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Constitutional Mixologists: Muddling the Analysis of Protectionist Alcoholic Beverage Laws After Granholm v. Heald

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CONSTITUTIONAL MIXOLOGISTS: MUDDLING THE ANALYSIS OF PROTECTIONIST ALCOHOLIC BEVERAGE LAWS AFTER *GRANHOLM V. HEALD*

ABSTRACT

In its 2005 decision in Granholm v. Heald*, the U.S. Supreme Court declared that state alcoholic beverage laws that discriminate against out-of-state entities are unconstitutional restrictions of interstate trade under the dormant Commerce Clause. Despite this holding, lower courts have split in their analyses and conclusions regarding protectionist alcoholic beverage laws. Specifically, the Eighth Circuit recently upheld Missouri's residency requirements for alcoholic beverage distributors. Meanwhile, a district court in Michigan has found that a similar law imposing residency requirements on alcoholic beverage retailers was an unconstitutional restriction of interstate commerce. This confusion adversely affects both consumers and smaller producers of alcoholic beverages. Therefore, this Note argues the Supreme Court should, in the appropriate case, clarify that* Granholm *applies to residency requirements for wholesalers and retailers, thereby subjecting these restrictions to heightened Commerce Clause scrutiny.*

INTRODUCTION

Many smaller breweries, wineries, cideries, and distilleries (hereinafter referred to collectively as "producers") limit their distribution within the United States, making their products available in one or more states but not in others.[1] Producers do so for a variety of reasons, including limits on their level of production, quality control concerns, low sales potential in particular markets, and expensive infrastructure requirements.[2] But there is

1. For example, as of 2003, less than seventeen percent of US wineries had national distribution. *Issue Summary*, FREE THE GRAPES!, http://freethegrapes.org/issue-summary/ (last visited Apr. 5, 2016), *archived at* http://perma.cc/SA5X-LAD5 (citing WINE INSTITUTE, MEMBER SURVEY (2003)).

2. *See, e.g.*, Greg Kitsock, *Distribution Models*, AM. BREWER, Winter 2009, at 11, 13, *available at* http://www.newglarusbrewing.com/News/DistributionModels.pdf (explaining that "[s]hipping beer outside your own backyard is more expensive, there's a greater risk of beer going bad, and you need to rely on wholesalers who have an awful lot of other brands to sell"). Small alcoholic beverage producers also may not have much say in the matter—the distributors to whom they sell often have much more control over where their products end up. *See, e.g.*, *Hey! Why Can't I Find Dogfish Head?*

another possible reason that these smaller producers do not distribute to a particular state. If the state's alcoholic beverage laws discriminate against out-of-state entities that produce, distribute, or sell alcohol, it may be difficult, if not impossible, for consumers to get these products imported.[3]

The US Supreme Court held in *Granholm v. Heald* that such laws are unconstitutional, and thus opened the market for out-of-state producers to directly ship to consumers in states that allow their in-state producers to do so.[4] Despite this holding, the lower courts are still fragmented in their analyses and conclusions regarding protectionist alcoholic beverage laws.[5] For example, the Eighth Circuit recently held that Missouri's residency requirements for alcoholic beverage distributors are constitutional.[6] Meanwhile, a district court in Michigan found the state's residency requirement for retailers to be an unconstitutional restriction of interstate commerce.[7] This split contributes to the bewildering disarray of alcoholic beverage laws in the United States, a particularly troubling situation in light of the increasing market for craft producers.[8] Many of these producers are considering expanding distribution,[9] yet may be unable to

(Or, How a Beer Gets from Us to You), DOGFISH HEAD BLOGFISH (Oct. 7, 2013, 10:22 AM), http://www.dogfish.com/community/blogfish/members/justin-williams/hey-why-cant-i-find-dogfish-head-or-how-a-beer-gets-from-us-to-you.htm, *archived at* http://perma.cc/Y2QU-VHZN.

3. For example, in New York, certain producers located inside the state can be licensed as "farm" producers and sell directly to consumers. *See* N.Y. ALCO. BEV. CONT. LAW § 51-a(2)(e) (McKinney 2014) (provision authorizing farm breweries to sell directly to consumers); *see also* Eric Hawkins, Note, *Great Beer, Good Intentions, Bad Law: The Unconstitutionality of New York's Farm Brewery License*, 56 B.C. L. REV. 313 (2015) (discussing New York's farm brewery law). But out-of-state producers are required to sell their product to a New York-licensed wholesaler, who in turn sells to a New York retailer, who then sells the product to consumers. Connor O'Shea, *Protectionism in New York Wine Law*, THE SOC'Y OF WINE & JURISPRUDENCE (Apr. 8, 2013), http://wineandjurisprudence.org/protectionism-in-new-york-wine-law, *archived at* http://perma.cc/ 4NU6-NS86.

4. 544 U.S. 460, 493 (2005).

5. *See* James J. Williamson II, Casebrief, *Raise Your Glass: The Third Circuit Holds New Jersey Wine Laws in Violation of the Dormant Commerce Clause and Leaves Room for a Future Challenge of the Direct Shipment Ban*, 56 VILL. L. REV. 753, 761–66 (2012) (discussing the circuit split). For a compilation of current state laws regarding the direct shipment of alcoholic beverages to consumers, see *Direct Shipment of Alcoholic Beverages to Consumers State Statutes*, NAT'L CONFERENCE OF STATE LEGISLATURES, http://www.ncsl.org/research/financial-services-and-commerce/direct-shipment-of-alcohol-state-statutes.aspx (last updated Jan. 12, 2016), *archived at* https://perma.cc/B5H3-DR7V.

6. S. Wine & Spirits of Am., Inc. v. Div. of Alcohol & Tobacco Control, 731 F.3d 799, 812 (8th Cir. 2013).

7. Siesta Vill. Mkt., LLC v. Granholm, 596 F. Supp. 2d 1035, 1044–45 (E.D. Mich. 2008).

8. *See, e.g.*, *Stats & FAQs*, BREWERS ASS'N, http://www.brewersassociation.org/press-room/stats-faqs/ (last visited Apr. 5, 2016), *archived at* http://perma.cc/8F82-Z65E (detailing the growth of the craft beer industry).

9. *See, e.g.*, *Distribution Expansion*, BEER ST. J., http://beerstreetjournal.com/distribution-expansion/ (last visited Apr. 5, 2016), *archived at* http://perma.cc/UX96-SU7C (documenting craft breweries that are expanding their distribution areas).

reach markets with smaller demand because of the costly multi-tier distribution systems many states mandate for the importation of alcohol from other states.[10]

Part I of this Note will address the ways in which the courts, Congress, and the states have historically struggled with the treatment of alcoholic beverages under the dormant Commerce Clause. Part II will explain the Supreme Court's most recent pronouncement on the subject, the 2005 case of *Granholm v. Heald*. Part III will examine post-*Granholm* decisions in which lower courts have split in their interpretation of *Granholm* and its applicability to laws that impose residency requirements on alcoholic beverage retailers or distributors, and will particularly focus on the most recent circuit court decision in this area, the Eighth Circuit's 2013 decision in *Southern Wine & Spirits of America, Inc. v. Division of Alcohol & Tobacco Control*. Finally, Part IV will argue that the Supreme Court should clarify that the heightened scrutiny analysis of *Granholm* applies to discriminatory state alcoholic beverage laws that impose residency restrictions. This Note contends that under such scrutiny, states would be hard pressed to justify their residency requirements as anything more than unconstitutional economic protectionism.

I. HISTORICAL INTERPRETATIONS OF THE INTERPLAY OF THE DORMANT COMMERCE CLAUSE AND THE REGULATION OF ALCOHOLIC BEVERAGES

The Commerce Clause of the Constitution states that Congress has the power to "regulate Commerce . . . among the several States."[11] The Commerce Clause also has a "dormant" aspect, which forbids states from unfairly protecting in-state interests at the expense of out-of-state entities.[12] In other words, "state laws violate the Commerce Clause if they mandate differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter."[13] Generally,

10. FED. TRADE COMM'N, POSSIBLE ANTICOMPETITIVE BARRIERS TO E-COMMERCE: WINE 6 (2003), *available at* http://www.ftc.gov/sites/default/files/documents/advocacy_documents/ftc-staff-report-concerning-possible-anticompetitive-barriers-e-commerce-wine/winereport2.pdf [hereinafter FTC REPORT].

11. U.S. CONST. art. I, § 8, cl. 3. The Commerce Clause was the constitutional solution to the "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, 325–26 (1979).

12. *See, e.g.*, United Haulers Ass'n v. Oneida-Herkimer Solid Waste Mgmt. Auth., 550 U.S. 330, 338 (2007) (citations omitted) ("[W]e have long interpreted the Commerce Clause as an implicit restraint on state authority, even in the absence of a conflicting federal statute. To determine whether a law violates this so-called 'dormant' aspect of the Commerce Clause, we first ask whether it discriminates on its face against interstate commerce.").

13. Granholm v. Heald, 544 U.S. 460, 472 (2005) (internal quotation marks omitted).

courts utilize two types of scrutiny to determine if these laws are constitutional. For statutes that "burden interstate transactions only incidentally," courts use a less-searching scrutiny in which parties challenging the laws must show that "the burdens they impose on interstate trade are 'clearly excessive in relation to the putative local benefits.'"[14] For statutes that "affirmatively discriminate" against interstate commerce either on their face or in practical effect, courts apply a "more demanding scrutiny" in which "the burden falls on the State to demonstrate both that the statute 'serves a legitimate local purpose,' and that this purpose could not be served as well by available nondiscriminatory means."[15]

The rationale behind states' desire to provide competitive advantages to in-state alcoholic beverage entities stems from the alcoholic beverage industry's tax revenue potential.[16] Courts, Congress, and the states have a long history, even prior to Prohibition, of grappling with how the regulation of alcohol should be examined pursuant to the dormant Commerce Clause.[17] This Part will briefly examine that history.

Congress passed two major laws in the pre-Prohibition era that attempted to delineate the amount of power states have over alcoholic beverages. The first, the Wilson Act, was passed in 1890 and allowed states to "regulate imported liquor on the same terms as domestic liquor."[18] The second, the Webb-Kenyon Act,[19] was passed in 1913 to close some Wilson Act loopholes[20] by giving states the authority to regulate the direct shipment of liquor from interstate sources.[21] But useful experience with Webb-Kenyon was short lived. In 1919, the states ratified the Eighteenth Amendment to the Constitution,[22] which rendered Webb-

14. Maine v. Taylor, 477 U.S. 131, 138 (1986) (quoting Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970)).

15. *Id.* (quoting Hughes v. Oklahoma, 441 U.S. 322, 336 (1979)).

