim against the Director is an anticipated refusal to transfer a license until the wholesalers are satisfied. The tax obligations owed to the TRD bear no relationship to the Debtor's claims against the Director or to the wholesalers claims against the Debtor. To find otherwise would render virtually boundless the waiver effected by § 106(b) and virtually meaningless the condition imposed by § 106(b) that the two claims arise out of the same transaction or occurrence, and would therefore lend give credence to the *Creative Goldsmith* view that § 106(b) is tantamount to a Congressionally-declared abrogation of 11th Amendment immunity.

It is true that, in *Straight*, the Tenth Circuit found that Wyoming's claims for unpaid unemployment taxes and for unpaid worker's compensation premiums arose out of the same transaction or occurrence as the debtor's claim against the Wyoming Department of Transportation to reinstate the debtor's status as a disadvantaged business enterprise after decertification of the

debtor by the Wyoming DOT. It is also true, as the Debtor asserts, that the Tenth Circuit said that the claims all “arose out of the same transaction or occurrence — the Debtor’s business”. *Id.* at 1392. However, the Wyoming DOT asserted and the court found that the decertification arose out the debtor’s “unpaid payroll liability”. *Id.* at 1391. Thus, the Wyoming DOT itself established the necessary commonality by asserting that decertification would not have occurred but for the debtor’s failure to meet its payroll obligations. The “unpaid unemployment taxes” and the “unpaid worker’s compensation premiums” for which the other two agencies filed proofs of claim would necessarily fall within the definition of the “unpaid payroll liability” which triggered the debtor’s decertification. The Tenth Circuit’s language and its holding must be viewed in the context of the admissions made by the Wyoming DOT.

The context presented by the Debtor’s motion is substantially different. The Director’s actions under § 60-6B-3 are independent of the Debtor’s tax liability, and § 60-6B-3 makes no mention of the Debtor’s tax liability. Nor has the Debtor complained in the present motion of any action by the Director in relation to the Debtor’s tax liability. Even if § 106(b) is constitutionally-sound, the claim filed by the TRD does not waive the sovereign immunity of the New Mexico Alcohol and Gaming Division.

D. *Ex parte Young* requirements have not been satisfied.

A limited exception to the state sovereign immunity under the 11th Amendment was framed by the Supreme Court in *Ex parte Young*, 208 US 123 (1908). This exception rests on the premise that a suit against the state official to enjoin an ongoing violation of federal laws not a suit against the state. *Ex parte Young*, 209 US 123 167 (1908). In order to claim the *Ex parte Young* exception a state official must be joined to the lawsuit. *In re Elias*, 218 B.R. 80

(9th Cir. BAP 1988). A bankruptcy court does not have jurisdiction over a state official representing an agency if that state official or agency is not a named party. *Id.*

Therefore, the Debtor's reliance on *Ex parte Young* fails on two counts. First, the Debtor must assert and establish an ongoing violation of federal law by a state official. The Debtor has not asserted and cannot assert such a violation, inasmuch as the Director has taken no action to date in relation to the Debtor's liquor licenses. Second, the Debtor has not effectively joined the Director as a party to this contested matter.

E. Conclusion

The Debtor has not "hurdled" the 11th Amendment bar. This Court has no jurisdiction to grant the relief requested by the Debtor.

III. Section 525: No Discriminatory Conduct.

The Debtor maintains that 11 U.S.C. § 525(a) prevents the Director from implementing the provisions of § 60-6B-3. However, § 525(a) requires a conclusion that discriminatory conduct has occurred. Section 525(a) itself makes no mention of action which would block a debtor's sale of a license. 11 U.S.C. 525(a). To the contrary, it is directed to actions which would cancel or impair status as a licensee, thus affecting a debtor's continued operation of a licensed business, and to actions which would cause a debtor's license application to be denied "solely because such bankrupt or debtor is or has been a debtor under this title . . . , has been insolvent [pre-petition or post-petition and pre-discharge] or has not paid a debt that is dischargeable in the case" 11 U.S.C. § 525(a).

