UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 08-15738

BLACK STAR FARMS LLC; JOHN NORTON, GARY FRISCH;
MICHELLE FRISCH; DAVID MONHEIT; MELISSA MONHEIT
Plaintiffs-Appellants
vs.

JERRY OLIVER, in his official capacity as the Director of the
State of Arizona Department of Liquor Licensing and Control,
Defendant-Appellee

ALLIANCE BEVERAGE DISTRIB. CO. LLC
Defendant-Intervenor-Appellee.

On Appeal from the United States District Court for the District of Arizona
D.C. No. 2:05-cv-02620 - MHM
Hon. Mary H. Murgia, Judge

OPENING BRIEF OF APPELLANTS
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CORPORATE DISCLOSURE STATEMENT

Pursuant to Fed.. R. App. P. 26.1, this corporate disclosure statement is filed on behalf of Black Star Farms, L.L.C.:

Black Star Farms, LLC, is not a parent, subsidiary or other affiliate of a publicly owned corporation and no publicly owned corporation owns any of its stock.

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JURISDICTIONAL STATEMENT

District Court Jurisdiction. Plaintiffs brought this action pursuant to 42 U.S.C. § 1983, claiming that certain provisions in Arizona's wine distribution laws discriminated against interstate commerce in violation of the Commerce Clause. The district court had jurisdiction to hear this case pursuant to 28 U.S.C. §§1331 and 1343(a)(3), which confer original jurisdiction on federal district courts to hear suits alleging the violation of rights and privileges under the United States Constitution.

Jurisdiction of Court of Appeals. This appeal is from a final order and judgment of the district court dismissing the complaint pursuant to a motion for summary judgment, Fed. R. Civ. P. 56. The judgment and order were entered on February 28, 2008. (Appellants' Extracts of Record ["ER"] 1, 3). Plaintiffs filed a notice of appeal on March 27, 2008 (ER 26), which is timely under Fed. R. App. P 4(1)(a). This court has jurisdiction pursuant to 28 U.S.C. § 1291, which authorizes the courts of appeals to hear appeals from final judgments of the district courts.

STATEMENT OF THE ISSUES

The general issue. The issue in this case is whether portions of Arizona's wine distribution laws violate the Commerce Clause because they favor in-state wineries and disadvantage their out-of-state competitors. Arizona does not explicitly discriminate against wineries based on where they are located. Rather, it

distinguishes wineries based on their size, giving favorable treatment to small wineries. However, it turns out that almost all Arizona wine is produced at small wineries but that more than 95% of American wine is produced by out-of-state wineries that are too large to receive the same favorable treatment. The question is whether this disparate impact is the kind of discriminatory effect prohibited under *Granholm v. Heald*, 544 U.S. 460 (2005) and *Hunt v. Washington State Apple Advertising Comm'n*, 432 U.S. 333 (1979), especially in light of evidence that the state intended to protect its fledgling local wine industry. 2nd Amended Compl. (ER 30); Case Mgmt Plan ¶¶ 1(a), 3 (ER 50-51, 55-57).

Specific issues:

1. Are laws (like Arizona's) that have the practical effect of favoring in-state wineries over their out-of-state competitors subject to heightened scrutiny under the dormant Commerce Clause, even if they do not explicitly discriminate?

2. Does Arizona's law denying favorable treatment to wineries producing more than 20,000 gallons annually discriminate against interstate commerce because 99% of such wineries are located out of state?

3. Does Arizona's law allowing a consumer to buy directly from wineries producing more than 20,000 gallons annually only if the consumer visits these wineries in person have a discriminatory effect in violation of the Commerce Clause

because the high cost of travel makes it unfeasible for consumers to buy wine from wineries located out of state?

4. Does Arizona's law prohibiting out-of-state wineries producing more than 20,000 gallons annually from selling directly to retailers violate the Commerce Clause when most Arizona wineries are permitted to sell directly to retailers?

5. Has Arizona shown that there are no reasonable nondiscriminatory alternatives that would adequately advance its interests so that the laws at issue can survive heightened scrutiny?

STATEMENT OF THE CASE

This is a constitutional challenge to Arizona's statutory scheme regulating direct wine sales. Arizona divides wineries into three categories by production volume.

- Wineries that produce fewer than 20,000 gallons per year may obtain a domestic farm winery license that allows them to take orders by Internet, telephone or mail, and to ship those purchases directly to consumers and retailers. The purchaser does not have to appear at the winery in person. Ariz. Rev. Stat. § 4-205.04©.
- Wineries that produce 20,000-40,000 gallons annually may obtain a domestic farm winery license but may not take Internet, mail or telephone orders. They may ship wine directly to consumers only if the consumer travels to the

winery and appears in person, and only up to two cases per year. They may not sell directly to retailers at all. Ariz. Rev. Stat. § 4-205.04©.

- Wineries that produce more than 40,000 gallons annually are not eligible for a domestic farm winery license, Ariz. Rev. Stat. § 4-205.04©, nor any other license that permits direct sales to consumers or retailers.[1] They must use a wholesaler and may not sell or ship directly to consumers under any circumstances, because wineries may sell in Arizona only pursuant to the terms of a license. Ariz. Rev. Stat. § 4-244(1).[2]

Twenty-six of Arizona's twenty-seven wineries fall into the first category and receive the most favorable treatment. They may freely sell and ship wine directly to Arizona consumers and retailers with few restrictions. By contrast, more than 95% of American wine produced by out-of-state wineries which fall into the second and third categories and are restricted or prevented from making such direct sales.

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[1]Large wineries are eligible for a so-called "direct shipment" license, Ariz. Rev. Stat. § 4-203.04, and a producer's license, Ariz. Rev. Stat. § 4-209(B)(1-2), but these licenses require wineries to use Arizona wholesalers and do not allow a winery to sell or ship directly to consumers, Ariz. Rev. Stat. §§ 4-203.04(G); 4-243.01(B); 4-244(3), or retailers. Ariz. Rev. Stat. §§ 4-243.01(A)(3), 4-244(7).

[2]In the district court, the attorney for the state argued that for the purposes of direct wine shipping, there are really only two categories because Ariz. Rev. Stat. § 4-203.04(J) could be interpreted to allow large wineries to ship to consumers upon the same terms as licensed domestic farm wineries producing between 20,000-40,000 gallons annually. The implausibility of this interpretation is discussed infra at n. 12.

Plaintiffs are five Arizona consumers and a Michigan winery that produces more than 20,000 gallons annually so is not eligible for the favorable treatment given to most Arizona wineries. They brought suit under 42 U.S.C. § 1983 seeking a declaratory judgment that this statutory scheme violates the Commerce Clause under *Granholm v. Heald*, 544 U.S. 460 (2005) and *Hunt v. Washington State Apple Advertising Comm'n*, 432 U.S. 333 (1979). Plaintiffs assert that the law favors in-state wineries and discriminates against those from other states in its practical effect. The law allows Arizona wineries to conveniently sell and ship wine directly to consumers and retailers, but places more than 95% of wine produced in other states off limits to direct sales. Plaintiffs do not contend that the law is explicitly discriminatory, but rather that the scheme has the discriminatory effect of putting Arizona wineries on one side and out-of-state wineries on the other side of a pragmatic barrier -- the requirement that a consumer travel to the winery and purchase the wine in person. Plaintiffs allege that the favorable treatment of in-state wineries was motivated by a legislative purpose to provide economic protection to the fledgling Arizona wine industry. 2d Amended Compl. ¶¶ 8-10 (ER 32-33); Case Mgmt. Report ¶¶ 1(a), 3 (ER 50-51, 55-57).

The defendant is the Director of the State of Arizona Department of Liquor Licensing and Control, the state agency charged with administering the state alcoholic

beverage laws. Ariz. Rev. Stat. § 4-112(B). Alliance Beverage Distributing Co., an Arizona wine wholesaler who fears loss of business if out-of-state wineries are permitted to sell directly to consumers and retailers, intervened as a co-defendant. The defendants deny that the statutory scheme is discriminatory or that it was motivated by economic protectionism. Case Mgmt. Report ¶¶ 1(b), 3 (ER 51-53, 55-57). Following discovery, the parties filed cross-motions for summary judgment on the question of whether the law violated the Commerce Clause, supported by numerous affidavits and exhibits. See District Court Docket Nos. ["CR"] 72, 75, 76, 78. A hearing was held on January 24, 2008.

The district court ruled in favor of the defendants. It read *Granholm* and the bulk of the Supreme Court's Commerce Clause cases narrowly and did not adopt either the Court's or the Ninth Circuit's opinions on what constitutes discrimination [ER 12-16]. Instead, it created its own standard that discriminatory effect could only be established by showing that the law "alters the proportional share of the wine market in favor of in-state wineries" [ER 19], and dismissed the complaint because plaintiffs had not proved that the law gave in-state wine a larger market share. [ER 17, 24-25]. Plaintiffs filed timely notice of appeal on March 27, 2008 (ER 26).

STATEMENT OF FACTS

Black Star Farms is a winery located in Suttons Bay, Michigan. [Coe Dep., ER

66]. It has potential customers who live in Arizona who would like to buy its wine. [Id., ER 81]. However, Black Star Farms produces around 35,000 gallons of wine per year [Id., ER 67] and therefore is not eligible for a license that would allow it to take orders by telephone or Internet and ship wine directly to consumers and retailers. The only license Black Star Farms could obtain prohibits direct shipments to retailers, and allows shipments to consumers only if the consumers travel to the winery and order the wine in person. [Gilchrist Dep., ER 95-96, 102]. It is 4200 miles round trip from Phoenix to Suttons Bay [ER 115]. Within the next few years, Black Star Farms' production will surpass 40,000 gallons per year [Coe Dep., ER 67], and it will no longer be eligible for a domestic farm winery license at all. [Gilchrist Dep., ER 88-89, 98-99]. It could then be closed out of the Arizona market altogether, even though it has potential customers there [Black Star Interrog. 16, ER 118], because it has no wholesaler willing to distribute its wine in the state despite its efforts to find one. [Coe Dep., ER 68-72].

Plaintiffs Gary Frisch, Michelle Frisch, David Monheit, Melissa Monheit, and John Norton are adult wine consumers who live in the greater Phoenix area. [ER 119, 122, 126]. They would like to be able to buy wine directly from out-of-state wineries like Black Star Farms but Arizona law prevents it. They cannot afford the time or cost to travel hundreds of miles just to buy wine. [ER 120, 123, 127]. It is 1500 miles

round trip from Phoenix to Napa Valley in California [ER 116], where many wineries are located from which the plaintiffs would like to obtain wine, but which produce more than 20,000 gallons annually and are therefore prohibited from taking telephone, mail and Internet orders. [Norton Aff. ¶ 5, ER 120, Monheit Aff. ¶ 5, ER 127]. More than 95% of U.S. wine is produced by approximately 800 wineries located outside Arizona that produce more than 20,000 gallons per year, at least half of which produce more than 40,000 gallons per year.[3] Some wineries have no on-site sales room open to the public but sell only by direct shipping. [Monheit Aff. ¶¶ 9-10, ER 128]. If consumers cannot obtain wine directly from the wineries, they must buy whatever is available through Arizona wholesalers and retailers, and pay the increased cost of their markups. Some of the wine they want is not carried by Arizona retailers for a variety of reasons. Some high-demand wines are sold only by the wineries that produce it. [McCardle Dep., ER 106-112]. Many out-of-state wineries cannot find a wholesaler willing to distribute their wines in Arizona. [FTC Report at 24, ER 135; McCardle Dep., ER 104, 113-14]. Arizona wholesalers distribute mostly the best known California wines, and a few from Oregon and

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[3] This is an estimate based on the Nelson Affidavit [ER 171] and data from the U.S. Treasury Tax and Trade Bureau [ER 149]. Because the actual production of a winery varies from year to year, it is not possible to give a precise number. See *Family Winemakers of Cal. v. Jenkins*, slip op. at 15 (1:06-cv-11682, D. Mass. 2008) (reviewing TTB data), addendum at 62-63, infra.

Washington, but are not willing to carry wines from other states like Michigan. [Coe Dep., ER 68-72; McCardle Dep., ER 104]. The Federal Trade Commission has studied the problem of market access by regional wineries, and concluded that state laws like Arizona's, which prevent direct sales and force producers to use wholesalers, are causing a closed market. [FTC Report, ER 131-32, 134-35].

By contrast, consumers face no legal or practical roadblocks to buying wine from Arizona wineries. Twenty-six of Arizona's 27 wineries produce fewer than 20,000 gallons annually, so consumers may order wine from them without leaving their homes -- by simply picking up the telephone or logging onto the Internet. [Gilchrist Dep., ER 86-87, 93-94]. The one Arizona winery that produces over 20,000 gallons is Kokopelli Winery [ER 96] which is located in a Phoenix suburb (Chandler) within easy driving distance of the plaintiffs' homes.[4]

For wineries like Black Star Farms, the most profitable way they can sell their product is by selling and shipping it directly to the purchaser. [Coe Dep., ER 83-84]. If they must use a wholesaler, they sacrifice approximately 50% of their profits. [Id., ER 78-80; FTC Report at 22, ER 133]. Although much of their business is done in person at the winery's tasting room, Black Star Farms has many customers who initially tasted its wine in person, and would like to order more. [ER 118]. To place

[4]See http://www.kokopelliwinery.com/ (last visited 2/14/09).

such an order, the purchasers must return to the winery in person, even if they are already known to the winery as responsible adults, have been regular customers for years, or have appeared in person only a few days before. [Gilchrist Dep. at 25, ER 97]. Because making subsequent journeys just to buy wine is not economically feasible, Black Star loses those sales.

