No. 08-10146

In the United States Court of Appeals for the Fifth Circuit

SIESTA VILLAGE MARKET LLC, d/b/a SIESTA MARKET;
KEN TRAVIS; KEN GALLINGER; MAUREEN GALLINGER;
DR. ROBERT BROCKIE;
Plaintiffs/Cross-Appellees
v.
JOHN T. STEEN, JR., Commissioner of the Texas Alcoholic Beverage Commission; GAIL MADDEN, Commissioner of the Texas Alcoholic Beverage Commission; JOSE CUEVAS, JR., Commissioner of the Texas Alcoholic Beverage Commission;
Defendants/Cross-Appellants
GLAZERS WHOLESALE DRUG COMPANY INC.;
REPUBLIC BEVERAGE COMPANY;
Intervenor Defendants/Appellees/
Cross-Appellants

WINE COUNTRY GIFT BASKETS.COM; K&L WINE MERCHANTS; BEVERAGES & MORE INC.; DAVID L. TAPP; RONALD L. PARRISH; JEFFREY R. DAVIS;
Plaintiffs/Appellants/Cross-Appellees
v.
ALLEN STEEN, in his official capacity as administrator of the Texas Alcoholic Beverage Commission;
Defendant/Appellee/Cross-Appellee/
Cross-Appellant
GLAZERS WHOLESALE DRUG COMPANY INC.;
REPUBLIC BEVERAGE COMPANY;
Intervenor Defendants/Appellees/
Cross-Appellants

On Appeal from the United States District Court
for the Northern District of Texas, Dallas Division
Case No. 3:06-CV-585
The Honorable SIDNEY A. FITZWATER
United States District Court Judge

BRIEF OF OHIO AND 17 OTHER STATES AS AMICI CURIAE IN SUPPORT OF DEFENDANTS/APPELLANTS SEEKING REVERSAL OF DISTRICT COURT ORDER

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TABLE OF CONTENTS

Page

TABLE OF CONTENTS i

TABLE OF AUTHORITIES iii

I. IDENTITY OF AMICI CURIAE 1

II. SOURCE OF AUTHORITY TO FILE 1

III. INTRODUCTION AND SUMMARY OF ARGUMENT 1

IV. INTEREST OF THE AMICI CURIAE 7

V. ARGUMENT 9

A. Under the Twenty-first Amendment to the United States Constitution, States have broad power to regulate alcohol imports for in-state use. 9

1. The Texas restrictions at issue in this case fall within both the express language and the core purposes of the Twenty-first Amendment. 10

2. States have the power under the Twenty-first Amendment to regulate in-state alcohol sales even when the result is differential treatment of in-state and out-of-state retailers. 14

B. States have multiple compelling interests in exercising their police powers to regulate alcohol sold within their borders. 18

1. Direct shipment interferes with the States' ability to collect legitimate sales and excise taxes, which are significant sources of state revenue. 21

2. The growth of the Internet and e-commerce threatens the States' ability to enforce their liquor laws and preserve a safe and orderly market in alcohol. 26

CONCLUSION 30

CERTIFICATE OF SERVICE .... unnumbered

CERTIFICATE OF COMPLIANCE .... unnumbered

APPENDIX

STAFF OF THE GAO, *INTERNET CIGARETTE SALES: GIVING ATF INVESTIGATIVE AUTHORITY MAY IMPROVE REPORTING AND ENFORCEMENT* GAO-02-743 (AUGUST 2002) .... EX. 1

GENERAL ACCOUNTING OFFICE, GAO/GGD/OCE-00-165, *SALES TAXES: ELECTRONIC COMMERCE GROWTH PRESENTS CHALLENGES; REVENUE LOSSES ARE UNCERTAIN* (JUNE 2000) . EX. 2

TABLE OF AUTHORITIES

Cases **Page**

Bacchus Imports v. Dias,
468 U.S. 263 (1984) 16

Beskind v. Easley,
325 F.3d 506 (4th Cir. 2003) 10

Black Star Farms v. Oliver,
544 F. Supp. 2d 913 (D. Ariz. 2008) 12

Bridenbaugh v. Freeman-Wilson,
227 F.3d 848 (7th Cir. 2000) 25

Brooks v. Vassar,
462 F.3d 341 (4th Cir. 2006) 15, 17

Brown & Williamson v. Pataki,
320 F.3d 200 (2d Cir. 2003) 29

Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.,
445 U.S. 97 (1980) 4, 18

Cherry Hill Vineyard, LLC v. Baldacci,
505 F.3d 28 (1st Cir. 2007) 18

Fulton Corp. v. Faulkner,
516 U.S. 325 (1996) 14

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

Heublein, Inc. v. South Carolina,
409 U.S. 275 (1972) 14, 15

Maine v. Taylor,
477 U.S. 131 (1986) 14, 26

New Energy Co. of Ind. v. Limbach,
486 U.S. 269 (1988) 14

North Dakota v. United States,
495 U.S. 423 (1990) 10, 16

Okla. Tax Comm'n v. Jefferson Lines, Inc.,
514 U.S. 175 (1995) 14

Quill Corp. v. North Dakota,
504 U.S. 298 (1992) 24

Rice v. Rehner,
463 U.S. 713 (1983) 19

Rowe v. N. H. Motor Transp. Ass'n.,
128 S. Ct. 989 (2008) 28

Constitutional Provisions, Statutes, and Rules

U.S. Const., amend. XVIII 2, 9

U.S. Const., amend. XXI .... *passim*

U.S. Const., amend. XXIV, § 2 .... 9, 10

27 U.S.C. § 122 Webb-Kenyon Act 18

Fed. R. App. P. 29(a) 1

Other Resources

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General Accounting Office, GAO/GGD/OCE-00-165, *Sales Taxes: Electronic Commerce Growth Presents Challenges; Revenue Losses Are Uncertain* (June 2000) 24

