No. 08-10146

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

SIESTA VILLAGE MARKET LLC, doing business as 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.

(*caption continued on inside cover)*

On Appeal from the United States District Court for the Northern District of Texas

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BRIEF *AMICI CURIAE* FOR WINE & SPIRITS WHOLESALERS OF AMERICA, INC., NATIONAL BEER WHOLESALERS ASSOCIATION, AND SAZERAC COMPANY IN SUPPORT OF DEFENDANTS AND REVERSAL

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(*case caption – continued*)

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,

v.

GLAZERS WHOLESALE DRUG COMPANY INC.; REPUBLIC BEVERAGE COMPANY,

Intervenor Defendants-Appellees-Cross-Appellants.

No. 08-10146, Siesta Village Market, et al. v. Perry, et al.

SUPPLEMENTAL STATEMENT OF INTERESTED PERSONS

The undersigned counsel of record certifies that the following listed persons and entities as described in the fourth sentence of Rule 28.2.1 and in the second sentence of Rule 29.2 have an interest in the outcome of this case. These representations are made in order that the judges of this court may evaluate possible disqualification or recusal.

1. AMICI CURIAE:

Specialty Wine Retailers Association

Wine & Spirits Wholesalers of America, Inc.

National Beer Wholesalers Association

Sazerac Company

2. PARTIES:

Plaintiffs - Appellants - Cross-Appellees:

Siesta Village Market, LLC, doing business as Siesta Market

Ken Travis

Ken Gallinger

Maureen Gallinger

Dr. Robert Brockie

Wine Country Gift Baskets.com

K&L Wine Merchants

Beverages & More, Inc.

David L. Tapp

Ronald L. Parrish

Jeffrey R. Davis

Defendants – Appellees – Cross-Appellants:

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

Alan Steen, in his official capacity as administrator of the Texas Alcoholic Beverage Commission

Intervenor Defendants – Appellees – Cross-Appellants:

Glazer's Wholesale Drug Company, Inc.

Republic Beverage Co., now known as Republic National Distributing Company

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STATEMENT OF INTEREST OF *AMICI CURIAE*

Wine & Spirits Wholesalers of America, Inc. ("WSWA") is a national trade organization and the voice of the wholesale branch of the wine and spirits industry. Founded in 1943, WSWA represents nearly 340 companies in all 50 States and the District of Columbia that hold state licenses to act as wine and/or spirits wholesalers and/or brokers. WSWA's members distribute more than 80% of all wine and spirits sold at wholesale in the United States.

Founded in 1938, the National Beer Wholesalers Association ("NBWA") serves as the national membership organization of the beer distribution industry representing the interests of 2,750 beer distributors nationwide. NBWA's members reside in all 50 States, including 148 distributors in Texas. Texas' beer distributors are responsible for delivering a wide variety of fresh beer to 36,547 licensed retail establishments in the State, and work closely with those retailers and regulators to ensure the product is consumed only by those individuals legally permitted to purchase it.

Sazerac Company is a privately held, family-owned manufacturer and marketer of distilled spirits that sells its products in all 50 States, exports to over ten countries and has 350 employees. Sazerac Company has been in business since 1850 and also owns the Buffalo Trace Distillery which has been in continuous operation since 1773.

In Texas and most other States, a three-tier distribution system plays a central role in the State's regulation of the importation and distribution of beverage alcohol. *Amici* are intimately involved in each tier of those systems. They know first-hand that the requirement that imported alcoholic beverages generally must be sold by licensed in-state wholesalers and licensed in-state retailers enables Texas and other States to maintain orderly markets and ensure product integrity, and to enforce the States' rules concerning: (1) unauthorized retail sales, especially sales to minors; (2) beverage content; (3) labeling; and (4) excise taxes.

The district court invalidated Texas' laws that permit in-state retailers of wine, but not out-of-state retailers of wine, to sell and deliver their products directly to state residents. This ruling fails to recognize that plaintiffs' dormant Commerce Clause challenge to these laws is nothing less than a direct assault on the three-tier system itself, which is foreclosed by the Supreme Court's recent decision in *Granholm* v. *Heald*, 544 U.S. 460 (2005). Accordingly, the ruling below ignores the critical role that three-tier systems play (and have played since the repeal of Prohibition) in enabling States to enforce their laws concerning the distribution of alcohol to their citizens. *Amici* therefore have a vital interest in the appeal of this ruling and respectfully submit that their knowledge and perspective on the alcohol industry and three-tier systems will assist the Court in reviewing the legal issues presented by this appeal.

STATEMENT OF THE CASE

Statutory Background

Texas, like numerous other States, regulates the sale and distribution of alcohol within its borders through a "three-tier system" of licensed and structurally separate producers, wholesalers, and retailers. Tex. Alco. Bev. Code §§ 102.01, 102.07. Under this system, producers of alcohol may sell in Texas only to Texas-licensed wholesalers, who in turn may sell only to Texas-licensed retailers, who may then sell to consumers. The basic statutory scheme requires virtually all alcohol sold in Texas to pass through this system. The principal exception to this rule is that in-state and out-of-state wineries can bypass the three-tier system and ship directly to Texas consumers, *see* Tex. Alco. Bev. Code §§ 16.09, 54.01-54.12, but that exception is not relevant here.