There is evidence that Arizona's production-limit scheme was intended, at least in part, to protect Arizona's fledgling wine industry. For two years prior to Ariz. Senate Bill 1276 (2006) that created the 20,000 gallon limit, the Arizona Department of Liquor License and Control asked in-state wineries to report their yearly production. [Oliver Interrog. 6, ER 158]. They had never done this before. All but one reported production of less than 20,000 gallons per year, and so the limit was set at that point. [*Id.*] Local wineries were assured that they could sell wine the easiest and most profitable way -- by taking telephone and Internet orders. Prior to the enactment of S.B. 1276, eligibility for an Arizona domestic farm winery license was set at 75,000 gallons annual production. S.B. 1276 reduced that amount to 40,000 gallons. [Senate Fact Sheet, ER 161]. Hundreds of out-of-state wineries fall into this over-40,000 gallon category and cannot get a domestic farm winery license, but not a single Arizona winery falls into this disadvantaged category. [Gilchrist Dep. at 16-17, ER 92-93]. Thus, only nonresident wineries are prohibited from making direct

sales in Arizona. According to the sponsor of S.B. 1276, these production limits were chosen by the legislature in order to "take care of" the Arizona wineries [Cheuvront Aff. ¶ 7, ER 167] and protect their economic viability. [Keeling Stmt., ER 169]. Senator Cheuvront has testified that "the specific purpose of the new legislation, using the gallonage levels that were created was to secure that the Arizona wineries were included except Kokopelli[5] and thus permit them to ship in-state." [Cheuvront Aff. ¶ 8, ER 168]. The President of the Arizona Wine Grower's Association has publicly thanked the sponsors of the bill for "their efforts on behalf of Arizona winegrowers," [Keeling Stmt., ER 169] and the governor for her "continuing support" in signing the bill despite the complaints of out-of-state wineries. [Id.].

SUMMARY OF ARGUMENT

Arizona law provides that a winery's ability to sell and ship directly to consumers and retailers depends on its size. If a winery produces less than 20,000 gallons per year, it may accept telephone, mail and Internet orders and ship wine directly to the purchaser. If it produces more than 20,000 gallons, it may not. This scheme violates the dormant Commerce Clause because it discriminates against the interstate market in wine and provides economic protection to the fledgling Arizona wine industry.

The Arizona law is not discriminatory on its face. It does not say "out-of-state

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[5] Kokopelli sells through a distributor and did not want to disturb that relationship. See Cheuvront Aff., ¶ 7 [ER 167].

wineries are prohibited from direct shipping but in-state wineries may do so." Instead, it has what the Supreme Court calls a discriminatory effect -- it achieves this result indirectly, rather than directly. All Arizona wineries but one produce less than 20,000 gallons per year and may take remote orders and ship directly to consumers and retailers. More than 95% of American wine comes from wineries that produce over 20,000 gallons per year and are denied this privilege.

Arizona's law has a second discriminatory effect. One Arizona winery and several hundred out-of-state wineries fall into a middle category (20,000-40,000 gallons/year) where they are not flatly prohibited from engaging in direct shipping, but are prohibited from taking telephone, mail and Internet orders. A potential customer must travel to the winery and appear in person. Because traveling hundreds or thousands of miles to buy two cases of wine is cost-prohibitive, but traveling a few miles is not, this regulation has the practical effect of preventing direct shipments from out-of-state wineries but not from the largest in-state winery.

State laws which at first glance appear even-handed on their face are nevertheless subject to heightened scrutiny (and presumptively invalid) if their practical effect is to discriminate against out-of-state entities and protect an in-state industry from competition. Arizona's scheme has the discriminatory effect of preventing or severely limiting direct shipments by out-of-state wine producers, and therefore

violates the dormant Commerce Clause under the authority of *Granholm v. Heald*, 544 U.S. 460 (2005), *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 193 (1994), and *Hunt v. Washington State Apple Advertising Comm'n*, 432 U.S. 333, 351-52 (1977). The legislation was passed purposefully to provide economic protectionism to the Arizona wine industry (both wineries and wine wholesalers), and therefore violates the Commerce Clause under the authority of *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984).

STANDARD OF REVIEW

The district court's entry of summary judgment and its resolution of constitutional issues are reviewed *de novo*. *S.D. Myers, Inc. v. City & Co. of San Francisco*, 253 F.3d 461, 466 (9th Cir. 2001). Summary judgment is appropriate when the court, viewing the record as a whole and in the light most favorable to the nonmoving party, determines that there exist no genuine issues of material fact and that the moving party is entitled to judgment as a matter of law. *Fontana v. Haskin,* 262 F.3d 871, 876 (9th Cir. 2001). The substantive law will identify which facts are material, and only disputes over facts that might affect the outcome of the case properly preclude the entry of summary judgment. *Arpin v. Santa Clara Valley Transp. Agency,* 261 F.3d 912, 919 (9th Cir. 2001).

ARGUMENT

I. The dormant Commerce Clause prohibits Arizona from discriminating against out-of-state wineries and giving economic protection to the in-state wine industry

A. The courts apply heightened scrutiny to laws with discriminatory effect

The Commerce Clause provides that "Congress shall have Power…To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." U.S. Const., Art. I, §8. The Supreme Court has long held that this affirmative grant of power to Congress implies a negative or "dormant" constraint on state authority. States may not set up trade barriers that interfere with interstate commerce nor engage in economic protectionism designed to benefit local industry by restricting competition from out-of-state business interests. *Assoc.Indus. of Mo. v. Lohman*, 511 U.S. 641, 646-47 (1994).[6] The principle of free trade among the states in all products (including wine) is fundamental to the fabric of our Republic.

> Our system, fostered by the Commerce Clause, is that every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation, that no home embargoes will withhold his exports, and no foreign state will by customs duties or regulations exclude them. Likewise, every consumer may look to the free competition from every producing area in the Nation to protect him from exploitation by any. Such was the vision of the Founders; such has been the doctrine of this Court which has given it reality.

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[6] The dormant commerce clause principle was first articulated in *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1, 231-232, 239 (1824).

H.P. Hood & Sons, Inc. v. DuMond, 336 U.S. 525, 539 (1949).

State statutes challenged as violating the dormant Commerce Clause may be given either heightened scrutiny or minimal scrutiny, depending on the circumstances.

> [The Supreme] Court has adopted what amounts to a two-tiered approach to analyzing state economic regulation under the Commerce Clause. When a state statute directly regulates or discriminates against interstate commerce, or when its effect is to favor in-state economic interests over out-of-state interests, we have generally struck down the statute without further inquiry. See, e. g., *Philadelphia v. New Jersey,* 437 U.S. 617 (1978); *Shafer v. Farmers Grain Co.,* 268 U.S. 189 (1925); *Edgar v. MITE Corp.,* 457 U.S. 624, 640-643 (1982) (plurality opinion)When, however, a statute has only indirect effects on interstate commerce and regulates evenhandedly, we have examined whether the State's interest is legitimate and whether the burden on interstate commerce clearly exceeds the local benefits. *Pike v. Bruce Church, Inc.,* 397 U.S. 137, 142 (1970).

Brown-Forman Distillers Corp. v. N.Y. State Liquor Auth., 476 U.S. 573, 578-79 (1986). *Accord Granholm v. Heald*, 544 U.S. 460, 487 (2005); *S.D. Myers, Inc. v. City & Co. of San Francisco*, 253 F.3d 461, 466 (9th Cir. 2001).

The choice of the appropriate level of scrutiny is among the most important decisions the court will make, because the level of scrutiny often determines the outcome. A statute subject to heightened scrutiny "is virtually *per se* invalid," *Oregon Waste Sys. v. Dept. of Environmental Quality*, 511 U.S. 93, 100 (1994), and is usually struck down. *Granholm v. Heald*, 544 U.S. 460, 476 (2005). By contrast, statutes subject only to minimal scrutiny are usually upheld, *Dept. of Revenue of Ky.*

v. Davis, 128 S.Ct. 1801, 1808-09 (2008), because the courts generally defer to the legislature when balancing of values is involved. *See Id.* at 1821 (Scalia, J., concurring in part).

The courts apply heightened scrutiny in at least five situations. These categories tend to overlap, and statutes often display characteristics of more than one.

1) Facial discrimination -- when a state law explicitly (on its face) discriminates against out-of-state businesses or products and favors in-state industry. *Granholm*, 544 U.S. at 473-74 (law allowed in-state wineries to ship directly to consumers but restricted out-of-state wineries from doing so). *See also Pacific Nw. Venison Producers v. Smitch*, 20 F.3d 1008, 1012 (9th Cir. 1994) (heightened scrutiny would be given to "a law that overtly blocks the flow of interstate commerce at a State's borders"). Explicit discrimination is established if:

- The law bans out-of-state entities from the market. *Granholm v. Heald*, 544 U.S. at 473-74 (Michigan allowed in-state wineries to ship directly to consumers, but prohibited out-of-state wineries from doing so).
- The law places out-of-state businesses at a relative disadvantage compared to local businesses, by raising their costs, depriving them of their competitive advantage, or giving in-state businesses preferential treatment. *Granholm v. Heald*, 544 U.S. at 474 (New York wineries

eligible for farm winery license; out-of-state wineries only for commercial winery license that was more restrictive); *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 193 (1994) (an assessment on cheaper out-of-state milk that raised its cost to the same level as more expensive in-state milk); *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 275 (1988) (fuel dealers received a tax credit for in-state but not out-of-state ethanol).

- A nonresident must establish a physical presence in the state or must use a local processor or distributor, in order to do business in that state. *Granholm v. Heald*, 544 U.S. at 475 (out-of-state winery could sell and ship directly to consumers only from premises located in New York); *C & A Carbone, Inc. v. Town of Clarkstown, N.Y.*, 511 U.S. 383 (1994) (town required all solid waste to be processed through a local recycling center).

2) Discriminatory effect -- when state law has the practical effect of "favor[ing] in-state economic interests over out-of-state interests," *Granholm*, 544 U.S. at 487, regardless of whether it is explicitly discriminatory. *Assoc. Indus. of Mo. v. Lohman,* 511 U.S. 641, 654 (1994) ("[W]e repeatedly have focused our Commerce Clause analysis on whether a challenged scheme is

discriminatory in effect").[7] For example:

- Massachusetts imposed an assessment on both in-state and out-of-state milk sold in Massachusetts, but subsidized in-state dairy farmers to offset the assessment, so the law had the effect of raising the cost of out-of-state milk compared to in-state milk and was unconstitutionally discriminatory. *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 193-94 (1994).

- North Carolina prohibited both in-state and out-of-state apple growers from labeling their apples with any grade other than the federal standard. This rule had the practical effect of discriminating against the Washington apple industry which had its own higher standard of quality, by "raising [their] costs of doing business," "stripping away [their] competitive ... market advantage vis-a-vis local producers... in those categories where

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[7]*See also Best & Co. v. Maxwell,* 311 U.S. 454, 455-456 (1940) ("The commerce clause forbids discrimination, whether forthright or ingenious. In each case it is our duty to determine whether the statute under attack... will in its practical operation work discrimination against interstate commerce"); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 270 (1984) ("A finding that state legislation constitutes 'economic protectionism' may be made on the basis of either discriminatory purpose... or discriminatory effect"); *Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979) ("we must inquire ... whether the challenged statute ... discriminates against interstate commerce either on its face or in practical effect"). The Ninth Circuit has not previously heard a discriminatory effect case, but has stated the general rule in dictum. *See S.D. Myers, Inc. v. City & Co. of San Francisco*, 253 F.3d 461, 466 (9th Cir. 2001) (quoting *Brown-Forman*); *NCAA v. Miller,* 10 F.3d 633, 638 (9th Cir. 1993).

the Washington grade is superior" and protecting an inferior local product from competition. *Hunt v. Washington State Apple Advertising Comm'n*, 432 U.S. 333, 351-52 (1977).

3) Overt economic protectionism --when a state law purposefully disadvantages out-of-state businesses or products in order to give economic protection to an in-state industry. *Bacchus Imports Ltd. v. Dias,* 468 U.S. 263, 276 (1984) (state conceded that exemption from 20% liquor tax for locally produced wine and brandy was intended "to promote local industry"). *See also Pacific Nw. Venison Producers v. Smitch*, 20 F.3d 1008, 1012 (9th Cir. 1994) (heightened scrutiny if "the purpose ... of the regulation is economic protectionism").

4) Subtle economic protectionism -- when a statute appears to regulate evenhandedly and promote a legitimate local purpose (and therefore would be subject only to minimal scrutiny), but in reality "the asserted benefits of the statute are in fact illusory or relate to goals that evidence an impermissible favoritism of in-state industry over out-of-state industry." *See UFO Chuting of Hawaii, Inc. v. Smith*, 508 F.3d 1189, 1196 (9th Cir. 2007).[8]

5) Extraterritoriality -- when a state statute imposes a burdensome regulation

[8]This is a Ninth Circuit doctrine that has neither been approved nor rejected by any Supreme Court case.

directly on a business located in another state. *Brown-Forman,* 476 U.S. at 579 (New York attempted to regulate liquor producers located in other states); *NCAA v. Miller*, 10 F.3d 633, 638 (9th Cir. 1993) (Nevada statute attempted to prevent NCAA from disciplining UNLV basketball coach Jerry Tarkanian).

If plaintiffs establish that a law is discriminatory or protectionist, it is presumptively invalid, and the burden shifts to the State to prove that the law "advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." *Granholm*, 544 U.S. at 489; *New Energy Co. of Ind. v. Limbach,* 486 U.S. 269, 278-79 (1988). The State's burden is a heavy one, and the Supreme Court "has upheld state regulations that discriminate against interstate commerce only after finding, based on concrete record evidence, that a State's nondiscriminatory alternatives will prove unworkable. *Granholm,* 544 U.S. at 492-93. A state's purported justification must "pass the 'strictest scrutiny." *Oregon Waste Sys. v. Dept. of Env'l Quality*, 511 U.S. 93, 101 (1994).

B. The 21st Amendment does not immunize a state wine law from Commerce Clause scrutiny

The 21st Amendment provides that "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, XXI, § 2. That language gives states broad power to regulate the sale of wine, set up a distribution system, collect

excise taxes, and require that all persons dealing in alcoholic beverages obtain state licenses and abide by state regulations, *North Dakota v. United States*, 495 U.S. 423, 431-32 (1990) (plurality opinion), as long as such regulations are not discriminatory. *Id.* at 444, 448 (Scalia, J. Concurring). The Supreme Court has consistently held that the 21st Amendment power to license and regulate those who deal in alcohol is limited by the States' other constitutional obligations.[9]

Among those other constitutional obligations is the Commerce Clause principle that states may not discriminate against interstate commerce nor favor local industry. The Supreme Court made this point clearly in *Granholm v. Heald:*

> [T]he Twenty-first Amendment does not supersede other provisions of the Constitution and, in particular, does not displace the rule that States may not give a discriminatory preference to their own producers. 544 U.S. at 486.
>
> [D]iscrimination is neither authorized nor permitted by the Twenty-first Amendment. *Id.* at 466.
>
> 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 476.