16. *See* RICHARD MENDELSON, FROM DEMON TO DARLING: A LEGAL HISTORY OF WINE IN AMERICA 24 (2009) (describing how the "alcoholic beverage industry became increasingly entrenched in American law, culture, and politics" due to its role as a major source of tax revenue).

17. *See, e.g.*, Scott v. Donald, 165 U.S. 58, 101 (1897) (holding that "when a state recognizes the manufacture, sale and use of intoxicating liquors as lawful, it cannot discriminate against . . . importing [such articles] from other states" and that "such legislation is void as a hindrance to interstate commerce and an unjust preference of the products of the enacting state").

18. *Granholm*, 544 U.S. at 478 (discussing the Wilson Act of 1890, 27 U.S.C. § 121 (2014)).

19. Webb-Kenyon Act of 1913, 27 U.S.C. § 122 (2014). The Wilson Act and Webb-Kenyon Act are still in force today. *See* MENDELSON, *supra* note 16, at 47.

20. *See* Danielle M. Teagarden, Note, *Brewing Tension: The Constitutionality of Indiana's Sunday Beer-Carryout Laws*, 47 IND. L. REV. 335, 342–43 (2014).

21. 27 U.S.C. § 122.

22. *Granholm*, 544 U.S. at 484.

Kenyon pointless by prohibiting "the manufacture, sale, or transportation of intoxicating liquors within, the importation thereof into, or the exportation thereof from the United States and all the territory subject to the jurisdiction thereof for beverage purposes."[23]

Fourteen years of Prohibition failed to curb alcohol consumption and sparked a crime wave revolving around illegal manufacturing and distribution of alcoholic beverages.[24] In the wake of this largely unsuccessful national experiment, and motivated by the economic pressures of the Great Depression,[25] the states ratified the Twenty-First Amendment in 1933 to repeal the Eighteenth Amendment.[26] However, Congress wanted to allow each state to choose whether liquor would be allowed for sale within that state.[27] To that end, section two of the Twenty-First Amendment prohibits "[t]he 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."[28] Each state was left to manage the social responsibility element of alcoholic beverage consumption within its borders and shut down the criminal network of illegal trade in alcohol that had developed during Prohibition.[29]

States responded to these problems in a variety of ways.[30] Some states initially chose to remain dry.[31] Others passed the responsibility onto localities by allowing for a "local option," wherein counties or municipalities could decide whether to legalize alcohol.[32] When a state did choose to legalize alcoholic beverages, it needed a system to control the legal distribution and taxation of the product. This was generally accomplished in one of two ways: the state either enacted a three-tier

23. U.S. CONST. amend. XVIII, § 1 (repealed 1933).

24. *See* MENDELSON, *supra* note 16, at 50–93.

25. *See id.* at 88 (explaining that the "Great Depression provided new arguments and enthusiasm for the proponents of Repeal"); Seth G. Mehrten, Comment, *Pruning Direct Shipping Barriers for Optimal Yield: How the Dormant Commerce Clause Limits the Twenty-First Amendment*, 21 SAN JOAQUIN AGRIC. L. REV. 155, 163–64 (2012).

26. U.S. CONST. amend. XXI, § 1.

27. *See* MENDELSON, *supra* note 16, at 90.

28. U.S. CONST. amend. XXI, § 2.

29. *See* MENDELSON, *supra* note 16, at 51 ("Lawlessness is the longest-lasting legacy of Prohibition. . . . Criminal syndicates ran a black market for liquor, associating it with a variety of vices."); Shirley Chen, *Craft Beer Drinkers Reignite the Wine Wars*, 26 LOY. CONSUMER L. REV. 526, 528 (2014).

30. *See* MENDELSON, *supra* note 16, at 96–121.

31. *Id.* at 99, 230 n.23 (explaining that there were seven dry states in 1936, three in 1940, and none as of 1966).

32. *See id.* at 99 (noting that many "local option" laws are still in effect today).

system[33] to create a competitive market for alcoholic beverages under strict state control of the state, or it enacted a control system in which the state government would have a legal monopoly over the wholesale tier—and sometimes the retail tier—of the distribution system.[34] In a control system, the state effectively substitutes itself for the private marketplace by retaining the exclusive right to sell alcohol through government-operated enterprises at the wholesale or retail level.[35] In a three-tier system, the state turns the sale of alcohol over to the private marketplace, maintaining control by funneling alcohol through a system of strictly licensed producers, wholesalers, and retailers.[36]

Three-tier systems were enacted primarily to prohibit so-called "tied-house" arrangements, common before Prohibition,[37] wherein alcoholic beverage producers (particularly breweries) would also own retail establishments such as saloons or taverns that only sold their own beverages.[38] States were particularly concerned with two dangers of the tied-house arrangements: "the ability and potentiality of large firms to dominate local markets through vertical and horizontal integration and the excessive sales of alcoholic beverages produced by the overly aggressive

33. The three-tier distribution system is the most common way states regulate the sale of alcoholic beverages within their borders. *See* Bridenbaugh v. Freeman-Wilson, 227 F.3d 848, 851 (7th Cir. 2000). The three tiers are manufacturers (or producers) of alcoholic beverages, distributors (or wholesalers), and retailers. *See id.*

34. *See* Lindsey A. Zahn, *Is There a Future for the Three-Tier Alcohol Beverage Distribution System?*, ON RESERVE: A WINE LAW BLOG (July 28, 2010), http://www.winelawonreserve.com/2010/07/28/is-there-a-future-for-the-three-tier-alcoholic-beverage-distribution-system/, *archived at* http://perma.cc/NR7L-MEXA (explaining that under the control system "state governments maintain a legal monopoly over the distribution tier" and sometimes the retail tier as well); Chen, *supra* note 29, at 529 (describing the two systems).

35. *See Historical Overview*, NAT'L ALCOHOL BEVERAGE CONTROL ASS'N, http://www.nabca.org/page/historical-overview (last visited Apr. 5, 2016), *archived at* http://perma.cc/UC2U-2BYG. This Note does not focus on the control system, but it is worth noting that even absent the Twenty-First Amendment's grant of power, under the market participant doctrine, a state may be able to discriminate in favor of in-state entities when it acts as a participant in a particular market. *See, e.g.*, Hughes v. Alexandria Scrap Corp., 426 U.S. 794, 809–10 (1976) (recognizing that states may participate in a particular market and favor their own citizens within that market); Brooks v. Vassar, 462 F.3d 341, 355–60 (4th Cir. 2006) (using the market participant doctrine to uphold Virginia's limitation of selling only Virginia wines in its state-owned retail stores). However, if the state has a true monopoly over the liquor market, it may no longer be considered a "participant" and therefore may be subject to heightened Commerce Clause scrutiny. *See Brooks*, 462 F.3d at 363 (Goodwin, J., dissenting) (arguing that Virginia actually had a monopoly, such that the market participant exception did not apply).

36. *See* Cal. Beer Wholesalers Ass'n v. Alcoholic Beverage Control Appeals Bd., 487 P.2d 745, 748 (Cal. 1971).

37. *See id*.

38. *See* MENDELSON, *supra* note 16, at 30–33.

marketing techniques of larger alcoholic beverage concerns."[39] By separating alcoholic beverage distribution into three tiers and prohibiting entities from holding a license for more than one tier, the three-tier system was meant to prevent these tied-house arrangements and the saloons they produced.

Since the Twenty-First Amendment's ratification, courts—including the Supreme Court—have struggled to interpret the states' "virtually complete control"[40] over the importation and distribution of liquor within their borders when a state's use of that control implicates the dormant Commerce Clause.[41] In 2005, the Supreme Court attempted to clarify the analysis in its decision in *Granholm v. Heald*.[42]

II. THE SUPREME COURT FINDS DISCRIMINATORY STATE LIQUOR LAWS UNCONSTITUTIONAL UNDER COMMERCE CLAUSE SCRUTINY

The Supreme Court handed down its most recent and definitive ruling on the subject of unconstitutionally discriminatory state liquor laws in the 2005 case of *Granholm v. Heald*.[43] In *Granholm*, the Court reviewed challenges to two state liquor laws, one in Michigan and one in New York.[44] The Supreme Court held that the Twenty-First Amendment neither saves state liquor laws from dormant Commerce Clause analysis nor alters the level of scrutiny to be used in this analysis.[45] This Part will review the two laws that were challenged; the Court's analysis, reasoning, and holding; and the Court's dicta on the continued constitutionality of the three-tier system.

The Michigan law at issue in *Granholm* required wine producers to distribute their wine through in-state wholesalers.[46] In-state wineries,

39. *Cal. Beer Wholesalers Ass'n*, 487 P.2d at 748 (citations omitted). These aggressive marketing techniques included "free lunches, free rounds (known as 'treating'), free goods such as glassware and serving trays, and activities such as billiards, not to speak of gambling and prostitution." MENDELSON, *supra* note 16, at 31–32 (footnote omitted).

40. Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97, 110 (1980) (cautioning, however, that this control "may be subject to the federal commerce power in appropriate situations").

41. *See* Granholm v. Heald, 544 U.S. 460, 486–89 (2005) (describing the history of Supreme Court jurisprudence regarding protectionist state liquor laws after the enactment of the Twenty-First Amendment).

42. *Id.* at 464–93.

43. *Id.* at 493; *see also* S. Wine & Spirits of Am., Inc. v. Div. of Alcohol & Tobacco Control, 731 F.3d 799, 806 (8th Cir. 2013) ("*Granholm* is the Court's most recent pronouncement on the subject.").

44. *Granholm*, 544 U.S. at 465.

45. *See id.* at 493.

46. *Id.* at 469.

however, could obtain a "wine maker" license that allowed them to ship wine directly to in-state consumers.[47] New York's law set out a more complex scheme, only allowing out-of-state wineries to ship directly to consumers if they first established a distribution operation—consisting of, at minimum, a branch office, factory, or warehouse—in New York.[48]

The Court began by determining that Michigan's and New York's direct-shipping laws discriminated against interstate commerce.[49] According to the Court, these types of laws: (1) deprive citizens of their right to equal access to the markets of all states;[50] (2) necessitate reciprocal sales laws stemming from an "ongoing, low-level trade war";[51] and (3) create prohibitive barriers to entry for out-of-state producers by increasing overhead costs.[52] Importantly, the Court found that New York's requirement that out-of-state wineries establish an in-state presence violated Supreme Court precedent disapproving of such residency requirements.[53] As the Court explained, "[s]tates cannot require an out-of-state firm 'to become a resident in order to compete on equal terms.'"[54]

Having decided that Michigan's and New York's laws were discriminatory, the Court next asked whether such laws "violate the dormant Commerce Clause in light of § 2 of the Twenty-first Amendment."[55] First, the Court determined that section two neither authorized nor saved the Michigan and New York statutes in question.[56] The Court then applied the heightened scrutiny analysis required for

47. *Id.*

48. *Id.* at 470. Additionally, even when out-of-state wineries met this residency requirement, they were still ineligible to obtain a "farm winery" license, which would have provided the most direct means of shipment to New York consumers. *Id.* at 475. The Court explained that these requirements amounted to an "indirect way of subjecting out-of-state wineries, but not local ones, to the three-tier system." *Id.* at 474; *see also* Chen, *supra* note 29, at 532.