Texas allows Texas-licensed retailers to sell and ship alcoholic beverages to Texas residents within the county in which they are located. *See* Tex. Alco. Bev. Code § 22.03(a) (holders of retail package store permits may deliver and ship alcoholic beverages within the county in which they are located in response to customer orders). The parties agree that retailers located outside of Texas cannot obtain any license that allows them to ship alcohol directly to Texas residents. Indeed, Texas law provides that any person (other than an out-of-state winery that obtains a direct shipper's permit) "in the business of selling alcoholic beverages in

another state or country who ships or causes to be shipped any alcoholic beverage directly to any Texas resident" violates Texas law. *Id.* § 107.07(f); *see also id.* § 54.12 ("Any person who does not hold an out-of-state winery direct shipper's permit who sells and ships alcohol from outside of Texas to an ultimate consumer in Texas" commits a crime).

This case involves a dormant Commerce Clause challenge to Texas' laws that allow Texas-licensed retailers, but not out-of-state retailers, to sell and ship wine directly to Texas residents (the "retail direct" laws).

Procedural Background

The underlying lawsuit is a consolidated action in which two sets of plaintiffs, the "Siesta Village" plaintiffs (a Florida wine retailer along with Texas consumers) and the "Wine Country" plaintiffs (several California wine retailers along with Texas consumers), filed complaints challenging the constitutionality of the sections of Texas' Alcoholic Beverage Code that permit Texas-licensed retailers, but not out-of-state retailers, to sell and ship wine directly to Texas residents. The gravamen of their complaints is that Texas' laws "discriminate against interstate commerce and violate the Commerce Clause" because they "distinguish between in-state wine retailers and out-of-state wine retailers" and "burden out-of-state wine retailers simply to give a competitive advantage to in-state wine retailers." First Amended Complaint ¶ 35, *Wine Country Gift*

Baskets.com v. *Steen*, No. 4:06-CV-0232-A (N.D. Tex. Apr. 12, 2006); *see also* First Amended Civil Complaint ¶ 20, *Siesta Village Market, LLC* v. *Perry*, No. 3:06-CV-0585-D (N.D. Tex. May 2, 2006) (alleging that Texas' statutory scheme "discriminates against out-of-state wine retailers and provides economic advantages and protection to wine retailers in Texas, in violation of the Commerce Clause of the United States Constitution"). The plaintiffs request both declaratory and injunctive relief.

After discovery and briefing on the parties' cross-motions for summary judgment, the district court held that Texas' laws regulating the retail shipment of wine "plainly discriminate against interstate commerce." *Siesta Vill. Mkt., LLC* v. *Perry*, 530 F. Supp. 2d 848, 863 (N.D. Tex. 2008) ("Decision"). The court noted that Texas gives "wine retailers who [are] physically located in Texas the right to ship wine to residents throughout Texas, while denying that right to out-of-state retailers." *Id.* It then held that this amounts to an impermissible "physical presence requirement[]" because it effectively requires out-of-state wine retailers to establish physical facilities in Texas in order to "'compete on equal terms'" with Texas retailers. *Id.* (quoting *Granholm* v. *Heald*, 544 U.S. 460, 474-75 (2005)); *see also id.* at 865 ("A law that relies on the requirement of a physical, in-state location to afford some retailers the right to sell and ship wine to Texas consumers,

while denying the same right to others who are located out-of-state, is therefore constitutionally suspect").

After holding that the Texas laws are discriminatory, the district court concluded that they do not survive the heightened scrutiny that applies under the dormant Commerce Clause to laws that discriminate against interstate commerce. Decision, 530 F. Supp. 2d at 866-67; *see New Energy Co. of Ind.* v. *Limbach*, 486 U.S. 269, 278 (1988) (a discriminatory law will be upheld only if it "advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives"). The district court concluded that Texas had failed to establish that its laws "are necessary to achieve a legitimate state interest." Decision, 530 F. Supp. 2d at 868.

The district court next addressed the relief to which plaintiffs are entitled. It declared unconstitutional and enjoined enforcement of the statutory provisions that ban the sale and shipment of wine by out-of-state retailers to Texas consumers. *See id.* at 872, 874. The district court also held, however, that the retailer-plaintiffs "must first obtain TABC permits before selling and shipping wine to consumers within Texas" and "must purchase from TABC-licensed wholesalers and wineries the wine they sell to consumers within Texas." *Id.* at 869. The district court reasoned that the wholesaler-purchase requirement is "plainly imposed by the

[Alcoholic Beverage] Code." *Id.; see also id.* (noting that the Code is "unambiguous").

Both sets of plaintiffs appealed. The Siesta Village plaintiffs subsequently abandoned their appeal, but the Wine Country plaintiffs are appealing the district court's remedy ruling. The State defendants and the intervening defendants are cross-appealing the district court's ruling on the merits and the intervening defendants are cross-appealing additional issues.

SUMMARY OF ARGUMENT

The district court's invalidation of Texas' statutory scheme with respect to the sale and shipment of wine by retailers licensed by the State and located within the State to Texas residents is erroneous and inconsistent with the Supreme Court's Twenty-first Amendment and dormant Commerce Clause jurisprudence.