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[9] See *44 Liquormart, Inc. v. Rhode Island*, 517 U.S. 484, 516 (1996) (21st Amendment does not override 1st Amendment and give states power to restrict liquor advertising), *Craig v. Boren*, 429 U.S. 190, 204-09 (1976) (21st Amendment does not override Equal Protection Clause and give states power to set different minimum drinking age based on gender); *Department of Revenue v. James B. Beam Distilling Co.*, 377 U.S. 341, 345-46 (1964) (21st Amendment does not override Export-Import Clause and allow states to tax imported whisky).

> [D]iscrimination is contrary to the Commerce Clause and is not saved by the 21st Amendment. *Id.* at 489.
>
> States have broad power to regulate liquor under *§ 2 of the Twenty-first Amendment*. This power, however, does not allow States to ban, or severely limit, the direct shipment of out-of-state wine while simultaneously authorizing direct shipment by in-state producers. *Id.* at 493.

See also Healy v. The Beer Institute, 491 U.S. 324, 342 (1989) ("[T]he Twenty-first Amendment does not immunize state laws from invalidation under the Commerce Clause"); *Bacchus Imports, Ltd. v. Dias,* 468 U.S. at 276 ("[O]ne thing is certain: The central purpose of the [21st Amendment] was not to empower States to favor local liquor industries by erecting barriers to competition"). The 21st Amendment did not immunize discriminatory state alcohol laws from heightened scrutiny under the dormant Commerce Clause.

With this summary in mind, we turn to a description of the operation of Arizona's wine distribution regulations.

II. Arizona's wine distribution laws disadvantage out-of-state wineries, favor in-state wineries, and protect the economic interests of the Arizona wine industry, in violation of the Commerce Clause

A. Arizona's wine distribution scheme

Arizona law divides wineries into three groups by annual production volume. The first category is wineries producing less than 20,000 gallons annually. They may obtain a Domestic Farm Winery license under Ariz. Rev. Stat. § 205.04(C), which

gives them four privileges:

a. They may sell wine directly to consumers who place orders by telephone, mail, or Internet. Ariz. Rev. Stat. § 4-205.04(C)(4),(9).

b. They may sell wine directly to consumers who visit their premises in person. Ariz. Rev. Stat. § 4-205.04(C)(9)

c. They may sell wine directly to retailers. Ariz. Rev. Stat. § 4-205.04(C)(7).

d. They may deliver or ship wine to customers in any quantity 4-205.04(C)(9)

The second category is wineries producing between 20,000 - 40,000 gallons annually. These wineries also may obtain a Domestic Farm Winery license, but it gives them fewer privileges:

a. They may sell wine directly to consumers, but only if the consumer visits the winery in person. Ariz. Rev. Stat. § 4-205.04(C)(4),(9).

b. They may deliver or ship wine to consumers, but only up to two cases per year. Ariz. Rev. Stat. § 4-203.04(J).

Wineries in this middle category may not take telephone, mail or Internet orders, Ariz. Rev. Stat. § 4-205.04(C)(4),(9), nor may they sell directly to retailers. Ariz. Rev. Stat. § 4-205.04(C)(7).

The third category comprises wineries producing more than 40,000 gallons

annually. Wineries in this group are not eligible for a Domestic Farm Winery license, which is the only license that carries direct-sale privileges. Ariz. Rev. Stat. § 4-205.04(C) ("a person may be licensed as a domestic farm winery ... if in a calendar year it produces ... not more than forty thousand gallons of wine"). They are eligible only for a so-called Direct Shipment license, Ariz. Rev. Stat. § 4-203.04, or a producer's license, Ariz. Rev. Stat. § 4-209(B)(1-2),[10] but these licenses require wineries to use Arizona wholesalers and do not allow them to sell or ship directly to consumers or retailers. Ariz. Rev. Stat. §§ 4-203.04(G) ("A person who holds a direct shipment license shall deliver spirituous liquor [only] to a wholesaler"); 4-243.01(B) ("All spirituous liquor shipped into this state shall be invoiced to the wholesaler"); Ariz. Admin. Code R19-1-108(A) (2009) (An "entity that ships ... spiritous liquors from a point outside Arizona to a final destination in Arizona shall ensure that [it] is consigned to a wholesaler").[11] Of course, it is unlawful for a winery to sell or ship wine to Arizona without a license, Ariz. Admin. Reg. 19-1-201(A) (2009) ("a person shall obtain a license ... before the person manufactures, sells or deals in spiritous liquors"); and unlawful for an Arizona resident to purchase wine from an unlicensed

[10]*See also* Ariz. Admin. Reg. R19-1-204 (2009) (eligibility requirements for an out-of-state producer's license).

[11]See also Ariz. Rev. Stat. §§ 4-244(3) (producer may only sell to licensee); 4-243.01 (retailer may only buy from wholesaler or domestic farm winery licensee).

seller. Ariz. Rev. Stat. § 4-244(21).[12]

This scheme appears on its face to treat in-state and out-of-state wineries alike, but in practical effect it discriminates against out-of-state wineries in two significant ways. First is the obvious one. Under this scheme, every Arizona winery is allowed to sell wine directly to the public in the State, but hundreds of out-of-state wineries that account for more than 95% of U.S. wine production, may not. [Fact Stmt. supra at 7-8] Twenty-six out of twenty-seven Arizona wineries fall into the first category and may therefore sell directly to the public the least expensive and most profitable way -- by telephone or Internet order. [Fact Stmt. supra at 9]. The one remaining

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[12]In the district court, the State's attorney argued that Ariz. Rev. Stat. 4-203.04(J) should be interpreted as allowing out-of-state wineries producing over 40,000 gallons to ship wine directly to consumers just as if it held a Domestic Farm Winery license. To reach that conclusion, section (J) has to be read as allowing unlicensed wineries to ship into Arizona, thereby nullifying the fundamental principle that alcoholic beverages may only be sold by properly licensed entities, or that these wineries can obtain a Domestic Farm winery license despite the clear statement to the contrary in Ariz. Rev. Stat. 4-205.04(C), thereby nullifying the language limiting those licenses to wineries producing fewer than 40,0000 gallons. It does not seem likely that the legislature intended to nullify either law. Although section (J) does begin with the boilerplate statement that it applies "notwithstanding any other law," it also provides that any direct sales and shipments pursuant to its terms must be "otherwise lawful," e.g., licensed, so the State's attorneys's interpretation is implausible. In any event, the attorney's interpretation is not shared by the defendant Department of Liquor Licensing and Control, which says these larger wineries may only direct ship through a wholesaler and cannot make direct shipments under any circumstances. [Gilchrist Dep., ER 97-99].

Arizona winery (Kokopelli) falls into the middle category, and may therefore sell directly to the public the next least expensive and most profitable way -- by selling to consumers who appear in person at the winery. [Fact Stmt. supra at 9]. No Arizona winery falls into the third category. By contrast, at least 480 out-of-state wineries fall into the third category and are not eligible for a Domestic Farm Winery permit and therefore prevented from selling directly to consumers in Arizona. [Fact Stmt. supra at 8]. Plaintiff Black Star Farms will find itself in this unenviable position in a few years. [Fact Stmt. supra at 7].

The second discriminatory effect is not quite so obvious. Both the one in-state winery and the approximately 200[13] out-of-state wineries falling into the middle category (20,000-40,000 gallon annual production) are eligible for a Domestic Farm Winery license and both in-state and out-of-state wineries are constrained by the fact that the license only authorizes them to sell wine directly to consumers who appear in person on their premises. However, the "equal treatment" stops here and is illusory. When one tries to apply the terms of the license to real-world situations in which consumers want to buy wine directly from the winery, one discovers that the playing field is not level, and the rules operate quite differently for in-state and out-of-state wineries.

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[13] The number is estimated. See n. 3, supra.

The only Arizona winery producing between 20,000 - 40,000 gallons per year is Kokopelli, located in the suburbs of Phoenix, less than 20 miles from the homes of the consumer plaintiffs. [Fact Stmt., supra at 9]. It is easy for them, and the approximately 4 million other residents of the Phoenix area,[14] to drive to the winery to buy wine in person. By contrast, Plaintiff Black Star Farms also falls into this middle category, but is located in Suttons Bay, Michigan, which is a 4200-mile round trip from Phoenix. [Fact Stmt. supra at 7]. The cost in dollars and time of making a trip from Arizona to Michigan makes direct sales impractical from an economic standpoint, and few such sales will occur. [Id.]. Since Black Star Farms has been unable to find a wholesaler willing to distribute its wine in Arizona, it is closed out of the state market altogether. [Id.].

B. Arizona's production-limit scheme, in which larger wineries located exclusively out of state are prevented from shipping directly to Arizona residents, discriminates against out-of-state wineries in practical effect

The Arizona statutory scheme is not discriminatory on its face. It does not say "out-of-state wineries may not sell and ship their wine directly to the public, but in-state wineries may do so." Explicit discrimination against interstate commerce is obviously unconstitutional. *Granholm v. Heald,* 544 U.S. at 466. Instead, Arizona has enacted a clever law that appears on its face to treat in-state and out-of-state

[14]http://www.census.gov/population/www/estimates/CBSA-est2006-annual.html (last visited 6/25/07).

wineries equally, but in practical effect operates exactly like an outright ban on direct shipping for more than 95% of American wine produced at out-of-state wineries that fall into the "wrong" category. The scheme is discriminatory in effect.

Discrimination is unconstitutional whether forthright or ingenious, *de jure* or *de facto,* purposeful or in effect. A state may not accomplish indirectly that which it is forbidden to do directly. The Supreme Court and this circuit have said repeatedly that discrimination is not simply a question of whether a statute is even-handed or discriminatory on its face, but of whether it discriminates against out-of-state businesses in practical effect.

> When a state statute directly regulates or discriminates against interstate commerce, or when it effect is to favor in-state economic interests over out-of-state interests, we have generally struck down the statute without further inquiry.

S.D. Myers, Inc. v. City and Co. of San Francisco, 253 F.3d 461, 466 (9th Cir. 2001) (quoting *Brown-Forman Distillers Corp. v. N.Y. State Liq. Auth.*, 476 U.S. at 579).

> The guiding principle in determining whether a state regulation discriminates against interstate or foreign commerce is whether either the purpose or the effect of the regulation is economic protectionism.

Pacific Nw. Venison Producers v. Smitch, 20 F.3d 1008, 1012 (9th Cir. 1994) (quoting *Philadelphia v. New Jersey,* 437 U.S. 617, 623-24 (1978)). *Accord Assoc. Indus. of Mo. v. Lohman*, 511 U.S. at 654 ("[W]e repeatedly have focused our Commerce Clause analysis on whether a challenged scheme is discriminatory in

effect"); *Hughes v. Oklahoma*, 441 U.S. at 336 (inquiry is whether a law "discriminates against interstate commerce either on its face or in practical effect").

Indeed, in *Granholm*, the Court struck down a New York's wine distribution law that was even-handed on its face but had the practical effect of "mak[ing] direct sales impractical from an economic standpoint." 544 U.S. at 466. The Court held:

> The New York regulatory scheme ... does not ban direct shipments altogether. Out-of-state wineries are instead required to establish a distribution operation in New York in order to gain the privilege of direct shipment. This, though, is just an indirect way of subjecting out-of-state wineries, but not local ones, to the three-tier system.... In-state producers ... can ship directly to consumers from their wineries. Out-of-state wineries must open a branch office and warehouse in New York, additional steps that drive up the cost of their wine. For most wineries, the expense of establishing a bricks-and-mortar distribution operation in 1 State, let alone all 50, is prohibitive.

544 U.S. at 474-75 (internal citations omitted).

Arizona's wine law produces the very kinds of discriminatory effects condemned in prior cases.

First, Arizona totally bans wineries producing more than 40,000 gallons annually from selling or shipping wine directly to anyone. They must use a wholesaler under the terms of their out-of-state producer's license. Not a single Arizona winery is similarly constrained. This violates the holding in *Granholm* that a state is not allowed "to ban, or severely limit, the direct shipment of out-of-state wine while simultaneously authorizing direct shipment by in-state producers," 544 U.S. at 493,

nor to "indirect[ly] subject[]out-of-state wineries, but not local ones, to the three-tier system." *Id.* at 474. Forcing nonresident wineries to use an Arizona wholesaler and retailer to sell their wine violates *C & A Carbone,* 511 U.S. at 391 (court has long held "local processing requirements [to be] invalid"). The extra costs tacked on by these middlemen [Fact. Stmt., supra at 8-9] raise the price of out-of-state wine in relation to in-state wine in violation of *West Lynn Creamery,* 512 U.S. at 194 (regulation cannot make products "produced out of State more expensive" than those produced in state). Hundreds of out-of-state producers that cannot find a wholesaler are totally excluded from the Arizona wine market, in violation of *Philadelphia v. New Jersey,* 437 U.S. at 624 ("clearest example of [discrimination] is a law that overtly blocks the flow of interstate commerce at a State's borders")

Second, consumers must travel to and appear in person at out-of-state wineries that produce 20,000-40,000 gallons per year in order to purchase wine and have it shipped. The cost of traveling hundreds or even thousands of miles to visit out-of-state wineries to buy a maximum of two cases is obviously prohibitive. [Fact. Stmt. supra at 7]. The IRS has calculated that the true cost of travel in a private vehicle is 58.5 cents per mile.[15] It is a 4200-mile round trip from Phoenix to Suttons Bay, Michigan, so a trip to buy Michigan wine would add $2457 to the cost of buying wine

[15] http://www.irs.gov/taxpros/article/0,,id=156624,00.html (last visited 2/17/09).

from Black Star Farms. It is 1500 miles to travel to Napa and back, which trip would cost $877.50. The in-person appearance rule raises the cost of direct sales to the point where they "make direct sales impractical from an economic standpoint," in violation of *Granholm,* 544 U.S. at 466. [16]

Two other circuit courts -- the Sixth and the Seventh --have considered the constitutionality of requirements that consumers must appear in person at out-of-state wineries in order to have wine shipped directly to them, and they have reached different results. In the wake *Granholm,* Indiana and Kentucky repealed laws that explicitly prohibited out-of-state wineries from selling and shipping directly to consumers[17] and replaced them with laws (like Arizona's) requiring that consumers had to travel to out-of-state wineries to make purchases in person, in order not to carry those purchases home, but to have them shipped. The Sixth Circuit in *Cherry Hill Vineyards, LLC v. Lilly*, 553 F.3d 423 (6th Cir. 2008) declared that Kentucky's in-person requirement[18] violated the Commerce Clause because the cost of traveling

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[16]Even if wineries producing more than 40,000 gallons were allowed to engage in direct shipping, as argued by the state's attorney in the district court, see n. 12, they would still fall into this category where a consumer is required to appear in person.

