Texas Wesleyan Law Review

Volume 17 | Issue 2 Article 8

1-1-2011

A Twisted Vine: The Aftermath of Granholm v. Heald

Desireé C. Slaybaugh

A TWISTED VINE: THE AFTERMATH OF *GRANHOLM V. HEALD*

By Desireé C. Slaybaugh

I. INTRODUCTION

Since 2005, American wine enthusiasts have had the answer they have been waiting for—somewhat. The ever-increasing convenience of e-commerce permits consumers looking to satisfy their palate with their favorite cabernets, chardonnays, pinot noirs and such to do so with greater ease of access and at significantly lower prices. When given the ability to have their wines shipped directly to their homes, consumers are able to purchase many wines that are otherwise unavailable to them and also at lower costs.[1] After at least fifteen years of limitations by many state-imposed three-tiered distribution systems, the Supreme Court, in a 2005 opinion, determined how direct shipping of wine would maintain a balance between the Twenty-first Amendment, which repealed the Eighteenth Amendment's prohibition of alcohol, and the dormant Commerce Clause.[2] However, consumers permitted by states' statutes to receive direct shipments of wine may still be a little confused about from whom exactly they may order wines coming from outside their state. The ruling of *Granholm v. Heald* has met with conflicting interpretations by federal courts at trial and appellate levels and the resulting cases are expected by some to go before the Supreme Court.[3]

Granholm held that states retain the right to regulate wine and spirits under the Twenty-first Amendment, but stipulated that states choosing to ban direct shipping of wines must do so "on even-handed terms."[4] Essentially, a state can either choose to ban direct shipping of alcohol entirely or choose to allow it entirely, but those that ban it must do so without discriminating as to the origin of the product. The ruling indisputably resolves the issue of direct shipping under the interstate dormant Commerce Clause regarding producers, the first tier in the prevalent three-tier distribution system; however, it remains yet to be seen whether the scope of the Court's ruling in *Granholm* should extend to the second and third tiers, which are the wholesale and retail levels of distribution.

1. FTC, POSSIBLE ANTICOMPETITIVE BARRIERS TO E-COMMERCE: WINE 16 (2003), http://www.ftc.gov/os/2003/07/winereport2.pdf (last visited Oct. 20, 2010).

2. Granholm v. Heald, 544 U.S. 460, 493 (2005).

3. Diane Jennings, *Texas wine distribution lawsuit becomes vintage fight over consumer rights*, DALLAS MORNING NEWS, Mar. 14, 2009, *available at* http://www.dallasnews.com/sharedcontent/dws/dn/latestnews/stories/031409dnmetwine.3f15cf9.html (last visited Oct. 20, 2010).

4. *Granholm*, 544 U.S. at 493.

DOI: https://doi.org/10.37419/TWLR.V17.I2.7

Section II of this article will lay out the history of wine distribution, beginning with the rise of the three-tier distribution system. Next, it discusses the modern growth of e-commerce and the events leading to the *Granholm* decision. Section III will explain the *Granholm* ruling and demonstrate how lower federal courts inconsistently interpreted *Granholm* outside the production tier. Finally, Section IV will explain the problems created by inconsistent application of *Granholm*, analyze the reasoning and intent of the Court's opinion, note applicable political considerations, and analyze the dormant Commerce Clause in order to show that the ruling should be extended to all distribution tiers, rather than applying exclusively to the first tier.

II. HISTORY

A. *The Three-Tiered Distribution System*

After Congress ratified the Twenty-first Amendment, many states adopted a three-tier system as their method of regulating alcohol distribution.[5] Initially, the system was set up as a response to the criminal syndicate fostered by prohibition.[6] The idea was to separate the "production" end from the "selling" end of the industry, thus curtailing bootleg sales of wine grapes.[7] The two ends would be separated by a "wholesaler," creating a three-tier distribution system.[8] That system has been met with predominantly negative criticism from people in the first and third tiers of the industry, as well as consumers, but is firmly defended by those in the second tier.

The first tier, production, has experienced problems with the wholesale, or distribution tier. One anonymous wine producer claims that "[the distribution tier] is a politically effective restraint on trade. . . . a monopoly that restricts trade and that leads to poor service."[9] He notes there are good, bad, and mid-range distributors, but many just bring in profits without providing any service.[10] According to him, distributors rake in huge profits with virtually no responsibility, or risk for that matter.[11]

Individuals at the third tier, the retail level, view the distribution tier with mixed feelings.[12] Some feel it merely increases the cost of wines to them, and ultimately to the consumer; others recognize a

5. FTC, *supra* note 1, at 5–6.
6. Russ Bridenbaugh, *The 3-Tier System: Is Anyone Happy?*, WINES & VINES (Apr. 2002), http://findarticles.com/p/articles/mi_m3488/is_4_83/ai_85242685/ (last visited Oct. 20, 2010).
7. *Id.*
8. *Id.*
9. *Id.*
10. *Id.*
11. *Id.*
12. *Id.*

need for the separation, citing the wholesaler as a means for them to obtain a more complete stock in spite of multiplication of brands.[13] Overwhelmingly, however, there are complaints of failure of service from the wholesalers. Even those who recognize the need for the separating tier claim that there should be some alternative available to them when the wholesaler does not adequately perform.[14]

The distributors, represented by the Wine & Spirits Wholesalers of America (WSWA), obviously have a different view of the system. Citing a 1990 Supreme Court case determining that the three-tier system is "unquestionably legitimate,"[15] WSWA president Craig Wolf claims that "the system has ably served consumers, communities, and our industry since its inception . . . the evidence is overwhelming that our system is the best in the world by an absolutely huge margin."[16] His "evidence" for this assertion includes claims that no one has died in the U.S. from consuming tainted product, that alcohol abuse by both adolescents and adults is more stringently controlled, that the collection of taxes to the various levels of government is efficiently run, and that American consumers have a wider range of choices than their counterparts worldwide.[17]