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The Surgeon General's Call to Action to Prevent and Reduce Underage Drinking 2007 at 5, *available at* http://www.surgeongeneral.gov/topics/underagedrinking/ (visited July 3, 2008)..28

Who is Minding the Internet Liquor Store?, *available at* http://www.msnbc.msn.com/id/14271378/ (visited July 3, 2008) 29

I. IDENTITY OF AMICI CURIAE

Ohio and 17 other States submit this brief as amici curiae under Rule 29(a) of the Federal Rules of Appellate Procedure.

II. SOURCE OF AUTHORITY TO FILE

Rule 29(a) authorizes the States to file this brief without obtaining the consent of the parties or leave of court.

III. INTRODUCTION AND SUMMARY OF ARGUMENT

This case asks whether the Twenty-first Amendment should continue to be read as granting extensive powers to the States to regulate retail liquor sales, or whether the Supreme Court's decision in *Granholm v. Heald*, 544 U.S. 460 (2005), should be expansively interpreted as eviscerating that constitutional authority. *Granholm* itself *answers* this question. As the Court stated, "States have broad power to regulate liquor under § 2 of the Twenty-first Amendment." *Id*. at 493.

Granholm represents a narrow and truly limited exception—for wine producers—to the State's Twenty-first Amendment power. The *Granholm* Court held that the dormant Commerce Clause overcame the States' regulatory interests in that case because sales by wineries—and only by wineries—did not present either the danger of lost tax revenues or other enforcement difficulties because such wineries are federally regulated and thus can be monitored for compliance.

Retail liquor stores, however—which are at issue in this case, unlike in *Granholm*—are not so regulated, and are a hundred times more numerous than wineries, so the concerns that did not justify regulation in that case are at full force here. Moreover, although the decision below purported to enjoin Texas's laws as to wine retailers, the court's logic—once it leaped from wine producers to retailers—applies across the board to all types of alcohol sold at retail, including beer and hard liquor. Thus, the decision below imperils all State regulations that involve interstate direct retail sales of alcohol, and that in turn threatens all State interests related to controlling alcohol, including the prevention of sales to minors. Given the States' strong interests, the decision would be wrong even as a matter of "regular" dormant Commerce Clause analysis, but the decision is especially wrong in light of the States' unique power over alcohol, as granted by the Twenty-first Amendment.

The Twenty-first Amendment arose from the pre-Eighteenth Amendment history of alcohol regulation in this country. Before the Eighteenth Amendment and federal Prohibition, the States regulated the sale and distribution of alcohol within their own borders. National regulation of alcohol, by way of a total nation-wide prohibition of its sale and consumption, was attempted in 1919 with the ratification of the Eighteenth Amendment. Fourteen years later, after this experiment in national regulation failed, the Twenty-first Amendment returned

regulation of the sale and consumption of alcohol to the States. As Section Two of the Amendment states: "The transportation or importation into any State . . . for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited."

The Twenty-first Amendment empowers States to pursue several goals regarding alcohol, and it allows the States to choose different means to achieve those goals. States often use that power to promote temperance, to ensure orderly market conditions, and to raise revenue. States use several different tools to achieve these purposes, with regulations that target the varied stages of importation, sales, and consumption of alcohol.

In exercising their Twenty-first Amendment powers, most States rely on the concept of locality: ensuring that some local entity is involved before liquor reaches the end consumer, so that the State can keep a closer watch. In-state entities that buy and sell liquor are more easily subject to the State's investigatory and enforcement power. Retailers in particular can be investigated for violations of the health, safety, and tax codes when they are located in-state. By contrast, when retailers are located out-of-state, investigation and enforcement becomes difficult, if not impossible. Retailers across the country far outnumber wine producers. Thus, while a State can keep an investigative eye on local licensees, it cannot realistically investigate the many out-of-state entities that deal with the

State's citizens only remotely, whether online or by mail. Moreover, the out-of-state retailer has far less incentive to comply with a State's laws than the out-of-state wine producer because it has only its home state license to lose; for them, unlike for wine producers, there is no federal license to protect.

Thus, the Twenty-first Amendment gives States virtually complete control over whether to permit the importation and sale of liquor and how, if a State decided to allow the importation and sale, to structure the liquor distribution system. *Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 110 (1980). Texas's regulation at issue here allows retailers to ship liquor directly to consumers, but only to consumers who are located within the same Texas county in which the retailer is located. This regulation falls squarely within the Twenty-first Amendment's grant of State control over the importation and sale of liquor.