The district court's invalidation of Texas' retail direct scheme is fundamentally flawed because the challenged laws are squarely within the authority granted Texas by the Twenty-first Amendment. They are an integral part of Texas' three-tier system – a system that dates back to the end of Prohibition and that was specifically designed to protect the State's consumers and prevent the sorts of socially irresponsible retail sales that flourished in the pre-Prohibition era. Significantly, the Supreme Court consistently has affirmed the States' authority under the Twenty-first Amendment to employ three-tier systems that funnel all

alcohol sold in the State through licensed in-state wholesalers and retailers. The district court therefore failed to recognize that plaintiffs' lawsuit is nothing less than a frontal assault on Texas' three-tier system: they want to do away with state regulation and supervision over the third tier, the retailers. This must fail because the Supreme Court has unequivocally affirmed the constitutional validity of such systems.

Granholm, 544 U.S. 460, provides no support for plaintiffs' dormant Commerce Clause challenge to Texas' laws because the holding and analysis of that decision are limited to producer-based and product-based distinctions. Moreover, the Supreme Court's express endorsement of three-tier systems in *Granholm* forecloses plaintiffs' dormant Commerce Clause claim. These long-standing systems, as they have existed since Prohibition, plainly do *not* grant out-of-state retailers and in-state retailers (or out-of-state wholesalers and in-state wholesalers) equal access to in-state alcohol markets. The Supreme Court's express reaffirmance of the constitutional validity of three-tier systems therefore can only mean that the Constitution permits the differential treatment of in-state and out-of-state retailers (and in-state and out-of-state wholesalers) that is inherent in such systems.

Nor was the district court correct in concluding that Texas' retail direct laws impose an impermissible "physical presence" requirement on out-of-state retailers.

The district court's conclusion simply ignores that (1) traditional three-tier systems deliberately grant the right to do business in a State only to retailers and wholesalers that are physically present in the State, and (2) the Supreme Court has expressly affirmed the constitutionality of such systems.

Because Texas' retail direct laws are constitutional, plaintiffs are not entitled to any remedy and their complaints should be dismissed. If, however, the Court determines that Texas' laws are unconstitutional, then *amici* defer to the arguments of the State and the intervening defendants concerning the propriety of the remedy that the district court ordered. In this regard, *amici* merely offer the observation that the Twenty-first Amendment unquestionably grants the State of Texas authority to require out-of-state retailers to obtain Texas permits and to require all wine that enters Texas to pass through Texas-licensed wholesalers.

ARGUMENT

I. THE DISTRICT COURT ERRED IN HOLDING THAT TEXAS' RETAIL DIRECT LAWS ARE UNCONSTITUTIONAL.

The district court erred in failing to recognize that Texas' retail direct laws are squarely within the State's Twenty-first Amendment authority to regulate the sale and distribution of alcohol products within its borders. These laws are an integral part of Texas' three-tier system – a system that (1) necessarily differentiates between licensed in-state and unlicensed out-of-state wholesalers and retailers, and (2) the Supreme Court affirmed in *Granholm*, 544 U.S. 460, as an

"'unquestionably legitimate'" exercise of plenary state authority under the Twenty-first Amendment. *Id.* at 489 (quoting *North Dakota* v. *United States*, 495 U.S. 423, 432 (1990)). The district court therefore failed to recognize that plaintiffs' legal theory is nothing less than an impermissible attack on the three-tier system itself. To understand why, it is necessary to start with the Twenty-first Amendment and its historical background. Once this background is properly understood, it becomes clear that the district court failed to understand that the Supreme Court addressed a fundamentally different dormant Commerce Clause issue in *Granholm*, and that its analysis in that case not only fails to support plaintiffs' legal theory, but in fact forecloses it.

A. Texas' Retail Direct Laws Are Within The Authority Granted The State By The Twenty-first Amendment.

The Twenty-first Amendment not only ended Prohibition by repealing the Eighteenth Amendment, but also granted the States plenary authority to regulate the distribution and transportation of alcohol within their borders.[1] The adoption of this Amendment reflected recognition by both Congress and the States that the difficult problem of regulating alcohol, a socially sensitive product that can be misused and thereby give rise to numerous problems for local communities,

[1] Section 2 of the Twenty-first Amendment provides: "The transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited." U.S. Const. amend. XXI, § 2.

required that the States have maximum authority to develop solutions tailored to their citizenry. The Supreme Court consistently has recognized the broad scope of the States' powers under the Twenty-first Amendment. *See Cal. Retail Liquor Dealers Ass'n* v. *Midcal Aluminum, Inc.*, 445 U.S. 97, 110 (1980) ("[t]he Twenty-first Amendment grants the States virtually complete control over whether to permit importation or sale of liquor and how to structure the liquor distribution system"); *Capital Cities Cable, Inc.* v. *Crisp*, 467 U.S. 691, 712 (1984) ("[t]he States enjoy broad power under § 2 of the Twenty-first Amendment to regulate the importation and use of intoxicating liquor within their borders"); *Granholm*, 544 U.S. at 484 (the purpose of the Twenty-first Amendment is "to allow States to maintain an effective and uniform system for controlling liquor by regulating its transportation, importation, and use").

