IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

ANHEUSER-BUSCH, INC. et al.,	)	
	)	
Plaintiffs,	)	
	)	Case No.: 10-CV-01601
vs.	)	
	)	Hon. Robert M. Dow, Jr.
	)	
STEPHEN B. SCHNORF, et al.,	)	
	)	
Defendants.	)	

DEFENDANTS' RESPONSE TO PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT ON THEIR COMMERCE CLAUSE CLAIM

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INTRODUCTION

Plaintiffs insist that they are *not* attacking Illinois' three-tier system for liquor production, distribution, and sale. Not only does their lawsuit attack the State's three-tier system, but it does so in two different ways:

First, it challenges Illinois' right to determine who can be a "distributor" in its three-tier system. At plaintiffs' request, the Illinois Liquor Control Commission held a Special Session to determine whether beer producer Anheuser-Busch, a "non-resident dealer," may act as a distributor in Illinois by acquiring a 100% interest in CITY Beverage, an in-state distributor. The Commission held that the proposed transaction violates the Illinois Liquor Control Act ("Act")—the Act's definition of "distributor" specifically excludes "non-resident dealers." In arguing that the Commission's interpretation violates the dormant commerce clause, plaintiffs are challenging a core feature of Illinois' three-tier system.

Second, as a remedy for the alleged commerce clause issue, the lawsuit asks this Court to transform Illinois' three-tier system into a "two-tier" system by permitting all beer producers to self-distribute. The Commission interprets the Act to permit only in-state producers to distribute their own product. And only *two small* in-state brewers take advantage of this limited exception to the general rule that all tiers in the three-tier system must remain separate. Extending self-distribution rights to all out-of-state producers—including Anheuser-Busch, the largest beer producer in the United States—would collapse Illinois' three-tier system. It would open the State to a flood of high volume, low cost alcohol, crippling its ability to promote temperance. At the same time, it would compromise the State's ability to prevent tax fraud.

Plaintiffs' motion for summary judgment should be denied. The United States Supreme Court has repeatedly emphasized that the three-tier system is "unquestionably legitimate." In arguing that this Court should apply a traditional dormant commerce clause analysis here, plaintiffs ignore that liquor is unique. They ignore that the Twenty-First Amendment grants the states "virtually complete control" over how to structure a distribution system. They ignore that the "core concerns" test immunizes state liquor laws like the one at issue here from constitutional challenge. And, finally, they ignore recent appellate decisions, including *Siesta Village Market LLC v. Steen*, 595 F.3d 249 (5th Cir. 2010), confirming that states may make distinctions between in-state and out-of-state entities as part of their three-tier systems.

Plaintiffs' reliance on *Granholm v. Heald*, 544 U.S. 460 (2005), is both ironic and misplaced. In *Granholm*, the Supreme Court invalidated two states' protectionist bans on direct-to-consumer wine shipping. The laws allowed in-state wineries to ship directly to consumers, while *completely blocking* out-of-state wineries from selling their product in those states. Plaintiffs' reliance on this case is ironic because the Beer Institute, of which Anheuser-Busch is a leading member, submitted an *amicus* brief in *Granholm* arguing that the states' "reasonable restrictions" on out-of-state wineries were "integral" to the three-tier system, "proper" under the Twenty-First Amendment, and "immune" from the dormant commerce clause. And it is misplaced, because unlike the situation in *Granholm*, Illinois does not permit businesses to bypass the three-tier system, and does not block out-of-state producers from selling their product in Illinois. Last year, CITY Beverage distributed more than 38 million gallons of Anheuser-Busch beer, resulting in "tens of millions of dollars" in revenues.

ARGUMENT

Liquor holds a unique place in the U.S. constitutional scheme. In 1933, the Twenty-First Amendment repealed prohibition and gave the states plenary authority to regulate liquor within their borders.[1] The Amendment authorizes states to funnel alcohol sales through a "three-tier system," and the Supreme Court has repeatedly emphasized that the three-tier system is "unquestionably legitimate." *Granholm*, 544 U.S. at 489. The Amendment "grants the States *virtually complete control* over whether to permit importation or sale of liquor and how to structure the liquor distribution system." *Id.* at 488 (emphasis added); *see also Baude v. Heath*, 538 F.3d 608, 611-12 (7th Cir. 2008) ("State laws that regulate the distribution chain…have been sustained against other challenges under the commerce clause.").

Despite Illinois' broad Twenty-First Amendment authority to regulate liquor, plaintiffs filed the present motion for summary judgment challenging the Commission's ruling on who can be a "distributor" in the State's three-tier system. Summary judgment is proper only when "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. Pro. 56(c). Here, plaintiffs fail the second requirement—the Court should deny plaintiffs' motion because they are not "entitled to judgment as a matter of law." *Id.*[2]

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

[2] To the extent that plaintiffs dispute defendants' factual submissions, this also requires denial of plaintiffs' motion. The moving party has the burden of showing the absence of a genuine issue of material fact, and the evidence is to be considered in the light most favorable to the non-moving party. *Celotex Corp. v. Catrett*, 477 U.S. 317, 325 (1986); *Wheeler v. Lawson*, 539 F.3d 629, 633 (7th Cir. 2008).