Despite intense criticism of the three-tier system amid mixed viewpoints, the Supreme Court has rendered the three-tier system a valid exercise of state authority to regulate alcohol under the Twenty-first Amendment.[18] The Court, in evaluating a conflict between state and federal statutes regulating alcohol shipping to two military bases in North Dakota, explained that North Dakota could enforce its three-tier system under the Twenty-first Amendment, stating that "[i]n the interest of promoting temperance, ensuring orderly market conditions, and raising revenue, the State has established a comprehensive system for the distribution of liquor within its borders. That system is *unquestionably legitimate*."[19] It is significant that 15 years later, the *Granholm* Court confirmed this view, citing the words "unquestionably legitimate," the same words used by Mr. Wolf in defense of the second tier.[20]

B. *Increase in E-commerce and Effect on Direct Shipping of Wine*

With modern technological advancements, the growth of e-commerce has played a major role in both businesses' and consumers' in-

13. *Id.*
14. *Id.*
15. North Dakota v. U.S., 495 U.S. 423, 432 (1990).
16. Craig Wolf, *Reverberations of the Costco Ruling*, BEVERAGE DYNAMICS (Mar. 1, 2008), 2008 WLNR 25429480.
17. *Id.*
18. *North Dakota*, 495 U.S. at 432.
19. *Id.* (emphasis added) (citing Carter v. Virginia, 321 U.S. 131 (1944); Cal. Bd. of Equalization v. Young's Mkt. Co., 299 U.S. 59 (1936)).
20. Granholm v. Heald, 544 U.S. 460, 489 (2005).

creased interest in the direct shipment of goods. The internet, the key player in this development, has proven beneficial by providing increased competition and lower prices, more choices in products, and the convenience of being able to place orders from anywhere in the world to anywhere in the world at the consumer's leisure.[21] Increased broadband access and rapid expansion of the internet have caused rapid growth of the two consumer-oriented forms of e-commerce—business-to-consumer and consumer-to-consumer transactions.[22] The Organisation for Economic Co-operation and Development (OECD) reported in December of 2009 that the number of adults making purchases over the internet rose from 26.9 percent in 2004 to 35 percent in 2008.[23] It further notes that "66% of 'online Americans' purchased a product on-line in 2007, up from 46% in 2000."[24] The OECD attributes this growth to factors such as increased population with access to the internet, broadband penetration and increased use of mobile devices, and the heightened presence of e-retailers.[25] It predicts continued growth and importance of e-commerce, noting that the financial and economic crisis has actually given e-commerce a boost.[26] "In the United States, while most economic sectors were experiencing a downturn in the first quarter of 2009, online retail sales rose by an average of 11%; about 70% of both consumer brand manufacturers and multichannel retailers reported online sales increases."[27] The U.S. Department of Commerce's quarterly report released in May of 2010 shows similar results, indicating its fourth-quarter estimate for 2009 showed a 4.5 percent increase from the third quarter.[28] Furthermore, e-commerce sales from the fourth quarter showed a substantial 14.4 percent increase over the same quarter in 2008, dwarfing the mere 2.2 percent increase in total retail sales.[29] The appreciable outweighing of total sales growth by e-commerce growth indicates that, although still a relatively small contributor to overall sales, e-commerce will inevitably become a much more significant percentage of total retail sales.

With such a rapid increase in e-commerce, consumers have and will increasingly want to take advantage of the benefits of direct shipping by ordering their wines online. From a consumer's perspective, and especially from a collector's perspective, the wine market relies heav-

21. *Empowering E-consumers: Strengthening Consumer Protection in the Internet Economy*, ORGANISATION FOR ECON. CO-OPERATION & DEV., 6 (Dec. 8–10, 2009), http://www.oecd.org/dataoecd/44/13/44047583.pdf. (last visited Oct. 20, 2010).

22. *Id.*

23. *Id.*

24. *Id.* at 7.

25. *Id.* at 8–9.

26. *Id.* at 10.

27. *Id.*

28. U.S. CENSUS BUREAU, QUARTERLY RETAIL E-COMMERCE SALES: 4TH QUARTER 2009 (2009), http://www2.census.gov/retail/releases/historical/ecomm/09Q4.pdf.

29. *Id.*

ily on one's ability to obtain certain varieties of the product. The nature of wine is unique in that a specific vintage of a specific label, perhaps from a specific region, is vastly different from another. To an oenophile, details that with most products would constitute only a minor difference have a tremendous impact on purchasing decisions. With this in mind, the difference made by direct shipping on the wine market is particularly significant. For example, one sample taken in northern Virginia showed that of seventy-two popular bottles available for retail sale, all of them were available for sale from online wine sellers that would ship to Virginia.[30] However, of the same sample, nine of those selections, or 12.5 percent, were not available from physical, or "bricks-and-mortar" locations within ten miles of McLean, Virginia.[31] McLean, a "wealthy suburb approximately ten miles from Washington, D.C."[32], would be the type of area that would represent the market for high-end, rare, and boutique wines.

Under the predominant three-tier distribution systems, it had typically been illegal for wineries or retailers to ship wine directly to consumers; by the early years of the twenty-first century, however, several states had passed interstate direct shipment laws.[33] This, however, presented another problem altogether: many of the laws favored in-state wineries and retailers to those that were out-of-state.[34]

III. *GRANHOLM V. HEALD*

A. *The Court's Opinion*

In the 2005 Supreme Court decision *Granholm v. Heald*, New York and Michigan each defended their respective statutes that discriminated against out-of-state wine producers.[35] Michigan's law included a complete ban on out-of-state wineries from directly shipping to consumers within its borders while allowing in-state wineries to do so as long as they had acquired the proper license.[36] New York's law was similar to Michgan's, but did not include a complete ban; it required any out-of-state winery to establish a physical presence in-state in order to be allowed to ship to New York consumers.[37]

The states first argued that the legality of their enforcement of these statutes originated under their Twenty-first Amendment rights.[38] After Section 1 of the Twenty-first Amendment repeals prohibition, Sec-

30. Alan E. Wiseman & Jerry Ellig, *The Politics of Wine: Trade Barriers, Interest Groups, and the Commerce Clause*, 69 J. POL. 859, 866 n.3 (2007).
31. *Id.*
32. *Id.* at 865.
33. *Id.* at 861–62 n.3 (2007).
34. *Id.* at 862.
35. Granholm v. Heald, 544 U.S. 460 (2005).
36. *Id.* at 473–74.
37. *Id.* at 474.
38. *Id.* at 476.