The Debtor relies on *In re William Tell II, Inc.*, 138 B.R. 327, 330 (N.D. Ill. 1983). The Debtor's reliance is misplaced. *William Tell II* involved an revocation of a debtor's license. Section 525(a) speaks directly to revocations, presumably to allow the debtor to continue its

operations in a chapter 11, chapter 12, or chapter 13 case or the trustee in a chapter 7. Section 525(a) does not offer a debtor or trustee complete freedom to sell a license to another so that another may operate under the license.

The Debtor also relies on *Campbell v. Perez, supra*. Here again, the Debtor's reliance is misplaced. *Campbell v. Perez* involved a state law which, by its express terms, would result in license revocation for failure to pay debts discharged in bankruptcy. Thus, the statute there at issue fell within the plain terms of § 525(a). The statute at issue relates to license transfers, not license revocation.

Moreover, after the Supreme Court's holding in *Seminole Tribe v. Florida, supra*, the it is doubtful that § 525(a) can be relied upon by the Debtor in any event, since it is clear under *Seminole Tribe* that a State may not be sued in any court under any law enacted pursuant to Congress's Article I powers and it is clear that § 525(a) was enacted under the Article I bankruptcy power. *In re Creative Goldsmiths*, 119 F.3d at 1146-47; "Section 525(a) of the Bankruptcy Code and Sovereign Immunity: The Supreme Court's Creation of a Super Creditor", 17 Bankr. Devel. J. 605 (2001).

IV. Pre-Emption: The Bankruptcy Code Does Not Pre-Empt the New Mexico Liquor Control Act.

The Bankruptcy Code does not pre-empt valid regulation of traffic and distribution of intoxicating liquors within a state. *In re Anchorage International Inn, Inc.*, 718 F.2d 1446 (9th Cir. 1983) (addressing the conflict between the Alaska liquor control act and the pre-1981 Bankruptcy Act).

The logic and lesson of *In re Anchorage International Inn* are apt here. The Ninth Circuit addressed the apparent conflict between an Alaska statute similar to the LCA which, in

effect, prohibited liquor license transfers where the transferor “has not paid all debts or taxes arising from the conduct of the business licensed under [the Alaska liquor control act] unless (A) he [i.e., the transferor] gives security for the payment of the debts or taxes satisfactory to the creditors or taxing authority.” *In re Anchorage International Inn, Inc.*, 718 F.2d at 1448 (quoting from Alaska Stat. § 04.11.360(4)(A) (1982)). The Alaska statute actually created a broader class of creditors protected by its provisions than does the LCA at § 60-6B-3; the Alaska statute would benefit all creditors of a liquor retailer, not just wholesalers. The creditor relying on the Alaska statute was a trade pension fund, the Alaska Hotel and Restaurant Employees Health & Welfare Trust and Pension Trust, attempting to collect unpaid employee benefit contributions. The trustee contended that the Bankruptcy Act pre-empted application of the Alaska statute. The bankruptcy court and the district court both agreed with the trustee. The Ninth Circuit, however, did not.

Recognizing that the “primary” objective of the Bankruptcy Act was to provide for an equitable distribution of assets among all creditors, and recognizing that Congress intended to pre-empt the field of bankruptcy law in enacting the Bankruptcy Act, the Ninth Circuit nevertheless held that the Alaska statute was not pre-empted because it did not create a disguised bankruptcy distribution scheme. Instead, it created a state law priority in favor of a particular class of creditors which was operative without regard to the licensee’s financial condition. The Ninth Circuit likened the statutory priority system created by the Alaska liquor control act to the statutory priorities created by mechanic’s and materialman’s lien laws. In particular, the Alaska statute did not conflict with the federal law distribution scheme because there is no general federal policy against state-created liens favoring one class of creditors over another. *Id.* at 1451. Furthermore, the Alaska statute did not frustrate the Bankruptcy Act’s purpose of providing an equitable distribution of non-exempt assets to all creditors of the same class, because the creditors benefitting from the Alaska statute

were simply not in the same class as other creditors. *Id.* at 1451-52. (The Bankruptcy Act did not, and the Bankruptcy Code does not, attempt to place all creditors in a single class.) Finally, the Ninth Circuit concluded that, while federal law would override state-created priorities operative only in the event of bankruptcy or insolvency, the priority granted by the Alaska statute was operative independent of the licensee's financial condition. *Id.* at 1452.