[17]See former Ky. Rev. Stat. §§ 243.155, 243.156 (2006); former Ind. Code § 7.1-5-11-1.5 (2005).

[18]Ky. Rev. Stat. 243.155(2) (winery may "sell ... wine [and] ship to a customer [only] if the wine is purchased by the customer in person at the ... winery.")

to out-of-state wineries to appear in person was so high that it "makes it economically and logistically infeasible for most consumers to purchase wine from out-of-state ... wineries," 553 F.3d at 433, and "that the challenged statutes discriminate against interstate commerce in practical effect." *Id.* By contrast, the Seventh Circuit in *Baude v. Heath*, 538 F.3d 608 (7th Cir. 2008) (*pet. for cert. pending)* held that Indiana's in-person appearance rule[19] did not violate the Commerce Clause because it applied "on its face" to both in-state and out-of-state wineries alike.

The different results are easily explained. The Sixth Circuit properly followed *Granholm* and the other Supreme Court cases holding that discrimination was primarily a question of the effect of a law. It therefore looked at whether the face-to-face rule had the practical effect of making it harder and more expensive to buy wine from out-of-state wineries than local ones. It concluded that the cost of traveling thousands of miles impermissibly made such direct sales economically and logistically infeasible, *Cherry Hill*, 553 F.3d at 433, and declared that, since other methods of verifying age were available, the rule was invalid under the heightened scrutiny given to discriminatory regulations. *Id*. at 434.

The Seventh Circuit ignored the language in *Granholm* and a dozen other

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[19]Ind. Code § 7.1-3-26-6 (a winery "may sell and ship wine directly only to a consumer who ... has [made] one initial face-to-face transaction at the seller's place of business.")

Supreme Court cases that discrimination was a question of effect, and held discrimination had to be apparent on the face of a statute in order to receive heightened scrutiny. The panel concluded that since Indiana's face-to-face law does not "discriminate[] explicitly [and] applies to every winery, no matter where it is located," that *Granholm's* heightened scrutiny analysis did not apply. *Baude*, 538 F.3d at 611. It held, contrary to *Granholm,* 544 U.S. at 466, 487*; West Lynn Creamery, Inc. v. Healy*, 512 U.S. at 193; and *Hunt v. Washington State Apple Advertising Comm'n*, 432 U.S. at 351-52, that even though "the rules impose higher costs on interstate commerce as a practical matter," it would be subject only to minimal scrutiny. 538 F.3d at 611. Under minimal scrutiny, cost disparity "is not enough to declare a law unconstitutional" 538 F.3d at 614. The Seventh Circuit declined to follow the prior decisions of the Supreme Court, this circuit, and every other circuit[20] and analyze whether the in-person rule had a discriminatory effect.

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[20]*Cloverland-Green Spring Dairies, Inc. v. Penn. Milk Marketing Bd*., 298 F.3d 201, 210 (3d Cir. 2002) (statute invalid if it discriminates "either on its face or in practical effect"). *Accord Jelovsek v. Bredesen*, 545 F.3d 431, 436 (6th Cir. 2008); *Island Silver & Spice, Inc. v. Islamorada*, 542 F.3d 844, 846 (11th Cir. 2008); *Cherry Hill Vineyard, LLC v. Baldacci*, 505 F.3d 28, 33 (1st Cir. 2007); *Allstate Ins. Co. v. Abbott*, 495 F.3d 151, 160 (5th Cir. 2007); *Town of Southold v. Town of East Hampton*, 477 F.3d 38, 48 (2d Cir. 2007); *Jones v. Gale*, 470 F.3d 1261, 1267 (8th Cir. 2006); *Yamaha Motor Corp., U.S.A. v. Jim's Motorcycle, Inc.*, 401 F.3d 560, 567 (4th Cir. 2005); *S.D. Myers, Inc. v. City and Co. of San Francisco*, 253 F.3d 461, 466 (9th Cir. 2001)*; American Target Advertising, Inc. v. Giani*, 199 F.3d 1241, 1254 (10th Cir. 2000).

Baude is simply not good law.

The Arizona scheme contravenes prior Supreme Court decisions in other ways. For wineries producing 20,000 -40,000 gallons per year, only those physically located in the state have any realistic opportunity to sell directly to Arizona residents, in violation of *Granholm,* 544 U.S. at 475 ("cannot require an out-of-state firm 'to become a resident in order to compete on equal terms'"). By making it harder, more expensive and sometimes impossible for Arizona consumers and retailers to purchase wine from out-of-state wineries that are producing over 20,000 gallons annually, the quality of which may be higher than that of Arizona wine, the state has "stripp[ed] away [their] competitive ... market advantage vis-a-vis local producers" and protected an inferior local product from competition, in violation of *Hunt v. Washington State Apple Adv. Comm'n*, 432 U.S. at 351-52.

Arizona wineries can sell directly to consumers and retailers without paying the wholesalers' markup. They can sell wine in Arizona even if no wholesaler will distribute them. All but one can take telephone, mail and Internet orders and ship throughout the state. They are not on the wrong side of a trade barrier that prevents Arizona residents from having direct access to 95% of the wine produced in the United States. The Arizona direct sales law gives the Arizona wine industry exactly what is condemned in *Granholm* -- economic protection and "access to the State's

consumers on preferential terms." 544 U.S. at 474-75.

It does not matter that some out-of-state wineries are small enough to qualify for an Arizona domestic farm winery license and engage in direct shipping. The number of firms affected is not usually relevant, *New Energy of Ind. v. Limbach*, 486 U.S. at 276-77 ("varying the strength of the bar against economic protectionism according to the size and number of in-state and out-of-state firms affected would serve no purpose"). The Commerce Clause "protects the interstate market, not particular interstate firms, from prohibitive or burdensome regulations," *Exxon Corp. v. Gov. of Maryland*, 437 U.S. 117, 127-28 (1978), and 95% of American wine is burdened by Arizona's restrictions. As one court stated:

> [The] statute in practice prevents direct shipment of approximately 98% [sic] of out-of-state wine while allowing 100% of [in-state] wineries to sell direct. This clearly confers disproportionate benefits on both [in-state] wineries and wholesalers.

Family Winemakers of Cal. v. Jenkins, Slip op. at 17-21 (1:06-cv-11682, D. Mass. 2008) (addendum at 67-68).

C. The reason for the discriminatory effect is simple economic protectionism

The 20,000 and 40,000 gallon production limits are not natural conditions or pre-ordained definitions of small, medium and large wineries. They were deliberately chosen by the Arizona legislature. Why these limits? Other states do not use them. Some set no production limits. E.g., Colo. Rev. Stat. § 12-47-104. Others use quite

different limits. E.g., Ind. Code § 7.1-3-26-7(a)(7) (500,000 gallons). Indeed, Arizona itself used a different limit prior to 2006 -- 75,000 gallons. [Fact Stmt. supra at 10]. When it changed the law to make out-of-state wineries eligible for the Domestic Farm Winery permit, why did the legislature suddenly lower the limits to make fewer out-of-state wineries eligible?

The answer is obvious: simple economic protectionism. The 20,000 gallon limit was set because all Arizona wineries but one produce less than that amount. For two years prior to the passage of S.B. 1276[21] in 2006, the Department of Liquor License and Control asked in-state wineries to report their yearly production. They had never done this before. When most reported producing less than 20,000 gallons per year, the limit was set accordingly to make sure the fledgling Arizona wine industry would be economically protected and allowed to sell wine the easiest and most profitable way -- by taking telephone and Internet orders. [Fact Stmt supra at 10].

Prior to the enactment of S.B. 1276, when Arizona law made out-of-state wineries explicitly ineligible for a domestic farm winery license, the production limit was set at 75,000 gallons per year. After *Granholm*, when the legislature realized they had to allow out-of-state wineries to apply on equal terms, they reduced that amount to 40,000 gallons. Every Arizona winery produces less than that amount, so the

[21]SB 1276 was the bill that created the 20,000 and 40,000 gallon limits.

reduction excluded no local winery. However, hundreds of U.S. wineries produce over 40,000 gallons, so only out-of-state wineries were affected by the gallonage reduction. According to the sponsor of S.B. 1276, these numbers were set by the legislature in order to "take care of" the Arizona wineries and protect their economic viability. Senator Cheuvront testified that "the specific purpose of the new legislation, using the gallonage levels that were created was to secure that the Arizona wineries were included except Kokopelli[22] and thus permit them to ship in-state." The President of the Arizona Wine Growers publicly thanked the sponsors of the bill for "their efforts on behalf of Arizona winegrowers," and the governor for her "continuing support" of the bill despite complaints of out-of-state wineries. [Fact. Stmt., supra at 10-11]

This evidence of the legislature's protectionist purpose, although largely circumstantial, is important. As this court has previously stated,

> The guiding principle in determining whether a state regulation discriminates against interstate or foreign commerce is whether either the purpose or the effect of the regulation is economic protectionism.

Pacific Nw. Venison Producers v. Smitch, 20 F.3d 1008, 1012 (9th Cir. 1994) (quoting *Philadelphia v. N.J.,* 437 U.S. at 623-24). Economic protectionism is

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[22] Kokopelli sells through a distributor and did not want to disturb that relationship. See Cheuvront Aff., ¶ 7 [ER 167].

defined as "[s]hielding in-state industries from out-of-state competition," which "is almost never a legitimate local purpose." *Maine v. Taylor*, 477 U.S. 131, 148 (1986). *Accord West Lynn Creamery*, 512 U.S. at 205 ("Preservation of local industry by protecting it from...interstate competition is the hallmark of ....economic protectionism").[23]

However, the courts do not require that purpose be proved by direct evidence. States rarely admit that their motives are unconstitutional, so findings of legislative purpose are usually based on circumstantial evidence. *See McCreary Co., Ky. v. ACLU*, 545 U.S. 844, 861-862 (2005) (determining purpose "is a staple of statutory interpretation that makes up the daily fare of every appellate court in the country"); *accord Provenz v. Miller,* 102 F.3d 1478, 1490 (9th Cir. 1996). The court is not required to check its common sense at the courthouse steps. *McKinney v. De Bord*, 507 F.2d 501, 504 (9th Cir. 1974). A finding of improper legislative purpose may be based on "the sequence of events leading to passage of the statute," *Edwards v. Aguillard*, 482 U.S. 578, 595 (1987), and the "public comments of its sponsor." *McCreary Co., Ky. v. ACLU*, 545 U.S. at 862. See also *Hunt v. Washington Apple Adv. Comm'n*, 432 U.S. at 352 (comment by state official that rule was in interest of local apple producers was "most glaring" evidence of protectionist purpose). Indeed,

[23]The district court for unexplained reasons did not engage in an analysis of whether the law was protectionist.

the only federal court so far to consider the constitutionality of gallonage limits that "just happen" to favor in-state wineries and disadvantage their larger out-of-state competitors has found such limits to be protectionist. *Family Winemakers of Cal. v. Jenkins*, Slip op. at 17-21 (06-11682 D. Mass. 2008) (addendum at 64-67). Economic protectionism has no place in our national market and violates the Commerce Clause. *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 276 (1984).

D. The State has failed to prove that there are no reasonable nondiscriminatory alternatives that would advance its regulatory interests

The State obviously has a legitimate interest in regulating alcohol sales and distribution. The 21st Amendment allows the State to regulate alcohol sales within its borders. No one disputes that. However, the Supreme Court holds that discrimination against interstate commerce cannot be justified simply because a state law serves legitimate local concerns. The Court has repeatedly struck down laws that advanced important state interests but discriminated against nonresidents and excluded out-of-state products in the process. *E.g., H.P. Hood & Sons, Inc. v. Du Mond*, 336 U.S. 525 (1949) (New York cannot exclude out-of-state dairy products in the interests of protecting public health); *Chemical Waste Mgmt., Inc. v. Hunt*, 504 U.S. 334 (1992) (Alabama cannot discriminate against and exclude hazardous waste from other states in the interest of public safety).

The Supreme Court requires a State to show not only that the regulation serves

an important interest, but also that no reasonable non-discriminatory alternative exists that would adequately advance such interests.

> Our cases leave open the possibility that a State may validate a statute that discriminates against interstate commerce by showing that it advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives....[T]he standards for such justification are high.

New Energy Co., 486 U.S. at 278. At a minimum, " discrimination invokes the strictest scrutiny of any purported legitimate local purpose and of the absence of nondiscriminatory alternatives." *Hughes v. Oklahoma*, 441 U.S. at 337. *See also Oregon Waste Systems*, 511 U.S. at 101 (the state's purported justification must "pass the 'strictest scrutiny."). The burden of proof on this issue rests with the State. *Chemical Waste Mgmt,* 504 U.S. at 342 ("the burden falls on the State"); *Hunt v. Washington State Apple Adv. Comm'n*, 432 U.S. at 342 ("the burden falls on the State"); *Maine v. Taylor*, 477 U.S. at 138 ("burden falls on the State").

It is difficult for a state to meet this burden. The Supreme Court has only rarely found that discrimination was justified, and then only upon an extensive factual record clearly demonstrating the absence of workable alternatives. *See Maine v. Taylor*, 477 U.S. 131, 140-43 (1986) (imported bait fish could introduce non-native parasites that could harm Maine fish; experts testified no way to prevent it other than a total ban); *Sporhase v. Nebraska ex rel. Douglas*, 458 U.S. 941, 956-57 (1982)

(reserving ground water for own citizens in time of drought was only way to insure adequate water supply).

In this case, the State claimed in the district court that restricting direct wine sales advanced its interest in reducing youth access to alcohol. This is the same claim made by the states in *Granholm* and rejected by the Supreme Court. The Court held:

> The States provide little evidence that the purchase of wine over the Internet by minors is a problem. Indeed, there is some evidence to the contrary. A recent study by the staff of the FTC[24] found that the 26 States currently allowing direct shipments report no problems with minors' increased access to wine. FTC Report 34.[25] This is not surprising for several reasons. First, minors are less likely to consume wine, as opposed to beer, wine coolers, and hard liquor. Id., at 12. Second, minors who decide to disobey the law have more direct means of doing so. Third, direct shipping is an imperfect avenue of obtaining alcohol for minors who, in the words of the past president of the National Conference of State Liquor Administrators, "'want instant gratification.'" Id., at 33, and n 137 (explaining why minors rarely buy alcohol via the mail or the Internet). Without concrete evidence that direct shipping of wine is likely to increase alcohol consumption by minors, we are left with the States' unsupported assertions. Under our precedents, which require the "clearest showing" to justify discriminatory state regulation, this is not enough.
>
> Even were we to credit the States' largely unsupported claim that direct shipping of wine increases the risk of underage drinking, this would not justify regulations limiting only out-of-state direct shipments.