tion 2 states, "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."[39] Applying the principle that Section 2 does not rescind Congress's Commerce Clause power respecting liquor, and focusing on a prior holding that, "[t]he central purpose of the [Amendment] was not to empower States to favor local liquor industries by erecting barriers to competition,"[40] the Court held that neither of the states' statutes could be preserved under the Twenty-first Amendment.[41] The Court noted that state regulation of alcohol under the Twenty-first Amendment is subject to limitation under the nondiscrimination principle of the Commerce Clause.[42]

The states then argued that such a holding would call into question the validity of their three-tier systems.[43] The Court, citing *North Dakota*, disagreed, pointing out that it was the discrimination itself that violates the Commerce Clause, not the distribution system: "States may assume direct control of liquor distribution through state-run outlets or funnel sales through the three-tier system. . . . State policies are protected under the Twenty-first Amendment when they treat liquor produced out-of-state the same as its domestic equivalent."[44]

To determine whether a statute is constitutional under the dormant Commerce Clause, "[d]iscriminatory laws motivated by 'simple economic protectionism' are subject to a 'virtually *per se* rule of invalidity,' which can only be overcome by a showing that there is no other means to advance a legitimate local purpose."[45] Thus, the states, facing that their statutes were, in fact, discriminatory, argued that the statutes advanced legitimate local purposes that could not be served by a reasonable non-discriminatory alternative.[46] The two purposes advanced by the states were prevention of the acquisition of alcohol by minors and facilitation of tax collection.[47] Citing an FTC report indicating that the internet purchase of wine is not a significant problem with respect to either of the proposed purposes, the Court found there was not sufficient evidence to satisfy the requirement of the "clearest showing" to justify discriminatory state regulation.[48] Moreover, it noted, such a purpose still would not justify the discriminatory

39. U.S. CONST. amend. XXI, § 2.

40. *Granholm*, 544 U.S. at 487 (quoting Bacchus Imps., Ltd. v. Dias, 468 U.S. 263, 276 (1984)).

41. *Id.* at 489.

42. *Id.* (citing New Energy Co. of Ind. v. Limbach, 486 U.S. 269, 278 (1988)).

43. *Id.* at 488.

44. *Id.* at 489.

45. United Haulers Ass'n, Inc. v. Oneida-Herkimer Solid Waste Mgmt. Auth., 550 U.S. 330, 331 (2007) (citing Philadelphia v. New Jersey, 437 U.S. 617 (1978); Maine v. Taylor, 477 U.S. 131 (1986)).

46. *Granholm*, 544 U.S. at 489.

47. *Id.*

48. *Id.* at 490.

nature of the statute, since minors could just as easily order wine from in-state producers as they could from out-of-state producers.[49] With respect to tax collection as the states' justification, the Court debunked its validity by noting that the increase in direct shipping would yield a high potential for tax evasion whether it was in-state or out and suggested that there are better, alternative means of achieving such a regulatory objective without discriminating against interstate commerce.[50] The Court noted that the states' evidentiary burden was to provide the "clearest showing" that the statute advanced a legitimate local purpose, and found that the evidence presented was insufficient to meet that standard.[51]

In rendering its final ruling, the Court summarized by saying:

> States have broad power to regulate liquor under § 2 of the Twenty-first Amendment. This power, however, does not allow States to ban, or severely limit, the direct shipment of out-of-state wine while simultaneously authorizing direct shipment by in-state producers. If a State chooses to allow direct shipment of wine, it must do so on even-handed terms.[52]

The practical effect of the Court's holding in *Granholm* is that states may still ban direct shipment of wine to their residents, but if they do, they must do so from all producers, whether in-state or out. If, however, they allow direct shipping for in-state producers, they must do so for out-of-state producers as well, without showing any preferential treatment to in-state producers. The holding has clashed with several states' three-tier systems, which the opinion itself recognizes as "unquestionably legitimate,"[53] thus creating problems for courts in interpreting and applying the *Granholm* decision.

B. *The Aftermath of* Granholm*: Application to the Second Tier*

The *Granholm* decision has been met with mixed interpretations by the lower federal courts. In particular, courts are unsure whether the Court limited the ruling to producers of wine or whether the ruling would extend to wholesalers and retailers.

1. Courts' Arguments for a Narrow Scope of *Granholm*

Some courts have held that the ruling applies to the production tier only. In 2009, the Second Circuit considered the distinction between retailers and producers and upheld a statute in New York that discriminated between in-state and out-of-state retailers.[54] New York's alcoholic beverage code, or ABC law, permitted licensed in-state re-

49. *Id.*
50. *Id.* at 491.
51. *Id.* at 490.
52. *Id.* at 493.
53. *Id.* at 489.
54. Arnold's Wines, Inc. v. Boyle, 571 F.3d 185, 192 (2nd Cir. 2009).

tailers to obtain a license to ship wine directly to New York residents, but required out-of-state retailers to first establish an in-state operation before obtaining the requisite license.[55] Essentially, the ABC law impacted out-of-state retailers in the same manner that the New York statute at issue in *Granholm* had impacted out-of-state wineries: it required any out-of-state retailer to establish an in-state presence in order to be permitted to ship to in-state consumers. New York residents wishing to purchase wine from an out-of-state retailer brought suit, challenging the ABC law on the grounds that it granted in-state retailers benefits not afforded to out-of-state retailers, thereby discriminating against interstate commerce.[56]