No case relied on by the Debtor is more to the point. Like the Alaska statute, the LCA is operative regardless of the licensee's financial condition. The LCA does not create a bankruptcy distribution scheme, nor does it conflict with the distribution scheme found in the Bankruptcy Code. It merely creates a state law priority and lien which may and should be given full effect in the bankruptcy context. Certainly, applying LCA § 60-3B-3 would result in payment to the liquor wholesalers at the time of the closing of the sale to Fleming. At the same time, it appears undisputed by the Debtor that LCA § 60-3B-3 validly grants to the liquor wholesalers super-priority liens which are recognized and effective in bankruptcy. As a result, the liquor wholesalers would receive the first proceeds of the sale in any event. Thus, there is no harm to the Debtor or the estate or the other creditors in paying the wholesalers at closing, as required by the LCA.⁴

A. The Debtor cannot transfer more license rights than it holds.

The Debtor's argument fails for another reason. The Debtor attempts to pass

on to Fleming more than the Debtor possesses. At the time that the Debtor filed for bankruptcy the Debtor's liquor licenses were burdened with obligations to the wholesalers by virtue of the Debtor's

⁴The Debtor may argue that payment to the wholesalers in excess of the value of the licenses would harm the estate and the other creditors. However, that particular circumstance is not presented and need not be addressed here; the Debtor and the Lenders should not prevail on the basis of facts and circumstances not presented in this case. Here, the value of the licenses exceeds the amounts due to the wholesalers. The motion should be decided based upon the facts presented, not upon some possibility not here extant.

the provisions of the LCA. The Debtor-in-Possession takes the Debtor's assets as it finds them. *In re Daniel Nejberger*, 934 F.2d 1300 (3rd Cir. 1991). In *Nejberger*, the debtor's liquor license expired pre-petition. The debtor was attempting to renew the license at the time he filed for bankruptcy relief. The Third Circuit held that, "the debtor did not hold a license." *Id.*, at 1303. "What he did hold was the opportunity to have his renewal application reconsidered during a ten-month 'grace period' following the expiration of the license." *Id.*, at 1303. "Although [S]ection 541 defines property of the estate, we must look to state law to determine if a property right exists and to stake out its dimensions. *See Butler v. United States*, 440 U.S. 48, 54-55, 99 S. Ct. 914, 917-18, 59 L. Ed. 2d 136 (1979); *In re Roach*, 824 F.2d 1370, 1374 (3rd Cir. 1987) ('property interests are created and defined by state law')." *Id.*, at 1302.

Here, the property interest in question is subject to priorities and restrictions which operate without regard to the Debtor's financial condition. The priorities and restrictions are an integral part of a comprehensive state law which creates the property right (i.e., the license) and defines its dimensions. The DIP gets only what the Debtor had⁵, a license subject to pre-petition priority liens transferable only upon satisfaction of the requisite conditions.