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[24]See ER 129 et seq.

[25]Since the FTC Report, that number has increased. *See Cherry Hill Vineyards v. Hudgins*, 488 F. Supp. 2d 601, 620 n.24 (W.D. Ky. 2006) (noting that 32 states allow remote ordering and direct wine shipping); *Jelovsek v. Bredesen*, 482 F. Supp. 2d 1013, 1014 (E.D. Tenn. 2007) (number of states that currently prohibit the direct shipment of wine from out-of-state wineries to in-state consumers is steadily decreasing).

> [M]inors are just as likely to order wine from in-state producers as from out-of-state ones.... In addition, the States can take less restrictive steps to minimize the risk that minors will order wine by mail. For example, the Model Direct Shipping Bill developed by the National Conference of State Legislatures requires an adult signature on delivery and a label so instructing on each package.

Granholm v. Heald, 544 U.S. at 490-91 (citation omitted).

Arizona has not and cannot meet its burden of proving that it has no alternative but to discriminate against out-of-state wine. It is in exactly the same position as the states trying to defend their laws in *Granholm*. It already allows in-state wineries to ship directly to consumers. Indeed, Arizona also allows some smaller out-of-state wineries to direct ship, so it cannot even make the argument that it has to discriminate against out-of-state wineries because it has greater regulatory control over in-state producers, an argument that was also raised (and rejected) in *Granholm*. 544 U.S. at 490. It has already adopted the Supreme Court's reasonable alternative for wineries under the 20,000 gallon limit, allowing them to take Internet orders and ship wine without a face-to-face appearance, Ariz. Rev. Stat. § 4-205.04(C)(9), as long as the shipping carton is labeled to require an adult signature, the carrier verifies age in a face-to-face delivery, and the winery reports the names and addresses of the persons shipped to. Ariz. Rev. Stat. § 4-205.04(C)(9)-(E). Arizona can revoke a winery's license to sell and ship in Arizona if it violates these rules. See Ariz. Rev. Stat. § 4-244(1), (3). Many other states have adopted this alternative for all wineries, not just

the smallest ones, e.g., Mich. Comp. L. § 436.1203; N.C. Gen. Stat. § 18B-1001.1; Tex. Alc. Bev. Code §§ 54.01-54.07, and the Supreme Court has endorsed it. *Granholm*, 544 U.S. at 491 ("licensing and self-reporting [will] provide adequate safeguards for wine distributed through ... direct shipments").

The only conceivable reason Arizona wants to prevent the larger out-of-state wineries from selling directly is the fear that doing so will hurt in-state businesses. Representing these larger wineries is the economic lifeblood of the Arizona wholesalers [Fact Stmt., supra at 8], and they fear loss of business if these wineries can bypass them and sell directly. Much of the wine produced at these out-of-state wineries is of better quality or is better known to consumers than Arizona wine, so making it more easily available will hurt local winery sales. And, if a consumer wants a particular wine from one of the larger out-of-state wineries and cannot buy it directly, the consumer will have to buy it from an Arizona retailer. Thus, the Arizona scheme runs afoul of the Ninth Circuit rule that it is a violation of the Commerce Clause when the asserted state interest is "illusory or relate[s] to goals that evidence an impermissible favoritism of in-state industry over out-of-state industry." *UFO Chuting of Hawaii, Inc. v. Smith*, 508 F.3d 1189, 1196 (9th Cir. 2007).

E. Part of the Arizona scheme regulates only out-of-state wineries and therefore violates *NCAA v. Miller*

Part of the Arizona wine distribution scheme purports to regulate wineries

producing over 40,000 gallons per year. Wineries falling into this category are ineligible for the domestic farm winery license that all in-state wineries may obtain. Without this license, these wineries may not sell directly to consumers or retailers in Arizona. Because no Arizona winery falls into this category, Arizona is attempting to directly regulate interstate commerce in violation of *NCAA v. Miller*, 10 F.3d 633 (9th Cir. 1993).

In *NCAA v. Miller*, this court reviewed a Nevada law that purported to regulate "interstate national collegiate athletic associations." The law imposed stringent requirements upon such organizations when they sought to discipline Nevada university employees and monetary penalties for failure to comply. The practical effect of the law would have been to prevent the NCAA from "doing business" in Nevada and to nullify the NCAA's attempt to penalize UNLV and its basketball coach, Jerry Tarkanian. 10 F.3d at 636-37. This court held that "[i]t is clear that this statute is directed at interstate commerce and only interstate commerce." because there were no in-state organizations covered by this law. 10 F.3d at 638. By setting the conditions under which the NCAA could operate, Nevada had put it in an intolerable situation where it could be simultaneously subject to conflicting state laws with inconsistent obligations. 10 F.3d at 639-40.

The part of Arizona's wine distribution law regulating wineries producing over

40,000 gallons annually is like the law struck down in *NCAA v. Miller*. There are hundreds of out-of-state wineries that fall into this category and they produce more than 95% of American wine. No Arizona winery falls into this category, so the rules governing larger wineries regulate no Arizona producer. The regulations governing these large wineries are therefore "directed at interstate commerce and only interstate commerce," so the 40,000 gallon limit should be struck down even if the 20,000 gallon limit is not.

CONCLUSION

Arizona's statutory scheme is not explicitly discriminatory, but it has the practical effect of favoring its in-state wineries in contravention of the Commerce Clause principles set out in *Granholm v. Heald*. Arizona allows its own wineries to sell and ship directly to customers but prevents out-of-state wineries that produce more than 95% of American wine from doing so. The result is economic protection of the in-state wine industry. Almost every drop of wine sold in the state is handled by an Arizona winery, wholesaler or retailer. The State's legitimate regulatory interests could just as easily be advanced by using the same licensing and regulation system for out-of-state wineries producing more than 20,000 gallons per year as it does for smaller wineries. This court should reverse the district court, declare unconstitutional the 20,000 and 40,000 gallon production limits in Ariz. Rev. Stat. § 4-205.04 and

remand the case to the district court for the entry of an order consistent with this court's opinion.

Respectfully submitted:

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CERTIFICATE OF COMPLIANCE PURSUANT TO FED. R. APP. P. 32(a)(7)© AND CIRCUIT RULE 32-1, CASE NO. 08-15738

I certify that pursuant to Fed. R. App. P. 32 (a)(7)(C) and Ninth Circuit Rule 32-1, the attached opening brief is proportionately spaced, has a typeface of 14 points or more and contains 11,399 words.

Date: February 17, 2009

s/ James A. Tanford
James A. Tanford

CERTIFICATE OF SERVICE

I hereby certify that on February 17, 2009, I electronically filed the foregoing brief with the Clerk of the Court of the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system.

Participants in the case are registered CM/ECF users will be served by the appellate CM/ECF system.

I further certify that one of the participants in the case is not a registered CM.ECF user. I have mailed the foregoing document by First-Class Mail, postage prepaid, to the following non-CM/ECF participant:

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ADDENDUM

A. Relevant Sections of Arizona Revised Statutes (2009)

Ariz. Rev. Stat. § 4-203.04. Direct shipment license
A. The director may issue a direct shipment license to a person who is engaged in business as a distiller, vintner, brewer, rectifier, blender or other producer of spirituous liquor if the person is licensed in the state where the person's principal place of business is located and the director determines that the person is capable and reliable and is qualified to hold a direct shipment license.
B. A person shall apply for a direct shipment license on a form prescribed by the director. The director may charge an application fee. In addition to other matters required by the director, an application for a direct shipment license shall include:

* * *

4. The names and addresses of the wholesalers licensed in this state through which the applicant will ship spirituous liquor into or within this state

* * *

E. A resident of this state who is twenty-one years of age or older may place an order in person, by telephone, mail or catalog or on the internet for spirituous liquor for the person's own personal use with a person who holds a direct shipment license

* * *

G. A person who holds a direct shipment license shall deliver spirituous liquor ordered pursuant to subsection E of this section to a wholesaler who is licensed in this state....

* * *

J. Notwithstanding any other law, a person may ship wine as long as all of the following apply:

1. The wine was purchased while the purchaser was physically present at the winery.
2. The purchaser of the wine provided the winery verification of legal age to purchase alcohol.
3. The shipping container in which the wine is shipped is marked to require the signature on delivery of an adult who is of legal age to purchase alcohol and delivery confirmation.
4. The wine is for personal use only and not for resale.
5. The winery ships to a residential or business address other than a premises licensed pursuant to this title.
6. The purchaser could have carried the wine lawfully into or within this state.

7. The winery ships not more than two cases of wine per winery to the purchaser in any calendar year.

Ariz. Rev. Stat. § 4-205.04. Domestic farm winery license
* * *
C. A person may be licensed as a domestic farm winery to sell wine produced or manufactured if in a calendar year it produces at least two hundred gallons and not more than forty thousand gallons of wine and may make sales and deliveries of wine only as specifically provided in this section and as follows:

1. A licensed domestic farm winery may make sales and deliveries of wine to wholesalers licensed to sell wine under this title.
2. A licensed domestic farm winery may serve wine produced or manufactured on the premises for the purpose of sampling the wine.
3. A representative of the licensed domestic farm winery may consume small amounts of the products of the licensed domestic farm winery for the purpose of sampling the wine.
4. A licensed domestic farm winery may sell to a consumer physically present on the premises wine produced or manufactured on the premises in the original container for consumption on or off the premises.
5. A licensed domestic farm winery may purchase and sell wine produced by another licensed domestic farm winery only if the retail sale is to a consumer physically present on the premises of the domestic farm winery.
6. If the licensed domestic farm winery is not otherwise engaged in the business of a distiller, vintner, brewer, rectifier, blender or other producer of spirituous liquor in any jurisdiction, the licensed domestic farm winery may hold licenses prescribed in § 4-209, subsection B, paragraphs 7, 10 and 12 on the licensed domestic farm winery premises or other retail premises. The licensed domestic farm winery shall purchase all spirituous liquor for sale at the other on-sale retail premises from wholesalers who are licensed in this state, except that a licensed domestic farm winery may:
    (a) Purchase wine from other domestic farm wineries pursuant to paragraph 7 of this subsection.
    (b) Make deliveries of the wine that the domestic farm winery produces to the domestic farm winery's own commonly controlled retail licensed premises.
    © The wine is for personal use only and not for resale.
    (d) The wine is shipped to a residential or business address other than a premises licensed pursuant to this title.

(e) The purchaser could have carried the wine lawfully into or within this state.
(f) The delivery is made by a person who is at least twenty-one years of age.
(g) The domestic farm winery shall collect payment for the price of the spirituous liquor no later than at the time of delivery.

10. A licensed domestic farm winery may make sales and deliveries as expressly permitted by §§ 4-203.03, 4-203.04 and 4-244.04.

Ariz. Rev. Stat. § 4-209. Fees for license, application, issuance
* * *
B. Issuance fees for original licenses shall be:

1. For an in-state producer's license, to manufacture or produce spirituous liquor in this state, one thousand five hundred dollars.
2. Except as provided in paragraph 15 of this subsection, for an out-of-state producer's, exporter's, importer's or rectifier's license, two hundred dollars.
* * *
15. For an out-of-state winery that sells not more than fifty cases of wine in this state in a calendar year, twenty-five dollars.

Ariz. Rev. Stat. § 4-243.01. Purchasing from other than primary source of supply unlawful
A. It is unlawful:

1. For any supplier to solicit, accept or fill any order for any spirituous liquor from any wholesaler in this state unless the supplier is the primary source of supply for the brand of spirituous liquor sold or sought to be sold and is duly licensed by the board.
2. For any wholesaler or any other licensee in this state to order, purchase or receive any spirituous liquor from any supplier unless the supplier is the primary source of supply for the brand ordered, purchased or received.
3. Except as provided by § 4-243.02 for a retailer to order, purchase or receive any spirituous liquor from any source other than any of the following:
(a) A wholesaler who has purchased the brand from the primary source of supply.
(b) A wholesaler who is the designated representative of the primary source of supply in this state and who has purchased such spirituous liquor from the designated representative of the primary source of supply within or without this state.
© A registered retail agent pursuant to § 4-101.

(d) A domestic farm winery licensed under § 4-205.04 and subject to the limitations prescribed in § 4-205.04, subsection C, paragraph 7.

(e) A licensed domestic microbrewery licensed under § 4-205.08.

B. All spirituous liquor shipped into this state shall be invoiced to the wholesaler by the primary source of supply. All spirituous liquor shall be unloaded and remain at the wholesaler's premises for at least twenty-four hours. A copy of each invoice shall be transmitted by the wholesaler and the primary source of supply to the department of revenue.

Ariz. Rev. Stat. § 4-244. Unlawful acts

It is unlawful:

1. For a person to buy for resale, sell or deal in spirituous liquors in this state without first having procured a license duly issued by the board.
2. For a person to sell or deal in alcohol for beverage purposes without first complying with this title.
3. For a distiller, vintner, brewer or wholesaler knowingly to sell, dispose of or give spirituous liquor to any person other than a licensee except in sampling wares as may be necessary in the ordinary course of business, except in donating spirituous liquor to a nonprofit organization which has obtained a special event license for the purpose of charitable fund raising activities or except in donating spirituous liquor with a cost to the distiller, brewer or wholesaler of up to one hundred dollars in a calendar year to an organization that is exempt from federal income taxes under § 501© of the internal revenue code and not licensed under this title.

* * *

7. For any retail licensee to purchase spirituous liquors from any person other than a solicitor or salesman of a wholesaler licensed in this state.

* * *

21. For a person to have possession of or to transport spirituous liquor which is manufactured in a distillery, winery, brewery or rectifying plant contrary to the laws of the United States and this state. Any property used in transporting such spirituous liquor shall be forfeited to the state and shall be seized and disposed of as provided in § 4-221.