I. THIS LAWSUIT CHALLENGES ILLINOIS' THREE-TIER SYSTEM FOR LIQUOR PRODUCTION, DISTRIBUTION, AND SALE.

Plaintiffs' proposed transaction threatens Illinois' three-tier system for liquor production, distribution, and sale. Anheuser-Busch, an out-of-state producer, seeks to operate as an Illinois distributor. This request is indisputably improper under the traditional three-tier system. It is also barred under Illinois' three-tier system—the Illinois Liquor Control Act does not permit a merging of the tiers unless the producer and distributor are both in-state and therefore fully subject to the State's regulatory control. This limited exception does not apply here.

A. For Important Policy Reasons, The Traditional Three-Tier System Precludes Producers From Acting As Distributors.

The traditional three-tier system mandates a strict separation between liquor producers, distributors, and retailers. *Family Winemakers of Calif. v. Jenkins*, 592 F.3d 1, 5 (1st Cir. 2010) (noting that the "hallmark of the three-tier system is a rigid, tightly regulated separation" between the tiers). The system establishes a "vertical quarantine" such that "no layer in the vertical hierarchy [may] act in the capacity of another." *Bainbridge v. Turner*, 311 F.3d 1104, 1106 (11th Cir. 2002). Producers sell only to separate in-state distributors, and distributors sell only to separate in-state retailers. States may limit "vertical integration" between the tiers to ensure their independence. *Granholm*, 544 U.S. at 466, 489.

By insisting that producers, distributors, and retailers remain separate, the three-tier system promotes both temperance and competition among brands. As one court explained, the rule against vertical integration "prevent[s] the perceived danger of 'tied houses,' i.e. large manufacturers that control[] the entire distribution process all the way

down to the final sale." *Nat'l Wine & Spirits, Inc. v. Michigan*, No. 243524, 2004 WL 595068, at *4 (Mich. Ct. App. Mar. 25, 2004). This causes "increased sales, abusive sales practices, and excessive consumption." *Id.*; *see also Manuel v. Louisiana*, 982 So. 2d 316, 330 (La. Ct. App. 2008) (noting that vertical integration may suppress competition among brands).

The three-tier system also helps ensure regulatory control. On the theory that "presence ensures accountability," states may insist that distributors and retailers are located in-state. *Granholm*, 544 U.S. at 489, 523; *Siesta Vill. Market LLC*, 595 F.3d at 260 (noting that "wholesalers and retailers may be required to be within the State"). This "local presence" requirement makes distributors and retailers "more amenable to regulation and naturally keeps them accountable." *Manuel*, 982 So. 2d at 330. It facilitates tax collection and makes tax evasion less likely, for example. *Id.* at 333; *Cherry Hills Vineyard, LLC v. Balducci*, 505 F.3d 28, 30 (1st Cir. 2007). In addition, it reduces the risk of contaminated product entering the system, or being diverted out of the system, resulting in immoderate consumption or illegal sales to minors. *Manuel*, 982 So.2d at 330.

B. Illinois' Three-Tier System Precludes Producers From Acting As Distributors Unless Both Are Subject To The State's Regulatory Control.

As plaintiffs admit, Illinois regulates the production, importation, distribution, and sale of liquor through a three-tier system. (Pls. Mot. Summ. J. (Dkt. 29) at 5) The purpose of the Illinois Liquor Control Act of 1934 ("Act"), 235 ILCS 5/1-1 *et seq.*, is to protect the health, safety, and welfare of Illinois citizens and promote "temperance in the consumption of alcoholic liquors" through "sound and careful control and regulation of [their] manufacture, sale, and distribution." *Id.* at 5/1-2. Under the Act, the Commission

issues various types of liquor licenses, including (1) manufacturer's, (2) distributor's and importing distributor's, and (3) retailer's licenses. *Id.* at 5/5-1. It also issues non-resident dealer's (NRD) licenses for firms that export liquor into the State for sale to Illinois-licensed importing distributors. *Id.* at 5/1-3.29.[3]

Regardless of how plaintiffs frame their argument, one point is clear: their lawsuit challenges Illinois' right to determine who can be a "distributor" in its three-tier system. Plaintiff Anheuser-Busch currently holds a non-resident dealer's license and proposes to become a distributor by acquiring a 100% ownership interest in Illinois distributor CITY Beverage. (Compl. (Dkt. 1) at ¶¶ 2, 3) The Act's definition of "distributor," however, specifically *excludes* non-resident dealers: "'Distributor' means any person, *other than* a manufacturer or non-resident dealer licensed under this Act, who is engaged in this State in purchasing, storing, possessing, or warehousing any alcoholic liquors for resale or reselling at wholesale, whether within or without this State." 235 ILCS 5/1-3.15 (emphasis added) The Act's plain language does not permit what plaintiffs want to accomplish.