49. *Granholm*, 544 U.S. at 476.

50. *Id.* at 473.

51. *Id.* (explaining that reciprocal trade laws "condition the right of out-of-state wineries to make direct wine sales to in-state consumers on a reciprocal right in the shipping State").

52. *Id.* at 474–75. In fact, no out-of-state wineries had even attempted to "run the State's regulatory gauntlet" in New York. *Id.* at 474.

53. *Id.* at 475–76.

54. *Id.* at 475 (quoting Halliburton Oil Well Cementing Co. v. Reilly, 373 U.S. 64, 72 (1963)).

55. *Id.* at 471.

56. *Id.* at 487–89 (discussing Bacchus Imps., Ltd. v. Dias, 468 U.S. 263, 276 (1984), in which the Court held that the Twenty-First Amendment does not authorize state alcoholic beverage laws whose legislative purpose is "mere economic protectionism"). The Court examined the legislative and judicial history of interstate liquor laws at length, finding that both Congress and the Court had consistently disfavored allowing states to protect in-state interests at the expense of out-of-state goods. *Id.* at 476–89.

discriminatory laws,[57] asking "whether either state regime 'advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives.'"[58] To survive such scrutiny, the state has the burden of demonstrating: (1) that its discriminatory law serves at least one distinct local purpose; and (2) that there are no nondiscriminatory laws that could sufficiently advance the same goal.[59] This is a heavy burden, as the Court requires the "clearest showing" that the discriminatory law is the only way the state can adequately advance its legitimate purpose.[60]

The *Granholm* Court held that Michigan and New York had failed to meet this burden.[61] The Court dismissed the states' two primary justifications, "keeping alcohol out of the hands of minors and facilitating tax collection,"[62] reasoning that the states had not shown that either of these was substantially furthered by the restriction of direct shipments by out-of-state wineries.[63] According to the Court, the states had failed to provide enough evidence that minors were using the Internet to purchase wine.[64] Instead, the Court cited a Federal Trade Commission report with a contrary finding.[65] The tax-collection grounds also failed. The Court determined that Michigan's system of "licensing and self-reporting," which provided "adequate safeguards for wine distributed through the three-tier system," would also be effective for direct shipments.[66] Similarly, in New York, less discriminatory means were available to facilitate tax collection, such as requiring a direct-shipment permit along with applicable sales reporting and tax payments.[67] The Court also noted that technological improvements, such as the availability of electronic

57. *See* Maine v. Taylor, 477 U.S. 131, 138 (1986) (explaining the levels of scrutiny required by the Court's dormant Commerce Clause jurisprudence); *see also* Amy Murphy, Note, *Discarding the* North Dakota *Dictum: An Argument for Strict Scrutiny of the Three-Tier Distribution System*, 110 MICH. L. REV. 819, 828 (2012).

58. *Granholm*, 544 U.S. at 489 (quoting New Energy Co. of Ind. v. Limbach, 486 U.S. 269, 278 (1988)).

59. *See id.* at 489.

60. *See id.* at 490 (internal quotation marks omitted).

61. *Id.*

62. *Id*. at 489.

63. *Id.* at 489–92.

64. *Id.* at 490.

65. *Id.* (citing FTC REPORT, *supra* note 10, at 34). The Court also noted that even if increased underage drinking were a legitimate concern, this would not justify discriminating against out-of-state direct shipments, because "minors are just as likely to order wine from in-state producers." *Id.*

66. *Id.* at 491.

67. *Id.* The Court also noted that the 2003 FTC Report found no disclosed problems with tax collection in states that allowed direct interstate wine shipments. *Id.* (citing FTC REPORT, *supra* note 10, at 38–40).

background checks and electronic transfer of financial records and sales data, have "eased the burden of monitoring out-of-state wineries."[68]

The Court concluded that the two state laws unfairly and unconstitutionally discriminated against interstate commerce.[69] Allowing in-state wineries to ship directly to consumers while prohibiting out-of-state wineries from doing so was unconstitutional economic protectionism that was neither saved by the Twenty-First Amendment nor justified by the states' purported local purposes.[70] However, the *Granholm* Court also reaffirmed a proposition from a previous Supreme Court decision, *North Dakota v. United States*,[71] in which the Court recognized the three-tier distribution system itself as being "unquestionably legitimate."[72] While this reaffirmation was dictum,[73] the language appears to be of central importance to the circuit court decisions that have upheld discriminatory state liquor laws after *Granholm*.[74] The Court in *Granholm* suggested that as long as a three-tier system does not favor in-state entities over out-of-state entities, it can withstand constitutional scrutiny.[75] Viewed in context,[76] the Court's statement has been interpreted as distinguishing structural distribution laws that "treat liquor produced out of state the same as its domestic equivalent" from "straightforward attempts to discriminate in favor of local producers," such as the Michigan and New York laws in *Granholm*.[77] Structural distribution laws fall within the states' Twenty-

68. *Id.* at 492.

69. *Id.* at 493.

70. *Id.* (explaining that states' "broad power to regulate liquor" did "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"). Four justices dissented and, in an opinion by Justice Thomas, argued that alcohol should be analyzed differently than other articles of commerce under the dormant Commerce Clause due to the power granted to the states by the Webb-Kenyon Act and Twenty-First Amendment. *Id*. at 497–527 (Thomas, J., dissenting).

71. 495 U.S. 423, 432 (1990).

72. *Id.* (as cited by *Granholm*, 544 U.S. at 489) (internal quotation marks omitted).

73. *See, e.g.*, S. Wine & Spirits of Am., Inc. v. Div. of Alcohol & Tobacco Control, 731 F.3d 799, 809 (8th Cir. 2013) (recognizing that the language may be dictum, but nonetheless compelling); Arnold's Wines, Inc. v. Boyle, 571 F.3d 185, 191 (2d Cir. 2009) (same).

74. *See, e.g.*, Wine Country Gift Baskets.com v. Steen, 612 F.3d 809, 819, 821 (5th Cir. 2010), *cert. denied*, 562 U.S. 1270 (2011); *Arnold's Wines, Inc.*, 571 F.3d at 190–91; *see also generally* Murphy, *supra* note 57, at 829–31.

75. *Granholm*, 544 U.S. at 485–89. *But see* Murphy, *supra* note 57, at 837 (arguing that the *Granholm* Court "recited the *North Dakota* dictum in an ill-considered fashion" and that "*North Dakota* had no place in *Granholm*'s analysis").

76. *See* Ind. Petro. Marketers & Convenience Store Ass'n v. Cook, 808 F.3d 318, 321 (7th Cir. 2015) (explaining that *Granholm*'s statement regarding the "unquestionably legitimate" nature of the three-tier system "must be understood in context" and that the test is whether "a three-tier distribution system . . . treats all alcohol sales equivalently regardless of origin").

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

First Amendment authority; discriminatory laws do not.[78] The lower courts, however, have struggled to separate what is "structural" from what is "discriminatory," contributing to the split in authority discussed below.

III. THE LOWER COURTS CONFRONT THE IMPLICATIONS OF *GRANHOLM* FOR STATE LIQUOR LAWS THAT IMPOSE RESIDENCY REQUIREMENTS

Despite *Granholm*, circuit and district courts continue to come down on different sides of the issue of whether and to what extent state alcoholic beverage laws can constitutionally differentiate between in-state and out-of-state entities, particularly distributors and retailers.[79] In response to *Granholm*, many states have revised their alcoholic beverage laws[80] but have not completely abandoned attempts to protect in-state entities.[81] In particular, many states still distinguish between in-state and out-of-state distributors and retailers, allowing in-state entities to ship directly to consumers while prohibiting out-of-state entities from doing so.[82] Despite challenges declaring that these types of state alcoholic beverage laws violate the holding in *Granholm*, the Second, Fifth, and Eighth Circuits have found such laws constitutional, based on the language of the Twenty-First Amendment and the "unquestionably legitimate" language in *Granholm*.[83] Several district courts have come to the opposite conclusion,

78. *See id.*

79. *See* Williamson, *supra* note 5, at 761–66 (discussing the circuit split).

80. *See, e.g.*, Robert Taylor, *U.S. Wine Shipping Laws, State by State*, WINE SPECTATOR, http://www.winespectator.com/webfeature/show/id/50258#WineryMap (last updated Mar. 31, 2016), *archived at* http://perma.cc/VGC9-L4D6 ("The number of states that permit winery direct-to-consumer shipping has risen from 27 in 2005 to 42 as of January 2016 . . . ."); *see also* Maureen K. Ohlhausen & Gregory P. Luib, *Moving Sideways: Post-*Granholm *Developments in Wine Direct Shipping and Their Implications for Competition*, 75 ANTITRUST L.J. 505, 512–13, 516 (2008) (documenting states that amended their statutes post-*Granholm* to permit direct shipping from wineries).

81. *See* William C. Green, *Creating a Common Market for Wine: Boutique Wines, Direct Shipment, and State Alcohol Regulation*, 39 OHIO N.U. L. REV. 13, 14 & n.6 (2012) (citing Ohlhausen & Luib, *supra* note 80, at 514 nn.64–67). Current state laws regarding the direct shipment of alcoholic beverages are described in *Direct Shipment of Alcoholic Beverages to Consumers State Statutes*, *supra* note 5.

82. *See* Taylor, *supra* note 80 (explaining that "most states will allow consumers to have wine delivered from a local retailer, but not from one beyond the state's borders"). In fact, since *Granholm*, the number of states allowing out-of-state retailers to ship directly to consumers has actually "fallen, from 18 states in 2005 to just 14 today." *Id.* Moreover, several of the states that allow direct shipping from out-of-state retailers have reciprocity provisions such that consumers are only allowed "to receive wine orders from retailers located in other states whose consumers are permitted to order wine from its retailers." *Id.*

83. *See* S. Wine & Spirits of Am., Inc. v. Div. of Alcohol & Tobacco Control, 731 F.3d 799, 802, 812 (8th Cir. 2013) (internal quotation marks omitted) (upholding a Missouri law that required wholesalers to be "resident corporation[s]" and allowed such a designation only when all corporate officers and directors had been "bona fide residents" of the state for at least three years); Wine Country

determining that such regulations are unconstitutionally restrictive of interstate commerce, based on the Commerce Clause and the holding in *Granholm*.[84]

The *Granholm* Court only explicitly addressed the constitutionality of discriminatory alcoholic beverage laws that favored in-state wineries over out-of-state wineries,[85] leaving the legality of other discriminatory laws open to interpretation. First, it is unclear whether the Court's holding in *Granholm* applies to the other two tiers in the three-tier system. Therefore, lower courts have split in their analyses of state laws that distinguish between in-state and out-of-state distributors and retailers. Second, *Granholm* left undecided how, if at all, the analysis should change for evenhanded laws—those that do not, on their face, distinguish between in-state and out-of-state alcoholic beverage entities. It is unclear how these facially neutral laws should be treated when they discriminate or burden interstate commerce either in purpose or in effect.[86] Finally, since the laws in *Granholm* dealt specifically with wineries, it is unclear how *Granholm* should apply to laws that discriminate against other types of alcoholic beverage producers.[87] This Note focuses only on the first question identified above, and this Part examines the lower court decisions that have analyzed how *Granholm* applies to state alcoholic beverage laws that impose residency requirements on distributors and retailers.

