

## INTRODUCTION

One of our most fundamental constitutional principles is that we are one national economic union. The United States Supreme Court has long held that the Commerce Clause prohibits state laws that “overtly block the flow of interstate commerce at a State’s borders,” *City of Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978), and that the mere fact of nonresidence may not prevent sellers in one state from accessing markets in other states, see *H.P. Hood & Sons, Inc. v. Du Mond*, 336 U.S. 525, 539 (1949). In the recent landmark decision *Granholm v. Heald*, the Supreme Court extended this venerable constitutional principle to the interstate market in wine. 125 S. Ct. 1885 (2005).

In *Heald*, the Court concluded that the nondiscrimination principle of the Commerce Clause applies in full force to the sale of alcohol, notwithstanding section 2 of the Twenty-first Amendment. 125 S.Ct. at 1892. The Court declared that “[s]tate laws violate the Commerce Clause if they mandate differential treatment that benefits the former and burdens the latter. This rule is essential to the foundations of the Union. The mere fact of nonresidence should not foreclose a producer in one State from access to markets in other states. States may not enact laws that burden out-of-state producers or *shippers* simply to give a competitive advantage to in-state businesses.” *Id.* at 1892. These principles that bar states from discriminating against out-of-state wineries also bar states from discriminating against out-of-state wine retailers. In short, the constitutional principle that we are one national economic union requires states to grant out-of-state wineries and wine retailers access to their markets on equal terms with in-state wineries and in-state wine retailers. See *Heald*, 125 S.Ct. at 1895 (citing *Du Mond*, 336 U.S. at 539).

We write on behalf of the Specialty Wine Retailers Association in support of legislation that would remove unconstitutional regulatory barriers that deny wine retailers the right to ship their wines in interstate commerce. In considering such legislation, states should recognize that allowing wineries and wine retailers to ship wine in interstate commerce is not only required by the constitutional principle of a single national economic union but also will generate substantial economic benefits to consumers and retailers. See Federal Trade Commission, *Possible Anticompetitive Barriers to E-Commerce: Wine* 3, available at <http://www.ftc.gov/os/2003/07/winereport2.pdf> (“FTC Report”).

Borderless retail-to-consumer shipping will benefit consumers. They will pay lower prices, choose from a greater variety of wine, and enjoy the convenience of home delivery. Because the number of wine retailers in a national online wine market will greatly exceed the number of wine retailers consumers may have in their local market, consumers will likely find lower wine prices online than in local stores. Broader access to wine retailers promotes consumer choice by expanding the variety of wine from which a consumer may choose and giving consumers access to the nation’s small wineries whose production volumes are too low for many distributors to carry their products. Home delivery is a timesaving convenience that may encourage purchases at the margin and will encourage travel and tourism by enabling consumers to purchase wine when visiting an out-of-state wine retailer for shipment back home. See FTC, *supra*, at 14-26; see also Alan E. Wiseman & Jerry Ellig, *How many Bottles Make a Case Against Prohibition? Online Wine and Virginia’s Direct Shipment Ban* 25-35 (2003). Each

of these benefits is consistent with our constitutional scheme of promoting free trade across state borders.

Borderless retailer-to-consumer wine shipping will benefit retailers by creating a national wine market and eliminating free market anomalies caused by the patchwork of state laws that restrict interstate commerce in wine. Existing state laws severely limit retailers' ability to develop a national customer base; wine retailers often must refuse sales because shipping wine to willing consumers across some state lines is illegal. The economic effect of these foregone sales are monopoly profits for in-state wine retailers and a deadweight social loss. In contrast, an open market will allow retailers, regardless of their state residence, to obtain competitive returns. A national wine retail market would thus correct the current paradox that the margin of profit a retailer enjoys on wine sales varies accidentally with the state of residence, rather than competitively in a system of free competition. Reforming these anti-competitive and discriminatory state laws will thus lift "the single largest regulatory barrier to expanded e-commerce in wine." See *FTC, supra*, at 14-26; *Wiseman & Ellig, supra*, at 25-35.

State laws discriminating against out-of-state retailers raise the same policy and constitutional concerns as state laws discriminating against out-of-state wineries. Thus, *Heald* applies equally to wineries and wine retailers.