In upholding the statute's constitutionality, the Second Circuit first reasoned that the claim against the law was a frontal attack on New York's three-tier system.[57] Referring to the *Granholm* Court's reaffirmation of the constitutional validity of the three-tier system as "unquestionably legitimate," the court deduced that "had the three-tier system itself been unsustainable under the Twenty-first Amendment, the *Granholm* Court would have had no need to distinguish it from the impermissible regulations at issue."[58] The court then defended the statute as being in compliance with *Granholm*, and nondiscriminatory such that it did not require a Commerce Clause analysis on the grounds that it required all liquor, whether produced in or out-of-state, to have been through the three-tier system. It reasoned that "[r]equiring out-of-state liquor to pass through a licensed in-state wholesaler and retailer adds no cost to delivering the liquor to the consumer not equally applied to in-state liquor."[59] At the end of the opinion, the court was careful to note that "the three-tier system treats in-state and out-of-state *liquor* the same and does not discriminate against out-of-state *products* or *producers* . . . ."[60] Additionally, it addressed in the footnotes that an alternative ruling that would be both applicable and in compliance with the three-tier system would mean that the out-of-state retailers would have to obtain their products from in-state wholesalers, meaning that the product would have to cross the New York state line three or more times.[61] It claimed that the imposition of such a requirement would create an "absurd operational result."[62]

---

55. *Id.* at 188.
56. *Id.* at 187.
57. *Id.* at 190.
58. *Id.* at 190–91.
59. *Id.* at 191. The court conveniently disregarded the added practical burden imposed on out-of-state retailers by overhead business costs, tax requirements, and other costs associated with establishing the in-state presence necessary to obtain the requisite license. *See id.*
60. *Id.* at 191 (emphasis added).
61. *Id.* at 192 n.3.
62. *Id.*

By placing strong emphasis on the statute's equal treatment of producers, the court's opinion seems to have interpreted the nondiscriminatory principles embodied in the dormant Commerce Clause as applying only to interstate *products* rather than interstate commerce as a whole. Furthermore, it interpreted the *Granholm* decision in a way that would apply those principles differently to retailers than to producers. Through its analysis, the Second Circuit very narrowly construed the *Granholm* holding and the dormant Commerce Clause altogether.

Early in 2008, a federal district court in Texas found that Texas's ban on the shipment of wine from out-of-state retailers, but not shipment from in-state retailers, violated the dormant Commerce Clause.[63] However, it also held that the state's requirement that the wine being shipped must first go through the state-licensed wholesalers was constitutional.[64] This ruling meant that ultimately, under Texas law, although out-of-state retailers were allowed to sell their wines to Texas consumers, those wines must have crossed state lines multiple times before finally reaching the consumer.[65]

After first determining that the Texas statute was, in fact, discriminatory,[66] the court faced the same "legitimate local purposes" that had been argued before the *Granholm* Court.[67] Finding no stronger evidence than that before the *Granholm* Court in support of those contentions, it ruled exactly as the Supreme Court had ruled—the statute did not survive the dormant Commerce Clause analysis.[68]

The court then faced the same quagmire the Second Circuit had faced—the coexistence of a state's permission of direct shipping from out-of-state retailers and compliance with that state's three-tier distribution system.[69] However, it did not agree with the wholesalers' contention that allowing direct shipment from out-of-state retailers would necessarily exempt the liquor they sell from passing through the three-tier system.[70] In fact, it referred to the Southern District of New York's opinion on the *Arnold's Wines* case, stating:

> The court respectfully disagrees with *Arnold's Wines*, concluding, *inter alia*, that it is based on a misreading of *Granholm*, and that it elevates a state's rights under the Twenty-first Amendment to a level that improperly supersedes the dormant Commerce

63. Siesta Vill. Mark., L.L.C. v. Perry, 530 F. Supp. 2d 848, 868 (N.D. Tex. 2008), *vacated by* Wine Country Gift Baskets.com v. Steen, No. 08-10146, 2010 WL 2857269 (5th Cir. July 22, 2010).

64. *Id.* at 870.

65. This is the same result rejected by the court in *Arnold's Wines*, 571 F.3d at 192 n.3, as being "an absurd operational result."

66. *Perry*, 530 F. Supp. 2d at 864.

67. *Id.* at 866.

68. *Id.* at 868.

69. *Id.* at 867.

70. *Id.* at 870.

> Clause. . . . [A]s the court explains in today's opinion, a state can treat in-state and out-of-state *entities* on equal terms and still preserve its three-tier system.[71]

Under application of the court's analysis, practically all liquor sold to Texas consumers must first go through a Texas-certified wholesaler, meaning that the products sold may have been through a seemingly arbitrary process: first shipped into Texas, then out of Texas, and then back into Texas again, finally reaching the consumer.

In 2010, the Fifth Circuit reversed the District Court's ruling in *Perry*.[72] Noting the constitutional legitimization of the three-tier system, the court reasoned, "[t]he discrimination that would be questionable . . . is that which is not inherent in the three-tier system itself."[73] Ultimately, the court read the *Granholm* opinion's "legitimizing" of the three-tier system to be "a caveat to the statement that the Commerce Clause is violated if state law authorizes 'differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter.'"[74] The court's reasoning implies that the dormant Commerce Clause does not apply in its traditional manner to products over which power is granted under constitutional amendment. In essence, the Fifth Circuit has appointed the legitimacy of the three-tier system to be a limitation on Congress's control of interstate commerce under the dormant Commerce Clause.

2. Courts' Argument for an Expanded Scope of *Granholm*

In 2008, the Eastern District of Michigan found another similar statute invalid where it prohibited out-of-state retailers from shipping directly to Michigan consumers unless they became part of the State's three-tier distribution system and maintained an in-state location.[75] The court ruled that the requirement of operating a separate location was adequate discriminatory treatment of out-of-state interests under the Commerce Clause.[76] The State attempted to distinguish the case from *Granholm* based on the fact that, unlike in *Granholm*, many out-of-state retailers had chosen to comply with the requirement.[77] To combat this distinction, the court emphasized the principle that differential treatment violates the Commerce Clause when out-of-state businesses are subjected to higher overhead costs than in-state businesses, stating that "[the discriminatory burden] exists on out-of-state *retailers* here, even if the burden may be less than that imposed upon

71. *Id.* at 867 n.19 (emphasis added).
72. Wine Country Gift Baskets v. Steen, 612 F.3d 809 (5th Cir. 2010).
73. *Id.* at 818.
74. *Id.* at 818–19.
75. Siesta Vill. Mkt. v. Granholm, 596 F. Supp. 2d 1035, 1037 (E.D. Mich. 2008).
76. *Id.* at 1040.
77. *Id.*

out-of-state wineries."[78] Just as its predecessors had, the State argued that the statute served legitimate local purposes that could not be achieved by alternative means, basing the argument on the same three proposed justifications: (1) tax evasion; (2) the State's interest in having an in-state location for regulatory purposes; and (3) the impracticability of regulating thousands of retailers with the amount of employees they had at the time.[79] Ultimately, the court concluded that none of the arguments were valid because, with respect to any of the three considerations, "[t]he State. . . entertain[ed] no discussion about how it regulate[d] wine shipped directly from out-of-state *wineries* and why the same procedures would be unworkable in regulating shipments from out-of-state *retailers*."[80] The court's response to the three arguments is strikingly similar to those used by the Supreme Court in *Granholm*.