Following a Special Session of the Commission where Anheuser-Busch presented an alternative interpretation of the Act, the Commission issued the Declaratory Ruling attached hereto as Exhibit A. The Commission ruled that the Act "prohibits an Illinois-licensed Non-Resident Dealer from possessing an ownership interest in a licensed Illinois distributor." (Ex. A at 2) It also stated that if the proposed transaction proceeds, CITY Beverage's distributor's licenses would be subject to revocation. (*Id.*) In support of its

[3] A 1979 Illinois Attorney General Opinion interpreted the Act as requiring out-of-state producers to hold a brewer's license (a certain type of manufacturer's license) "in order to bring beer into the State and sell it." 1979 Op. Atty. Gen., No. S-1462. In 1982, the legislature amended the Act and created an NRD license for producers that export liquor into Illinois "from any point outside of this State." 235 ILCS 5/1-3.29.

decision, the Commission explained that the three-tier system promotes temperance by "protect[ing] against vertical monopolies and economies of scale that would lead to the introduction of cheap alcoholic liquor into the marketplace." (*Id.* at 1) The Commission also cited the State's interest in tax collection, an orderly market, and public safety, and emphasized that one of the Act's "fundamental objective[s] is "[p]reserving Illinois' three-tier system." (*Id.* at 1)

C. Allowing Anheuser-Busch To Act As A Distributor In Illinois Would Undermine The State's Three-Tier System.

Plaintiffs nevertheless insist that they are not attacking Illinois' three-tier system. (Pls. Resp. Mot. Intervene (Dkt. 53) at 2-3) They point out that the Commission interprets the Act to permit in-state brewers to act as distributors.[4] But only *two* small in-state brewers—Argus and Big Muddy—currently hold distribution rights, and they are limited to distributing their own products.[5] The Commission issued Argus' distributor's license on February 19, 2010 (less than three months ago) and Big Muddy's on June 17, 2009 (less than one year ago). (Exhibits C, D) In 2009, Argus expected to produce less than 60,000 barrels of beer. (Exhibit C). And for FY2010, to date Big Muddy has produced only 2,211 gallons of beer. (Exhibit E)

[4] The Act states that a "[b]rewer may make sales and deliveries of beer…to retailers provided that the brewer obtains an importing distributor's license or distributor's license in accordance with the provisions of this Act." 235 ILCS 5/5-1(a). At the Special Session, Staff Counsel for the Commission argued that only in-state producers can hold brewer's licenses. Plaintiffs accept this position for purposes of their commerce clause claim but otherwise "vigorously contest" defendants' interpretation of the Act. (Pls. Mot. Summ. J. (Dkt. 29) at 2 n.2) Intervenor WSDI insists that the Act permits neither in-state nor out-of-state producers to self-distribute. (Mot. Intervene (Dkt. 40) at 13-18)

[5] A third in-state brewer, Goose Island Beer Co., holds a distributor's license but currently does not self-distribute. Plaintiffs' allegation that Anheuser-Busch "compete[s] directly with Goose Island" (Compl. (Dkt. 1) at ¶ 37) is disingenuous because Anheuser-Busch has an ownership interest in Goose Island. (Exhibit B)

Because these companies are so small, and produce such a limited volume of beer, permitting them to self-distribute does not jeopardize the Act's goal of promoting temperance and competition. In addition, their in-state presence allows the State to exercise regulatory control over them.

In contrast, given Anheuser-Busch's size and significant market presence, allowing it to own CITY Beverage and act as a distributor would be a fundamental alteration to Illinois' three-tier system. As plaintiffs admit, Anheuser-Busch is the United States' leading producer of beer. (Compl. (Dkt. 1) at ¶ 11)[6] Anheuser-Busch operates twelve breweries in the United States and produces over 100 beverages, including the two "best-selling beers in the world" and three other beers that "hold the No. 1 positions in their respective U.S. market segments." (*Id.*) Its beer is "widely distributed, sold, and consumed in Illinois." (Pls. L.R. 56.1 Stmt. (Dkt. 30) at ¶ 3) In 2009 alone, CITY Beverage distributed within Illinois more than 38 million gallons of Anheuser-Busch beer, resulting in "tens of millions of dollars" in revenues for the companies. (*Id.* at ¶ 7) To date in FY2010, Anheuser-Busch has sold over 77.6 million gallons of beer in Illinois. (Exhibit E**)**

Exhibit F hereto is an affidavit from Pamela S. Erickson. Ms. Erickson formerly served as Executive Director of the Oregon Liquor Commission. (*Id.*) Her affidavit confirms that allowing Anheuser-Busch—and, by extension, all other beer producers throughout the world—to act as Illinois distributors would collapse Illinois' three-tier system and cripple the State's ability to promote temperance. Through its proposed deal

[6] In 2008, Anheuser-Busch combined with Belguim-based InBev creating "the global leader in beer and one of the world's top five consumer products companies." Last year, Anheuser-Busch InBev generated $36.8 billion in revenues. *See* 2009 Annual Report, available at http://www.ab-inbev.com/go/media/annualreport2009.

with CITY Beverages, Anheuser-Busch intends to build efficiencies into its beer production and distribution process: the transaction would "generate many synergies," allow for "profit maximization," and permit the companies "to leverage the competitiveness of their brands." (Pls. Mot. Expedite (Dkt. 18) at 3 n.3, 11) This transaction would allow plaintiffs to cut costs and sell at higher volume, undercutting the State's interest in promoting temperance. (Exhibit F at ¶ 7) (explaining that the three-tier system moderates price to "prevent large quantities of cheap alcohol that is heavily promoted from flooding the marketplace").