Texas' three-tier system dates back to the end of Prohibition. In order to understand the purposes of that system, and the laws that are an integral part of it, it is necessary to understand the States' core concerns as they exercised their newly-granted authority under the Twenty-first Amendment. When Prohibition ended and the States were faced with the formidable task of designing alcohol distribution systems that would prevent the abuses and problems that had prompted Prohibition in the first place, it was recognized that "[v]irtually all the individual and social evils of the liquor traffic arise from an inadequately regulated and

overstimulated retail sale." Raymond B. Fosdick & Albert L. Scott, *Toward Liquor Control* 65 (1933) ("Rockefeller Report"); *see also id.* at 16 ("The saloon, as it existed in pre-prohibition days, was a menace to society and must never be allowed to return").

Much of the criticism of retail alcohol sales in the pre-Prohibition era was spawned by the existence of a "tied" system between producers and the retailers who exclusively sold their products. Prior to Prohibition, suppliers often owned or indirectly controlled retailers, creating so-called "tied houses." It was widely recognized that these tied houses were a root cause of alcohol abuse and related social problems because retailers were pressured to sell product by any means, including selling to minors, selling after hours, and overselling to intoxicated patrons. Moreover, this system "had all the vices of absentee ownership," whereby local retail establishments were under obligation to distant producers who "cared nothing about the community." *Id.* at 43; *see also id.* at 16 (describing the "aggressiveness" of brewers and distillers in the pre-Prohibition era, as well as their "campaigns against temperance" and "corrupt legislative activities"). This environment of stimulated sales and demand resulted in excessive alcohol consumption and a host of social problems for local communities. *Id*. at 16 ("Behind [the saloon's] blinds degradation and crime were fostered, and under its principle of stimulated sales[,] poverty and drunkenness, big profits and political

graft, found a secure foothold"). Indeed, the "tied" system "was widely believed to have enabled organized crime to dominate the industry." *Arnold's Wines, Inc.* v. *Boyle*, 515 F. Supp. 2d 401, 407 (S.D.N.Y. 2007).

The "tied house" system also involved "a multiplicity of outlets, because each manufacturer had to have a sales agency in a given locality." Rockefeller Report at 43. This resulted in "a large excess of sales outlets," which was a matter of significant concern because of its "effect in stimulating competition in the retail sale of alcoholic beverages." *Id.*

To prevent the re-emergence of the "tied house" system and the socially irresponsible retailers that this system created, a study done at the request of John D. Rockefeller, Jr. recommended that States either: (1) establish a state monopoly on alcohol distribution, *see id.* at 63-93; or (2) establish a licensing system for entities that handle alcohol, *see id.* at 35-62. Both of these strong regulatory alternatives recognized that vigorous state supervision of sales to ultimate consumers was necessary to avoid the social harms that had resulted from less structured systems. Most States, including Texas, adopted the latter alternative and implemented three-tier systems of licensed private producers, wholesalers, and retailers, with independent wholesalers serving as a structural buffer between producers and retailers. By requiring alcohol businesses to obtain licenses and by interposing independent wholesalers between producers and retailers, three-tier

systems prevent the domination of retailers by producers or other interests who care nothing about temperance or local laws. These systems therefore serve the critical purpose of ensuring that in-state retailers – the entities that put alcohol into the hands of state residents – are socially responsible businesses that answer to the communities in which they operate.

Given the critical role of alcohol retailers as the entities that have direct contact with consumers, it is not surprising that Texas and other States subject retailers to heavy regulation. State regulation of retailers is essential because when Congress adopted the Federal Alcohol Administration Act of 1935, it only provided for federal regulation of alcohol importers, suppliers, and wholesalers, but not retailers. Yet a critical lesson of the pre-Prohibition era was that retailers must be carefully regulated in order to prevent their profit motives from leading them to sell alcohol in a socially irresponsible manner. Accordingly, through licensing schemes, Texas and other States subject retailers to substantial restrictions and obligations in return for the state-granted privilege to distribute alcohol to state residents. For example, in order even to qualify for a license, retailers typically must submit to a criminal background check, meet financial responsibility requirements, and demonstrate that they have appropriate moral character and business experience to operate a viable alcoholic beverage business in a lawful manner. Once licensed, they are subject to comprehensive regulations

governing their operations, as well as detailed record-keeping requirements and inspections to ensure that they comply with these regulations. These are not mere "hoops" for retailers to jump through. These requirements enable the State to ensure that alcohol is sold to its citizens in a responsible manner, and provide the State and its citizens with the ability to penalize those retailers who do not comply with the rules.[2]

It also is not surprising that Texas and most other States that adopted the three-tier system at the end of Prohibition elected to limit the issuance of retail and wholesale licenses to businesses in the State. *See Arnold's Wines*, 515 F. Supp. 2d at 407 (citing Note, *Economic Localism in State Alcoholic Beverage Laws – Experience Under the Twenty-First Amendment*, 72 Harv. L. Rev. 1145, 1148 (1959)). The States' decisions reflected the concerns in the Rockefeller Report that "non-resident" alcohol sellers "[see] none of the abuses" that they create and are "beyond local social influence." Rockefeller Report at 43. These decisions also reflected the Rockefeller Report's recommendation that state and local governments exercise control with respect to the physical locations at which alcohol would be available to their citizens. *See id.* at 44 (recommending that "[s]uitable restrictions should be established by the license law or by

[2] Texas also has a "dram shop law," which holds retailers accountable for any harm – death, injury, or property damage – caused by an intoxicated patron. Tex. Alco. Bev. Code §§ 2.01-03.

administrative regulation with respect to the number and character of *places* where liquor may be sold") (emphasis in original).