In addition to conflicting district court rulings, the Seventh Circuit has also recognized the conflict between direct shipping and the three-tier system. In *Baude v. Heath*, the court evaluated two provisions that had been enjoined on the grounds that they had a different impact on out-of-state sellers than they did on in-state sellers.[81] The plaintiffs there, a group of wine connoisseurs wanting easier access to wines from small vineyards in states outside their own, did not argue that the statutes at issue, which were aimed at the wholesale level, were discriminatory.[82] Instead, by acknowledging that the statutes applied equally to all wineries, no matter the location, they pointed out that the regulations created higher costs for interstate commerce.[83] Thus, they attacked the statutes under a different rule: the rule from *Pike v. Bruce Church, Inc.*, which states, "[w]here the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits."[84]

The first statute at issue prohibited wholesalers from selling directly to consumers.[85] Recognizing that different states have entirely different distribution systems, some with only two tiers,[86] the court reasoned that the practical effect of the combination of the statute and other states' varied distribution systems would be the prevention of

78. *Id.*
79. *Id.* at 1042.
80. *Id.* at 1041 (emphasis in original).
81. Baude v. Heath, 538 F.3d 608, 611 (7th Cir. 2008), *cert. denied*, 129 S. Ct. 2382 (2009).
82. *Id.*
83. *Id.*
84. *Id.* (citing Pike v. Bruce Church, Inc., 397 U.S. 137 (1970)).
85. *Id.*
86. "California, Oregon, and Washington, which produce 93% of this nation's wine, have two-tier systems, in which retailers buy from producers without a middleman." *Id.* at 612.

direct shipment of almost all out-of-state wine while allowing direct shipment of in-state wines.[87] In combating the wholesalers' argument in favor of the validity of the three-tier system, the court recognized the *Granholm* decision's holding that the system can coexist with the dormant Commerce Clause, but it carried it one step further, stating that "once a state allows any direct shipment it has agreed that the wholesaler be bypassed."[88]

The Seventh Circuit, along with the two district courts, rendered its ruling with a very different view of *Granholm* than that of the Second and Fifth Circuits. These courts interpreted *Granholm* as applying to all levels of the three-tier distribution system. In short, they concluded that *any* in-state and out-of-state businesses that are similarly situated must be treated on "even-handed" terms, regardless of where they fall in the system. The emphasis of these courts' rulings focuses not on discrimination against the out-of-state product itself, but against any and all interstate commerce, regardless of the origin of the product.

IV. *GRANHOLM* SHOULD APPLY EQUALLY TO ALL THREE TIERS

A. *Problems Created by Mixed Interpretations of* Granholm

As a practical matter, several problems have arisen as a result of courts' mixed interpretations of *Granholm*. Among those problems are limitations on industry growth, potential violations of consumers' rights, and potential violations of current laws by confused industry employees.

First, the limiting regulations have resulted in a restriction on the growth ability of various players in the wine market. Increases in California wineries' gains since the *Granholm* decision[89] illustrate the potential for the wine market to flourish despite the current economic downturn. California gains from direct shipping increased 7.4 percent from 2006 to 2007, likely resulting from the Court's decision.[90] However, if a narrow interpretation of *Granholm* is taken, this type of growth will only be possible for states like California, Oregon, and Washington, which have large numbers of wineries. Those players in states whose wine market participation lies predominantly in the other two tiers will be unable to generate additional revenue by means of direct shipping. Moreover, even where a retailer or wholesaler is allowed to ship, but is subject to additional requirements, particularly substantial ones such as the in-state presence required in New York under the *Arnold's Wines* holding, that player will experience a large opportunity cost. Because of the player's substantial expenditure to

87. *Id.*
88. *Id.*
89. Kate Lavin, *Direct Sales Boost California Gains*, WINES & VINES (Apr. 3, 2008), http://www.winesandvines.com/template.cfm?section=news&content=54583.
90. *Id.*

establish an in-state presence or otherwise comply with limiting statues, the player will have fewer funds available for marketing and production. That opportunity cost is the discriminating factor that the Second Circuit entirely ignored in its *Arnold's Wines* analysis.[91] Especially in the case of smaller businesses, there is a good chance that the costs associated with statutory compliance could be higher than the additional income they would gain given the opportunity to ship directly to the consumer, rendering their participation in the direct shipping market entirely fruitless. Such discouragement from market participation would lead to the second problem associated with limiting direct shipping: violation of consumer rights.

Consumers who desire easier access to wines outside their respective states have brought several of the cases pertaining to the applicability of *Granholm* outside of the first tier. When obtaining a license is not cost effective enough to make direct shipping for out-of-state retailers worthwhile, and when "most or all states will not allow their retailers to buy from out-of-state wholesalers,"[92] consumers have difficulty accessing the wines they want from the places they want at the prices they want. During the Christmas season of 2009, after the district court's ruling in *Siesta Village Market v. Perry*, UPS and FedEx allowed direct shipments to Texas from out-of-state wineries, but not from out-of-state retailers.[93] Keith Wollenberg, an owner of K&L Wine Merchants, one of the nation's largest suppliers of hard-to-find bottles, admits that his company has had to cease its activity in the Texas market for now.[94] Connoisseurs and collectors feel entitled to purchase the wines they want when they want them.[95] Moreover, "there's absolutely no logic in permitting a winery to ship its wine to Texans while prohibiting an online retailer from doing so. For a state that prides itself on being a great defender of personal freedoms, [Texas] seem[s] to have some conveniently protectionist attitudes."[96]