B. Unpublished opinion, Family Winemakers of Cal. v. Jenkins, 1:06-cv-11682 (D. Mass. 2008)

UNITED STATES DISTRICT COURT DISTRICT OF MASSACHUSETTS
CIVIL ACTION NO. 06-11682-RWZ

FAMILY WINEMAKERS OF CALIFORNIA, et al.

vs

EDDIE J. JENKINS in his official capacity as Chairman of the Massachusetts Alcoholic Beverages Control Commission, et al.

MEMORANDUM OF DECISION AND ORDER
November 19, 2008

ZOBEL, D.J.

Plaintiffs, two Massachusetts consumers and a non-profit trade association which advocates the rights and interests of its member wineries, challenge the constitutionality of certain provisions of a Massachusetts statute which limits wine shipment rights based on wineries' total annual production of wine and existing relationships with Massachusetts-licensed wholesalers. Defendants are sued in their official capacities as members of the Massachusetts Alcoholic Beverages Control Commission (Commission). [1] The matter is before me on the parties' cross-motions for summary judgment.[2]

I. Legal Standard

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[1] The Commission "consist[s] of a commissioner and 2 associate commissioners appointed by the treasurer." Mass. G en. Laws ch. 10, § 70. The Commission exercises "general supervision of the conduct of the business of manufacturing, importing, exporting, storing, transporting and selling alcoholic beverages." Id. § 71.

[2] The court acknowledges the brief submitted by amicus curiae Wine & Spirits Wholesalers of Massachusetts, Inc. (Docket # 77).

Summary judgment is appropriate where "there is no genuine issue as to any material fact and . . . the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56©. "A dispute is 'genuine' if the evidence about the fact is such that a reasonable jury could resolve the point in favor of the non-moving party." Sanchez v. Alvarado, 101 F.3d 223, 227 (1st Cir. 1996) (internal quotation marks and citations omitted). A material fact is one which has the "potential to affect the outcome of the suit under the applicable law." Id. (internal quotation marks and citations omitted). Generally the court must view the record in the light most favorable to the non-moving party and indulge all reasonable inferences in that party's favor. See O'Connor v. Steeves, 994 F.2d 905, 907 (1st Cir. 1993). On cross-motions for summary judgment, however, the court simply determines "whether either of the parties deserves judgment as a matter of law on facts that are not disputed." Barnes v. Fleet Nat'l Bank, N.A. , 370 F.3d 164, 170 (1st Cir. 2004).

Under Rule 56, supporting or opposing affidavits "must be made on personal knowledge, set out facts that would be admissible in evidence, and show that the affiant is competent to testify on the matters stated." Fed. R. Civ. P. 56(e). "[I]f a party does not move to strike an inadmissible affidavit, 'any objections to its consideration are deemed to have been waived and it may properly be considered by the court when ruling on the motion.' Desrosiers v. Hartford Life and Acc. Co. , 515 F.3d 87, 91 (1st Cir. 2008) (quoting Davis v. Sears, Roebuck & Co., 708 F.2d 862, 864 (1st Cir. 1983)).[3]Neither party lodged objections to the affidavits submitted in support of the summary judgment motions. The court therefore accepts and considers the affidavits in ruling on this motion. Additionally, defendants respond to many of the facts in plaintiffs' Local Rule 56.1 Statement of Undisputed Material Facts by simply stating that they "lack knowledge necessary to respond . . . ." (See, e.g. , Docket # 102 ¶¶ 49-66.) However, defendants did not seek a continuance under Federal Rule of Civil Procedure 56(f) to investigate the accuracy of plaintiffs' statements of fact and, under the Local Rule, "[m]aterial facts of record set forth in the statement required to be served by the moving party will be deemed for purposes of the motion to be admitted by opposing parties unless controverted by the statement

[3] Desrosiers noted that a written motion to strike is not always required; however, a party must take "some action" wh ich is "substantially equivalent" to a motion to strike to apprise the court of its objection to an affidavit. 515 F.3d at 91 (quoting Perez v. Volvo Car Corp., 247 F.3d 303, 314 (1st Cir. 2001)).

required to be served by opposing parties." D. Mass. R. 56.1. Accordingly, such undisputed statements are deemed admitted by defendants.[4]

II. Factual Background

A. Granholm v. Heald

In 2005 the Supreme Court held in Granholm v. Heald that state laws which permit in-state wineries to sell wine directly to consumers in the State but prohibit out of-state wineries from doing so discriminate against interstate commerce in violation of the Commerce Clause.[5] 544 U.S. 460, 466 (2005). The Granholm decision invalidated laws in Michigan and New York which discriminated against interstate commerce in different ways. The Michigan scheme was facially discriminatory, in that it allowed instate producers to ship wines directly to Michigan customers while banning out-of-state producers from doing so. "The differential treatment requires all out-of-state wine, but not all in-state wine, to pass through an in-state wholesaler and retailer before reaching customers. These two extra layers of overhead increase the cost of out-of-state wines to Michigan consumers. The cost differential, and in some cases the inability to secure a wholesaler for small shipments, can effectively bar small wineries from the Michigan market." Id. at 474.

The New York scheme did not ban direct sales altogether; rather, it allowed wineries to direct-ship only if they first established a physical presence in New York. In finding that the law was simply "an indirect way of subjecting out-of-state wineries, but not local ones, to the three-tier system," the Court noted that for most out-of-state wineries the expense of establishing a physical presence was prohibitive, making direct sales "impractical from an economic standpoint." Id. at 475, 466.

B. Stonington Vineyards, Inc. v. Jenkins

[4] Plaintiffs, similarly, did not address paragraphs 13 and 14 of Defendants' Local Rule 56.1 Statement. (Compare Docket # 80, with Docket # 104, 8-9.) These statements are also deemed admitted.

[5] U.S. Const. art. I, § 8, cl. 3.

A lawsuit challenging the constitutionality of Massachusetts' law was pending in the United States District Court for the District of Massachusetts at the time Granholm was decided. See Stonington Vineyards, Inc. v. Jenkins, Civ. A. No. 05 10982-JLT (D. Mass. filed May 12, 2005). Massachusetts law at that time allowed in state wineries to apply for "farmer-winery licenses" which permitted them to sell wine to both wholesalers and consumers. Mass. Gen. Laws ch. 138, § 19B (2002).[6] In contrast, the law granted out-of-state wineries a certificate of compliance but did not permit them to sell directly to consumers in Massachusetts. See id. §§ 18, 18B.[7] In the aftermath of Granholm, the district court in Stonington Vineyards declared Mass. Gen. Laws ch. 138 §§ 2, 18 and 19B unconstitutional and enjoined the Commission from enforcing those provisions. Stonington Vineyards, Civ. A. No. 05-10982-JLT, slip op. at

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[6] Section 19B provided:

(a) For the purpose of encouraging the development of domestic vineyards, the commission shall issue a farmer-winery license to any applicant who is both a citizen and a resident of the commonwealth, and to applying partnerships composed solely of such individuals, and to applying corporations organized under the laws of the commonwealth or organized under the laws of any other state of the United States and admitted to do business in this commonwealth . . .

. . . .

(g) A winegrower [defined in ch. 138, § 1 as "any person licensed to operate a farmer's winery under section nineteen B] may sell wine or winery products:

(1) at wholesale . . .

. . .

(7) at retail by the bottle to consumers for consumption off the winery premises . . .

Mass. Gen. Laws ch. 138, § 19B. See also Mass. Gen. Laws ch. 138, § 22 (2002) (authorizing farmer-winery license holders to ship wine by parcel delivery service).

[7] Under the statute, Massachusetts wholesalers could only import wine from wineries which held certificates of compliance. Id. § 18.

1-2 (D. Mass. Oct. 5, 2005).

C. Section 19F

In response to the Stonington Vineyards decision, the Massachusetts House and Senate passed House Bill No. 4498, "An Act Authorizing the Direct Shipment of Wine," on November 17, 2005. Then-Governor Romney vetoed the bill on November 23, 2005. (See Docket # 88-2, 2.) The legislature overrode the veto on February 15, 2006.[8]

The Act creates a new section, 19F, to regulate the direct shipment of wine. Mass. Gen. Laws ch. 138, § 19F ("§ 19F"). Section 19F provides for a two-tier licensing scheme based upon whether the winery's total annual production of wine is above or below 30,000 gallons.[9] Wineries producing 30,000 gallons of wine or

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[8] Passage of H.B. 4498 is discussed in further detail infra.

[9] The 30,000 gallon limit is sometimes referred to as a "gallonage cap." [10] Section 19F reads in relevant part:
(a) The commission may issue to an applicant, who: (1) operates a winery whose total annual production, including that of its affiliates, franchises and subsidiaries, is 30,000 gallons of wine or more; provided, however, any wine or wine product fermented from other than grapes shall not be included in the aforementioned 30,000 gallon figure; and (2) is authorized by the appropriate licensing authority to manufacture, export and sell wine, a large winery shipment license to sell and ship wine or winery products produced by the winery directly to consumers; provided that the winery has not contracted with or has not been represented by a wholesaler licensed under section 18 for the preceding 6 months.
(b) The commission may issue to an applicant who: (1) operates a winery whose total annual production, including that of its affiliates, franchises and subsidiaries, is less than 30,000 gallons of wine; provided, however, any wine or wine product fermented from other than grapes shall not be included in the aforementioned 30,000 gallon figure; and (2) is authorized by the appropriate licensing authority to manufacture, export and sell wine, a small winery shipment license to sell and ship wine or winery products produced by the winery: (I) at retail directly to consumers; (ii) at wholesale in kegs, casks, barrels or bottles to a person licensed under section 12, 13 or 14; (iii)

more are considered "large" wineries, while t hose producing less than 30,000 gallons of wine are "small wineries. Id. A "small winery may sell wine to wholesalers, retailers, restaurants and bars and directly to consumers. Id. § 19F(b). A "large" winery, in contrast, may sell wine directly to consumers only if it "has not contracted with or has not been represented by a wholesaler licensed under section 18 for the preceding 6 months." Id. § 19F(a). In addition, "wine or wine product fermented from other than grapes" is not counted towards the 30,000 gallon figure. Id. [10]

Section 19F represents a departure from the so-called "three-tier system." Many states have chosen to regulate the distribution of alcoholic beverages by requiring that producers sell exclusively to licensed wholesalers who, in turn, sell only to licensed retailers; consumers may purchase alcoholic beverages for off-premises consumption only from licensed retailers. See Cherry Hill Vineyard, LLC v. Baldacci, 505 F.3d 28, 30 (1st Cir. 2007). However, § 19F permits producers to circumvent the three-tier system by allowing "small wineries to make direct sales to wholesalers, retailers and consumers and "large" wineries to choose between direct sales to wholesalers or consumers.

D. Passage of House Bill No. 4498

1. Drafting the Legislation

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at wholesale for the sole purpose of resale in containers in which wine was delivered to any person licensed under section 15; provided, that all direct deliveries of wine from a winery to a section 15 licensee shall not exceed 250 cases of wine annually; (iv) at wholesale to a person licensed under section 18, 19 or 19B . . . .
Id. Section 18 allows the issuance of wholesalers' and importers' licenses only to "any individual who is both a citizen and resident of the commonwealth, . . . to partnerships composed solely of such individuals, and to corporations organized under the laws of the commonwealth whereof all directors are citizens of the United States and a majority thereof residents of the commonwealth and to limited liability companies and limited liability partnerships organized under the laws of the commonwealth, subject to such conditions as the commission may prescribe . . . ." Id. § 18. See also id. ("In order to ensure the necessary control of traffic in alcoholic beverages for the preservation of the public peace and order, the shipment of such beverages into the commonwealth, except as provided in this section and section 19F, is hereby prohibited.").

State Senator Michael Morrissey and State Representative Vincent Pedrone were the co-chairmen of the Joint Committee on Consumer Protection and Professional Licensure[11] when the bill was passed, and Senator Morrissey was the primary driving force behind the enactment of the amended bill.[12] Massachusetts wholesalers, represented by the Wine and Spirits Wholesalers of Massachusetts ("WSWM"), [13]participated in drafting the legislation from an early point. By September 15, 2005 (prior to the district court's invalidation of the then-statute on October 5, 2005), the WSWM had submitted a draft of legislation to Senator Morrissey's and Representative Pedrone's staff that would have banned all direct shipping and allowed wineries to sell directly to consumers only if the consumer was on the winery premises. On October 6, 2005, Senator Morrissey's staff distributed a new draft that: (1) created a Section 19F which allowed all wineries to obtain a license to ship directly to consumers "provided however, that said winegrower cannot be affiliated with, contracted with, or represented by a Massachusetts wholesaler;" and (2) created a Section 19G which allowed for direct shipment of wine from a winery producing less than 50,000 gallons of wine annually to a retailer "provided that said winegrower cannot be affiliated with, contracted with, or represented by a Massachusetts wholesaler. . . ." (Docket # 91-12.) In-state wineries strongly opposed the suggestion that direct shipping would only be permitted for wineries which did not have wholesaler relationships. Kipton Kumler ("Kumler") is the owner of Turtle Creek Winery in Lincoln, Massachusetts, and the president of the Massachusetts Farm Wineries and Growers Association, whose members produce over 90% of the wine production in the Commonwealth. (Decl. of Kipton Kumler (Docket # 88-5) ¶¶ 3, 7.) Kumler voiced his opposition to Senator Morrissey's staff on October 14, 2005 (see Docket # 93-11). Richard Pelletier ("Pelletier") is the majority owner and operator of Nashoba Valley Spirits, Inc. ("Nashoba Valley"), which at that time was Massachusetts' largest winery. On October 18, 2005, Pelletier e-mailed numerous senators and representatives to voice his opposition to the proposed amendment. He

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[11] This committee heard all alcoholic beverage bills.

[12] (See, e.g., Docket # 93-3, 6 (draft press release stating that Senator Morrissey authored the legislation).)

[13] The WSWM is comprised of five members which together sell approximately 75% of all wine within the Commonwealth.

stressed the importance of allowing wineries to sell their wines through wholesalers and retailers and directly to customers, and he noted that the proposed bill was "not the compromise that Massachusetts wineries were promised but instead represents an attack on my farm, other Massachusetts farms and especially on Massachusetts's wineries. If passed, you will have voted on a proposal that will put many of our existing wineries out of business. (Docket # 91-15, 2.)