B. The Tax cases relied on by the Debtor are inapposite.

The Debtor relies upon cases holding that tax collection mechanisms preventing a liquor license transfer are ineffective in bankruptcy. In those cases, the courts (with the notable exception of the Ninth Circuit) held that liquor license regulations which are used to collect unpaid taxes are pre-empted in bankruptcy for various reasons, including generally that unpaid taxes are specifically addressed in the Bankruptcy Code and that tax collection is not a valid exercise of

⁵*In re Farmers Markets, Inc.*, 792 F.2d 1400 (9th Cir. 1986).

police powers because it constitutes an attempt by the State to do indirectly what it cannot do directly. *See, e.g., In re Aegean Fare, Inc.*, 35 B.R. 923, 928 (Bankr. D. Mass. 1983); *see also In re Hoffman*, 65 B.R. 985 (Bankr. D.R.I. 1986). The distinction is obvious. We are not dealing here with a State's attempt to collect taxes. Nor, as discussed above, is § 60-6B-3, considered in context, properly classified as a collection mechanism. In reality, it is an integral part of a comprehensive scheme designed to regulate the sale and the manner of sale of alcoholic beverages within the borders of New Mexico; i.e., a valid exercise of police powers.

C. *Perez v. Campbell* is inapposite.

Perez v. Campbell, 402 U.S. 637 (1971), where an Arizona statute specifically provided that a bankruptcy discharge would not prevent suspension of a debtor's driver's license based on the debtor's failure to satisfy unpaid judgments arising from the operation or use of a vehicle. Since the statute attempted to negate or render ineffective a bankruptcy discharge, the Supreme Court held that it conflicted with and was pre-empted by the Bankruptcy Act. However, the LCA does not attempt to negate a bankruptcy discharge. Instead, it creates a priority in favor of a particular class of creditors. Furthermore, the case is inapposite because it does not address conditions for transfer of a property right. Instead, it addresses a direct attempt to negate the effect of a bankruptcy discharge for driver's license holders.

D. *The Campbell v. Perez* analysis.

The Supreme Court laid out a two-step process for determining whether a state statute is in conflict with (and, therefore, pre-empted by) a federal statute. First, ascertain the construction of the two statutes. Second, determine whether the statutes conflict. *Perez v. Campbell*, 402 U.S. at 644. In ascertaining the construction of the Arizona statute, the court looked first to Arizona's construction of its own statute. If a question of constitutionality is raised, it is a cardinal

principal that a court will first ascertain whether a construction of the statute is fairly possible by which a question may be avoided. *Crowell v. Benson*, 285 U.S. 22, 262, 52 S. Ct. 285, 296, 76 L. Ed. 598 (1932). “Moreover, bankruptcy and state law are accommodated by a judicially-created concept of deference to state policies that do not conflict with federal law.” *In re Davis*, 194 F.3d 570 (5th Cir. 1999). The construction of a state statute is resolved by examining state law. See *Perez v. Campbell*, 285 U.S. at 644-45.

The LCA provides that, “It is the policy of the Liquor Control Act that the sale, service and public consumption of alcoholic beverages in the state shall be licensed, regulated and controlled so as to protect the public health, safety and morals of every community in the state” § 60-3A-2.A NMSA 1978 (1998 Repl.). “It is the intent of the [LCA] that each person to whom a license is issued shall be fully liable and accountable for the use of the license, including but not limited to liability for all violation of the [LCA]” § 60-3A-2.B NMSA 1978 (1998 Repl.). A citizen has no inherent right to sell intoxicating liquors, and the liquor business is attended with danger to the community and is subject to regulation or prohibition. *Alamogordo Imp. Co. v. Prendergast*, 109 P.2d 254, 45 NM 40 (1940).

The LCA itself may be examined to determine its purpose and effect. See *Perez v. Campbell*, 402 U.S. at 44-48. As discussed in detail above, the LCA establishes a comprehensive scheme for regulating sales of liquor between wholesalers and retailers. Section 60-6B-3 is but one aspect of a comprehensive system of controls.