Texas's regulatory scheme is consistent with *Granholm*. The *Granholm* Court narrowly held that, because of the unique nature of wineries, State regulations that treat out-of-state wine producers differently from in-state wine producers, to the disadvantage of those out-of-state wine producers, violate the dormant Commerce Clause. Specifically, the Court held that the States' concern with preventing Internet wine sales to minors was not compelling because minors were "less likely to consume wine, as opposed to beer, wine coolers, and hard

liquor." 540 U.S. at 490. Similarly, the Court held that the State's interest in policing tax collection of wine sales was not persuasive because the combination of state and federal licensing of wine producers adequately protected the "State from lost tax revenue." *Id.* at 492. However, this analysis does not apply to out-of-state retailers, as opposed to wine producers, as the retailers are not federally licensed in the way that wineries are, and the greater number of retailers make them harder to monitor for compliance with tax and other laws. Further, in most or all States, wine retailers—again, unlike wineries—typically sell beer or other liquors, so some of those retailers, once they build direct customer relationships that bypass local regulations, will surely wish to sell their other products as well. The decision below directly addressed wine, but the Texas statutes at issue cover all alcohol, and the decision's analysis appears to apply logically to all alcohol sales. That, in turn, implicates not only tax concerns, but also the States' ongoing concerns with the problem of minors buying alcohol online. The *Granholm* Court expressly acknowledged minors' greater interests in purchasing non-wine alcoholic products, *id.* at 490, and moreover, the evidence of minors' purchases, which was not fully established in *Granholm,* has since been verified by studies and other materials cited below. Thus, this case presents State concerns greater than those at issue in *Granholm*.

Not only does *Granholm* not help plaintiffs' cause, but instead, *Granholm* supports Texas's regulations here, because plaintiffs' attack is so broad that it seeks to invalidate a system that *Granholm* validated. Here, plaintiffs do not merely challenge a law, as in *Granholm*, that simply regulates a product as it moves across state lines. Rather, these plaintiffs attack Texas's three-tier scheme of liquor control. Their attack may be formally limited to the third tier, or retail sales, but by suggesting that the State's regulation of that retail tier is unconstitutional, their attack would surely undermine the entire three-tier scheme. Yet, as *Granholm* itself indicates, the States may legitimately impose a three-tier scheme of liquor regulation under their Twenty-first Amendment powers. *Granholm*, 544 U.S. at 489.

In creating such a scheme, States have compelling interests in using their powers to regulate liquor sold within their borders. Specifically, States have an interest in preventing minors' ready and easy access to liquor, and in properly collecting tax revenue. Direct shipping by retailers would make it difficult, if not impossible, for the States to address these concerns. Because of the sheer number of retailers across the country with the potential to ship directly to a consumer without the knowledge of the consumer's home state, a State would be hard-pressed, first, to identify the transaction itself, and second, to verify that the transaction complied with state law.

For these reasons, the States urge this Court to reverse the decision of the court below and hold that Texas's regulation is both proper under the Twenty-first Amendment and that it does not violate the dormant Commerce Clause. If, however, the Court determines that Texas's laws are unconstitutional, then the Amici States take no position on the specific structure and mechanics of Texas's permit system and the propriety of the remedy that the district court ordered below.

IV. INTEREST OF THE AMICI CURIAE

The States are greatly concerned about maintaining the ability to regulate the flow of alcohol into their borders. This is particularly so in light of the growth of the Internet and electronic commerce, both of which have dramatically increased shipments from out-of-state sources directly to consumers' doorsteps. These evolving technologies threaten the States' ability to maintain control over alcohol distribution and to ensure that alcohol does not end up in the hands of children. These same technologies also threaten the States' ability to collect legitimate taxes on these consumer products.

The States submit this amicus brief to assert the importance of their roles in controlling the importation of liquor across their borders. The Amici States believe that States may legitimately distinguish between in-state and out-of-state retailers with regard to the ability to ship directly to consumers. This distinction falls

squarely within the Twenty-first Amendment's grant of power to the States to regulate alcohol imports.

The regulatory system used by most States, the three-tier system, allows the States to address legitimate concerns of enforcing and monitoring their liquor distribution systems by requiring all alcohol shipments to enter the State and arrive to the consumer through a licensed entity with a localized presence. By prohibiting out-of-state retailers from directly shipping to consumers, States are doing nothing more than requiring that all liquor sold for use in the State be purchased from a licensed entity that is subject to the enforcement and tax authority of the State.

The Amici States have a strong interest in maintaining appropriate control over the distribution of alcohol. Accordingly, the States are an important voice in any conversation regarding the appropriate scope of the Twenty-first Amendment. The States raise that voice to ask the Court to reverse the decision below and hold that States may restrict out-of-state retailers from shipping directly into the State's borders, while at the same time, States may allow their licensed in-state retailers to ship directly to that State's residents.

V. ARGUMENT

A. Under the Twenty-first Amendment to the United States Constitution, States have broad power to regulate alcohol imports for in-state use.

The States possess broad power to regulate alcohol entering their borders for in-state consumption. Through the Twenty-first Amendment, the Constitution expressly grants the States the power to regulate this form of interstate commerce.[1] More than simply repealing the Eighteenth Amendment, the Twenty-first Amendment affirmatively shifted the authority to regulate and control the in-state sale and distribution of alcohol away from the federal government and back to the States themselves.