Senator Morrissey's staff sent a revised draft of the legislation to Pelletier on the evening of October 18, 2005. The revised draft allowed wineries which produced less than 30,000 gallons to ship directly to consumers without regard to whether they had wholesaler representation. (Docket ## 91-16, 91-17.) Pelletier responded on October 19, 2005, that the draft was "much improved" but that he was concerned about the 30,000 gallonage cap because "apples not sold to customers w ill be collected and made into wine. I may not sell this wine for 3 years but to maximize my farming efforts and the fruit grown, I will be producing more than I can sell in a particular year and it could reach 30000." (Docket # 91-16, 2.)

During this time Robert Buckley ("Buckley") was President of the WSWM and Carol Mantel ("Mantel") was a lobbyist working on behalf of the Wine Institute, an advocacy organization that represents California wineries at the state, federal and international level. Both were actively involved in lobbying legislators to obtain the most advantageous legislation for their respective groups. Both state that the wholesalers initially opposed any direct shipping, and once it became clear that direct shipping would be allowed the wholesalers sought a low gallonage cap. (See Decl. of Carol Mantel (Docket # 91-7) ¶ 11; Buckley Dep. 26, Mar. 4, 2008 (Docket # 91-2); id. at 23.) Craig Wolf ("Wolf") served as general counsel for the Wine and Spirit Wholesalers of America ("WSWM") during this time. (Docket # 87 ¶¶ 119.) He advised Representative Pedrone's aide that the WSWM supported limits on direct shipping by wineries, noting, "the only businesses being hurt by this legislation are Massachusetts wholesalers and retailers. . . . [Wholesalers] are taking a substantial hit by accepting this legislation and legislators should understand that every deviation from the three-tier system takes business away from those in-state businesses and could ultimately cost the Commonwealth jobs and revenue . . . . While direct-to-consumer sales are currently only a small percentage of the sales nationwide, that number could increase dramatically over time – to the detriment of your in-state wholesalers and retailers." (Id. ¶¶ 179-180.)

On November 3, 2005, the Joint Committee on Consumer Protection and Professional Licensure voted in favor of House Bill 4477. The bill proposed two amendments to Mass. Gen. Laws ch. 138: (1) under a new § 19F, wineries were permitted to ship wine directly to consumers provided that the winery had not contracted with or been represented by a Massachusetts wholesaler for the preceding six months; and (2) under a new § 19G, wineries producing less than 30,000 gallons annually were permitted to ship directly to consumers, retailers and wholesalers. (Docket # 92-4.) The bill was amended on November 9, 2005, and renamed House Bill 4490. (Id.) House Bill 4490 was substantively the same as H.B. 4477 but structurally eliminated § 19G in favor of §§ 19F(a) and (b). Wineries producing 30,000 gallons or more annually were denoted "large wineries" subject to § 19F(a), while those producing less than 30,000 gallons were "small wineries" subject to § 19F(b). (Docket # 92-5.) On November 14, 2005, the bill was amended once more and renamed House Bill 4498. It was passed by the House that same day. House Bill 4498 changed the annual gallonage cap from 30,000 to 50,000 gallons. (Docket ## 92-6, 92-9.)

2. Debate in the Senate

The Senate debated House Bill 4498 on November 16, 2005. During the debate Senator Antonioni, who represents the area encompassing Nashoba Valley, expressed concern that the 30,000 gallonage cap would hurt the winery, as it "is growing" and "right now, my understanding is that winery comes close to the 30,000 production limit." (Tr. of Mass. Sen. Sess. Regarding House Bill 4498, Nov. 16, 2005 (Docket # 92-11), 29.)

Senator Morrissey vigorously argued in favor of passage of H.B. 4498. (See id. at 8-14, 19-21, 23-26, 31-33.) He recognized that all of the wineries in Massachusetts produced less than the 30,000 gallonage cap. (See id. at 9 ("Now, if someone wants a list of who the wineries are and what their production is, I have that . . . . We have a number of wineries in Massachusetts who [*sic*], over the years, we have granted broad, broad powers to do business here and also outside the Commonwealth. We preserved that right for all the wineries here in Massachusetts."); see also id. at 11 ("Very simply, [we've] protected the wineries here and given everybody across the country the same rights that those wineries have based upon a gallon production.").) The Senator also repeatedly noted that most of

the wine nationwide is produced by a small number of wineries, and a majority of wineries produce less than 30,000 gallons annually. (See id. (". . . 10 percent of the wine owners do 90 percent of the business. And 70 to 80 percent of the wineries in this country make less than 25,000 gallons, and those are the people that we are actually opening our doors completely to . . ."); id. at 20 ("So 80 percent of the vineyards in this country are going to be given the same rights as Massachusetts wineries have.").)

Senator Morrissey also trumpeted the choice given to "large" wineries. (See id. at 12 ("We are not making them do anything t hey don't want to do. They have to pick their own business model. Whatever works for them is a choice they are going to make."); id. at 20 ("If you are over that gallon production, we treat them the same as well. . . . Make a choice: Go with the wholesaler or be a direct shipper. It's a business decision. It's that easy.").) At the same time, however, he noted that using wholesalers is the only economically rational "choice" for the largest ten percent of wineries. (See id. ("If 10 percent of the wineries control 90 per cent of the business, you got to think they are going to go with the wholesaler because they can't move that much wine. So they are going to use the wholesale market. So it's a very small percentage [of wineries which may choose direct sales over wholesalers]. But we give them a choice.").) Senator Morrissey noted, "We al so have a lot of industries here too, and there's a lot of working people that earn it: The small liquor stores, the grocery stores that sell alcohol and other people that handle the shipping. So we have a lot of people working in that business as well. This strikes a good balance." (Id. at 25.) Finally, Senator Morrissey concluded the discussion by noting: "But every body can do business here now. And ironically, with the limitations that we are suggesting in the legislation, we are really still giving an inherent advantage indirectly to the local wineries." (Id. at 33.)

3. Passage of the Final Version

The Senate passed H.B. 4498 on November 16, 2005, with certain amendments by Senators Morrissey and Antonioni. (Docket # 92-10, 2.) That evening, Pelletier arranged to have a message sent to Senator Morrissey's aide indicating that he would prefer an increase of the gallonage cap over an exclusion of fruit wine from the gallonage cap. (Docket # 93-2.)

The next day the House concurred with the Senate's amendments and made amendments of its own, and the Senate concurred with the House amendments and receded from some of the Senate amendments.[14] (Docket # 92-10, 2.) The bill was enacted by both the House and the Senate on November 17, 2005. (Id.) The final version of H.B. 4498 differed from the initial version passed by the House on November 14, 2005, in two notable ways: (1) it changed the gallonage cap from 50,000 gallons to 30,000 gallons; and (2) it excluded fruit wine from the gallonage cap. (Docket # 93-3, 10.) Nashoba Valley's production is approximately 75% fruit wine. (Docket # 87, ¶ 40.) Governor Romney vetoed the bill four days later. In January 2006 he introduced a competing direct shipping bill which did not contain a gallonage cap or an either/or choice between engaging in direct shipping and having representation by a Massachusetts wholesaler. The proposed bill eliminated the two-tier licensing scheme for large and small wineries and instead allowed all wineries to obtain a direct shipping license on the same terms. (Docket # 93-4.) In a letter accompanying the proposed bill, the Governor expressed his belief that H.B. 4498 "would unduly burden Massachusetts wine consumers," and that t he two-tier licensing scheme "specifically benefitted the wholesaler industry." (Id.) On February 15, 2006, the House and Senate overrode Governor Romney's veto and enacted H.B. 4498.

E. The Wine Market

The Alcohol and Tobacco Tax and Trade Bureau ("TTB"), a bureau under the United States Department of the Treasury, assembles statistical data relating to the production of wine in the United States. The National Revenue Center (NRC") is the division within TTB primarily responsible for assembling and maintaining this data. Roger L. Bowling, Director of the NRC, submitted a Declaration responsive to both parties' requests for statistical information, and which both parties accept as accurate. (See Decl. of Roger L. Bowling (Docket # 83).) According to the Declaration, wineries in the United States produced over 646 million gallons of wine in the calendar year 2006. Approximately 12% of wineries (637) produced more than 30,000 gallons, but these larger operations produced 98% of the total volume of wine.

[14] The content of any of the House or Senate amendments is not clear from the record.

(Id. ¶ 9.) There were 5,912 wineries in the United States in calendar year 2007, which produced over 653 million gallons of wine. Approximately 11% of the wineries (627) produced more than 30,000 gallons; they account for 98% of the total volume of wine in 2007. Approximately 2,800 wineries produced less than 30,000 gallons but more than one gallon of wine. (Id. ¶¶ 7, 12.) Approximately 2,500 wineries produced less than one gallon of wine. (Id. ¶ 7.)

There are 31 wineries in Massachusetts. The amount of wine that these Massachusetts wineries produce annually ranges from approximately 200 gallons to 24,000 gallons. (Docket # 80, ¶¶ 8-9.)

The wine distribution system is shaped like an hourglass, in that there are a large number of producers (the top) and a large number of consumers (the bottom), but significantly fewer wholesalers (the middle). This structure has the effect of giving wholesalers greater bargaining power with both wineries and retailers in states where it is mandatory to have a wholesaler. Generally wholesalers prefer to carry a larger volume of a particular wine, rather than an equivalent volume of several wines, because it is more profitable for a wholesaler to warehouse, manage and sell a single wine. Many wineries produce both specialty wines in small quantities and higher-volume wines. It is rare for a winery producing approximately 30,000 gallons per year to have all of its wines represented by a wholesaler.

Wholesalers and retailers mark up the price of wine to cover their business costs. The general "rule of thumb" is that the price of a wine at retail w ill cost a consumer twice the price the wholesaler pays for the wine at the winery. Wineries enjoy higher profit margins on direct-shipping sales. A winery can discount its direct ship wines and still earn more revenue per bottle than for wine sold through a wholesaler. This allows wineries to compete with wholesalers in states where direct shipping is allowed.

III. Discussion

A. The Dormant Commerce Clause

The Commerce Clause grants Congress the power to "regulate Commerce . . . among the several States[.]" U.S. Const. art I, § 8, cl. 3. This affirmative grant of power implies a "negative" or "dormant" constraint on state regulatory authority. "[T]his negative aspect of the Commerce Clause prohibits economic protectionism – that is, regulatory measures designed to benefit in-state economic interests by

burdening out of-state competitors." Wyoming v. Oklahoma , 502 U.S. 437, 454 (1992). "A court may find that a state law constitutes 'economic protectionism on proof either of discriminatory effect . . . or of discriminatory purpose . . . ." Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456, 472 n.15 (1981) (internal citations omitted).[15] The inquiry should "eschew[] formalism for a sensitive, case-by-case analysis of purposes and effects." West Lynn Creamery, Inc. v. Healy , 512 U.S. 186, 201 (1994). "[T]he initial burden of establishing discrimination rests with the challenger. Once discrimination is established, however, the devoir of persuasion shifts and the affected state must demonstrate that no reasonable nondiscriminatory regulation could achieve its objectives. Cherry Hill Vineyard, LLC v. Baldacci , 505 F.3d 28, 33 (1st Cir. 2007) (internal citations omitted). Laws that regulate evenhandedly and only incidentally burden commerce are subjected to a less searching scrutiny known as the Pike test, under which the statute will be upheld "unless the burden imposed on [interstate] commerce is clearly excessive in relation to the putative local benefits." Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970).

B. Discriminatory Purpose

"A court's finding of improper purpose behind a statute is appropriately determined by the statute on its face, its legislative history, or its interpretation by a responsible administrative agency. The plain meaning of the statute's words, enlightened by their context and the contemporaneous legislative history, can control the determination of legislative purpose. Moreover, in determining the legislative purpose of a statute, the Court [ ] also consider[s] the historical context of the statute and the specific sequence of events leading to passage of the statute." Edwards v. Aguillard, 482 U.S. 578, 594-95 (1987) (internal citations omitted). See also McCreary Cty., Ky. v. Am. Civil Liberties Union of Ky., 545 U.S. 844, 862 (2005) (noting that in Edwards the Court "relied on a statute's text and the detailed public comments of its sponsor" in determining the purpose of a state law).

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[15] Statutes may also discriminate facially, such as in Granholm. See 544 U.S. at 473-74 (Michigan statute expressly permitted in-state wineries to ship directly to consumers but prohibited out-of-state wineries from doing so). However, the parties agree that the Massachusetts statute at issue here is facially neutral.

In this instance the text of the statute is not especially helpful, as House Bill No. 4498, "An Act Authorizing the Direct Shipment of Wine," simply states that its purpose is "to authorize forthwith the direct shipment of wine . . . ." H.B. 4498, 184th Gen. Ct., 2006 Reg. Sess. (Mass. 2006). However, the sequence of events leading up to the passage of the bill and the public comments by the bill's sponsor, detailed supra, provide strong support for plaintiffs' assertion that § 19F was designed to allow all instate wineries to continue direct shipping while forcing the majority of interstate wine to go through the three-tier system, thereby preserving the economic interests of both Massachusetts wholesalers and Massachusetts wineries.[16] The most damning evidence is the exemption for fruit wine, which has no stated purpose or rationale but benefits Nashoba Valley, the only in-state winery which – absent the exemption – would approach the 30,000 gallonage cap. See Kassel v. Consol. Freightways Corp. of Delaware, 450 U.S. 662, 676 n.22 (1981) (plurality op.) (statutory exemptions benefitting in-state entities "contribute[d] to the pattern of parochialism apparent" in the statute); Bacchus Imps., Ltd. v. Dias, 468 U.S. 263, 273 (1984) (statute which exempted fruit wine manufactured in Hawaii from imposition of 20% excise tax on all liquor sales found to have discriminatory purpose); see also Raymond Motor Transp., Inc. v. Rice, 434 U.S. 429, 446-47 (1978) (statutory exemptions favorable to in-state industries "weaken the presumption in favor of the

[16] "[A]ny notion of discrimination assumes a comparison of substantially similar entities." Gen. Motors Corp. v. Tracy, 519 U.S. 278, 298 (1997). For purposes of this analysis the out-of-state wineries are similarly situated to both in-state wineries and instate wholesalers, as the "large" wineries would compete with wholesalers to sell to retailers and restaurants if they had the same privileges that "small wineries enjoy. Tracy, 519 U.S. at 300 (Commerce Clause challenge must involve "actual or prospective competition between the supposedly favored and disfavored entities"); Bacchus Imps., Ltd. v. Dias, 468 U.S. 263, 268 (1984) (extent of competition between entities unimportant). Additionally, to the extent a winery is able to ship directly to a consumer, it can compete with wine available at retail stores which has gone through the three-tier system. Cf. West Lynn Creamery, 512 U.S. at 202 ("For over 150 years, our cases have rightly concluded that the imposition of a differential burden on any part of the stream of commerce–from wholesaler to retailer to consumer–is invalid, because a burden placed at any point will result in a disadvantage to the out-of-state producer.")

validity of the [statute], because they undermine the assumption that the State's own political processes w ill act as a check on local regulations that unduly burden interstate commerce"). In addition, the statute's sponsor recognized that the "c hoice" in § 19F(a) for large out-of-state wineries to either direct ship or sell through a Massachusetts wholesaler is an illusory one, as it would be economically irrational for a large winery to give up its wholesaler relationship. (See Docket # 92-11, 20 (comments of Senator Morrissey during Senate debate: "If 10 percent of the wineries control 90 percent of the business, you got to think they are going to go with the wholesaler because they can't move that much wine. So they are going to use the wholesale market.").) It is further notable that § 19F permits "large" wineries to choose only between selling to wholesalers and selling directly to consumers, while "small" wineries may sell to wholesalers, retailers, restaurants and consumers. Accordingly, even if a "large winery were willing to undertake the expense and effort of selling its wine without a wholesaler, under the statute there is no set of circumstances under which it could sell to retailers and restaurants, making it even more unlikely that a "large" winery would ever choose the direct shipping option. [17] Finally, the statute's sponsor explicitly stated, "with the limitations that we are suggesting in the legislation, we are really still giving an inherent advantage indirectly to the local wineries." (Id. at 33.) See Hunt v. Washington State Apple Adver. Commn , 432 U.S. 333, 352 (1977) (referring to State Commissioner's statements of protectionist intent as the "most glaring" evidence of discriminatory purpose).