The third, and most practical, problem associated with the varied interpretations of *Granholm* is simply the confusion created in the wine industry, both from a consumer's perspective as well as a seller's. In Texas, "[c]onsumers [were] understandably confused because while the original lawsuit was pending, shipments from out-of-state retailers were allowed. But that[ ] [was] not the case during the appeal."[97] Until the Supreme Court resolves the issue, the varied rulings and differing combinations of state regulations will continue to befuddle consumers who already have a difficult time keeping track of when,

91. *See supra* note 59.
92. Jennings, *supra* note 3.
93. Dale Robertson, *Ordering Wine Online? Not So Fast*, HOUS. CHRONICLE, Dec. 9, 2009, http://www.chron.com/disp/story.mpl/life/food/6759790.html.
94. *Id.*
95. Jennings, *supra* note 3.
96. Robertson, *supra* note 93.
97. Jennings, *supra* note 3.

what, and from whom they may order wines directly. Moreover, the confusion caused by the three-tier system and changes to distribution laws extends so far as to reach first and second tiers. For instance, California, after a time without consistent enforcement of its "tied-house" laws, began enforcing the laws, under which a winery owner can only sell his or her wine in two of the restaurants in which he or she has an interest.[98] Pat Kuleto, a winemaker in Napa Valley who also owns an interest in seven different restaurants, was unaware of the change and continued selling in more than the two restaurants allowed; following negotiations, California attempted to punish Mr. Kuleto by closing three of his restaurants and his winery for a period of three months in addition to fining him $300,000.[99] Although Mr. Kuleto was able to negotiate with the state to reduce his to only an $80,000 fine, the laws are "confusing and apparently contradictory at times."[100] In an industry that is as highly regulated as the alcohol industry, it is more important than ever to ensure consistency of law. However, consistent compliance with the law is unlikely considering that each state's regulatory system is distinct and that states' views of the *Granholm* decision vary. Just as the variations in law will continue to befuddle consumers, so, too will they confuse industry employees at different distribution tiers, thus resulting in the imposition of inequitable penalties on parties intending to comply.

B. *Intent and Reasoning of the* Granholm *Court*

The *Granholm* Court's awareness of the potential for economic protectionist motives on the part of those seeking to restrict direct shipping is a key theme in the opinion. The Court recognized in its analysis the constitutional Framers' concern and awareness that "in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the colonies and later among the States under the Articles of Confederation."[101] Reflecting this consideration, the Court held that "States may not enact laws that burden out of state producers *or shippers*, simply to give a competitive advantage to in-state businesses."[102] The Court's inclusion of "shippers" in its analysis indicates that the holding was intended to apply to more than just the producers alone.

The Court's analysis also suggests a strong concern for consumer rights. In its criticism of the Michigan and New York statutes, the Court pointed out that such laws "deprive citizens of their right to

98. Paul Franson, *Tied-house Laws Bind Vintner: Restaurateur Fined for Selling His Wine*, WINES & VINES (Oct. 1, 2009), 2009 WLNR 21310616.

99. *Id.*

100. *Id.*

101. Granholm v. Heald, 544 U.S. 460, 472 (2005) (citing Hughes v. Oklahoma, 441 U.S. 322, 325–26 (1979)).

102. *Id.* at 472.

have access to the markets of other States on equal terms."[103] The Court warned of the potential that discriminatory statutes could "generate[ ] the trade rivalries and animosities, the alliances and exclusivity, that the Constitution and, in particular, the Commerce Clause were designed to avoid."[104] The Court's acknowledgement of these principles in the context of direct shipment of wines shows that it did not intend its holding to apply in a manner in which it would ultimately deprive American consumers of the products they want, which has clearly been a result of the various statutes that have failed to apply the *Granholm* holding to the retail tier. The removal of retailers selling rare or otherwise difficult-to-obtain bottles from local state markets, like K&L from the Texas market, is a clear deprivation of the "access" that the Court referred to as a citizen's right. Moreover, a consumer's right to have access to another state's market inherently includes the right to pay the lowest price available by way of increased competition. By requiring wines to be pushed through the "middleman" wholesalers, states utilizing the three-tier system are necessarily padding the prices of the wines to the consumer. Thus, a consumer in one state may not be able to obtain the same product at a price comparable to a consumer in another state simply because of the state in which the consumer lives.

Those states that are continuing to place extensive limitations on the direct shipment of out-of-state wine seem to have missed the Court's point in *Granholm*: the Twenty-first Amendment does not give states the right to close or limit market access for their consumers in a manner that favors in-state businesses.

C. *Political Considerations*

The dormant Commerce Clause is violated where a state law mandates "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter."[105] Once a law has been found to be discriminatory, it may still survive if it "advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives."[106] Under this dormant Commerce Clause analysis, the *Granholm* Court rejected the "local legitimate purpose[s]" the states had presented on two grounds: (1) there was insufficient evidence to prove that the statutory objectives were being met, and (2) the states failed to prove that they could not effectively accomplish those objectives by taking less restrictive steps.[107] These are both legally valid reasons for the Court's refusal to allow the statutes, but it also appears that the two primary justifica-

103. *Id.* at 473.
104. *Id.*
105. *Id.* at 472.
106. *Id.* at 489.
107. *Id.* at 490.

tions offered by the states as "local legitimate purposes" may have been mere pretext for hidden agendas promoting economic protectionism—and not only for the state.