Gift Baskets.com v. Steen, 612 F.3d 809, 821 (5th Cir. 2010), *cert. denied*, 562 U.S. 1270 (2011) (upholding a Texas law requiring retailers to maintain a physical presence in the state in order to deliver to consumers located roughly within the same county as the retailer, but not overruling the District Court's invalidation of a one-year citizenship requirement for retailers); Arnold's Wines, Inc. v. Boyle, 571 F.3d 185, 192 (2d Cir. 2009) (upholding a New York law allowing in-state, but not out-of-state, retailers to deliver to consumers).

84. *See, e.g.*, Siesta Vill. Mkt., LLC v. Granholm, 596 F. Supp. 2d 1035, 1044–45 (E.D. Mich. 2008) (invalidating a Michigan law that allowed in-state retailers to ship to consumers but prohibited out-of-state retailers from doing so); S. Wine & Spirits of Tex., Inc. v. Steen, 486 F. Supp. 2d 626, 632 (W.D. Tex. 2007) (invalidating a Texas law requiring one year of residency for alcoholic beverage wholesalers because the law was facially discriminatory and because the state failed to "prove that no nondiscriminatory alternative means" were available to achieve Texas' interest in ensuring distributors "have a stake in the welfare of the community in which they operate").

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

86. *See* Green, *supra* note 81, at 42–43 (explaining how various parties have read *Granholm* either as being limited to facially discriminatory laws or as being applicable to statutes that discriminate in purpose or effect).

87. *See, e.g.*, Chen, *supra* note 29, at 543 (arguing that *Granholm* should apply to direct-shipment laws for breweries as well).

A. A District Court Finds a One-Year Residency Requirement for Wholesalers Unconstitutional

In 2007, the US District Court for the Western District of Texas invalidated the state's one-year residency requirement for wholesalers in *Southern Wine and Spirits of Texas, Inc. v. Steen*.[88] Texas required applicants for alcoholic beverage permits to be residents and citizens of the state for at least one year prior to filing their application.[89] The Texas Alcoholic Beverage Commission ("TABC") conceded that this statute was facially discriminatory and attempted to justify the statute as advancing a legitimate local purpose that could not be adequately served by nondiscriminatory alternatives.[90] TABC proffered three such purposes for its laws:

> (1) they ensure that those who distribute a dangerous product, alcoholic beverages, have a stake in the welfare of the community in which they operate; (2) they provide a guard against the threats of organized crime; and (3) nonresident absentee owners have less incentive to refrain from practices that, although profitable, could expose the community to harm.[91]

The court reviewed an earlier Fifth Circuit decision, *Cooper v. McBeath*,[92] that had invalidated "Texas's durational residency and citizenship statutes regarding mixed-beverage retail permits and licenses" and found that the holding and reasoning in *Cooper* applied to this case.[93]

The court found unpersuasive TABC's argument that the residency requirement was needed to ensure that distributors have a stake in the welfare of the community.[94] The court noted that because "Texas is a large state," in many cases an out-of-state wholesaler will be closer to a Texas consumer than an in-state wholesaler located on the other side of Texas.[95] TABC's justifications presented "no more a compelling case" than the justifications rejected by the Supreme Court in *Granholm*.[96] As the state "wholly failed" to meet its "burden of demonstrating, under rigorous

88. 486 F. Supp. 2d at 627–33.
89. *Id.* at 628–29.
90. *Id.* at 630.
91. *Id.*
92. 11 F.3d 547 (5th Cir. 1994).
93. *Steen*, 486 F. Supp. 2d at 631.
94. *Id.* at 631–32.
95. *Id.*
96. *Id.* at 632.

scrutiny, that it ha[d] no other means to advance a legitimate local interest," the court held that Texas's one-year residency requirement was unconstitutional as applied to wholesalers.[97]

B. The Fifth Circuit Upholds a Physical Presence Requirement for Retailers

In 2008, the US District Court for the Northern District of Texas declared that Texas's one-year residency requirement was equally unconstitutional as applied to alcoholic beverage retailers.[98] The Fifth Circuit reviewed this decision in the 2010 case of *Wine Country Gift Baskets.com v. Steen*.[99] The Fifth Circuit did not reverse the invalidation of the one-year citizenship requirement.[100] But the court did uphold Texas's statute requiring retailers to maintain a physical presence in the state to deliver to consumers there.[101]

The Fifth Circuit analogized the three-tier system to a funnel with "an opening at the top available to all."[102] The court meant that after *Granholm*, producers could ship directly to consumers regardless of where the producer is located.[103] However, according to the court, a state may require wholesalers and retailers to be within the state to ship directly to consumers there.[104] This is contrary to *Granholm*'s explanation that a law is discriminatory when it requires an out-of-state entity to "become a resident in order to compete on equal terms," and that such laws trigger heightened scrutiny that requires the state to justify its law as having a legitimate local purpose that could not be adequately served by nondiscriminatory means.[105]

But the Fifth Circuit read *Granholm* as concluding that the dormant Commerce Clause applies differently to alcoholic beverages because of the Twenty-First Amendment and limited *Granholm* to prohibiting "discrimination against out-of-state *products* or *producers*," not

97. *Id.* (internal quotation marks omitted).
98. Siesta Vill. Mkt., LLC v. Perry, 530 F. Supp. 2d 848, 868–74 (N.D. Tex. 2008), *vacated on other grounds*, Wine Country Gift Baskets.com v. Steen, 612 F.3d 809, 821–22 (5th Cir. 2010).
99. 612 F.3d 809 (5th Cir. 2010), *cert. denied*, 562 U.S. 1270 (2011).
100. *Id.* at 812–13, 821–22 (explaining, *inter alia*, that Texas did not contest this decision).
101. *Id.* at 811, 821–22.
102. *Id.* at 815.
103. *See id*.
104. *Id.*
105. Granholm v. Heald, 544 U.S. 460, 475, 489 (2005).

wholesalers or retailers.[106] Again, this is contrary to *Granholm*, which prohibits state laws "that burden out-of-state producers *or shippers* simply to give a competitive advantage to in-state businesses."[107] The district court in this case had considered "[t]he disability imposed on out-of-state retailers" and found the Texas statute discriminatory.[108] But because the Fifth Circuit instead compared the burdens imposed on in-state and out-of-state products and producers, it did not find any discrimination that would trigger heightened scrutiny.[109]

The Fifth Circuit also concentrated on the fact that Texas's statute allowed in-state retailers to make sales "to proximate consumers, not those distant to the store."[110] But if *Granholm*'s discrimination analysis ended with products and producers, it should not have mattered whether in-state retailers were allowed to ship only locally or throughout the whole state. This reasoning strays from *Granholm*'s central message: that discriminatory alcoholic beverage laws are subject to the same heightened scrutiny as any other protectionist laws. Instead, the Fifth Circuit focused on the Supreme Court's dictum about the constitutionality of the three-tier system.[111]

The Fifth Circuit viewed the "local deliveries as a constitutionally benign incident of an acceptable three-tier system."[112] But here, as plaintiff-appellant Wine Country explained, "the three tiers have tumbled because Texas has permitted [in-state] retailers to make home deliveries" while prohibiting out-of-state retailers from doing so.[113] This is what *Granholm* said as well: once a state allows in-state entities to ship directly to consumers, it can no longer prohibit out-of-state entities in the same tier

106. *Wine Country Gift Baskets.com*, 612 F.3d at 820. The court also utilized the "unquestionably legitimate" language about three-tier systems from *Granholm* to answer this challenge to "an inherent aspect of that system." *Id.* at 818, 821. The Fifth Circuit's sentiment on this issue may be changing. *See* Cooper v. Tex. Alcoholic Bev. Comm'n, No. 14-51343, 2016 U.S. App. LEXIS 7269 (5th Cir. Apr. 21, 2016). In *Cooper*, the Fifth Circuit distinguished *Wine Country* by explaining that "state regulations of the retailer and wholesaler tiers are not immune from Commerce Clause scrutiny just because they do not discriminate against out-of-state liquor." *Id.* at *26 (expressly declining to follow S. Wine & Spirits of Am., Inc. v. Div. of Alcohol & Tobacco Control, 731 F.3d 799 (8th Cir. 2013)). Thus, in the Fifth Circuit's view, the Twenty-first Amendment allows states to "impose a physical-residency requirement on retailers and wholesalers of alcoholic beverages" but not "a durational-residency requirement on the owners of alcoholic beverage retailers and wholesalers." *Id.*

107. *Granholm*, 544 U.S. at 472 (emphasis added).

108. *Wine Country Gift Baskets.com*, 612 F.3d at 818 (citing Siesta Vill. Mkt., LLC v. Perry, 530 F. Supp. 2d 848, 865–66 (N.D. Tex. 2008)).

109. *Id.* at 819–21.

110. *Id.* at 820.

111. *Id.* at 818–19.

112. *Id.* at 820.