Ms. Erickson's affidavit also discusses the importance of local regulatory control. (*Id.* at ¶ 8) Local companies are "more responsive to local concerns" because they are impacted by local publicity and pressure to follow regulations. (*Id.*) As a practical matter, it is more difficult for state regulatory agencies with limited budgets and resources to exert regulatory control over out-of-state licensees. (*Id.*) Tax collection is one example. In Illinois, beer producers report the volume of product sold while beer distributors pay the excise taxes. There is an increased risk of tax evasion when a producer and distributor affiliate, and when the producer is out-of-state, it is more difficult to counteract this risk through a series of cross-checks. This additional reason buttresses the Commission's decision to disallow Anheuser-Busch, an out-of-state producer, from affiliating with an in-state distributor.

II. ILLINOIS' THREE-TIER SYSTEM IS PROTECTED BY THE TWENTY-FIRST AMENDMENT AND MUST BE UPHELD REGARDLESS OF THE DORMANT COMMERCE CLAUSE.

The Twenty-First Amendment insulates Illinois' three-tier system from plaintiffs' dormant commerce clause challenge. It affords "special protection" to state liquor

control polices, which are "supported by a strong presumption of validity and should not be set aside lightly." *North Dakota v. United States*, 495 U.S. 423, 433 (1990). Plaintiffs err in assuming that the "dormant" commerce clause—a judicial creation that appears nowhere in the Constitution—trumps Illinois' express Twenty-First Amendment right to determine who can be a "distributor" in its three-tier system.

A. The Twenty-First Amendment Grants The States Broad Power To Regulate Liquor And Structure A Distribution System.

The Twenty-First Amendment is the only amendment our Nation's history to have been ratified by the people in state conventions, rather than by state legislatures. *Granholm*, 544 U.S. at 496-97. In unequivocal terms, the Amendment states that the "transportation or importation" of liquor "for delivery or use" in a State "in violation of the laws thereof" is prohibited. U.S. Const. amend. XXI, § 2. Among other things, it "limits the effect of the dormant Commerce Clause." *44 Liquormart, Inc. v. Rhode Island*, 517 U.S. 484, 516 (1996); *see also Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691, 712 (1984) (noting that the Amendment "reserves to the States power to impose burdens on interstate commerce in intoxicating liquor that, absent the Amendment, would clearly be invalid under the Commerce Clause").

Based on the Twenty-First Amendment's plain language, the Supreme Court initially found state liquor regulations exempt from dormant commerce clause, equal protection, and due process challenges. In *State Board of Equalization of California v. Young's Market Co.*, the Court noted that requiring states to let domestic and foreign liquor compete on equal terms "would involve not a construction of the amendment, but a rewriting of it." 299 U.S. 59, 62 (1936) (upholding statute imposing license fee for importing beer); *see also Mahoney v. Joseph Triner Corp.*, 304 U.S. 401, 403 (1938)

(upholding registration statute that "clearly discriminat[ed] in favor of liquor processed within the State"); *Indianapolis Brewing Co. v. Liquor Control Comm'n of the State of Michigan*, 305 U.S. 391, 394 (1939) (upholding statute despite its alleged protectionist purpose, "the right of a state to prohibit or regulate the importation of intoxicating liquor is not limited by the commerce clause").

The Supreme Court's Twenty-First Amendment jurisprudence has evolved since these early cases. *See, e.g.*, *Hostetter v. Idlewild Bon Voyage Liquor Corp.*, 377 U.S. 324, 331-32 (1964) (noting that the Twenty-First Amendment did not "repeal" the commerce clause in the liquor context). But plaintiffs have not cited a *single* decision—early or modern—invalidating the type of liquor law at issue here.

Plaintiffs cite three pre-*Granholm* Supreme Court cases. (*Granholm* is discussed in Part III below.) All are easily distinguished. Two of the cases, *Brown-Forman* and *Healy*, involved "price affirmation" statutes that had the practical effect of controlling liquor prices in other states. *Brown-Forman Distillers Corp. v. New York State Liquor Auth.*, 476 U.S. 573, 582-83 (1986); *Healy v. Beer Inst.*, 491 U.S. 324, 337 (1989). This type of "extraterritorial" regulation is not at issue here.

The third case, *Bacchus*, involved a tax exemption that Hawaii applied only to certain locally produced wines. *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 265 (1984). In the lower courts, Hawaii "expressly disclaimed" any reliance on the Twenty-First Amendment. *Id.* at 274 n.12. The Supreme Court struck down the tax exemption because Hawaii conceded that its purpose was protectionist and did not "seek to justify its tax on the ground that it was designed to promote temperance or carry out any other purpose of the Twenty-First Amendment." *Id.* at 276. Here, Illinois' three-tier system

promotes temperance and ensures regulatory control, and plaintiffs have offered no evidence showing that it has a protectionist purpose.