As the Supreme Court indicated in *Granholm*, a State's power to regulate imported alcohol is not unlimited and may occasionally conflict with the dormant Commerce Clause. However, the *Granholm* Court recognized that a State's power in this area is limited by the dormant Commerce Clause only in very narrow circumstances—when a wine producer ships its own product into a State. See, e.g., *Granholm*, 544 U.S. at 493 (holding invalid under the Commerce Clause New York and Michigan regulations allowing direct shipment of wine from in-state

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[1] The text of the Twenty-first Amendment reads, in pertinent part, "The transportation or importation into any State . . . for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited." U.S. Const., amend. XXIV, § 2.

wineries while prohibiting it from out-of-state wineries). This case does not fall within that narrow set of circumstances. Instead, the regulation at issue here is consistent with both the plain text and the core purposes of the Twenty-first Amendment, and any concerns about differential treatment of out-of-state and in-state retailers must yield to the States' power to regulate the in-state sale and distribution of alcohol under the Twenty-first Amendment.

1. The Texas restrictions at issue in this case fall within both the express language and the core purposes of the Twenty-first Amendment.

The Twenty-first Amendment explicitly empowers the States to regulate "[t]he transportation or importation . . . of intoxicating liquors" for delivery or use in the State. U.S. Const., art. XXIV, § 2. The regulations here represent Texas's attempt to do just that, and the State is therefore permitted to enact such regulations under its Twenty-first Amendment powers.

In addition to falling within the Amendment's express language, the Texas regulations are consistent with the "core purposes" of the Amendment. Those "core purposes" include allowing States to "impose temperance in the consumption of alcoholic beverages," *Beskind v. Easley*, 325 F.3d 506, 513 (4th Cir. 2003), ensure orderly market conditions, *North Dakota v. United States*, 495 U.S. 423, 432 (1990), and raise revenue, *id*.

To achieve these core purposes, States have enacted a variety of legislative schemes. Of utmost importance within these schemes is the concept of locality. In-state retailers are plainly subject to a State's regulations and enforcement powers. A State is able to impose inspections, subpoenas, taxes, record-retention requirements, and license sanctions on retailers within the State, and any violation of those requirements or other state laws can result in a fine or a suspension or revocation of the retailer's license. Critically, because the retailers are in-state, the State has the power and practical ability to see that its regulations are appropriately enforced.

In the case of out-of-state retailers, in contrast, none of these regulatory safeguards exist. A State may wish to impose a suspension or fine on an out-of-state retailer—for selling to minors, for example—but the State will be unable to enforce effectively such a punishment (unless the out-of-state retailer has an in-state presence). Similarly, a State has no way to inspect an out-of-state retailer for possible health violations or adulterated liquor. Finally, a State is unable to enforce collection of alcohol taxes against an out-of-state retailer that ships directly to consumers within the State. Thus, the State has only two choices: restrict direct shipments by out-of-state retailers, or leave this potentially dangerous product virtually unregulated whenever it is shipped directly to a consumer from out-of-state.

The *Granholm* Court held that because out-of-state wineries face the loss of state and federal licenses if they fail to comply with state law, the States' regulation-through-suspension-or-revocation argument fails. *Granholm*, 544 U.S. at 490. However, wine and liquor retailers differ starkly from wineries in terms of federal licensing. Alcohol retailers greatly outnumber wineries. According to a 2007 survey conducted by TDLinx (an ACNielson brand) for the Beer Institute and National Beer Wholesalers Association, there were 531,034 retail alcohol establishments in the United States. BeerServesAmerica.org, *available at* http://www.beerservesamerica.org/state.php?state=US (visited July 3, 2008). If even a small percentage of these retailers started to directly ship liquor into any given State, that State would be hard-pressed to police such out-of-state entities. Wineries, by contrast, are not nearly as common; in contrast to over 500,000 retail outlets for beer and liquor, there are only about 4,700 wineries in the nation. See *Black Star Farms v. Oliver,* 544 F. Supp. 2d 913, 917 (D. Ariz. 2008) (reporting 4,700 wineries as of 2007).

Moreover, unlike the wineries in *Granholm*, none of these wine or liquor retail establishments has a federal license; all liquor retailers are regulated only by the State of their geographic location. Thus, to ensure compliance of an out-of-state liquor retailer through suspension or revocation of a license, a State would have to work with the licensing State and hope for cooperation in disciplining one

of that licensing State's home businesses. To be effective, a hearing on the license discipline would need to occur in both the State where the retailer is located and in the State where the product was illegally delivered. This fragmented litigation would require the transportation of witnesses, state agents, documents, and attorneys. Between the cost and logistical problems, the enforcement of such an action is unlikely. Each State can more effectively regulate by restricting or banning the direct shipment by out-of-state retailers of liquor, if the State so chooses, rather than trying to discipline out-of-state retailers through licensing.

In short, the sale and delivery of alcohol is a uniquely local issue best regulated by state and local governments. Indeed, the intensely local nature of alcohol regulation is shown not only by the federalist nature of the Twenty-first Amendment, which leaves regulation to the States, but also is demonstrated by many States' further delegation of regulatory power to local subdivisions. Many States are divided into "wet" and "dry" counties, townships, or even precincts that completely ban the sale of alcohol. Thus, a mandate that States allow direct shipments from out-of-state would trump these local controls along with statewide laws.