113. *Id.* at 819.

from doing the same. The Texas law "deprive[s] *citizens* of their right to have access to the markets of other States on equal terms"[114] because in-state retailers are allowed to do what out-of-state retailers are not: ship directly to consumers.[115] Therefore, the statute should have been subject to the heightened scrutiny analysis required by *Granholm.*

C. A District Court Finds a Physical Presence Requirement for Retailers Unconstitutional

In contrast to the Fifth Circuit's decision, the US District Court for the Eastern District of Michigan determined in *Siesta Village Market, LLC v. Granholm* that the state had impermissibly discriminated against out-of-state retailers by only allowing retailers that maintained a location in the state to ship directly to consumers.[116] The court correctly analyzed the Supreme Court's *Granholm* decision as prohibiting "a system that discriminates against out-of-state interests."[117] Michigan's statute "create[d] an extra burden on out-of-state wine retailers" by requiring them to "open a location in Michigan, become part of the three-tier system," and then obtain a direct shipping license.[118] The court viewed this as creating "a higher overhead cost for doing business . . . for out-of-state businesses" and noted that the Supreme Court in *Granholm* had struck down such differential treatment.[119]

After determining the statute was discriminatory, the court applied *Granholm*'s heightened scrutiny, requiring Michigan to prove "that the law serves a legitimate local purpose and that the purpose cannot be adequately served by reasonable nondiscriminatory means."[120] The state made no attempt to show why nondiscriminatory alternatives would be ineffective or discuss why the procedures it used to regulate direct shipments from out-of-state producers "would be unworkable in regulating shipments from out-of-state *retailers*."[121] Instead, Michigan argued that allowing out-of-state retailers to directly ship to consumers would prevent the state from being able to "stop tax evasion" or "enforce labeling laws,"

114. Granholm v. Heald, 544 U.S. 460, 473 (2005) (emphasis added); *see also id.* at 475 (internal quotation marks omitted) ("We have viewed with particular suspicion state statutes requiring business operations to be performed in the home State that could more efficiently be performed elsewhere.").

115. *Wine Country Gift Baskets.com*, 612 F.3d at 812.

116. 596 F. Supp. 2d 1035, 1044–45 (E.D. Mich. 2008).

117. *Id.* at 1039.

118. *Id.*

119. *Id.*

120. *Id.* at 1040.

121. *Id.* at 1041.

"underage drinking laws," or "anti-tied-house vertical integration laws."[122] Since the state did not show any alternatives or why such alternatives would be unworkable, the court found that Michigan's concerns amounted to speculation "that it may have trouble regulating . . . out-of-state retailers without setting forth concrete proof that this will be the case."[123] Furthermore, the state's concern that "tax revenue would be lost" was "not a legitimate reason to uphold a discriminatory statute under well-established Commerce Clause law."[124] Because the state had failed to meet its burden to justify the discriminatory statute, the court struck down Michigan's residency requirement for retailers.[125]

D. The Second Circuit Upholds a Statute That Allowed Only In-State Retailers to Deliver to Consumers

In 2009, the Second Circuit upheld a New York law that allowed in-state, but not out-of-state, retailers to deliver to consumers in *Arnold's Wines, Inc. v. Boyle*.[126] The New York law permitted New York retailers to obtain off-premises licenses, allowing them to deliver alcohol to consumers' homes.[127] Out-of-state retailers could not obtain such a license,[128] thus imposing a residency requirement on these retailers to be able to ship directly to New York consumers. The court interpreted Supreme Court precedent, including *Granholm*, and determined that "the Twenty-first Amendment alters dormant Commerce Clause analysis" for state liquor laws.[129]

The Second Circuit found that the plaintiffs' challenge was a "frontal attack on the constitutionality of the three-tier system itself" and thus foreclosed by the "unquestionably legitimate" language in *Granholm*.[130] Because "[a]lcohol sold by in-state retailers directly to consumers in New

122. *Id.* at 1041–42.
123. *Id.* at 1041–43.
124. *Id.* at 1043.
125. *Id.* at 1045.
126. 571 F.3d 185, 187–88, 192 (2d Cir. 2009). In a concurring opinion, Judge Calabresi agreed completely with the outcome and reasoning, but observed that confusion about the meaning of the Twenty-First Amendment leaves uncertainty about where the Supreme Court will head next in its interpretation of this amendment. *Id.* at 192, 198–201 (Calabresi, J., concurring).
127. *Id.* at 188.
128. *Id.*
129. *Id.* This interpretation is at odds with the language of the *Granholm* opinion: "the Twenty-first Amendment does not supersede other provisions of the Constitution and, in particular, does not displace the rule that States may not give a discriminatory preference to their own producers." Granholm v. Heald, 544 U.S. 460, 486 (2005).
130. *Arnold's Wines, Inc.*, 571 F.3d at 190–91.

York has already passed through the first two tiers—producer and wholesaler—and been taxed and regulated accordingly," a similar requirement for out-of-state liquor did not increase delivery costs.[131] Therefore, the court concluded that the statute treated in-state and out-of-state liquor evenhandedly by requiring all of it to pass through the same three-tier system.[132] Like the Fifth Circuit, the Second Circuit compared the treatment of products and producers, not wholesalers or retailers.[133] Again, this ignores *Granholm*'s explanation that laws "that burden out-of-state producers *or shippers* simply to give a competitive advantage to in-state businesses" are discriminatory.[134] Because the Second Circuit determined that New York did "not discriminate against out-of-state products or producers," this ended its dormant Commerce Clause analysis.[135]

E. The Eighth Circuit Finds a Wholesaler Residency Requirement Constitutional

The Eighth Circuit reviewed a Missouri residency requirement in its 2013 decision of *Southern Wine & Spirits of America, Inc. v. Division of Alcohol & Tobacco Control*.[136] The court reviewed a Missouri law requiring a wholesaler to be a "resident corporation" to apply for a liquor distribution license and allowing a corporation to be designated a "resident" only when its officers and directors had all been "bona fide residents" of the state for at least three years.[137] Southern Wine & Spirits of America, Inc. ("SWSA"), a Florida corporation, challenged this provision after its wholly owned subsidiary, Southern Wine & Spirits of Missouri, Inc. ("Southern Missouri"), was denied a wholesaler license because Southern Missouri failed to satisfy the residency requirement.[138]

The Eighth Circuit noted that the Supreme Court had sent "conflicting signals" regarding the Commerce Clause in light of the Twenty-First

131. *Id.* at 191.
132. *Id.*
133. *Id.*; *see also supra* note 106 and accompanying text.
134. *Granholm*, 544 U.S. at 472 (emphasis added).
135. *Arnold's Wines, Inc.*, 571 F.3d at 191–92. Limiting *Granholm*'s heightened scrutiny analysis to products and producers is inconsistent with both general Commerce Clause jurisprudence and *Granholm*'s interpretation of the purpose of the dormant Commerce Clause. Murphy, *supra* note 57, at 842–43.
136. 731 F.3d 799 (8th Cir. 2013).
137. *Id.* at 802.
138. *Id.*

Amendment.[139] Similar to the Fifth Circuit in *Wine Country Gift Baskets.com*, the court interpreted *Granholm* as drawing "a bright line between the producer tier and the rest of the system."[140] The court rejected SWSA's evidence of protectionist intent.[141] It also decided that "state policies that define the structure of the liquor distribution system" are "'protected' against constitutional challenges based on the Commerce Clause."[142] Since the residency requirement at issue defined "the extent of in-state presence required to qualify as a wholesaler in the three-tier system," the court decided that this was a structural state policy.[143] The court held that the state should have "flexibility to define the requisite degree of 'in-state' presence to include the in-state residence of wholesalers' directors and officers."[144] Like the Fifth Circuit, the Eighth Circuit did not appear to address *Granholm*'s explanation that "[s]tates cannot require an out-of-state firm to become a resident in order to compete on equal terms."[145]

The Eighth Circuit also held that, assuming that the policies were subject to deferential scrutiny, Missouri had "established a sufficient basis for its residency requirement."[146] This basis included a belief that a wholesaler whose owners are Missouri residents is "more apt to be socially responsible" and "more likely to respond to concerns of the community."[147] The problem with this analysis is that *Granholm* requires a discriminatory statute to survive *heightened* scrutiny, which imposes a heavy burden on the state.[148] Missouri failed to provide any nondiscriminatory alternatives or explain why such alternatives would be unworkable, and therefore its requirement should have failed *Granholm*'s scrutiny analysis. But the Eighth Circuit concluded that Missouri's

139. *Id.* at 804 (explaining how the Supreme Court's early broad interpretation of states' power under the Twenty-First Amendment has been narrowed considerably over the decades).

140. *Id.* at 810; *see also supra* note 106 and accompanying text.

141. *S. Wine & Spirits of Am., Inc.*, 731 F.3d at 807–08. SWSA relied on a newspaper article published contemporaneously with the statute in question that described a state senator's view that the law was intended to prevent monopolization by out-of-state wholesalers. *Id.* at 807. The court dismissed this protectionist-intent argument on multiple grounds, including that SWSA had waived the argument on appeal by failing to raise it in the district court. *Id.* at 807–08.

142. *Id*. at 809 (relying on the "unquestionably legitimate" language of *Granholm*).

143. *Id.* at 809–10.

144. *Id.* at 810.

145. Granholm v. Heald, 544 U.S. 460, 475 (2005) (internal quotation marks omitted); *cf.* Wine Country Gift Baskets.com v. Steen, 612 F.3d 809, 815 (5th Cir. 2010) (also upholding a residency requirement).

146. *S. Wine & Spirits of Am., Inc.*, 731 F.3d at 812.

147. *Id.* at 811.

148. *See Granholm*, 544 U.S. at 489–90.

residency requirement was a valid exercise of the state's Twenty-First Amendment power that did not violate the dormant Commerce Clause.[149]

This Eighth Circuit case is the latest in a string of post-*Granholm* opinions that show that the allegedly "narrow" holding of *Granholm* has failed to create a useful structural framework for the lower courts to use in analyzing discriminatory state liquor laws. It is time for the Supreme Court to take up the issue again and clarify the extent to which its holding in *Granholm* applies to other types of alcoholic beverage regulations, including residency requirements for wholesalers and retailers.

IV. THE CONFUSION CREATED BY *GRANHOLM* HAS INSULATED CONSTITUTIONALLY PROBLEMATIC RESIDENCY REQUIREMENTS THAT IMPEDE CONSUMER CHOICE AND INTERSTATE COMMERCE

The Supreme Court has not yet examined the extent to which its holding in *Granholm* applies to state laws that impose residency requirements on the retail or wholesale tiers of the distribution system.[150] As discussed above, the lower courts have split in their analyses of these residency requirements.[151] Section A of this Part will briefly summarize the confusion created by the *Granholm* decision. Section B will examine the justifications given for these residency requirements and three-tier systems in general. Section C will show how these residency requirements impede consumer choice and the free flow of interstate commerce. In order to clear up this confusion, the next time the Supreme Court takes up a challenge to a discriminatory alcoholic beverage law, the Court should reiterate that the Twenty-First Amendment does not change the dormant Commerce Clause analysis and should clarify that its holding in *Granholm* applies with equal force to all parts of the three-tier system. The Court would, therefore, set forth a broader structural framework for lower courts to utilize when analyzing challenges to these types of regulations.

A. The Confusion Created by Granholm

The Supreme Court suggested in *Granholm* that as long as the three-tier distribution system is applied evenhandedly, the dormant Commerce

149. *See supra* notes 136–48 and accompanying text.