### LEGAL ANALYSIS

That we are one national economic union is a fundamental principle underlying our constitutional system. Thus, time and time again, the United States Supreme Court has held that, "in all but the narrowest circumstances, state laws violate the Commerce Clause if they mandate differential treatment of in-state and out-of-state economic interests that benefit the former and burden the latter." *Oregon Waste Sys., Inc. v. Dep't of Envtl. Quality of Oregon*, 511 U.S. 93, 99 (1994). This mandate "reflect[s] a central concern of the Framers that was an immediate reason for calling the Constitutional Convention: the conviction that in order to succeed, the new Union would have to avoid tendencies toward economic balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation." *Hughes v. Oklahoma*, 441 U.S. 322, 325-326 (1979). In the recent decision *Granholm v. Heald*, the Supreme Court reaffirmed this basic principle and established that the Commerce Clause prohibits state laws that allow differential treatment of wineries. 125 S.Ct. 1885 (2005). The same principle bars differential treatment of wine retailers. See *id.*

**The nondiscrimination principle of the Commerce Clause prohibits discriminatory state laws that favor in-state wineries and wine retailers.**

In *Heald*, the Court declared unequivocally that state laws that allow differential treatment of in-state and out-of-state wineries violate the Commerce Clause. 125 S.Ct. at 1907. This holding affirmed a fundamental principle of Commerce Clause jurisprudence: because state laws may not distinguish among economic actors on the basis of geographic origin, laws that discriminate against out-of-state economic actors face "a virtually per se rule of invalidity." See *Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978). Consistent with this principle, *Heald*

prohibits differential treatment not only of in-state and out-of-state wineries but also differential treatment of in-state and out-of-state wine retailers. *See Heald*, 125 S.Ct. at 1907.

In *Heald*, the Court reiterated that the Commerce Clause was designed to avoid trade rivalries and animosities among the states and observed that the patchwork of laws governing winery-to-consumer shipping created just such a situation. Specifically, the Court found that the direct wine shipping market prior to *Heald* was “essentially the product of an ongoing, low-level trade war” among the states; “some states bann[ed] direct shipments altogether, others d[id] so only for out-of state wines, and still others requir[ed] reciprocity.” *See* 125 S.Ct. at 1895-96. The current situation in state retail shipping laws is similar to the situation in winery direct shipping laws in *Heald*; some states ban direct retail shipments altogether, other states ban only direct shipments by out-of-state retailers, and still other states require reciprocity before allowing direct shipments by out-of-state retailers. Because the current patchwork of state retail shipping laws reflects the very same low-level trade war that the Court condemned, *Heald* applies to the retail shipping market. *See id.*

The basic principle that the Commerce Clause protects all actors in the economic chain requires that *Heald* apply equally to wineries and wine retailers. Discriminatory laws are invalid under the Commerce Clause whether the discrimination is directed against producers or retailers. Indeed, one of the key precedents underlying the *Heald* decision struck down state law discriminating against out-of-state liquor *wholesalers*, making clear that in the alcoholic beverage market as in other markets, the nondiscrimination principle of the Commerce Clause applies equally to sellers as well as producers. *See Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 276-77 (1984). Thus, *Heald*’s core holding applies equally to retailers - the Commerce Clause prohibits states from enacting “laws that burden out-of-state producers or *shippers* simply to give a competitive advantage to in-state businesses.” *See* 125 S.Ct. at 1895.

**The Twenty-First Amendment does not protect discriminatory state laws that violate the nondiscrimination principle of the Commerce Clause.**

In *Heald*, the Court declared unequivocally that the nondiscrimination principle of the Commerce Clause applies in full force to state regulation of alcohol, notwithstanding the states’ unique powers pursuant to section 2 of the Twenty-first Amendment. This holding affirmed the principle that “state laws that violate other provisions of the Constitution are not saved by the Twenty-first Amendment.” 125 S. Ct. at 1905. Thus a state may not violate the First Amendment, *44 Liquormart, Inc. v. Rhode Island*, 517 U.S. 484 (1996), the Establishment Clause, *Larkin v. Grandel’s Den, Inc.*, 459 U.S. 116 (1982), the Equal Protection Clause, *Craig v. Boren*, 429 U.S. 190 (1976), the Due Process Clause, *Wisconsin v. Constantineau*, 400 U.S. 433 (1971), or the Import-Export Clause, *Department of Revenue v. James B. Beam Distilling Co.*, 377 U.S. 341 (1964), simply because sales of alcohol are involved. *See Granholm*, 125 S.Ct. at 1903. The Court also reiterated that section 2 does not abrogate Congress’ Commerce Clause powers with respect to interstate commerce in alcohol. Thus, federal labor laws, *Capital Cities Cable Inc. v. Crisp*, 467 U.S. 691 (1980), and federal antitrust laws, *California Retail Liquor Dealers Assn. v. Midcal Aluminum Inc.*, 445 U.S. 97 (1980), apply to interstate markets in alcoholic beverages. In short, the Twenty-First Amendment did not repeal the Commerce Clause

for alcoholic beverages. *Heald*, 125 S.Ct. at 1904 (citing *Hostetter v. Idlewild Bon Voyage Liquor Co.*, 377 U.S. 324, 333 (1964)).