Because it is consistent with both the express language and the core purposes of the Twenty-first Amendment, the regulation is a valid exercise of the State's regulatory power, and the decision below should be reversed.

2. States have the power under the Twenty-first Amendment to regulate in-state alcohol sales even when the result is differential treatment of in-state and out-of-state retailers.

The dormant Commerce Clause "is driven by concern about economic protectionism—that is, regulatory measures designed to benefit in-state economic interest by burdening out-of-state competitors." *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 273-74 (1988); see, e.g., *Maine v. Taylor*, 477 U.S. 131, 151 (1986) ("As long as a State does not needlessly obstruct interstate trade or attempt to 'place itself in a position of economic isolation' it retains broad regulatory authority to protect the health and safety of its citizens . . . ." (citation omitted)); *Fulton Corp. v. Faulkner*, 516 U.S. 325, 330 (1996) ("[T]he Framers' purpose [was] to 'prevent a state from retreating into economic isolation.'" (citing *Okla. Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 180 (1995))). But the Texas restrictions at issue here, and similar regulations in other States, are animated not by economic protectionism but instead by valid health and safety concerns.

In addition to a proper motive, the Texas regulations serve a valid interest that many courts, including the Supreme Court, have recognized: accountability in liquor distribution. The Supreme Court addressed this issue when South Carolina passed a law requiring all producers of alcohol who were shipping alcohol into the State to have a resident representative in the State. *Heublein, Inc. v. South*

Carolina, 409 U.S. 275, 277 (1972). The Court held that the requirement did not violate the Commerce Clause because, "by requiring manufacturers to localize their [alcohol] sales, South Carolina establishes a check on the accuracy of these records." *Id.* at 282. Similarly, the Fourth Circuit has held that requiring all alcohol sales to be made through a State's three-tier system, except for the importation of a small amount for personal consumption, is an acceptable regulation "of the transportation, importation and use of alcoholic beverages in the State [that] is protected by the Twenty-first Amendment." *Brooks v. Vassar*, 462 F.3d 341, 354-55 (4th Cir. 2006). The Texas restriction at issue here, limiting direct shipment of alcohol to the county in which the retailer is located, likewise attempts to achieve accountability by requiring a localized presence. The regulation is motivated by a proper purpose, ensuring the health and safety of Texas consumers, and achieves a legitimate goal, establishing accountability in liquor distribution.

The Texas alcohol regulatory scheme takes the form of a three-tier system, licensing and regulating alcohol sales on three distinct levels—production, distribution, and retail sales. This type of system is common among States, and the Supreme Court has unequivocally approved such a scheme. See, e.g., *Granholm*, 544 U.S. at 489 ("States may also assume direct control of liquor distribution through state-run outlets or funnel sales through the three-tier system. We have

previously recognized that the three-tier system itself is 'unquestionably legitimate.'" (quoting *North Dakota v. United States*, 495 U.S. 423, 432 (1990))). A key facet of this three-tier system, of course, is that it is exclusive; licensed producers may sell only to licensed wholesalers, who in turn may sell only to licensed retailers. Allowing an end run at any point undercuts the entire system, making a mockery of *Granholm*'s reassurance that the three-tier system remains a valid form of State regulation.

Plaintiffs' challenge to the Texas scheme effectively amounts to a challenge to the constitutionality of the three-tier system. Plaintiffs assert that the requirement that the direct-ship customers of a retailer be located in the retailer's county amounts to an impermissible ban on direct shipping of alcohol by out-of-state retailers. However, this statute does not on its face benefit in-state products to the detriment of similar out-of-state products. Rather, it regulates the retailer itself—one of the three permissible tiers or control points within the entire regulatory scheme.

By contrast, the Supreme Court's decisions—including *Granholm* and *Bacchus Imports v. Dias*, 468 U.S. 263 (1984)—focus on the disparate treatment of in-state goods and similar or identical out-of-state goods. In *Granholm*, the Court stated that even if the Twenty-first Amendment limits the effect of the dormant Commerce Clause, "[t]he Amendment did not give States the authority to pass

nonuniform laws in order to discriminate against out-of-state *goods*, a privilege they had not enjoyed at any earlier time." *Granholm*, 544 U.S at 484-85 (emphasis added). The *Granholm* Court struck down laws that discriminated against out-of-state producers of certain products to the benefit of in-state producers of similar products, stating that "[t]he mere fact of nonresidence should not foreclose a *producer* in one State from access to markets in other States." *Id.* at 472 (emphasis added). Retailers, on the other hand, do not promote one particular product or even a line of products from one particular producer, and they do not necessarily promote one State's products over those of another State. Rather, retailers sell many different product lines and many different kinds of products, from many States and often from foreign countries. Consequently, by treating out-of-state liquor retailers differently from in-state retailers, a State does not benefit its own producers or products at the cost of other States' producers or products and thus cannot violate the dormant Commerce Clause.

Because this challenge does no more than compare the status of an in-state entity under the three-tier system with its out-of-state counterpart, it challenges the three-tier system itself. And *Granholm* and other cases—as well as the text of the Twenty-first Amendment—have already blessed that system. *Granholm*, 544 U.S. at 489; see, e.g., *Brooks*, 462 F.3d at 352.