B. Illinois' Three-Tier System Is Validly Grounded In The Twenty-First Amendment's "Core Concerns."

Although plaintiffs cite *Bacchus*, they overlook the Twenty-First Amendment "core concerns" test that the Supreme Court established in that case.[7] This test protects state liquor regulations implicating interests "so closely related to the powers reserved by the Twenty-First Amendment that the regulation may prevail, notwithstanding that its requirements directly conflict with express federal policies." *Bacchus Imports, Ltd.*, 468 U.S. at 275-76. If a state regulation implicates a "core concern" of the Twenty-First Amendment, the Amendment "removes the constitutional cloud from the challenged law so long as the state demonstrates that it genuinely needs the law to effectuate its proffered core concern." *Brainbridge*, 311 F.3d at 1112-13. Unlike the commerce clause burden that plaintiffs argue applies here, the state does *not* need to show that no non-discriminatory alternatives are available. *Id.* at 1115 n.17.

Here, the Twenty-First Amendment core concerns test insulates Illinois' three-tier system from plaintiffs' commerce clause challenge. By precluding large, out-of-state beer producers from acting as distributors (or affiliating with them), Illinois' three-tier system promotes temperance and competition among the brands. *See* Part I-C, *supra*. And the Act's limited exception to the rule against vertical integration, allowing in-state producers to self-distribute, does not surrender Illinois' interests in regulatory control and

[7] In *Granholm*, the Supreme Court cited *Bacchus* with approval. 544 U.S. at 487-88. Faced with protectionist laws completely banning out-of-state wineries from shipping directly to consumers, the Court in *Granholm* did not discuss the core concerns test. But the Fourth Circuit has specifically held that *Granholm* did not eliminate the test, at least when economic protectionism is not at issue. *Brooks v. Vassar*, 462 F.3d 341, 351 (4th Cir. 2006), *cert. denied*, 550 U.S. 934 (2007).

tax collection. *Id.* The Supreme Court has made clear that the States' "core" Twenty-First Amendment powers include "promoting temperance, ensuring orderly market conditions, and raising revenue." *North Dakota*, 495 U.S. at 432; *see also Milton S. Kronheim & Co., Inc. v. Dist. of Columbia*, 91 F.3d 193, 202-04 (1996) (upholding "facially discriminatory" local warehousing requirement, geographic proximity supports "the core enforcement function of the Twenty-First Amendment").

III. ILLINOIS' THREE-TIER SYSTEM IS LEGITIMATE UNDER THE SUPREME COURT'S RECENT *GRANHOLM* DECISION.

To avoid the reach of the Twenty-First Amendment, plaintiffs rely primarily on the Supreme Court's *Granholm v. Heald* decision. (Pls. Mot. Summ. J. (Dkt. 29) at 10-12) But in pronouncing the three-tier system "unquestionably legitimate," *Granholm* actually supports defendants' position. And although the Court in *Granholm* struck down the bans on direct-to-consumer wine shipping at issue there, the case does not require this Court to find Illinois' law unconstitutional. Plaintiffs ask this Court to extend *Granholm* well-beyond its facts—the Court should decline their invitation and reject their dormant commerce clause claim.

A. *Granholm* And Its Progeny Only Confirm That Illinois Has A Twenty-First Amendment Right To Determine Who Can Be A Distributor In Its Three-Tier System.

Granholm is the centerpiece of plaintiffs' motion. In *Granholm*, a bare majority of the Court invalidated—over a vigorous dissent—two states' direct-to-consumer wine shipping laws enacted as part of an "ongoing, low-level trade war." 544 U.S. at 473. Michigan and New York permitted in-state wineries (and, in New York, out-of-state wineries with a physical presence in the state) to *bypass* the three-tier system and sell directly to consumers, but did not grant out-of-state wineries the same privilege. *Id.* at

465-67. The practical effect of the Michigan and New York laws was to *completely block* small, out-of-state wineries, including the plaintiffs, from competing in those states. *Id.* at 467-68, 474-75. The Court considered the laws "straightforward attempts to discriminate in favor of local producers." *Id.* at 489.

Nothing in *Granholm* strips Illinois of its Twenty-First Amendment right to determine who can be a distributor in its three-tier system. In *Granholm*, the Court cited *Bacchus*, *Brown-Forman*, and *Healy* (all discussed above) for the proposition that the Twenty-First Amendment "does not immunize all laws from Commerce Clause challenge." *Id.* at 488. But the Court drew the line at the three-tier system, confirming that it remains "unquestionably legitimate." *Id.* at 489.[8] The States still have "virtually complete control" over "how to structure the liquor distribution system." *Id.* at 488. "State policies are protected under the Twenty-First Amendment when they treat liquor produced out of state the same as its domestic equivalent." *Id.* at 489. And this is precisely the case here—both in-state and out-of-state beer must pass through Illinois-licensed distributors and retailers.