150. The Supreme Court had the opportunity to examine this issue in 2011 in an appeal from the Fifth Circuit's *Wine Country Gift Baskets* decision but denied certiorari. Wine Country Gift Baskets.com v. Steen, 612 F.3d 809 (5th Cir. 2010), *cert. denied*, 562 U.S. 1270 (2011).

151. *See supra* notes 79–149 and accompanying text.

Clause does not automatically prohibit such a system.[152] But the lower courts have not been able to agree about how the Twenty-First Amendment and the dormant Commerce Clause interact when laws discriminate against out-of-state alcoholic beverage wholesalers or retailers.[153] Defendants in post-*Granholm* cases have argued, and some courts have agreed, that *Granholm* should be limited to its facts and heightened scrutiny only applied to laws that discriminate against alcoholic beverage products and producers.[154] These defendants argue that laws imposing residency requirements on wholesalers and retailers are simply insulated from the dormant Commerce Clause as part of the "unquestionably legitimate" structure of the three-tier system.[155] Post-*Granholm* courts that have struck down residency requirements for wholesalers and retailers have read *Granholm* broadly as requiring heightened scrutiny for all discriminatory alcoholic beverage laws, not just those discriminating against products or producers.[156] The courts that have upheld residency requirements have taken the narrower view advocated by defendants.[157]

Although the Court in *Granholm* held that "any contention that § 2 of the Twenty-first Amendment immunizes discriminatory direct-shipment laws from Commerce Clause scrutiny" was foreclosed by its own precedent,[158] the lower courts have not all followed this direction.[159] Also, the Supreme Court advised in *Granholm* that it would not approve of state laws that "require an out-of-state firm to become a resident in order to compete on equal terms,"[160] yet this appears to be exactly the type of provision that the Eighth Circuit upheld in *Southern Wine*.[161]

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152. Granholm v. Heald, 544 U.S. 460, 488–89 (2005); *see also* Teagarden, *supra* note 20, at 350–51.

153. *See, e.g.*, S. Wine & Spirits of Am., Inc. v. Div. of Alcohol & Tobacco Control, 731 F.3d 799, 804 (2013) ("[T]he Supreme Court has sent conflicting signals about the relationship between these two constitutional provisions."); Arnold's Wines, Inc. v. Boyle, 571 F.3d 185, 198–201 (2d Cir. 2009) (Calabresi, J., concurring) (explaining that there is confusion and uncertainty about where the Supreme Court will head next in its interpretation of the Twenty-First Amendment).

154. *See* Green, *supra* note 81, at 42–43.

155. *See, e.g.*, *S. Wine & Spirits of Am., Inc.*, 731 F.3d at 809–10.

156. *See, e.g.*, Siesta Vill. Mkt., LLC v. Granholm, 596 F. Supp. 2d 1035, 1039 (E.D. Mich. 2008).

157. *See, e.g.*, *S. Wine & Spirits of Am., Inc.*, 731 F.3d at 812.

158. Granholm v. Heald, 544 U.S. 460, 487–88 (2005).

159. *See, e.g.*, Wine Country Gift Baskets.com v. Steen, 612 F.3d 809, 820 (5th Cir. 2010) ("The dormant Commerce Clause applies, but it applies differently than it does to products whose regulation is not authorized by a specific constitutional amendment.").

160. *Granholm*, 544 U.S. at 475 (internal quotation marks omitted).

161. *S. Wine & Spirits of Am., Inc.*, 731 F.3d at 809–10 (giving the state "flexibility to define the requisite degree of 'in-state' residence" to "qualify as a wholesaler in the three-tier system"); *see also*

Furthermore, there is a question as to whether mandated three-tier systems are still constitutional after *Granholm*. If subject to heightened scrutiny—as *Granholm*'s overall reasoning would suggest—this system may not survive.[162] At the very least, residency requirements that require wholesalers or retailers to become residents of a state in order to directly ship to consumers should be subject to *Granholm*'s heightened scrutiny analysis. Lower courts, however, have used the "unquestionably legitimate" language to justify less stringent analysis.[163] Meanwhile, consumers must bear the negative effects of an alcoholic beverage distribution system that can no longer keep up with rapid technological advancements, the rise of craft beverage production, and the consolidation of the wholesaler tier.

B. The Justifications for the Three-Tier System and Residency Requirements

The three-tier system has—or at least had—admirable goals. As mentioned in Part I, states initially utilized this system as a means of preventing tied-house arrangements that had led to aggressive marketing techniques and the proliferation of the saloon.[164] Preventing tied-house arrangements can also encourage competition because independent distributors and retailers—in an ideal world—are just that: truly independent.[165] In theory, distributors can buy whatever they want, from

Wine Country Gift Baskets.com, 612 F.3d at 815, 819–20 (upholding a residency requirement for retailers despite *Granholm*'s admonition about requiring an out-of-state entity to become a resident in order to compete on equal terms).

162. For example, in *Siesta Village Market*, the court rejected Michigan's argument that requiring out-of-state retailers to open a location in Michigan, become part of the state's three-tier system, and obtain a license were parts of its three-tier system and therefore authorized by the Twenty-First Amendment. Siesta Vill. Mkt., LLC v. Granholm, 596 F. Supp. 2d 1035, 1039 (E.D. Mich. 2008); *see also generally* Murphy, *supra* note 57 (arguing that the three-tier system would likely not survive this heightened scrutiny).

163. *See, e.g.*, *supra* notes 154–55 and accompanying text.

164. *See* MENDELSON, *supra* note 16, at 30–33; *see also* Cal. Beer Wholesalers Ass'n v. Alcoholic Beverage Control Appeals Bd., 487 P.2d 745, 748 (Cal. 1971) ("The principal method utilized by state legislatures to avoid these anti-social developments was the establishment of a triple-tiered distribution and licensing scheme.").

165. This is not, however, an ideal world. Distributors are often under implicit, if not explicit (contractual), influence from big producers. *See* STEVE HINDY, THE CRAFT BEER REVOLUTION: HOW A BAND OF MICROBREWERS IS TRANSFORMING THE WORLD'S FAVORITE DRINK 164 (2014) (discussing "equity agreements" that large brewers used as an attempt "to ensure that their distributors concentrated their efforts on selling the large brewers' products"); *see also generally* Leslie Pariseau, *Have Big Liquor Brands Become Too Influential?*, PUNCH (Mar. 12, 2014), http://punchdrink.com/articles/have-big-liquor-brands-become-too-influential/, *archived at* http://perma.cc/J663-PQRF

whomever they want, and sell it to a variety of retailers, including bars, restaurants, and liquor stores.[166] This purportedly increases consumer choice because retail establishments are able to offer a wide variety of alcoholic beverage options instead of being "tied" to just one brand or one producer's products.[167]

Although distributors would benefit from the ability to ship directly to consumers in any state that allowed in-state distributors to do so, they have much to lose if the three-tier system is dismantled. As long as the three-tier system is intact, distributors are guaranteed a highly profitable[168] role as middlemen through whom alcoholic beverages must pass to reach consumers.[169] Alcoholic beverage distributors are powerful political entities[170] and have lobbied to restrict direct shipping from the other tiers.[171] They argue that the three-tier system creates important economies of scale[172] and emphasize the importance of face-to-face transactions in

(explaining that large "[l]iquor companies pay distributors who sell to the bars to focus their efforts on specific brands").

166. *What Is a Beer Distributor?*, NAT'L BEER WHOLESALERS ASS'N, https://www.nbwa.org/about/what-beer-distributor (last visited Apr. 25, 2016) ("Beer distributors source beer from a wide variety of importers and manufacturers."); *see also* MENDELSON, *supra* note 16, at 118 ("Many states also prohibit . . . exclusive dealing, in which a retailer is obligated to sell the alcoholic beverages of a particular producer of wholesaler.").

167. *See* Mike Reis, *Beer Issues: What's Up with the Three-Tier System?*, SERIOUS EATS (Jan. 8, 2014, 2:00 PM), http://drinks.seriouseats.com/2014/01/craft-beer-three-tier-system-pros-cons-distributor-retailer-debate.html, *archived at* http://perma.cc/9N2S-R4JC.

168. "[W]holesaling is big business." David White, *Wholesale Robbery in Liquor Sales*, N.Y. TIMES (Apr. 3, 2011), http://www.nytimes.com/2011/04/04/opinion/04white.html (describing how the nation's two largest wholesalers had combined revenues of about $13 billion).

169. *See* James Alexander Tanford, *E-Commerce in Wine*, 3 J.L. ECON. & POL'Y 275, 305 (2007) (describing how "a true national Internet wine market threatened the wine wholesalers' privileged (and lucrative) position as wine's exclusive distributor").

170. The Center for Responsive Politics lists the National Beer Wholesalers Association as number thirty-eight on its list of "Top Organization Contributors," with total political campaign contributions topping $33 million. *Top Organization Contributors*, CTR. FOR RESPONSIVE POLITICS, http://www.opensecrets.org/orgs/list.php?order=A (last visited Apr. 5, 2016), *archived at* http://perma.cc/FJ7D-B9WK.

171. *See* Tanford, *supra* note 169, at 305; *see also National Beer Wholesalers Assn*, CTR. FOR RESPONSIVE POLITICS, https://www.opensecrets.org/lobby/clientsum.php?id=D000000101&year=2015 (last visited Apr. 5, 2016), *archived at* https://perma.cc/F3WY-YXNQ (listing the National Beer Wholesalers Association's total lobbying expenditures for 2015 as $1,420,000).

172. *See* DAVID S. SIBLEY & PADMANABHAN SRINAGESH, WINE & SPIRITS WHOLESALERS OF AM., DISPELLING THE MYTHS OF THE THREE-TIER DISTRIBUTION SYSTEM 43 (2008), *available at* http://www.five-star-wine-and-spirits.com/includes/archivos/about_five_start/pdf/three_tier_01.pdf (concluding that allowing producers to ship directly to retailers would "reduce the economies of scope, scale and density in the traditional distribution system, increasing the costs of all the participants . . . and ultimately reducing the benefits of low prices and superior variety at nearby locations to customers who rely on the three-tier system").

the alcoholic beverage industry.[173] The rationale is that face-to-face transactions help avoid sales to minors,[174] but, as the Court in *Granholm* made clear, there are nondiscriminatory means for achieving this end.[175] The distributors have fought alongside the states in court to defend protectionist laws that keep their position in the marketplace intact.[176] They have also fought against the states, using *Granholm* to argue that residency requirements are unconstitutional as applied to them.[177]

Wholesalers also can perform important functions such as collecting state taxes, ensuring the legality of alcoholic beverage transactions, and creating economies of scale.[178] These functions and the noble goals of increasing competition and decreasing brazen marketing techniques at retail establishments may justify allowing beverage transactions to occur within a multi-tiered distribution system. They do not, however, justify mandating this system,[179] especially in light of the adverse effects the system has on consumers.[180]

Another rationale for protectionist alcoholic beverage laws is that alcohol is a unique article of commerce such that otherwise-impermissible burdens on interstate commerce are allowed.[181] Reasons often cited (and the reasons rejected by the majority in *Granholm*) for allowing these burdens are the prevention of underage alcohol consumption and the

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173. *See* Dana Nigro, *U.S. Supreme Court Overturns Wine-Shipping Bans*, WINE SPECTATOR (May 16, 2005), http://www.winespectator.com/webfeature/show/id/US-Supreme-Court-Overturns-Wine-Shipping-Bans_2543, *archived at* http://perma.cc/8GNJ-K3FM (quoting Wine & Spirits Wholesalers of America's President and CEO Juanita Duggan as claiming that, as a result of *Granholm*, "states have a choice between supporting face-to-face transactions by someone licensed to sell alcohol or opening up the floodgates").