States have virtually complete control over how to structure their liquor distribution systems, and a State's decision to limit the geographic area in which alcohol products are direct-shipped falls within its regulatory power under the Twenty-first Amendment. *Granholm*, 544 U.S. at 488 (citing *Midcal*, 445 U.S. at 110). Texas has determined that the best way to regulate the direct shipping of alcohol by retailers is to require that a retailer only ship to consumers within the retailer's county. This decision by the Texas legislature cannot be challenged as discriminating against out-of-state interests because the regulation is a valid exercise of the legislature's Twenty-first Amendment power. See, *e.g.*, *Cherry Hill Vineyard, LLC v. Baldacci*, 505 F.3d 28, 36 (1st Cir. 2007) (holding that a Maine statute banning direct shipping and requiring face-to-face transactions for the sale of alcohol is facially neutral).

B. States have multiple compelling interests in exercising their police powers to regulate alcohol sold within their borders.

The Twenty-first Amendment, the Webb-Kenyon Act,[2] and the States' inherent police power all authorize state regulation of how alcohol flows into the

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[2] The Webb-Kenyon Act states:

> The shipment or transportation . . . of any spirituous, vinous, malted, fermented, or other intoxicating liquor of any kind, from one State . . . into any other State . . . which said spirituous, vinous, malted, fermented, or other intoxicating liquor is intended, by any person interested therein, to be received, possessed, sold, or in any manner used, either in the original package or otherwise, in violation of any law of such State . . . is hereby prohibited.

State. See *Rice v. Rehner*, 463 U.S. 713, 724 (1983) (noting the State's unquestionable interest in the liquor traffic that occurs within its borders, independent of the authority conferred on the States by the Twenty-first Amendment). The type of regulation Texas enacted here falls well within a State's police power, as it imposes only minor limitations on imports, and the limitations are entirely justified by the dangers that unrestricted alcohol shipments present. The limitations are justified for three reasons. First, the regulations do not prevent access to state markets or state consumers; they merely regulate the means by which alcohol reaches consumers. Second, the growth of the Internet and e-commerce threatens the States' ability to enforce their liquor laws and preserve a safe and orderly market in alcohol. Finally, direct shipment interferes with the States' ability to collect legitimate sales and excise taxes, which are significant sources of State revenue.

When the *Granholm* Court considered the States' concerns with taxing out-of-state producers, it found that by requiring a permit to direct ship, the States would be able to require tax information from the producers. The Court noted that wineries were federally licensed, and that those federal licenses required the wineries to comply with State laws, including tax laws. Retailers are not similarly licensed at the federal level. Moreover, States' own tax compliance efforts,

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27 U.S.C. § 122.

without the federal controls, will surely fall short, as the sheer numbers of out-of-state retailers that could ship directly to the consumer make it impossible to States to ensure that out-of-state retailers comply: without a local presence either of the retailer itself or through an in-state licensed wholesaler, there is no way to verify the information that is being reported by the out-of-state retailers. It is likely that multiple retailers could ship directly to consumers and the State would be none the wiser. Accordingly, applying *Granholm*'s balancing—States' interests against the discriminatory effects on wine producers—to the situation presented here—States' interests against the discriminatory effects on retails—favors the States in protecting the safety, health, and welfare of their citizens.

Further, when the *Granholm* Court weighed the States' regulatory concerns regarding minors, it again looked at the nature of wines and wineries. In particular, the States had asserted concerns that allowing wineries to direct-ship would impair efforts to keep alcohol out of the hands of minors. The Court found little evidence that the purchase of wine over the Internet by minors is a problem, so the Court said that this concern could not justify the discriminatory state regulations at issue there. 544 U.S. at 490. But here, when the district court improperly leapt from *Granholm*'s winery focus to all wine retailers, it did so in a way that logically threatens State regulations as to *all* retail sales, including the beer and liquor that minors often crave. The Texas laws at issue cover all alcoholic beverages, and

indeed, in most or all States, there is no legally recognized entity called a "wine retailer." For example, in Ohio, anyone licensed to sell wine may also sell mixed alcoholic beverages, including some that appeal to minors, such as liquor-laced lemonade. Once those retailers may legally ship wine to Texans, the likelihood of beer or liquor shipments is a clear danger, both as a matter of the district court's logic and as a practical reality. Thus, the States' concerns with minors' access, which were minimized regarding wineries in *Granholm*, return to the fore in this case.

In addition, several States have state-run monopolies for the sale of spirits—something *Granholm* recognized as legitimate. 544 U.S. at 489 ("States may also assume direct control of liquor distribution through state-run outlets."). Allowing direct shipment by out-of-state retailers violates those States' rights to maintain those legitimate monopolies.

For these and other reasons detailed below, the States' interests justify maintaining the integrity of the three-tier system without being forced to allow direct shipments from out-of-state retailers.

1. Direct shipment interferes with the States' ability to collect legitimate sales and excise taxes, which are significant sources of state revenue.

Along with the States' interests in preventing sales to minors and maintaining an orderly market, States also share an interest in regulating liquor

markets to ensure proper tax collection. State legislatures have decided that limiting, restricting, or completely banning out-of-state retailers from shipping directly to consumers serves these tax collection interests. The *Granholm* Court determined that this concern is insufficient as it applies to wine producers' direct shipments of wine. That was so, said the Court, because a State could protect itself against lost tax revenue by requiring a permit as a condition of direct shipping. More important, the Court also noted that out-of-state wineries have added incentive to comply with state tax regulations because wineries face the loss of state and federal licenses if they fail to comply. *Id.*, 544 U.S. at 490.