The first "local legitimate purpose" advanced by the states was that of keeping alcohol out of the hands of minors.[108] While arguably a legitimate purpose, it is not one that is actually *advanced* by the refusal to allow direct shipping from out-of-state retailers while allowing it from in-state retailers. The Substance Abuse and Mental Health Services Administration conducted a four-year study that revealed that the majority of minors obtain alcohol from parents and other adults.[109] As reported, "[s]even out of 10 teens in the study got their alcohol for free; of the three in 10 who paid for it, two had someone buy for them and one bought it themselves [*sic*], usually at a store. Meanwhile, none of the tens of thousands of teens surveyed reported buying alcohol online. Zero."[110] Additional evidence also supports the proposition that minors do not purchase alcohol online. A market survey performed for a wine marketing symposium revealed that the market profile of consumers who are likely to purchase wine directly includes high-income persons, many of Hispanic or Asian ethnicity, who are tech-savvy and avid magazine readers.[111] Additionally, a survey conducted by American Express of its wine-buying cardholders found that customers' favorite interests included things like sailing, skiing, and tennis.[112] It seems highly unlikely that there is a substantial enough population of minors with a similar profile to justify depriving of-age wine enthusiasts access to other states' markets and, ultimately, the unique products they want. In fact, as the Court in *Granholm* recognized:

> First, minors are less likely to consume wine, as opposed to beer, wine coolers, and hard liquor. Second, minors who decide to disobey the law have more direct means of doing so. Third, direct shipping is an imperfect avenue of obtaining alcohol for minors who, in the words of the past president of the National Conference of State Liquor Administrators, "'want instant gratification.'"[113]

The Court's analysis also reasoned that even if minors were obtaining alcohol by ordering directly, it would not legitimize the statutes' discrimination favoring in-state wineries against out-of-state wineries because minors could just as easily order wines from in-state wineries.[114]

---

108. *Id.* at 489.

109. Dan & Krista Stockman, *Uncorked: Direct Wine Sale Ban Not About Minors*, FORT WAYNE J. GAZETTE, Oct. 17, 2009, 2009 WL 20794126.

110. *Id.*

111. Jim Gordon, *Who Buys Wine Direct?*, WINES & VINES (May 1, 2008), http://winesandvines.com/template.cfm?section=news&content=55226.

112. *Id.*

113. Granholm v. Heald, 544 U.S. 460, 490 (2005).

114. *Id.*

The second justification offered by the states as a "legitimate local purpose" was facilitation of tax collection.[115] Just as the Court pointed out in its analysis about minors' acquisition of alcohol,[116] there is no reason that taxes cannot be effectively collected from one party any more effectively than from another. The Court pointed out that increased direct shipping, whether in or out-of-state, will increase the potential for tax evasion and reasoned that because tax collection could be regulated without discriminating against interstate commerce, it was not a sufficient "legitimate local purpose."[117] The same reasoning would apply to retailers as well. As Mr. Wollenberg from K&L points out, "When we sell you a bottle of wine, we'll charge you the required state sales and excise taxes and send the money to Texas. It's that simple—that's what the wineries do—and we'd have no problem doing it."[118]

So why have the states made these arguments? The states' interest in maintaining the three-tier system is incongruous with their residents' interest in having equal access to other states' markets without first passing through the wholesale level because typically under the three-tier system, the products are taxed at all three levels. Thus, a state usually gains revenue from the same product twice, and sometimes three times. State promotion of the opening of the direct shipping market for wine would ultimately mean giving up an entire level of tax revenue.

Additionally, the fact that the states' arguments in favor of discriminatory direct shipping laws are so easily negated by reason and common sense suggests that they are a diversion from some other underlying purpose. Money being a motivating factor for lawmakers, it is notable that wholesalers comprise one of the largest contributors to American political campaigns.[119] Although there are exponentially fewer wholesalers in America than retailers and producers, $49 million of the $84 million contributed to state and local campaigns by the entire alcohol industry from 2000 to 2006 was from alcohol wholesalers.[120] In addition to those campaign funds, the wholesalers also contributed more than $19 million to federal political campaigns during that time.[121] Moreover, in the years since *Granholm*, the National Beer Wholesalers Association (NBWA) and the Wine and Spirits Wholesalers of America (WSWA) both increased their contributions

115. *Id.*
116. *Id.*
117. *Id.* at 491.
118. Robertson, *supra* note 93.
119. *Wholesale Protection: Alcohol Wholesalers' Control and Weakening of the American Wine Market Through Its $50,000,000 in Campaign Contribution*, SPECIALTY WINE RETAILERS ASS'N (Jan. 8, 2008), http://wwwspecialtywineretailers.org/documents/WholesaleProtection-2008.pdf.
120. *Id.*
121. *Id.*

to federal campaigns by thirty-three percent.[122] This term has been no exception, either. Of more than $9 million contributed to federal candidates and parties from the alcohol industry during the 2010 midterm elections, more than $3.5 million came from the NWBA and the WSWA alone.[123]

The proliferation of the three-tier system and continued attempts to impose limitations on direct shipping is only likely to increase. On January 21, 2010, the Supreme Court held that "the Government may not suppress political speech on the basis of the speaker's corporate identity. No sufficient governmental interest justifies limits on the political speech of nonprofit or for-profit corporations."[124] With the gloves officially off and sweeping campaign contributions from American wholesalers and wholesaler associations, it is no surprise that shortly thereafter, on April 15, 2010, members of the House of Representatives introduced a bill that would allow wholesalers to bypass the Commerce Clause altogether.[125] The "Comprehensive Alcohol Regulatory Effectiveness Act of 2010," also referred to as CARE, provides:

> Notwithstanding that the State or territorial law may burden interstate commerce or may be inconsistent with an Act of the Congress, the State law shall be upheld unless the party challenging the State or territorial law establishes by clear and convincing evidence that the law has no effect on the promotion of temperance, the establishment or maintenance of orderly alcoholic beverage markets, the collection of alcoholic beverage taxes, the structure of the state alcoholic beverage distribution system, or the restriction of access to alcoholic beverages by those under the legal drinking age.[126]

Although time is running out on this session, and only a few members of the Judiciary Committee consider it an urgent priority, many believe that the wholesalers will continue to push for it in the coming year.[127]

D. *A Question of Logic*

With political considerations aside, an uncertain future for House Bill 5034, and mixed rulings interpreting *Granholm*, the question still remains: How far did the *Granholm* Court intend its prohibition on

122. Robert Taylor & Ben O'Donnell, *Support for Direct Shipping Restrictions Builds in Congress*, WINE SPECTATOR (May 27, 2010), http://winespectator.com/webfeature/show/id/42823.