174. *Id.* ("Many of [the wholesalers'] anti-shipping campaigns have focused on the supposed ease with which teenagers could order wine online.").

175. Granholm v. Heald, 544 U.S. 460, 489–92 (2005). Also, producers may not share this favorable view of the distributors' role; instead, some see distributors "rak[ing] in huge profits with virtually no responsibility" or risk. Desireé C. Slaybaugh, *A Twisted Vine: The Aftermath of* Granholm v. Heald, 17 TEX. WESLEYAN L. REV. 265, 266 (2011).

176. *E.g.*, S. Wine & Spirits of Am., Inc. v. Div. of Alcohol & Tobacco Control, 731 F.3d 799, 799 (8th Cir. 2013) (with amicus briefs on behalf of the Missouri Division of Alcohol & Tobacco Control from the National Beer Wholesalers Association and the Missouri Beer Wholesalers Association); Wine Country Gift Baskets.com v. Steen, 612 F.3d 809, 811 (5th Cir. 2010) (describing the intervention of two Texas alcoholic beverage wholesalers on behalf of defendant Alan Steen, the Administrator of the Texas Alcoholic Beverage Commission).

177. *See, e.g.*, *S. Wine & Spirits of Am., Inc.*, 731 F.3d 799 (example of a wholesaler challenging a state's residency requirement for distributors).

178. *See generally* SIBLEY & SRINAGESH, *supra* note 172.

179. Indeed, states have no issue with soft drink producers, such as Coca-Cola and Pepsi, selling directly to retailers. *See* David White, *Prohibition, Online*, L.A. TIMES (Dec. 17, 2010), http://articles.latimes.com/2010/dec/17/opinion/la-oe-white-online-wine-20101217.

180. *See infra* Part IV.C.1.

181. *See, e.g.*, Granholm v. Heald, 544 U.S. 460, 494 (2005) (Stevens, J., dissenting).

assurance of tax collection.[182] These concerns about sales to minors and tax avoidance are even less persuasive when a state allows out-of-state producers to ship directly, but prohibits out-of-state wholesalers or retailers from doing so.[183] As the district court in *Siesta Village Market* noted many times, if a state is to defend such an arrangement, it needs to discuss its "experience regulating out-of-state [producers] and why those same methods would not work for out-of-state *retailers*."[184] States, apparently unable to do so, instead revert back to "sweeping assertions" about why they would not be able to regulate out-of-state entities—the "same 'sweeping assertions'" as those struck down by the Supreme Court in *Granholm v. Heald*.[185]

Another reason proffered to legitimize residency requirements for retailers or wholesalers is that in-state entities are expected to be more "socially responsible."[186] The Eighth Circuit found this argument persuasive in the *Southern Wine* case to justify Missouri's residency requirement.[187] The argument is that entities are more likely to be socially responsible when they are present in the surrounding communities that bear the negative externalities of liquor consumption, such as alcoholism, underage drinking, and drunk driving.[188] Alcohol traditionally,[189] and even today, has had a serious "moral" nature that puts it within a state's "police power."[190] This characterization of alcohol helps explain why the Supreme Court originally interpreted section two of the Twenty-First Amendment as giving states broad powers over the manufacture and sale of alcoholic

182. *See id.* at 490–91; *see also* Cherry Hill Vineyards, LLC v. Lilly, 553 F.3d 423, 434 (6th Cir. 2008).

183. *See* Dale Robertson, *Ordering Wine Online? Not So Fast*, HOUS. CHRON. (Dec. 8, 2009, 6:30 AM), http://www.chron.com/life/food/article/Ordering-wine-online-Not-so-fast-1566430.php (quoting a major California retailer who described the process for an out-of-state direct shipment to Texas as follows: "[W]e'll charge [the customer] 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.").

184. Siesta Vill. Mkt., LLC v. Granholm, 596 F. Supp. 2d 1035, 1044 (E.D. Mich. 2008).

185. *Id.* at 1041, 1044 (citing *Granholm*, 544 U.S. at 492).

186. *See* S. Wine & Spirits of Am., Inc. v. Div. of Alcohol & Tobacco Control, 731 F.3d 799, 811 (8th Cir. 2013).

187. *Id.* at 810–11 (but using "deferential scrutiny" in examining this justification).

188. *Id.*

189. In colonial times, the role of social responsibility for controlling alcohol consumption fell to retailers, who were subject to strict controls and were often required to have a "good reputation" in the community in order to be granted a liquor license. MENDELSON, *supra* note 16, at 19. Producers and distributors were mostly unregulated. *Id.*

190. *See id.* at 21. The police power gives states the authority to "protect the safety, health, welfare, and morals of the community." *Id.* at 21, 201 n.93. This power is conferred upon the states by the Tenth Amendment. *Id.* at 201 n.93.

beverages within their borders.[191] However, as Judge Calabresi has explained, "[i]n the ensuing decades . . . as attitudes toward alcohol have changed and its commerce has become more nationalized, the Supreme Court has increasingly read the Twenty-First Amendment more narrowly, and excluded from its protection any number of state regulatory schemes that, to be sure, discriminated against interstate commerce."[192] Thus, these social and moral justifications for allowing states to discriminate against out-of-state wholesalers and retailers are less viable today and, more importantly, out of line with the Supreme Court's modern jurisprudence as set forth in *Granholm.* Still, some circuit courts have been persuaded by these social and moral concerns.

C. The Adverse Effects of a Mandated Three-Tier Distribution System and Residency Requirements for Distributors and Retailers

Mandated three-tier distribution and discriminatory residency requirements for alcoholic beverage distributors and retailers result in increased burdens on out-of-state wholesalers and retailers. These laws "mandate differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter."[193] These burdens include requiring out-of-state entities to set up a location in the state or become a resident of the state in order to directly reach consumers there. But these residency requirements also, and more importantly, result in many adverse effects for consumers and smaller producers.

1. Adverse Effects for Consumers

One adverse effect for consumers is that the three-tier system increases prices because alcoholic beverages are subject to additional markups and taxes at every level of the system.[194] States may argue that higher prices actually serve a legitimate local purpose because higher prices reduce consumption[195] and thus the problems related to overconsumption.[196] But

191. *See* Granholm v. Heald, 544 U.S. 460, 485 (2005).

192. Arnold's Wines, Inc. v. Boyle, 571 F.3d 185, 192 (2d Cir. 2009) (Calabresi, J., concurring); *see also Granholm*, 544 U.S. at 485–86 (explaining that this early interpretation is "inconsistent" with the Court's current view, and that "more recent cases . . . confirm that the Twenty-first Amendment does not supersede other provisions of the Constitution").

193. *Granholm*, 544 U.S. at 472 (internal quotation marks omitted).

194. *See* Reis, *supra* note 167; White, *supra* note 168 (explaining that wholesaling increases the retail prices consumers pay by an estimated 18 to 25 percent).

195. *See* Elyse Grossman & James F. Mosher, *Public Health, State Alcohol Pricing Policies, and the Dismantling of the 21st Amendment: A Legal Analysis*, 15 MICH. ST. U. J. MED. & L. 177, 196–97

if states want to decrease the consumption of alcohol by increasing prices, this can be achieved by less discriminatory means, such as increased taxes for all liquor sold, regardless of where it is produced.[197] Instead, by forcing products through a three-tier system, this looks less like promoting temperance through increased prices and more like providing guaranteed roles for in-state alcoholic beverage entities.[198]

Discriminatory direct-shipping restrictions also increase consumer prices by largely cutting off online competition.[199] For example, a recent empirical study by Jerry Ellig and Alan E. Wiseman examined the price effects of two types of post-*Granholm* discriminatory alcoholic beverage statutes and found that these types of laws have "noticeable effects on price competition in local markets."[200] Ellig and Wiseman looked at laws that permit out-of-state producers to ship directly to consumers, but prohibit out-of-state retailers from doing so,[201] such as the laws in question in *Arnold's Wines*,[202] *Wine Country Gift Baskets.com*,[203] and *Siesta Village Market*.[204] They found that because alcoholic beverage producers "usually charge higher prices than online retailers, excluding out-of-state retailers limits the price savings that are available online."[205] As Ellig and Wiseman point out, "seemingly small details in law can map into substantial differences in outcomes when considering prices, consumer demand, and other aspects of alcohol consumption, production, and the like."[206] By

(2011) (explaining how the link between increased alcoholic beverage prices and decreased consumption is well established).

196. *See id.* at 197 (explaining that "higher prices . . . reduce the number of young people who drink and drive, die from alcohol-related traffic or injury fatalities, contract sexually transmitted diseases and engage in alcohol-related violence"). Grossman and Mosher also describe cases in which states have defended alcoholic beverage regulations on the grounds that the laws increased prices and therefore decreased consumption. *Id.* at 196–98.

197. *See id.* at 191 & n.116 (citing Costco Wholesale Corp. v. Hoen, No. C04-360P, 2006 U.S. Dist. LEXIS 27141, at *19 (W.D. Wash. Apr. 21, 2006)).

198. *See* Siesta Vill. Mkt., LLC v. Granholm, 596 F. Supp. 2d 1035, 1043 (E.D. Mich. 2008) (explaining that loss of tax revenue is "not a legitimate reason to uphold a discriminatory statute" and characterizing such a justification as "pure protectionism").

199. Jerry Ellig & Alan E. Wiseman, *Price Effects and the Commerce Clause: The Case of State Wine Shipping Laws*, 10 J. EMPIRICAL LEGAL STUD. 196, 197–98 (2013).