Three recent appellate decisions—none of which plaintiffs cite—confirm that *Granholm* permits distinctions between in-state and out-of-state interests made as part of a State's three-tier system. In *Siesta Village Market LLC v. Steen*, out-of-state wine retailers challenged a Texas law allowing only in-state retailers to deliver wine to the doors of their customers. 595 F.3d at 251. The Fifth Circuit held that Texas' distinction

[8] The Supreme Court's approval of the three-tier system is "a caveat to the statement that the Commerce Clause is violated if state law authorizes 'differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter.'" *Siesta Village Market, LLC*, 595 F.3d at 258.

is "*not discrimination in Granholm terms.*" *Id.* at 259 (emphasis added)[9] The Court reasoned that the distinction is part of Texas' three-tier system and, for that reason, not subject to attack under the dormant commerce clause. *Id.* at 258-59. It rejected plaintiffs' argument that "the three tiers have tumbled" because Texas permits retailers to make home deliveries. *Id.* at 259.

The Second and Fourth Circuits have taken a similar approach. In *Arnold's Wine's, Inc. v. Boyle*, the Second Circuit upheld a similar New York liquor law permitting only in-state retailers to deliver directly to consumers. 571 F.3d 185, 188 (2d Cir. 2009). The court characterized the plaintiffs' lawsuit as "a frontal attack on the constitutionality of the three-tier system itself." *Id.* at 190. Finally, in *Brooks v. Vassar*, the Fourth Circuit rejected an argument comparing the status of in-state and out-of-state retailers in Virginia's three-tier system. 462 F.3d at 354-55; *see also id.* at 352 ("[A]n argument that compares the status of an in-state retailer with and out-of-state retailer—or that compares the status of any other in-state entity under the three-tier system with its out-of-state counterpart—is nothing different than an argument challenging the three-tier system itself.").

B. *Granholm* Does Not Invalidate Illinois' Definition Of "Distributor" Merely Because The Definition Impacts Producers Seeking To Act As Distributors.

In an attempt to sidestep these recent appellate decisions and mimic *Granholm*, plaintiffs frame their commerce clause claim in terms of discrimination against

[9] In upholding the Texas law, the Fifth Circuit did not consider evidence regarding the purpose of the law or the existence of less-discriminatory alternatives. *Id.* at 252-53 ("We do no reach the policy justifications [for the Texas statute], as our reversal is for other reasons."); *see also id.* at 254 ("We do not discuss [the State's burden under the dormant commerce clause] because we determine that the Texas provisions are constitutional and do not need to be saved.").

"producers or products." (Pls. Mot. Summ. J. (Dkt. 29) at 8) *Granholm* certainly distinguishes between (impermissible) discrimination against producers and their products and (permissible) discrimination against distributors and retailers in a state's three-tier system. *See* 544 U.S. at 482-86; *Siesta Village Market LLC*, 595 F.3d at 256, 258, 260 ("[H]ow much further, if at all, beyond products and producers do the anti-discrimination principles go? The Second Circuit held products and producers are the limit."); citing *Arnold's Wines, Inc.*, 571 F.3d at 191.[10] But in this case, the Court's distinction gets plaintiffs nowhere.

Here, Anheuser-Busch's claim is that it cannot act as a *distributor* in Illinois' three-tier system. (Compl. (Dkt. 1) at ¶¶ 2, 3, 38; Pls. Mot. Summ. J. (Dkt. 29) at 1-2, 8, 13-14, 17) The Commission's interpretation of the Act—specifically, the Act's definition of "distributor"—affects Anheuser-Busch only insofar as it wants to act as a *distributor* in Illinois' three-tier system. There is no discrimination against Anheuser-Busch in its capacity as producer. Nor is there any discrimination against its products, because both in-state and out-of-state beer must go through Illinois' three-tier system. For at least three reasons, the type of discrimination against "producers and products" in *Granholm* is not present here:

First, in *Granholm*, the in-state producers were permitted to bypass the middle tier in the three-tier system, while the out-of-state producers were not. *Granholm*, 544 U.S. at 466-67 (noting that "the three-tier system is…mandated by Michigan and New

[10] In his dissent in *Granholm*, Justice Thomas criticized the Court for concluding that the Twenty-First Amendment protects only discrimination against distributors and retailers. *See* 544 U.S. at 517-18, 520-22 ("The majority's reliance on the difference between discrimination against manufacturers (and therefore, their products) and discrimination against wholesalers and retailers is difficult to understand."). Based on a careful legal and historical analysis, Justice Thomas concluded that the Amendment also permits discrimination against producers. *Id.* at 520.

York only for sales from out-of-state wineries"), 474 (noting that New York established "an indirect way of subjecting out-of-state wineries, but not local ones, to the three-tier system"). In contrast, under the Commission's interpretation of the Act, both in-state and out-of-state beer must go through licensed in-state distributors. Plaintiffs admit as much. (Pls. Mot. Expedite (Dkt. 18) at 10 n.7) ("Plaintiffs are not seeking to bypass the three-tier system, but only to operate at both the producer *and* distributor levels of the system, just as in-state brewers are permitted to do.").

Second, in *Granholm*, the out-of-state producers' wine was effectively blocked from Michigan and New York. As the Court explained, direct-to-consumer wine shipping is an "emerging and significant" business. *Granholm*, 544 U.S. at 467. Many small wineries "rely on direct shipping to reach new markets." *Id.* at 467. They "do not produce enough wine or have sufficient consumer demand for their wine to make it economical for wholesalers to carry their products." *Id.* Thus, Michigan's ban on direct-to-consumer shipping created a cost differential that "effectively bar[red] small wineries from the Michigan market." *Id.* at 474. Likewise, New York's physical presence requirement drove up costs such that no out-of-state winery availed itself of the state's direct shipping privilege. *Id.* at 475.