123. *Beer, Wine & Liquor: Top Contributors to Federal Candidates and Parties*, CENTER FOR RESPONSIVE POLITICS, http://www.opensecrets.org/industries/contrib.php?cycle=2010&ind=n02 (last visited Nov. 8, 2010).

124. Citizens United v. Fed. Election Comm'n, 130 S. Ct. 876, 913 (2010).

125. Comprehensive Alcohol Regulatory Effectiveness (CARE) Act of 2010, H.R. 5034, 111th Cong. (2010).

126. Id. § 3(c)(3).

127. Robert Taylor, *Congress Holds Hearing on Bill Threatening Wine Direct Shipping*, WINE SPECTATOR (Sept. 30, 2010), http://www.winespectator.com/webfeature/show/id/43670.

discriminatory direct shipping statutes to reach? Ultimately, it is a question of logic best described as a "which comes first" situation. There are two opposing logical views that may be employed in balancing the Twenty-first Amendment and Congress's Commerce Clause power.

First, the Second and Fifth Circuits' approach began with a presumption that states' three-tier systems are "unquestionably legitimate." The courts began with the rights provided under the Twenty-first Amendment as their basis and applied the dormant Commerce Clause as secondary, and therefore subject to the legitimacy of the already-existing three-tier systems. Under this interpretation, the three-tier system is essentially an exception to Congress' Commerce Clause power.

The alternative, the Seventh Circuit's approach, takes the same two conflicting powers in reverse order. It begins with a basic presumption of the Commerce Clause power and then applies the legitimacy of the three-tier system. Under this analysis, the three-tier system, although legitimate, becomes subject to the limitation imposed by the Commerce Clause power.

To determine which of the two approaches meets the Supreme Court's purposes and intent behind the *Granholm* decision, the question is: Is the Commerce Clause a limitation of states' rights under the Twenty-first Amendment, or are the states' rights under the Twenty-first Amendment a limitation on the Commerce Clause? In other words, which provision trumps the other? The *Granholm* Court clearly recognized both powers, but did not expressly state how both could coexist.

Contrary to what many of the lower federal courts' holdings imply, coexistence of the Commerce Clause and the Twenty-first Amendment is possible. If direct shipping is allowed in a state, then there is an inherent right to bypass the three-tier system. However, if a state finds its interests so great that it does not want the three-tier system bypassed, it is free to prohibit direct shipping to its state's consumers entirely. Under this rule, each state retains the right to determine how its alcohol is distributed, thereby enjoying its rights under the Twenty-first Amendment. But the state is prevented from discriminating against interstate commerce at every tier of distribution. Thus, both rights acknowledged under *Granholm* may coexist in harmony. Additionally, all parties will be in compliance with the principle asserted by the *Granholm* Court that "state regulation of alcohol is limited by the nondiscrimination principle of the Commerce Clause."[128]

128. Granholm v. Heald, 544 U.S. 460, 487 (2005).

V. CONCLUSION

The three-tier distribution system's rise after the passage of the Twenty-first Amendment was necessary when it passed to curb criminal activity during the prohibition era. Times have changed, however, and with the availability and increasing prevalence of electronic commerce, the expectations, as well as the rights of the American consumer are different than they were then. With this in mind, the Supreme Court intended the *Granholm v. Heald* decision to help transition a pre-internet America into an era that is being led forward rapidly by technological advancement. Although the Court reaffirmed the validity of the three-tier system, it is unlikely that it meant for it to be skewed in a way that would distort the meaning behind *Granholm*. Mixed and narrow interpretations of the holding have caused problems in the wine industry and the market at large: significantly increased costs can be detrimental to many small retailers, consumers seeking rare or hard-to-find wines are denied access to the market, and confusing laws cause headaches for both customers and industry employees.

Granholm's inclusion of both "producers" and "shippers" makes it very clear that the Court intended its holding to extend not only to the first tier of the distribution system, but equally to all three tiers.[129] Among its reasons for ruling as it did were considerations of citizens' rights to access to other states' markets.[130] As a result, states should not be able to discriminate against out-of-state producers, wholesalers, or retailers unless they do so on even-handed terms. Upon close examination of the various interpretations of the ruling, the Seventh Circuit seems to have best-stated the Court's intended result: "[O]nce a state allows any direct shipment it has agreed that the wholesaler be bypassed."[131] Realizing the variance in state distribution systems is an outside factor that sometimes prevents the peaceful coexistence of the three-tier system and equal regulation of direct shipping, the most effective means to promote consistence of the law and, in effect, prevent the confusion that leads to unintentional violation of state regulations would be a rule mandating the bypass of the wholesale tier for direct shipment to private customers in states where any direct shipment is allowed. States could and would continue to utilize the three-tier system for the majority of alcohol products, which are not shipped direct-to-consumer; the wholesale tier would continue to thrive through the many hotels, bars, restaurants, catering companies, and other businesses for which wholesalers can provide the valuable service of keeping them abreast of the most popular products and stocked up on a variety of products they need from the largest producers.

129. *Id.* at 472.
130. *Id.* at 473.
131. Baude v. Heath, 538 F.3d 608, 612 (7th Cir. 2008), *cert. denied*, 129 S. Ct. 2382 (2009).

With campaign contributions up and House Bill 5034 under evaluation by the Judiciary Committee, the future of direct shipping of wine remains uncertain. As Representative George Radanovich stated, "In [his] eight terms in Congress, [he] do[es] not recall another time when an industry group has come seeking complete immunity from nothing less than the U.S. Constitution . . . ."[132] However, should the Supreme Court have the opportunity to clarify the *Granholm* decision, it will likely rule that its holding had a wider scope than that interpreted by the Second and Fifth Circuits. It remains uncertain where the Court will draw the line when it comes to regulations that may be imposed. On a practical level, nearly any requirement at all will impose at least some additional costs on out-of-state businesses, but will there be some limit on the degree of imposition of additional expense that is permissible? Further, will the Court's ruling reflect the impact that those additional costs may have on the consumer's right to equal access to the market?

132. Wine & Spirits Daily, *HR 5034—Day Two*, JUST-DRINKS (Oct. 1, 2010) http://www.just-drinks.com/analysis/hr-5034-day-two_id102004.aspx.