State alcohol distribution schemes that limit retail sales privileges to businesses located in the State serve many vital public interests and prevent a return to the socially irresponsible practices of the past. For example, the in-state limitation ensures that States and local authorities can conduct effective investigations into the quality and character of persons entitled to sell alcohol in particular communities. State officials also are able to subject in-state retailers to far greater administrative oversight, including in-person observation and requirements that records be available for on-site inspection. Enforcement of local laws is also more likely to be effective when officials can wield the threat of revocation of a locally-issued license, a sanction that can have devastating consequences for an in-state retailer, but might be a matter of limited concern to an out-of-state retailer. The out-of-state retailer would be able to continue to sell alcohol to consumers in other States despite the loss of that permit in Texas.

The fundamental flaw in the district court's invalidation of Texas' retail direct laws is that the Supreme Court has unequivocally affirmed the constitutionality of the three-tier system:

> We have previously recognized that the three-tier system itself is "unquestionably legitimate." *North Dakota* v. *United States*, 495 U.S. at 432. See also *id.* at 447 (SCALIA, J., concurring in judgment) ("The Twenty-first

> Amendment . . . empowers North Dakota to require that all liquor sold for use in the State be purchased from a licensed in-state wholesaler").

Granholm, 544 U.S. at 489 (omission in original). The Court also has expressly approved the long-standing state practice of limiting participation in three-tier systems to wholesalers and retailers located in the State, *i.e.*, of excluding out-of-state retailers (and out-of-state wholesalers) entirely from liquor distribution systems. *See id.* at 469 (noting that under Michigan's three-tier system, alcohol producers "generally may sell only to licensed *in-state* wholesalers," which, in turn, "may sell only to *in-state* retailers") (emphases added); *id.* at 489 ("'The Twenty-first Amendment . . . empowers North Dakota to require that all liquor sold for use in the State be purchased from a licensed *in-state* wholesaler'") (emphasis added; omission in original) (quoting *North Dakota*, 495 U.S. at 447 (Scalia, J., concurring in judgment)); *id.* at 489 ("States may . . . funnel sales through the three-tier system"); *see also Arnold's Wines*, 515 F. Supp. 2d at 413 ("it was hardly by accident that the *Granholm* majority quoted Justice Scalia's concurrence in *North Dakota* confirming a State's core power to require all liquor to be purchased from licensed *in-state* wholesalers") (emphasis added).

Accordingly, the district court's invalidation of Texas' laws is erroneous because these laws are within the State's Twenty-first Amendment authority to adopt a three-tier system that utilizes only in-state wholesalers and in-state

retailers. The Supreme Court's express approval of such systems forecloses plaintiffs' claims.

B. *Granholm* Provides No Support For Plaintiffs' Dormant Commerce Clause Claim And, In Fact, Forecloses It.

Despite *Granholm*'s clear reaffirmance of the constitutionality of three-tier systems that funnel all alcohol sales through in-state wholesalers and in-state retailers, the district court nevertheless concluded that *Granholm* supports the conclusion that Texas' laws "plainly discriminate against interstate commerce." Decision, 530 F. Supp. 2d at 863.

The district court, however, fundamentally misread *Granholm*. No claim of discrimination against out-of-state retailers was presented in that case, and the Supreme Court therefore did not address that issue. Throughout its opinion, the Court focused solely on discrimination against out-of-state producers and their products.[3] By its terms, therefore, *Granholm* only addressed state laws that

[3] *See, e.g.*, *Granholm*, 544 U.S. at 466 ("It is evident that the object and design of the Michigan and New York statutes is to grant in-state *wineries* a competitive advantage over *wineries* located beyond the States' borders."); *id.* at 467 ("The differential treatment between in-state and out-of-state *wineries* constitutes explicit discrimination against interstate commerce."); *id.* at 472 ("The mere fact of nonresidence should not foreclose a *producer* in one State from access to markets in other States."); *id.* at 476 ("Section 2 does not allow States to regulate the direct shipment of wine on terms that discriminate in favor of in-state *producers*."); *id.* at 489 ("State policies are protected under the Twenty-first Amendment when they treat *liquor produced* out of state the same as its domestic equivalent."); *id.* ("The instant cases . . . involve straightforward attempts to discriminate in favor of *local*

distinguish between in-state and out-of-state producers and products, not state laws that distinguish between in-state and out-of-state retailers or wholesalers.

Because the holding and analysis of *Granholm* are limited to producer-based and product-based distinctions, *Granholm* provides no support for plaintiffs' dormant Commerce Clause challenge to Texas' laws. Those laws do not involve any producer-based or product-based distinctions. Texas-licensed retailers sell both alcohol produced in Texas and alcohol produced outside of Texas, which they obtain through Texas wholesalers from both in-state and out-of-state producers. As a result, in-state and out-of-state producers and their products are treated even-handedly by Texas' retail direct laws: all alcohol products, regardless of their State of origin, are sold by Texas-licensed retailers. Accordingly, there is no discrimination of the type that *Granholm* addressed.