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[17] There is also some question of whether Massachusetts law permits a winery which has already selected wholesaler representation to terminate the relationship. Under Massachusetts law a winery must show "good cause" to discontinue sales to a wholesaler. Mass. Gen. Laws ch. 138, § 25E (2008). The statute expressly limits "good cause" to five specific situations; pr eference for direct shipping is not included. Id. Defendants suggest that § 25E "prevents a producer that sells its products in the wholesale market from cutting off supplies to a wholesaler to which it has made regular sales during the prior six months, [but] it does not prevent a winery from surrendering its certificate of compliance issued pursuant to G.L. c. 138, § 18B, and foregoing sales to Massachusetts wholesalers altogether." (Docket # 101, 23.) However, the basis for this interpretation of § 25E is unclear.

The Commonwealth argues that § 19F was intended to benefit "small wineries, in accordance with Granholms recognition that smaller wineries have historically faced difficulties in obtaining wholesaler relationships and consequently rely upon direct shipping to reach new markets. (See Docket # 79, 13-14 (citing Granholm, 544 U.S. at 467).) But it does not logically follow that aiding "small wineries must be done at the expense of burdening "large" wineries with t he more onerous requirements of § 19F(a), particularly when the burden of § 19F(a) falls entirely on out-of-state wineries and its benefit entirely on in-state wholesalers. See Kassel, 450 U.S. at 675-76 ("[l]ess deference to the legislative judgment is due, however, where the local regulation bears disproportionately on out-of-state . . . businesses"); Bacchus Imps., 468 U.S. at 273 ("Virtually every discriminatory statute allocates benefits and burdens unequally . . . . The determination of constitutionality does not depend upon whether one focuses upon the benefitted or the burdened party. . . . [I]t could always be said that there was no intent to impose a burden on one party, but rather the intent was to confer a benefit on the other.").

C. Discriminatory Effect

The Commonwealth argues that there is no discriminatory effect on interstate commerce because "89% of all wineries in the United States are eligible for a 'small winery' direct shipment license under § 19F and, of these wineries, an overwhelming 99.5% are located outside of Massachusetts." (Docket # 79, 17.) However, the Commerce Clause "protects the interstate market, not particular interstate firms, from prohibitive or burdensome regulations." Exxon Corp. v. Governor of Maryland, 437 U.S. 117, 127-28 (1978); cf. Walgreen Co. v. Rullan, 405 F.3d 50, 58 (1st Cir. 2005) (rejecting notion that "favored group must be entirely in-state for a law to have a discriminatory effect on commerce"); New Energy Co. of Indiana v. Limbach, 486 U.S. 269, 274 (1988) (finding tax credit provision discriminatory in effect despite its availability to some out-of-state manufacturers). Thus, the relevant inquiry is the amount of wine in interstate commerce affected by § 19F(a), not the number of wineries affected. It is undisputed that in calendar year 2007 the 11% of wineries nationwide which produced more than 30,000 gallons of wine accounted for 98% of the total volume of wine production. As discussed supra, for these "large" wineries there is, as a practical matter, no real choice between direct shipping and a wholesaler relationship. Therefore, the Massachusetts statute in practice prevents direct

shipment of approximately 98% of out-of-state wine while allowing 100% of Massachusetts wineries to sell direct. This clearly confers disproportionate benefits on both Massachusetts wineries and wholesalers. See Dean Milk Co. v. City of Madison, Wis., 340 U.S. 349, 351 (1951) (invalidating statute which "in practical effect" erected an "economic barrier protecting a major local industry against competition from without the State"). Defendants rightly note that the Commerce Clause does not protect "the particular structure or methods of operation in a retail market." Exxon, 437 U.S. at 127. However, as the Seventh Circuit Court of Appeals recently noted in an analogous case, "the [Supreme] Court concluded in Exxon that Maryland's separation of the retail and wholesale functions did not affect interstate commerce in petroleum, all of which came from out of state no matter how the distribution system was organized." Baude v. Heath, 538 F.3d 608, 612 (7th Cir. 2008) (invalidating statute which "prevents direct shipment of almost all out-of-state wine while allowing all wineries in Indiana to sell direct").

Defendants heavily rely upon the First Circuit's recent opinion in Cherry Hill Vineyard, LLC v. Baldacci, 505 F.3d 28 (1st Cir. 2007), in which it considered the constitutionality of a Maine statute that permits wineries to sell directly to consumers only in face-to-face transactions. Plaintiffs in Baldacci asserted only that the statute was discriminatory in effect, forgoing any argument that the statute was discriminatory in purpose or failed the Pike test. Id. at 33. The plaintiffs there argued that consumers could easily travel to in-state wineries but the law effectively prevented out-of-state wineries from enjoying any real opportunity to sell directly to consumers. As a result, out-of-state wines would be available to Maine consumers only after the "middleman" mark-ups inherent in the three-tier system, or, for wineries too small to attract the attention of a wholesaler, not available at all. Id. at 33-34. Maine defended the face-to-face transactional requirement, and related restriction on direct shipping, as necessary to prevent underage persons from gaining access to alcoholic beverages. Id. at 32. The First Circuit held that the plaintiffs had failed to show a discriminatory effect because there was no evidence that: (1) "Maine law acts to protect Maine vineyards;" (2) "Maine consumers substitute wines purchased directly from Maine vineyards for wines that they otherwise would have purchased from out-of-state producers;" (3) "any wines at all are purchased by consumers directly from Maine vineyards;" (4) "the locus option somehow alters the competitive balance between instate and out-of-state firms;" and (5) "Maine consumers (like imbibers everywhere) [do not] view trips to a winery as a distinct experience

incommensurate with – and, therefore, unlikely to be replaced by – a trip to either a mailbox or a retail liquor store." Id. at 36-37.

In any event, Baldacci's utility to the present case is limited because the Maine statute did not allow any direct shipping. Accordingly, there was no "direct-shipping market" from which the in-state entities disproportionately benefitted. The First Circuit recognized this when it distinguished the Maine statute from the New York statute invalidated in Granholm:

> New York created an additional barrier to the entry of out-of-state wineries into the direct-shipping market – a barrier that Maine has not erected. To elaborate, New York created a direct-shipping market for wine; it allowed direct shipping on particular conditions, and those conditions were rigged to favor in-state wineries . . . Maine flatly outlaws any and all direct shipping of wine. Consequently, there is no direct-shipping market; neither in-state nor out-of-state wineries may direct ship.

Id. at 35. Finally, to the extent that the dormant Commerce Clause analysis requires a "sensitive, case-by-case analysis of purposes and effects," West Lynn Creamery , 512 U.S. at 201, the record in this case, unlike that in Baldacci, is replete with evidence of discriminatory effect. To begin with, as discussed supra, there is evidence that § 19F acts by design to benefit Massachusetts wineries and wholesalers. There is also evidence that Massachusetts wineries sell their wines directly to consumers as well as to retailers and wholesalers. Kumler, the president of the Massachusetts Farm Wineries and Growers Association (whose members produce over 90% of the wine in the Commonwealth), attested that "[m]ost of our association's members self-distribute some or most of their wines to restaurants and wine stores," and "[d]irect shipping and self-distribution to retailers allows us to build our brands, develop customer loyalty, and reach people who might not otherwise try our wines through a three-tier system." (Docket # 88-5, ¶ 11, 13; see also id. ¶ 15 ("Taking away direct shipping from our association's members would be a severe detriment to their business.").) Pelletier (of Nashoba Valley) testified that his winery has sold to consumers, retailers, wholesalers, and restaurants. (See Docket # 88-8, 19-20; see also Docket ## 88-9 - 89-12 (applications by eighteen wineries for "small winery shipment licenses).) The evidence also shows that 98% of the wine produced

out-of-state is made by "large" wineries and that, as a practical matter, these wineries cannot terminate their wholesaler relationships. Finally, it is undisputed that the wine distribution system's hourglass shape gives wholesalers greater bargaining power with wineries, and because wholesalers prefer higher-volume wines it is rare for a winery producing 30,000 gallons of wine per year to have all of its wines (i.e., both the high-volume brands and the lower-volume specialty brands) represented by a wholesaler. As a result, a "large" winery is unable to sell certain wines to Massachusetts consumers which its wholesaler has declined to carry.[18]

Accordingly, the court concludes that § 19F has a discriminatory effect on interstate commerce because as a practical matter it prevents the direct shipment of 98% of out-of-state wine to consumers but permits all wineries in Massachusetts to sell directly to consumers, retailers and wholesalers.

D. Legitimate Local Purpose

"When discrimination against commerce of the type we have found is demonstrated, the burden falls on the State to justify it both in terms of the local benefits flowing from the statute and the unavailability of nondiscriminatory alternatives adequate to preserve the local interests at stake." Hunt, 432 U.S. at 353 (citing Dean Milk, 340 U.S. at 354). The State has failed to sustain this burden on both scores. It argues that § 19F is shielded because the three-tier system is "unquestionably legitimate." (See Docket # 79, 13-15 (citing Granholm, 544 U.S. at 489).) However, § 19F by its terms is a departure from this system since it allows "small wineries to both direct ship and sell to wholesalers and retailers, and "large"

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[18] For example, plaintiff Gerald Leader stated that on a visit to Ravenswood Winery in Sonoma County, California, he tasted and enjoyed the winery's Early Harvest Gewurztraminer but was unable to purchase several cases for shipment to his home because Ravenswood Winery is a "large" winer y. In response, defendants investigated the availability of Ravenswood Winery wine in Massachusetts and submitted evidence that sixteen different brands are available for sale in the Commonwealth. However, the Early Harvest Gewurztraminer is not one of them. (Compare Decl. of Gerald Leader (Docket # 48-3) ¶ 4, with Second Aff. of William A. Kelley, Jr. (Kelley A ff.") (Docket # 82) ¶ 13 and Kelley Aff. Ex. B (Docket # 82-3) at 10.)

wineries to (theoretically) opt out of the system by choosing to direct ship instead of sell to wholesalers. The legitimacy of the three-tier system cannot provide succor to a statute which allows exceptions to that system which benefit in-state interests. See Peoples Super Liquor Stores, Inc. v. Jenkins, 432 F. Supp. 2d 200, 221 (D. Mass. 2006) ("While the three-tiered system is unquestionably legitimate, Granholm cannot be held to sanction protectionist policies at any of the tiers."); Baude , 538 F.3d at 612 (finding wholesale clause in statute unconstitutional despite legitimacy of three-tier system and noting, "once a state allows any direct shipment it has agreed that the wholesaler may be bypassed").

E. The Pike Test

In any event, even if § 19F were not discriminatory in purpose or effect, it would still fail the Pike test, under which a statute is upheld only if its burden on interstate commerce is not "clearly excessive in relation to the putative local benefits." Pike , 397 U.S. at 142.[19] "If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend upon the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities." Id. Under § 19F, "large" wineries are permitted, as a practical matter, to sell only to wholesalers, with the resultant unnecessary burdens on interstate commerce, as discussed supra. However, there are no putative local benefits served by § 19F's two-tier system. Moreover, even if one accepts the Commonwealth's assertion that the purpose of § 19F is to allow "small wineries nationwide to direct ship because of the difficulties they face in retaining wholesaler representation, this goal would not be undercut by allowing "large" wineries the same privileges.

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[19] Defendants and amicus suggest that the Commonwealth's authority to regulate alcohol distribution under the Twenty- first Amendment shields it from application of the Pike test. However, Granholm is clear that a state's authority under the Amendment does not allow even constitutionally authorized liquor regulations to escape Commerce Clause scrutiny. See Granholm, 544 U.S. at 487; see also Wine & Spirits Retailers, Inc. v. Rhode Island, 481 F.3d 1, 15 (1st Cir. 2007) (applying Pike to alcohol regulation statute); Baude, 528 F.3d at 611-12 (same).

IV. Conclusion

Plaintiffs' motion for summary judgment (Docket # 84) is ALLOWED.

Defendants' motion for summary judgment (Docket # 78) is DENIED.

Judgment may be entered enjoining defendants from further enforcing § 19F, and from further enforcing Massachusetts General Laws chapter 138, § 2 ("no person shall . . . sell . . . transport, import or export alcoholic beverages or alcohol, except as authorized by this chapter") and § 18 ("the shipment of [alcoholic] beverages into the commonwealth, except as provided in this section and section 19F, is hereby prohibited").

The parties shall jointly file a proposed form of judgment with the court.

November 19, 2008
DATE

/s/Rya W. Zobel
RYA W. ZOBEL
UNITED STATES DISTRICT JUDGE