The Twenty-first Amendment does not authorize state laws that discriminate against out-of-state retailers any more than it authorizes state laws that discriminate against out-of-state wineries. The Court's holding in *Heald* confirmed that the nondiscrimination principle of the Commerce Clause is so deeply rooted in the constitutional fabric of our Union that it admits of *no exception* for alcoholic beverages. Thus, the Court in *Heald* reaffirmed the principle that "state regulation of alcohol is limited by the nondiscrimination principle of the Commerce Clause." 125 S.Ct. at 1904. In reaching its decision, the Court did not cabin its analysis to producers. Rather, the Court relied on precedents that invalidated price-affirmation statutes that favored in-state beer sellers. *Brown-Forman Distillers Corp. v. New York State Liquor Authority*, 476 U.S. 573 (1986); *Healy v. Beer Institute, Inc.*, 491 U.S. 324, 340-41 (1989). *Heald* thus invalidated state laws that discriminate against out-of-state wine retailers no less than state laws that discriminate against out-of-state wineries.

**States may not evade the nondiscrimination principle of the Commerce Clause to advance legitimate state interests when reasonable nondiscriminatory alternatives exist.**

We do not dispute that the states have legitimate interests in restricting minors' access to alcohol and facilitating tax collection. But in *Heald*, the Court determined that such interests do not justify laws that discriminate against out-of-state direct shipping because reasonable nondiscriminatory alternatives exist to advance these objectives. In particular, the Court embraced the National Conference of State Legislatures' Model Direct Shipment Bill ("Model Bill") as a nondiscriminatory means to ensure that interstate wine shipping does not contribute to underage drinking or evasion of state taxes. 125 S.Ct. at 1905-06.

Practical experience confirms the effectiveness of the Model Bill and allays concerns surrounding direct retailer shipping. More than thirty states have adopted some variant of the Model Bill with respect to direct winery-to-consumer sales, and fourteen states currently allow both in-state and out-of-state retailers to ship wine directly to their citizens. States that allow direct shipping (both winery-to-consumer and retailer-to-consumer) report few or no problems with minor access or tax collection. FTC, *supra*, at 31, 38.

### Minor Access

The Court in *Heald* began its analysis of the issue of minors' access to alcohol by affirming the principle that a discriminatory state law will only survive Commerce Clause scrutiny after a finding, based on a concrete record, that out-of-state economic actors pose a unique problem that cannot be met by nondiscriminatory alternatives. See *Heald*, 125 S.Ct. at 1907 (citing *Maine v. Taylor*, 477 U.S. 131, 151 (1986)). Direct shipping by out-of-state wineries and wine retailers, concluded the Court, presents no unique problem. Indeed, the Court acknowledged that, "the states provide little evidence that the purchase of wine over the Internet by minors is a problem" and that, "there is some evidence to the contrary." Specifically, the Court noted that minors are less likely to consume wine than beer or spirits, minors have more direct means of obtaining alcohol than direct shipping, and that direct shipping is an imperfect

avenue of obtaining alcohol for minors who desire “instant gratification.” Under the Court’s holding in *Heald*, there is simply no basis to conclude that wine shipments from out-of-state wineries and wine retailers will increase minors’ access to alcohol. See *Heald*, 125 S.Ct. at 1905-06.

In *Heald*, the Court unequivocally declared that discriminatory laws are not the answer to protecting state interests. Better, said the Court, for the states to adopt a nondiscriminatory measure such as the Model Bill. *Heald*, 125 S.Ct. at 1905-06. The Model Bill requires that all shippers (including retailers and wineries) obtain a permit and meet certain requirements as a condition of selling alcohol in a state. The Model Bill also requires alcohol shippers to label packages as containing alcohol, obtain an adult signature upon delivery, remit taxes, maintain detailed sales records, consent to jurisdiction and inspection, and follow regulations in the state of delivery to the same extent as in-state retailers. These procedural safeguards prevent minors from accessing wine and ensure that states can collect taxes without discriminating against out-of-state sources of wine. In short, a license or permit system will add structure to the retail wine market by informing wine shippers of their legal obligations and thereby promoting compliance with the law. See FTC, *supra*, at 31-38.