Moreover, *Granholm* not only fails to support plaintiffs' dormant Commerce Clause claim, but in fact forecloses it. This is because the claim of discrimination that the plaintiffs raised in *Granholm* is fundamentally different from the claim of discrimination that plaintiffs raise here, and because *Granholm* reaffirmed the constitutional legitimacy of three-tier systems that differentiate between licensed in-state and unlicensed out-of-state wholesalers and retailers.

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producers.") (all emphases added).

In *Granholm*, the plaintiffs' claims of discrimination were based on the fact that New York and Michigan carved out exceptions to their three-tier systems to permit in-state wineries, but not out-of-state wineries, to bypass those systems completely and make direct sales to consumers. The *Granholm* plaintiffs argued, and the Supreme Court agreed, that these carve-outs for in-state wineries discriminated against out-of-state wineries because the passage of wine through a three-tier system entails "extra layers of overhead" and therefore additional costs. *Granholm*, 544 U.S. at 473-74. As a result, the Supreme Court held that the schemes were discriminatory because the three-tier system was asymmetrically "mandated . . . only for sales from out-of-state wineries." *Id.* at 467.

The claim of the out-of-state retailers here is fundamentally different. They do not claim that Texas has created an exception to its three-tier system that applies only to in-state entities; rather, they claim that Texas is discriminating against them because it has chosen to operate a traditional three-tier system that excludes out-of-state retailers, and thereby provides Texas retailers with preferential access to in-state wine consumers. The problem with this "equal access" theory is that it conflicts with the States' plenary power to funnel all alcohol sales through in-state wholesalers and retailers. The Supreme Court's express endorsement of three-tier systems is dispositive because these systems, as they have existed since Prohibition, plainly do *not* grant out-of-state retailers and

in-state retailers (or out-of-state wholesalers and in-state wholesalers) equal access to in-state alcohol markets. For reasons reflecting the community problems and local accountability concerns discussed in the Rockefeller Report, retailers located outside a State ordinarily have *no* authority to sell alcohol within the State at all.

Therefore, *Granholm* can only mean that the Supreme Court interprets the Constitution as permitting the differential treatment of in-state and out-of-state retailers (and in-state and out-of-state wholesalers) that is inherent in a three-tier system. As Justice Thomas correctly stated in his dissent in *Granholm*, the *Granholm* majority could only have struck down the Michigan and New York laws that discriminated against out-of-state producers, and simultaneously endorsed three-tier systems that funnel all alcohol sales through in-state wholesalers and retailers, by relying "on the difference between discrimination against manufacturers (and therefore, their products) and discrimination against wholesalers and retailers." *Granholm*, 544 U.S. at 521.[4]

[4] The Supreme Court's express affirmance of the constitutional legitimacy of "control" systems for distributing alcohol, *see Granholm*, 544 U.S. at 489, further undermines plaintiffs' claims. In control systems, the State itself is the exclusive wholesaler (and sometimes the exclusive retailer) of alcohol products, to the exclusion of all other wholesalers and/or retailers. As in three-tier systems, retailers in other States are completely shut out. The Supreme Court's unequivocal approval of control systems further confirms that: (1) it views disparate treatment of alcohol wholesalers and retailers differently than it views disparate treatment of alcohol producers; and (2) the Constitution does not require that out-of-state alcohol retailers have access to a State's consumers.

In sum, plaintiffs' claim that out-of-state retailers are entitled to equal access to Texas consumers, or a level economic playing field with Texas-licensed retailers, is a frontal assault on Texas' three-tier system itself. Plaintiffs can only prevail if essential features of Texas' three-tier system are unconstitutional – an outcome that *Granholm* expressly rejected. The district court therefore fundamentally erred in concluding that Texas' laws "plainly discriminate against interstate commerce." Decision, 530 F. Supp. 2d at 863.

For similar reasons, the district court also erred in concluding that Texas' retail direct laws suffer from the same constitutional flaw as the New York scheme invalidated by *Granholm* because they impose an impermissible "physical presence" requirement on out-of-state retailers. Decision, 530 F. Supp. 2d at 863 (concluding that Texas' laws create an impermissible "physical presence requirement[]" because they effectively require out-of-state wine retailers to establish physical facilities in Texas in order to "'compete on equal terms'" with Texas retailers) (quoting *Granholm*, 544 U.S. at 474-75). The problem with this argument is that it ignores the inherently different role of retailers and producers in three-tier systems, and the fact that *Granholm* addressed the latter and not the former.

In *Granholm*, the Court first held that Michigan's laws "obvious[ly]" discriminated against interstate commerce because Michigan permitted in-state

wineries to ship wine directly to Michigan consumers, but out-of-state wineries faced a "complete ban" on direct shipment. *Granholm*, 544 U.S. at 473-474. It then held that New York's requirement that out-of-state wineries establish costly bricks-and-mortar premises in New York as a condition of direct shipping was just an "indirect" way of accomplishing the impermissible "complete ban" because the requirement made "direct sales impractical from an economic standpoint." *Id.* at 466, 474-75; *see also id.* at 466 (noting that the "object and effect" of the Michigan and New York laws was "the same").