The situation here could not be more different. Needless to say, Anheuser-Busch is not comparable to the small wineries struggling to survive in *Granholm*. It is the United States' leading beer producer. (Compl. (Dkt. 1) at ¶ 11) And it has attained this status without the general self-distribution rights that it seeks here—the company relies on "a network of nearly 600 *independent* wholesalers" and only eleven company-owned

distributors. (*Id.*) (emphasis added) It distributes throughout the entire State of Illinois through independent distributors. (Exhibit G)

Unlike the situation in *Granholm*, Illinois' three-tier system does *not* create a barrier that precludes or restricts Anheuser-Busch's ability to sell its products in the State. Far from it: Anheuser-Busch concedes that its beer is "widely distributed, sold, and consumed in Illinois." (Pls. L.R. 56.1 Stmt. (Dkt. 30) at ¶ 3) Anheuser-Busch also admits that in 2009, CITY Beverage distributed within Illinois *more than 38 million gallons* of its beer, resulting in "tens of millions of dollars" in revenues for the companies. (*Id.* at ¶ 7)

Third, the distinction between in-state and out-of-state producers in *Granholm* was for a protectionist purpose. The Court made this clear: "It is evident that the object and design of the Michigan and New York statutes is to grant in-state wineries a competitive advantage over wineries located beyond the States' borders." *Granholm*, 544 U.S. at 466; *see also id.* 472 ("States may not enact laws that burden out-of-state producers or shippers simply to give a competitive advantage to in-state businesses."). In contrast, Illinois' distinction is grounded in its interests in temperance and regulatory control, including tax collection. See Part I-C, *supra*.[11] Plaintiffs offer no evidence suggesting a protectionist motive behind the Illinois General Assembly's definition of "distributor" in the Act.

[11] In *Granholm*, Michigan and New York apparently focused on underage drinking rather than temperance in defending their ban on direct-to-consumer shipping. 544 U.S. at 489-91. The Court found "little evidence" that underage drinking is a problem for wine (as opposed to beer).

Plaintiffs cite a handful of post-*Granholm* lower court decisions, but none of them address the issue presented here. (Pls. Mot. Summ. J. (Dkt. 29) at 12-13)[12] Although Anheuser-Busch vigorously opposed the result in *Granholm* (through the Beer Institute, which submitted an *amicus* brief on behalf of its members, attached as Exhibit H hereto), it now seeks to extend that decision well-beyond its facts. Neither *Granholm* nor its progeny require this Court to take that step. Plaintiffs ask the Court to "ignore too much of the [Twenty-First Amendment's] background jurisprudence and extend the trend well beyond *Granholm*." *Arnold's Wines, Inc.*, 571 F.3d at 201. As the Second Circuit cautioned, "[a]n extension of this sort is not for [the Court] to make." *Id.* Plaintiffs' commerce clause claim falls short and should be rejected.

IV. PLAINTIFFS' PROPOSED REMEDY WOULD UNDERMINE ILLINOIS' THREE-TIER SYSTEM AND IS NOT TAILORED TO DEFENDANTS' ALLEGED COMMERCE CLAUSE VIOLATION.

For the reasons stated above, the Act's limited exception allowing in-state brewers to self-distribute is constitutional. But if this Court finds otherwise, it should (1) provide a deadline to permit the Illinois General Assembly to amend the Act and, if the deadline passes, (2) strike from the Act the limited exception for in-state brewers. The factual predicate and "legal hook" for plaintiffs' commerce clause claim is their

[12] *See Action Wholesale Liquors v. Okla. Alcoholic Beverage Laws Enforcement Comm'n*, 463 F. Supp. 2d 1294 (W.D. Okla. 2006) (Oklahoma law "allow[ed] in-state wineries, but not out-of-state wineries, to ship directly to retailers and restaurants in Oklahoma"); *Baude*, 538 F.3d at 612 (Indiana law "prevent[ed] direct shipment of almost all out-of-state wine while allowing all wineries in Indiana to sell direct"); *Costco Wholesale Corp. v. Hoen*, 407 F. Supp. 2d 1247 (W.D. Wash. 2005) (Washington law required two-levels of "minimum mark-ups" for out-of-state beer and wine producers); *Huber Winery v. Wilcher*, 488 F. Supp. 2d 592, 594 (W.D. Ky. 2006) (Kentucky law "prohibit[ed] out-of-state wineries from selling and shipping wine directly to consumers and retailers while allowing in-state wineries to do so on a limited basis"); *Jelovsek v. Bredesen*, 545 F.3d 431, 434 (6th Cir. 2009) (Tennessee law permitted residents to "transport a greater quantity of wine purchased from a Tennessee winery as compared to wine purchased in another state" and provided other advantages to in-state wineries for admittedly protectionist purposes).

farfetched allegation that Anheuser-Busch is "competing at a disadvantage" with the handful of small, in-state brewers that distribute their own products. (Compl. (Dkt. 1) at ¶ 46) Plaintiffs assert that they want to "compete on equal footing" with these in-state brewers. (*Id.* at ¶ 2) Removing the exception for in-state brewers would eliminate the alleged differential treatment (the commerce clause's only concern) while only strengthening Illinois' three-tier system.