None of the purposes stated conflicts with the objectives of the Bankruptcy Code. Nor do the effects of the LCA conflict with the objectives of the Bankruptcy Code. *In re Anchorage International Inn, Inc.*, *supra*. None represents an invalid exercise of police powers. [See discussion, *infra*.] The obvious purpose of the Act is to prevent wholesalers from controlling

retailers and vice-versa. The priority provisions of § 60-6B-3, in effect, advance that objective by creating an incentive for retailers to remain current and an enforcement mechanism for the Director to assist retailers in accomplishing that objective. When considered in relation to the entire LCA, § 60-6B-3 is an integral part of a series of statutes regulating the terms of sale of liquor within the State of New Mexico and ensuring that transactions between wholesalers and retailers be conducted substantially on a cash basis, a perfectly valid exercise of both police and 21st Amendment powers. In this respect, the LCA bears little or no resemblance to the Florida statute at issue in *In re J.F.D. Enterprises, Inc.*, 183 B.R. 342 (Bankr. D. Mass. 1995), as discussed above.

Here, the LCA constitutes a legitimate exercise New Mexico's police power. There are two tests for determining whether agency actions constitute legitimate exercises of police powers: (1) the "pecuniary purpose" test and (2) the "public policy" test. *Cf., In re Universal Church, Inc.*, 128 F.3d 1294, 1297 (9th Cir. 1997). The former determines whether the government action in question relates primarily to the protection of *the government's* pecuniary interest, in which case it will not be treated as a valid exercise of police power. *Id.* at 1297. The latter distinguishes between government actions that effectuate public policy (i.e., a valid exercise) and those that "adjudicate" private rights (i.e., not a valid exercise). *Id.* at 1297. Here, as described above, § 60-6B-3 effectuates a valid public policy. It does not protect the government's pecuniary interest, nor does it "adjudicate" private rights. Furthermore, actions to advance the government's pecuniary interest may nevertheless constitute a valid exercise of police powers *as long as* advancement of the government's pecuniary interest is not the *sole* purpose of the action. *Id.* at 1299. Here, it cannot be said that advancement of a pecuniary interest is the "sole" purpose of § 60-6B-3.

V. **The Automatic Stay: Valid Exercise of Police Powers under § 362(b)(4).**

The exception to the automatic stay provided by 11 U.S.C. § 362(b)(4) excepts from the provisions of the stay government actions taken against a debtor to enforce a governmental unit's police or regulatory power. It provides an exception applicable to actions exercising control over the debtor's property. 11 U.S.C. § 362(a)(3), (b)(4). The Debtor argues that the exception does not apply because it is not a valid exercise of police powers. The Debtor relies on cases which holding that tax collection mechanisms are not valid exercises of police powers within the meaning of § 362(b)(4). The Debtor fails to address the issue presented. The test for determining whether an agency action qualifies as a valid exercise of police powers under § 362(b)(4) is described in *In re Universal Church, Inc.*, 128 F.3d at 1297, 1299. As discussed above, § 60-6B-3 constitutes a valid exercise of police powers under both the "pecuniary purpose" test and the "public policy" test. Application of § 60-6B-3 by the Director constitutes a valid exercise of police powers falling within the § 362(b)(4) exception to the automatic stay.

VI. **Conclusion.**

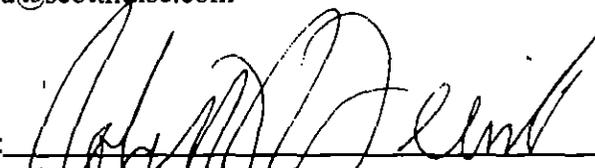
The Debtor's motion should be denied. First, action by the Director to implement § 60-6B-3 is a valid exercise of "central" 21st Amendment powers reserved to the States and not pre-empted by the Bankruptcy Code. Second, the 11th Amendment immunity applies, and this court has no jurisdiction to grant the relief requested. Third, 11 U.S.C. § 525(a) does not apply. Fourth, § 60-6B-3 is not pre-empted by the Bankruptcy Code. Fifth, any action by the Director to restrict transfer of the liquor licenses based on § 60-6B-3 would not be in violation of the automatic stay.