200. *Id.*

201. *Id.* Ellig and Wiseman also looked at state statutes that impose size restrictions on direct-to-consumer shippers, a type of discriminatory alcoholic beverage statute not considered by this Note. *Id.*

202. Arnold's Wines, Inc. v. Boyle, 571 F.3d 185, 187–88 (2d Cir. 2009).

203. Wine Country Gift Baskets.com v. Steen, 612 F.3d 809, 811–12 (5th Cir. 2010).

204. Siesta Vill. Mkt., LLC v. Granholm, 596 F. Supp. 2d 1035, 1037, 1040 (E.D. Mich. 2008).

205. Ellig & Wiseman, *supra* note 199, at 198. Specifically, online retailers offered price savings as compared to the lowest brick-and-mortar store price on 57 to 81 percent of wine bottles studied (shipping via ground). *Id.* at 211.

206. *Id.* at 204.

excluding out-of-state retailers from the alcoholic beverage market, states are reducing important competitive pressure that keeps prices in check. Although Ellig and Wiseman did not look at laws that impose residency requirements on distributors, such as the law in the *Southern Wine* case,[207] it is reasonable to presume that similar results would present themselves and that these laws also have adverse cost effects for consumers in the alcoholic beverage market by reducing competition from out-of-state distributors.

Additionally, despite the increasing viability and ubiquity of e-commerce,[208] consumers in many states are unable to take advantage of these technological advancements because the states prohibit out-of-state retailers or wholesalers from shipping directly to consumers. Infrastructure is being put in place to support online alcoholic beverage marketplaces.[209] For example, Amazon, a Fortune 100 company that specializes in e-commerce and online marketplaces,[210] has created an online marketplace that enables wineries to offer wine directly to consumers.[211] This service is only available in thirty states due to restrictions on direct shipping in other states.[212] Consumers in the other states are unable to enjoy the same variety and access to boutique products provided by such services.

These limits on direct shipment reduce consumer choice by prohibiting interstate shipment of products only available online.[213] Consumer interest in craft alcoholic beverages has surged, and the three-tier system cannot keep up.[214] Most wholesalers, and many retailers, do not have the ability or the will to stock thousands of low-volume craft products in brick-and-mortar establishments all over the country.[215] Therefore, an online, direct

207. S. Wine & Spirits of Am., Inc. v. Div. of Alcohol & Tobacco Control, 731 F.3d 799, 802–03 (8th Cir. 2013).

208. E-commerce accounted for 6.8 percent of total retail sales in the United States in the third quarter of 2015. Press Release, U.S. Census Bureau, Quarterly Retail E-Commerce Sales: 3rd Quarter 2015 (Nov. 17, 2015), *available at* http://www2.census.gov/retail/releases/historical/ecomm/15q3.pdf.

209. *See* Madeline Puckette, *What's the Three Tier System and Why Is It Corroding?*, WINE FOLLY (Aug. 29, 2014), http://winefolly.com/update/three-tier-system/, *archived at* http://perma.cc/4V3K-3CZN.

210. *Amazon.com*, FORTUNE, http://fortune.com/fortune500/amazon-com-29/ (last visited Apr. 5, 2016).

211. *Wine*, AMAZON.COM, http://www.amazon.com/wine (last visited Apr. 5, 2016); *see also* Puckette, *supra* note 209.

212. *Amazon Wine States*, AMAZON.COM, http://www.amazon.com/gp/help/customer/display.html?nodeId=201020560 (last visited Apr. 5, 2016).

213. *See* FTC REPORT, *supra* note 10, at 18.

214. *See* Tanford, *supra* note 169, at 303.

215. *See id.* ("When there are too many wineries and too few wholesalers, the system will fail because the wholesalers will service the large volume producers and the small wineries will be frozen out of access to the market . . . ."); *see also* HINDY, *supra* note 165, at 166–67 (quoting the Brewers

shipment from an out-of-state retailer or wholesaler may be the only way a consumer can obtain a specific brand or label.

The three-tier system is not able to respond adequately to this rapidly expanding and evolving market wherein consumers are seeking out new, rare, and exotic alcoholic beverage products. Because the official system has failed consumers and states have been slow to allow direct shipping from out-of-state retailers and wholesalers, illegal Internet black markets have developed to meet the demand for out-of-state craft alcoholic beverage products.[216] This back-channel, illicit dealing in alcohol is exactly the kind of problem post-Prohibition alcohol distribution laws were meant to curb.[217]

2. Adverse Effects for Small Producers

Small producers are also often negatively affected by the three-tier system and discriminatory shipping restrictions. These producers do not benefit from the economies of scale that large producers enjoy, and they lose a bigger percentage of their profit for every additional hoop their products must jump through to end up in consumers' hands.[218] Some small producers may not even be able to find a distributor willing to distribute their products because the distributor is unable to sell enough of these producers' beverages to make it worth the distributor's while to take on the additional overhead.[219] A surge of new, small producers[220] and

Association of America as taking the position that "the three-tier system does not cope with the vastly increased number of shipping breweries and the reduced number of wholesalers").

216. *See* Chen, *supra* note 29, at 542–43 (describing how consumer rights are often ignored in these illegal exchanges, leading to price gouging and product integrity concerns); *see also* Dan Adams & Callum Borchers, *Wine Connoisseurs, Vineyards Eagerly Await New Direct Shipping Rules*, BOS. GLOBE (Dec. 26, 2014), http://www.bostonglobe.com/business/2014/12/26/wine-connoisseurs-vineyards-eagerly-await-new-direct-shipping-rules/fniyUCXBn6FGvxZxzuJ7XJ/story.html (describing how Massachusetts consumers resorted to shipping wine to friends in bordering states or hiring companies to "discreetly repackage the wine" to circumvent Massachusetts' direct-shipping ban).

217. *See* Chen, *supra* note 29, at 529.

218. In fact, the 2003 FTC REPORT (cited in *Granholm*) found that small wineries were unable to access broader markets because of "fixed costs that make it uneconomical for a wholesaler to carry lesser-known wines that are available only in small quantities." FTC REPORT, *supra* note 10, at 6; *see also* Green, *supra* note 81, at 26.

219. *See* Reis, *supra* note 167; Tanford, *supra* note 169, at 303 (noting that out of four thousand wineries in the United States, fifty of these constitute 90 percent of the wine that gets distributed through the three-tier system).

220. For example, the number of breweries in the United States has increased from less than 100 in the 1980s to 4,269 as of 2015. *Number of Breweries*, BREWERS ASS'N, http://www.brewersassociation.org/statistics/number-of-breweries/ (last visited Apr. 5, 2016), *archived at* https://perma.cc/AW5B-DWFA. Just between 2012 and 2013, the number of craft breweries grew by 462, an increase of 19.2 percent. *Id.* Large, non-craft breweries, meanwhile, remained constant at twenty-three over the

consolidation in the wholesaler tier[221] have made it increasingly difficult for small producers to find a wholesaler to distribute their products through the traditional three-tier system.[222] Therefore, selling products through an online marketplace, such as the Amazon Wine Marketplace, may be the only way these small producers can connect with out-of-state consumers. But many states prohibit such an arrangement by imposing residency requirements for retailers or wholesalers to directly ship to consumers.

The market for craft alcoholic beverage producers has expanded exponentially in recent years. Craft breweries make up over 98 percent of the breweries in the United States,[223] and their numbers and production levels have increased even as total beer production numbers have been on a slow decline.[224] The discriminatory alcoholic beverage laws discussed in this Note are particularly problematic because they create a barrier to entry for these smaller entities that are looking to expand distribution into new states.[225] This barrier not only reduces consumer choice by inhibiting wider distribution of out-of-state products, but also makes it more difficult for small producers to survive in a competitive marketplace.[226]

Finally, just as large producers can have substantial influence and power over distributors,[227] large distributors can exercise substantial power over both smaller producers and retail establishments.[228] This power imbalance may actually obstruct the free market that the three-tier system is meant to encourage. It can also inhibit small producers who may have

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same period. *Id.* Similarly, in 2005, the number of wineries in the United States had increased "more than three times the number 30 years ago," to over three thousand. Granholm v. Heald, 544 U.S. 460, 467 (2005) (citing FTC REPORT, *supra* note 10, at 6). As of 2011, there were over six thousand wineries nationwide. White, *supra* note 168.

221. Tanford, *supra* note 169, at 316 ("The number of wholesalers has dropped from several thousand in the 1950s to a few hundred today.").

222. *See* Murphy, *supra* note 57, at 825 (explaining how "wholesalers tend to limit their purchases to wines produced only by the largest wineries" while excluding smaller brands); *see also* HINDY, *supra* note 165, at 200 (explaining that his small, Brooklyn-based brewery "would never have been able to get a foothold in New York City if we had been unable to exercise the right to distribute our own beer, at least until we could attract a big distributor").

223. *Stats & FAQs*, *supra* note 8.

224. *See* HINDY, supra note 165, at 182–83 (explaining that in the decade from 2000 to 2010, "[c]raft brewers enjoyed rapid growth . . . but overall beer consumption fell significantly," and that since 2009, AB InBev and MillerCoors, the two largest breweries in the United States, have "lost 17.6 million barrels of production").

225. *See* Chen, *supra* note 29, at 541.

226. *See id.* at 541–42.

227. *See* HINDY, *supra* note 165, at 90–91.

228. *See* Susan Lorde Martin, *Wine Wars—Consumers and Mom-and-Pop Wineries vs. Big Business Wholesalers: A* Citizens United *Example*, 21 KAN. J.L. & PUB. POL'Y 1, 5 (2011); Reis, *supra* note 167.

little say in where their products actually end up,[229] even though the producers may have a better idea of the markets in which their products will thrive.[230] If these producers were able to utilize online marketplaces, they would have access to a nationwide market that would allow them to sell their products everywhere consumer demand appeared.

CONCLUSION

The lower courts have split in their understanding of how the Supreme Court's analysis in *Granholm v. Heald* applies to residency requirements for alcoholic beverage distributors and retailers. Meanwhile, many businesses are suffering from increased and unnecessary costs of doing interstate business, or are precluded from doing business in certain states altogether. The Supreme Court should take up this issue to help alleviate the inconsistency of the lower courts' analyses of these laws in the wake of *Granholm*. The Supreme Court should explain that the heightened scrutiny analysis of *Granholm* applies to laws that discriminate against out-of-state retailers and wholesalers. The Court should reiterate that the Twenty-First Amendment does not change the dormant Commerce Clause analysis for state liquor laws, and that states need to justify residency requirements by showing how they advance legitimate local purposes not adequately served by reasonable nondiscriminatory alternatives. This will provide the lower courts with a broader structural framework to utilize when analyzing future challenges to discriminatory alcoholic beverage regulations. More importantly, it will result in increased consumer choice and lower barriers of entry for small producers, and will advance the development of a national market for alcoholic beverages in line with the purpose of the Commerce Clause and the free market system.

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229. *See Hey! Why Can't I Find Dogfish Head?*, *supra* note 2.

230. *See* Kitsock, *supra* note 2, at 12–13 (discussing the various factors brewers consider in determining where to distribute their beer).

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