But retailers are altogether different from wineries. As noted above, in 2007, there were 531,034 retail establishments in the United States. BeerServesAmerica.org, *available at* http://www.beerservesamerica.org/state.php?state=US (visited July 3, 2008). Even if only a small percentage of these retailers decide to obtain a permit and agree to pay state taxes, States would still face a huge number of retail establishments doing business in the State without any direct oversight by the State. How does a State regulate even 100,000 entities across the country, let alone 531,034 entities? Online audits would not be effective. As the *Granholm* Court noted, wineries and wholesalers risk losing a federal permit. Retail establishments, by contrast, do not have federal licenses; they are regulated only by the State of their geographic location. And, as described

above, obtaining the cooperation of the retailer's home State in disciplining one of its own businesses is impracticable and unlikely.

A GAO study noted that non-reporting of Internet sales by Internet vendors can significantly affect state sales tax receipts. Staff of the GAO, *Internet Cigarette Sales: Giving ATF Investigative Authority May Improve Reporting and Enforcement* GAO-02-743 (August 2002) at 11 (Ex. 1). The States' experience with Internet cigarette vendors illustrates the difficulty of collecting sales and excise taxes on direct shipments that bypass the state system. Internet cigarette vendors do not comply with the tax reporting requirements of the Jenkins Act. General Accounting Office, GAO-02-743, Internet Cigarette Sales (2002). The GAO reviewed 147 web site addresses for Internet cigarette vendors in the United States, and not a single site posted information that indicated the vendors complied with the Jenkins Act. GAO-02-743 at pp. 3, 4. "Conversely, information posted on 78 percent of the websites indicated the vendors do not comply with the Act." *Id.* at 4.

Nor, as the study shows, can States rely on buyers, rather than sellers, to remit taxes. To be sure, a consumer who buys products over the Internet from out-of-state vendors is liable for his own State's sales tax. *Id.* But despite a detailed federal regulation requiring reporting of information, officials from the nine States noted in the GAO study all expressed concern over the Internet cigarette vendors'

noncompliance with the Jenkins Act and the resulting loss of state sales tax revenue. *Id.* at 11. California estimated a loss of approximately $13 million in tax revenue during a thirty-month period. *Id.*

The States' experience with Internet cigarette sales likely indicates what will happen with online alcohol sales. The States have little reason to expect that they will have better luck taxing online alcohol sales than they have had with cigarette sales. Indeed, in a direct-shipping world, the State may have no way to collect a sales tax from an out-of-state retailer at all. See *Quill Corp. v. North Dakota,* 504 U.S. 298, 315-18 (1992) (holding that Commerce Clause bars imposition of sales tax where only contact between out-of-state entity and in-state consumer is mail ordering and direct shipment). Conversely, by requiring out-of-state retailers and other alcohol providers to participate in the three-tier distribution system, States are able to collect legitimate sales and excise taxes.

States' revenue concerns are not alleviated by any suggestion that States may rely on individual consumers to remit sales and excise taxes, as experience has already shown how tax revenues escape when online sales grow. The Government Accounting Office Report on sales taxes and electronic commerce reported that "use tax compliance by individual purchasers (for all purchases, not just those over the internet) was extremely low—on the order of 0 to 5 percent." General Accounting Office, GAO/GGD/OCE-00-165, *Sales Taxes: Electronic*

Commerce Growth Presents Challenges; Revenue Losses Are Uncertain (June 2000) at 17 (Ex. 2). A Congressional Budget Office paper also noted this threat: "[T]he administrative costs of use taxes paid by purchasers are relatively high and the rate of collections is quite low." Economic Issues in Taxing Internet and Mail-Order Sales, Congressional Budget Office paper (Oct. 2003) at 3, *available at* www.cbo.gov/showdoc.cfm?index+=4638 (visited July 3, 2008). One estimate is that the State of Florida alone may lose between $321 million and $1.28 billion in taxes on remote sales in 2003. See GAO Sales Taxes Report at App. V. "[S]tates have insuperable problems collecting their use taxes when people buy from out-of-state vendors that do not collect sales taxes. Noncompliance is almost impossible to detect, and rampant civil disobedience ensures that a handful of prosecutions would not be effective. Private gains from violating the laws vastly exceed the anticipated legal penalties." *Bridenbaugh v. Freeman-Wilson*, 227 F.3d 848, 850 (7th Cir. 2000).

In response to these concerns, several States, including Texas, have decided to require out-of-state retailers to sell through wholesalers that are present in the State. Such a regulatory scheme is a legitimate attempt at handling these problems, and it falls within the States' Twenty-first Amendment powers. As a result, the Texas regulation should be upheld, and the decision below should be reversed.