Respectfully submitted,

**SCOTT, HULSE, MARSHALL, FEUILLE,
FINGER & THURMOND, P.C.**

1100 Chase Tower
201 East Main Drive
El Paso, Texas 79901
(915) 533-2493
(915) 546-8333 Telecopier
bfeu@scotthulse.com

By: _____



ROBERT R. FEUILLE

Texas State Bar No. 06949100

BERNARD D. FELSEN

Texas State Bar No. 06889800

Attorneys for Desert Eagle Distributing Company
of New Mexico, L.L.C., a liquor wholesaler

CERTIFICATE OF SERVICE

I hereby certify that the foregoing Response was or will be served on the Debtor's counsel and on the persons identified in the attached mailing list by e-mail (Word format and Word Perfect format) or by facsimile and by first-class mail on the 9th day of August, 2001.



ROBERT R. FEUILLE

David G. Aelvoet
Linebarger Heard Goggan Blair
Graham Pena & Samson, L.L.P.

Regulation and Licensing Department
State of New Mexico
725 St. Michaels Drive

711 Navarro, Suite 300
San Antonio, TX 78205
210.226.4308 fax

Santa Fe, NM 87505
505.827.7064 fax

Jeffrey Fine
Strasburger & Price, L.L.P.
901 Main Street
Dallas, TX 75202
214.659.4074 fax

Hugh Dangler
Regulation Licensing Department
New Mexico Alcohol & Gaming
Division
725 St. Michaels Drive
Santa Fe, NM 87505
505.827.3999 fax

Kim Middlebrooks
Marchiondo, Vigil & Associates, P.C.
315 Fifth Street
Albuquerque, NM 87102
505.247.0758 fax

Daniel R. Rubin
Office of the Attorney General
P.O. Box 1508
Santa Fe, NM 87504-1508
505.827.5826

Bryan Brock
Director, New Mexico Alcohol and
Gaming Div.
Regulation and Licensing Department
725 St. Michaels Drive
Santa Fe, NM 87505
505.827.7168 fax

New Mexico Alcohol and Gaming
Division Regulation and Licensing
Department State of New Mexico
c/o Patricia A. Madrid
New Mexico Attorney General
P.O. Drawer 1508
Santa Fe, NM 87505
505.827.5826 fax

Mr. Ronald E. Andazola
Assistant United States Trustee
P.O. Box 608
Albuquerque, NM 87103
248.6558 fax

J.D. Behles & Associates, P.C.
Jennie Deden Behles
P.O. Box 849
Albuquerque, NM 87103
505.7262 fax

I. William Cohen
Pepper Hamilton, L.L.P.
100 Renaissance Center, 36th Floor
Detroit, Michigan 48243-1157
313.259.7926 fax

Michael J. Cadigan
Hisey & Cadigan
6400 Uptown Blvd, NE, Suite 570-W
Albuquerque, NM 87110
505.830.2385 fax

William F. Davis
Davis & Pierce, P.C.
P.O. Box 6
Albuquerque, NM 87103-0003
505.247.3185 fax

Gail Gottlieb
Sutin, Thayer & Browne P.C.
P.O. Box 1945
Albuquerque, NM 87103
505.883.6565 fax

David S. Heller
Latham & Watkins
233 South Wacker Drive
Scars Tower, Suite 5800
Chicago, IL 60606-6401
312.993.9767 fax

Donald Harris
New Mexico Taxation & Revenue
Department
P.O. Box 8485
Albuquerque, NM 87198-8485
505.827.9801 fax

Paul M. Fish
Modrall Sperling Roehl Harris & Sisk,
P.A.
500 Fourth Street, NW, #1000
Albuquerque, NM 87103-2168
505.848.1882 fax

Carlos Miranda
Krafsur Gordon Mott, P.C.
P.O. Box 1322
El Paso, TX 79947-1322
915.545.4433 fax

Ronald J. Silverman
Bingham Dana LLP
399 Park Avenue
New York, NY 10022-4689
212.752.5378 fax

Duncan Scott
Scott & Kienzle
P.O. Box 587
Albuquerque, NM 87103-0587
505.246.8682 fax