#### Tax Collection and Accountability

In *Heald*, the Court held that requiring a permit or license as a condition of direct shipping is a satisfactory nondiscriminatory alternative for the states to hold out-of-state shippers accountable for taxes on interstate wine sales. States that employ nondiscriminatory license or permit system to regulate out-of-state wine shippers have powerful mechanisms for holding out-of-state wineries accountable for any abuses; these mechanisms are equally effective whether the shipper is a retailer or a winery. See *Heald*, 125 S.Ct. at 1905-06; FTC, *supra*, 38-40.

Requiring an out-of-state business to obtain a license or permit to ship wine into a state provides states with the legal ability to enforce their taxes and rules against all out-of-state shippers, whether they are retailers or wineries. States with a license or permit requirement can enforce their laws against all out-of-state shippers in the same way that they enforce their laws against in-state retailers: by revoking the shippers’ license or permit to do business in the state if the retailer breaks the law. States may also use reciprocal enforcement provisions so that a shipper’s infractions in the shipment state will trigger sanctions in a shipper’s home state. Because reciprocal enforcement provisions allow for the revocation of a retailer’s operating license or permit, reciprocal enforcement provisions allay concerns that, unlike wineries, retailers do not require a revocable federal basic permit to operate. New Hampshire law is a good example of a reciprocal enforcement provision. New Hampshire’s version of the Model Bill includes a reciprocal enforcement provision authorizing the State to fine, suspend, or revoke the license of its retailers if they make illegal direct shipments to a reciprocal state. See N.H. Rev. Stat. § 178:27. Reciprocal enforcement provisions are thus a particularly powerful regulatory tool because revocation of a retail license or permit in the shipper’s home state will put the retailer out of business. See *Heald*, 125 S.Ct. at 1905-06; FTC, *supra*, 38-40.

Improvements in modern technology also ease the burden of tax collection and monitoring direct shipping by out-of-state wineries and retailers. States may perform

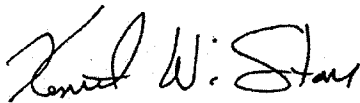
background checks electronically. Permit applicants may mail, fax, or electronically submit their books, records and financial data to state officials. See *Heald*, 125 S.Ct. at 1906; FTC, *supra*, 38-40. As one Court put it, “[in] this age of ... computer networks, fax machines, and other technological marvels,” it is no harder to inspect and regulate out-of-state license holders than in-state ones. *Cooper v. McBeath*, 11 F.3d 547, 554 (5th Circuit 1994). States may also conduct sting operations to verify that out-of-state shippers are complying with state law. Thus it is unsurprising that, according to the FTC Report, the 26 states that allowed direct shipping in 2003 had few or no problems holding out-of-state shippers accountable. FTC, *supra*, at 29-31.

**Applying Heald to retailers poses no threat to the three-tier system.**

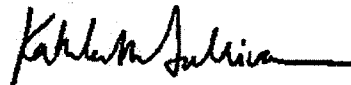
Direct retail-to-consumer shipping is not an exception to the three-tier system. In *Heald*, the Court did not question the constitutionality of the three-tier system by which alcohol has been marketed since the repeal of Prohibition. 125 S. Ct. at 1892 (quoting *North Dakota v. United States*, 495 U.S. 423, 432 (1990)). Under the three-tier system, manufacturers sell to wholesalers, wholesalers sell to retailers, and retailers sell to consumers. Because retailers are the last tier in the three-tier system wine will pass from producer to wholesaler and wholesaler to retailer before reaching the consumer if required by state law. Thus, even in a direct retailer shipping system, all wine that is required to pass through the three-tier system will pass through the three-tier system. Retailers will only ship their wines to consumers after first complying with state law. The only difference in direct-shipping retail transactions is that the consumer need not be physically located at the retailer’s place of business at the time of purchase. Because retailers will only ship wine after it passes through the three-tier system, if required by state law, direct shipping reinforces rather than threatens the three-tier system.

**CONCLUSION**

The constitutional principle that we are one national economic union requires states to grant out-of-state wineries and wine retailers access to their markets on equal terms with in-state wineries and wine retailers. Thus, states should support legislation that would remove unconstitutional regulatory barriers that deny wine retailers the right to ship their wines in interstate commerce. In considering such legislation, states should recognize that allowing wineries and wine retailers to ship wine in interstate commerce is not only required by the constitutional principle of a single national economic union but also will generate substantial economic benefits to consumers and retailers.



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