In sum, this case does not ask whether out-of-state retailers are forbidden from selling to in-state consumers; retailers consistently sell liquor in foreign States. The real issue is whether such out-of-state retailers are entitled to bypass State regulation and sell directly to consumers without the State having a say, or whether such retailers must comply with a State's established system if it wants to sell to customers in that State. That question should be easy: an out-of-state retailer has no constitutional right to bypass State laws controlling alcohol. Even in non-alcohol contexts, the Supreme Court has explained that "the Commerce Clause 'is not a guaranty of the right to import into a State whatever one may please, absent a prohibition by Congress, regardless of the effects of the importation upon the local community.'" *Taylor,* 477 U.S. at 149 n.19. Add the Twenty-first Amendment to the mix, and the answer is simple: the State regulations at issue here are perfectly valid, and the Court should uphold them.

2. The growth of the Internet and e-commerce threatens the States' ability to enforce their liquor laws and preserve a safe and orderly market in alcohol.

The States' inability to enforce state liquor laws against out-of-state entities is a very real problem, as is the harm caused by sale and shipment to minors by these out-of-state entities. The *Granholm* Court referenced a study by the Federal Trade Commission to downplay the States' concerns of direct shipping's ability to give minors greater access to alcohol. The Court stated in part that "minors are

less likely to consume wine, as opposed to beer, wine coolers, and hard liquor." *Granholm*, 544 U.S. at 490 (citing FTC Report 34). However, unlike the out-of-state wineries at issue in *Granholm*, liquor retailers do not limit their inventories or their sales to wine; rather, they have the authority to, and often do, stock and sell not only wine, but also beer and distilled spirits. Accordingly, invalidating the States' ability to distinguish between in-state and out-of-state retail sales of wine directly implicates the States' regulatory control over all out-of-State retail sales of alcohol, and thus implicates minors' access to all forms of alcohol. The number of alcohol retailers greatly amplifies this problem: again, States face the challenge of monitoring over 500,000 retailers nationwide, as opposed to the 4,700 federally-licensed wineries.

Minors can and do obtain alcohol online; this is not a phantom problem. On the Internet, alcohol websites offer a "cyber playground" for underage youths. A study by the Center on Alcohol Marketing and Youth at Georgetown University revealed that alcohol websites received 700,000 in-depth visits by underage youth from July through December 2003. See *Clicking with Kids: Alcohol Marketing and Youth on the Internet,* Center on Alcohol Marketing and Youth, *available at* http://camy.org/factsheets/print.php?FactsheetID=21 (visited July 3, 2008); full report *available at* http://camy.org/research/internet0304/report-high.pdf (visited July 3, 2008). The study revealed that thirteen percent of all visitors to fifty-five

alcohol company websites were under the age of twenty-one. While it is true that the sites generally require age verification, the only method of such "verification" is asking the user whether he or she is twenty-one years of age or older. The problem with this verification system, of course, is that there is no way to verify the user's truthfulness. *Id.*

Allowing Internet sales of highly dangerous and highly regulated products, including alcohol, at issue here, and tobacco, analyzed by the Supreme Court earlier this year, is a genuine concern for state legislatures and other regulatory bodies. See *Rowe v. N. H. Motor Transp. Ass'n.*, 128 S. Ct. 989, 999 (2008) (Ginsburg, J., concurring) ("State measures to prevent youth access to tobacco, however, are increasingly thwarted by the ease with which tobacco products can be purchased through the Internet."). Justice Ginsberg's concern regarding the ease with which minors are able to purchase tobacco over the Internet is even more pertinent when the substance at issue is alcohol rather that tobacco. In 2007, the Surgeon General reported that alcohol far surpassed tobacco as the drug of choice among adolescents. The Surgeon General's Call to Action to Prevent and Reduce Underage Drinking 2007 at 5, *available at* http://www.surgeongeneral.gov/topics/underagedrinking/ (visited July 3, 2008).

Ample evidence shows minors' ability to obtain alcohol from out-of-state online liquor retailers. In April 2006, a study conducted by Teen Research

Unlimited for the Wine & Spirits Wholesalers of America, Inc. reported that of the one thousand youths aged fourteen to twenty who took the survey; two percent reported having bought alcohol online; twelve percent reported having a friend who had bought alcohol online; nearly one in ten said they had visited a web site that sells alcohol; and nearly four in ten thought alcohol is available by Internet. See Survey Reveals Minor Buy Alcohol Online, *available at* http://www.pointclickdrink.com/about/Kidsalcohol.cfm (visited July 3, 2008); also reported at WebMD, http://www.webmd.com/parenting/news/20060811/ teens-buy-alcohol-online (visited July 3, 2008); full study *available at* http://www.hoosier-rad.org/HRAD/Docs/TRUSurvey080206.pdf (visited July 3, 2008). NBC News, in reporting on the Teen Research Unlimited survey, conducted its own research and found that two packages of alcohol ordered from internet web sites were delivered to a State where mail order alcohol is illegal: "one was delivered to a 15-year-old who happened to be standing in the front yard, no questions asked." See Who is Minding the Internet Liquor Store?, *available at* http://www.msnbc.msn.com/id/14271378/ (visited July 3, 2008). Accordingly, the regulations here are justified by important concerns about alcohol being sold to minors. See *Brown & Williamson v. Pataki*, 320 F.3d 200 (2d Cir. 2003) (upholding a regulation prohibiting Internet, telephone, or mail order sales of cigarettes because of the serious threat to public health, safety, and welfare).

CONCLUSION

For the above reasons, the Amici States respectfully request the Court reverse the district court decision.

RESPECTFULLY SUBMITTED this 14th day of July, 2008.

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