Here, while it may be true that Texas' laws effectively require out-of-state wine retailers to establish physical facilities in Texas in order to have the same opportunities to sell to Texas residents as Texas retailers, *see* Decision, 530 F. Supp. 2d at 863, this circumstance does not raise any issue under the dormant Commerce Clause because it is an inherent feature of the constitutionally permissible three-tier system. As noted, in traditional three-tier systems, out-of-state retailers (unlike out-of-state producers) ordinarily have *no* access to a State's consumers at all, *i.e.*, they face a "complete ban" from the in-state market that is completely permissible. In order to have such access (or in the words of the district court, "equal access") an out-of-state retailer must effectively became an in-state retailer by coming to the State, obtaining a license, and becoming part of the State's three-tier system. In other words, traditional three-tier systems

deliberately grant the right to do business in a State only to retailers and wholesalers that are physically present in the State. Accordingly, the district court's holding that Texas' system is unconstitutional on that basis is fundamentally flawed because it is tantamount to a holding that *all* three-tier systems are unconstitutional – a conclusion that is wholly at odds with the Supreme Court's contrary conclusion in *Granholm.*[5]

C. The District Court's Ruling Is Inconsistent With Recent New York District Court And Fourth Circuit Decisions That Have Rejected Plaintiffs' Legal Theory.

Consistent with the foregoing analysis, a New York district court and the Fourth Circuit have expressly rejected the legal theory that plaintiffs' lawsuit is based on.

In *Arnold's Wines*, 515 F. Supp. 2d 401, the district court dismissed a complaint raising an essentially identical dormant Commerce Clause challenge to New York's laws that, like Texas' laws, permit in-state retailers, but not out-of-state retailers, to sell and ship wine to state residents.[6] The district court held that

[5] To be sure, some States have chosen to depart from traditional three-tier systems by permitting out-of-state retailers to ship wine directly to their citizens, as is their prerogative under the Twenty-first Amendment. But their choices in this regard do not have any bearing on the constitutionality of the decisions of Texas and other States to maintain their long-standing systems that bar out-of-state wholesalers and out-of-state retailers from distributing alcohol to their citizens.

[6] The New York plaintiffs have appealed the district court's ruling to the Second Circuit (No. 07-4781-cv). Briefing is complete and oral argument has not yet been

the New York plaintiffs' claims are foreclosed by the Supreme Court's holdings in *Granholm*. It reasoned that "[b]ecause in-state retailers are the last tier in the State's three-tier system, plaintiffs' challenge to the ABC Law's provisions blocking out-of-state entities from obtaining licenses to compete at this tier is clearly an attack on the three-tier system itself." *Id.* at 411. It then concluded that this challenge "must fail" because "the Supreme Court reaffirmed the constitutionality of the three-tier system in *Granholm*." *Id.* (citing *Granholm*, 544 U.S. at 488-89).

The district court expressly rejected the New York plaintiffs' argument that it should "dismiss *Granholm's* explicit endorsement of the three-tier system as dicta." *Id.* at 412. The court held:

> [I]f dicta this be, it is of the most persuasive kind. In upholding the three-tier system, the Supreme Court acted intentionally to limit application of the nondiscrimination principle enunciated in *Granholm* to products and producers, as opposed to wholesalers and retailers, a result consistent with prior holdings of the Court regarding the power of the States [under the Twenty-first Amendment] to regulate the distribution, importation, and transportation of alcohol within their borders.

Id. In this regard, the district court noted that the dissenters in *Granholm* recognized that the majority drew a distinction "'between discrimination against manufacturers (and therefore, their products) and discrimination against

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wholesalers and retailers'" and that "all nine Justices agreed that the three-tier system is within the scope of Commerce Clause immunity granted the States by Section 2 of the Twenty-first Amendment." *Id.* at 412-13 (quoting *Granholm*, 544 U.S. at 521). The district court also affirmed "the legitimacy of state laws that limit licenses to retailers and wholesalers located within the state," citing the *Granholm* majority's endorsement of "a State's core power [under the Twenty-first Amendment] to require all liquor to be purchased from licensed in-state wholesalers." *Id.* at 413 (citing *Granholm*, 544 U.S. at 488-89).

Because the court found that the challenged New York laws "are an integral part of the three-tier system upheld by the Supreme Court in *Granholm*," it concluded that "these provisions are within the authority granted to New York by the Twenty-first Amendment." *Id.* at 413-14.

Similarly, in *Brooks* v. *Vassar*, 462 F.3d 341 (4th Cir. 2006), *cert. denied*, 127 S. Ct. 2251 (2007), the Fourth Circuit rejected a dormant Commerce Clause challenge to Virginia's "personal import" exception to its three-tier system, which allows individual consumers to bring into Virginia for personal consumption one gallon or four liters of alcoholic beverages without going through the three-tier system. The Virginia plaintiffs argued that this exception violates the dormant Commerce Clause because "in-state *retailers* are favored over out-of-state *retailers*." *Id.* at 352 (emphases in original). Specifically, the plaintiffs argued that

Virginia's statutory scheme favored in-state retailers because Virginia consumers can bring home virtually unlimited quantities of alcohol purchased from in-state retailers, but can import only one gallon of alcohol purchased from out-of-state retailers.

The Fourth Circuit rejected this argument on the ground that the underlying legal theory is an impermissible frontal assault on "the three-tier system itself." *Id.* As Judge Niemeyer cogently noted, the Virginia plaintiffs' argument that in-state and out-of-state retailers of alcohol are entitled by the dormant Commerce Clause to equal treatment under state alcohol distribution laws is "foreclosed" by *Granholm*:

> But an argument that compares the status of an in-state retailer with an out-of-state retailer – or that compares the status of any other in-state entity under the three-tier system with its out-of-state counterpart – is nothing different than an argument challenging the three-tier system itself. As already noted, this argument is *foreclosed* by the Twenty-first Amendment and the Supreme Court's decision in *Granholm*, which upheld the three-tier system as "unquestionably legitimate."

Id. (emphasis added).

The *Brooks* plaintiffs sought review of the Fourth Circuit's decision in the Supreme Court, arguing that the court of appeals erred in construing *Granholm* as "foreclos[ing]" their legal theory. *See* Pet. for a Writ of Cert., at 18-19, *Brooks* v. *Vassar*, No. 06-1111 (Feb. 8, 2007). The Supreme Court denied their petition.

Ultimately, the New York district court and the Fourth Circuit concluded that the Twenty-first Amendment grants the States plenary authority to regulate the distribution of alcohol, including through three-tier systems that limit distribution rights to in-state retailers. Accordingly, the New York district court and the Fourth Circuit flatly rejected the argument that New York and Virginia could be constitutionally required to accord equal status to out-of-state retailers. The reasoning of these courts is sound and demonstrates that the district court's decision below cannot withstand scrutiny.

II. THE PLAINTIFFS ARE NOT ENTITLED TO ANY REMEDY, BUT IF THEY ARE, TEXAS HAS PLENARY AUTHORITY UNDER THE TWENTY-FIRST AMENDMENT TO REQUIRE OUT-OF-STATE RETAILERS TO OBTAIN TEXAS PERMITS AND TO PURCHASE ALL OF THE WINE THAT THEY SELL TO TEXAS RESIDENTS FROM TEXAS-LICENSED WHOLESALERS.

The foregoing analysis demonstrates that the district court made a fundamental error in invalidating Texas' retail direct laws. The plaintiffs therefore are not entitled to any remedy and their complaints should be dismissed.

If, however, the Court determines that Texas' laws are unconstitutional, then *amici* defer to the arguments of the State and the intervening defendants concerning the propriety of the remedy that the district court ordered. In this regard, *amici* merely offer two observations. First, the Twenty-first Amendment unquestionably grants the State of Texas authority to require out-of-state retailers to obtain Texas permits, and therefore subject themselves to Texas' regulatory

authority, as a condition of making any direct shipments to Texas residents. The States have plenary authority under the Amendment to regulate retail sales to ultimate consumers. As a result, in-state retailers in Texas are subject to numerous regulations and requirements that render them accountable to the State and its communities. Indeed, Texas' retail permit regime is essentially a *quid pro quo*: in return for the privilege of selling and shipping alcohol directly to Texas citizens, retailers agree to abide by extensive regulations. *See* Tex. Alco. Bev. Code § 6.01 (extending the "right or privilege" of selling, importing, and delivering alcohol only if "the person has first obtained a license or permit of the proper type as required by this code"). Accordingly, the State of Texas plainly has the authority to subject out-of-state retailers to a similar *quid pro quo* and require that they obtain a permit or license from the State as a condition of engaging in direct shipping.

Second, the State of Texas also unquestionably has authority under the Twenty-first Amendment to require all wine that enters Texas to pass through Texas-licensed wholesalers. *See Granholm*, 544 U.S. at 489 ("'The Twenty-first Amendment . . . empowers North Dakota to require that all liquor sold for use in the State be purchased from a licensed *in-state* wholesaler'") (emphasis added; omission in original) (quoting *North Dakota*, 495 U.S. at 447 (Scalia, J., concurring in judgment)); *id.* at 489 ("States may . . . funnel sales through the

three-tier system"). Accordingly, Texas plainly can require out-of-state retailers to purchase the wine that they sell to Texas consumers from Texas-licensed wholesalers.[7]

CONCLUSION

Amici respectfully request that the Court reverse the decision of the district court invalidating Texas' laws and dismiss the plaintiffs' complaints.

Respectfully submitted,

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[7] Plaintiffs point out that out-of-state retailers often sell and ship alcohol that has already passed through *another State's* three-tier system. *See* Appellants' Br. at 43, 51. But this has no bearing on Texas' unquestioned authority under the Twenty-first Amendment to require alcohol that crosses its borders to pass through Texas-licensed wholesalers that are accountable to the State of Texas.

CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32(a)(7)(C), I certify that the foregoing Brief of *Amici Curiae* in Support of Defendants and Reversal complies with the type-volume limitations of Fed. R. App. P. 32(a)(7)(B). Exclusive of the exempted portions in Fed. R. App. P. 32(a)(7)(B)(iii), the brief contains 6782 words.

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Carter G. Phillips

STATEMENT OF PARTIES' CONSENT TO FILING OF BRIEF

Amici Curiae file this brief supporting Defendants and Reversal with the consent of the parties.

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Carter G. Phillips

CERTIFICATE OF SERVICE

I, John P. Meehan, certify that on July 16, 2008, two copies of the foregoing Brief *Amici Curiae* in Support of Defendants and Reversal were served by first-class mail on the following counsel along with an electronic copy:

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