Plaintiffs' proposed remedy would have the opposite effect and should be rejected. Because their real goal is to see their proposed transaction go forward, plaintiffs call on the Court to expand self-distribution rights to *all* producers. (Pls. Mot. Summ. J. (Dkt. 29) at 17-21)[13] But the commerce clause does not protect plaintiffs' preferred business arrangement. *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 119-20, 127 (1978) (upholding law preventing petroleum producers or refiners from operating retail service stations); *Ford Motor Co. v. Texas Dept. of Transp.*, 264 F.3d 493, 498, 505 (5th Cir. 2001) (upholding law preventing automobile manufacturers from acting as dealers). This Court should not needlessly collapse the producer and distributor tiers in Illinois' three-tier system and undermine the State's interests in temperance, regulatory control, and tax collection. *See* Part I-C, *supra*; Exhibit F at ¶ 8 (failing to protect Illinois' three-tier system would "destabilize the market, disadvantage small operators, and allow for further monopolization of Illinois' beer market" and "consumption would likely rise with its inevitable social problems").

[13] To the extent that Anheuser-Busch intends to distribute *other* producers' beer, its proposed relief should be denied because the Commission permits in-state brewers to distribute only their own product. (Exhibits C, D) The dormant commerce clause does not entitle Anheuser-Busch to greater privileges than in-state producers have. *See Siesta Village Market, LLC*, 595 F.3d at 260.

Beskind v. Easley, a case that plaintiffs ignore, confirms that such a disruptive remedy is improper. There, the Fourth Circuit held that it was *reversible error* for the lower court to extend direct-to-consumer shipping rights to out-of-state wineries to redress a dormant commerce clause violation. 325 F. 3d 506, 517-20 (4th Cir. 2003). The Fourth Circuit applied a "minimum damage approach" and stuck the provision authorizing in-state wineries to sell directly to consumers:

> [W]e have little difficulty in concluding that it causes less disruption to North Carolina's…laws to strike the single provision—added in 1981 and creating the local preference—as unconstitutional and thereby leave in place the three-tiered regulatory scheme that North Carolina has employed since 1937 and has given every indication that it wants to continue to employ.

Id. at 519. The court added that "[t]he local preference provision gave [plaintiffs] the opportunity to challenge the discrimination but not the right to dictate the course that cures the constitutional violation." *Id.* at 520; *see also id.* at 518 (noting that plaintiffs merely "latched onto a violation of the Commerce Clause" as "leverage" for their proposed remedy). The same is true here.

Not only do plaintiffs ignore *Beskind*, they ignore the holdings in two of the cases cited in their own brief. In *Costco Wholesale Corp. v. Hoen*, the court determined that withdrawing self-distribution privileges from in-state wineries would result in the "minimum damage" to Washington's three-tier system:

> Defendants' proposed remedy would remove a limited exception to Washington's long-standing three-tier system, while Plaintiffs' proposed remedy would significantly expand this exception. Extending the self-distribution privilege to out-of-state producers would also require more significant changes in the State's licensing, enforcement, and tax collection efforts for beer and wine than withdrawing the privilege from in-state producers. Therefore, the more appropriate remedy from a judicial perspective would be to withdraw the self-distribution from in-

> state producers, rather than extending the privilege to out-of-state producers.

407 F. Supp. 2d at 1255-56. Rather than implementing this approach immediately, however, the court stayed its order to give the Washington legislature time to amend the statute. *Id.* at 1256 ("The constitutional defects in the current Washington system present a policy choice between two alternatives, a decision that is within the discretion of the State Legislature.").

In *Action Wholesale Liquors v. Oklahoma Alcoholic Beverage Laws Enforcement Commission*, the court took the same approach. There, the court invalidated a law allowing in-state wineries, but not out-of-state wineries, to ship directly to retailers in Oklahoma. 463 F. Supp. 2d. at 1305. In crafting a remedy, the court recognized that regulation of the alcoholic beverage industry is a "quintessentially legislative function" implicating policy judgments that "courts are ill-equipped to make." *Id.* at 1306.[14] The court gave the legislature time to act, but also made clear that should the legislature fail to act, nullification is more appropriate than extension because it "would be much less disruptive to Oklahoma's long-standing regulatory scheme" to remove the exception to the three-tier system for in-state wineries than it would be to expand it to all wineries. *Id.* at 1306-07.

The cases that plaintiffs rely on do not support their proposed remedy. First, although the United States Supreme Court stated in a footnote in *Heckler v. Matthews*

[14] The Court emphasized that the legislature has more flexibility to craft an appropriate remedy, and is not "confined to the binary choice" between nullification and extension. *Id.* As an example, it noted that the legislature may favor small wineries (in-state and out-of-state) over large ones. *Id.* at n.8; *see also Black Star Farms LLC v. Oliver*, No. 08-15738, 2010 WL 1443284 (9th Cir. April 13, 2010) (upholding law permitting only small wineries to ship directly to consumers). The Illinois General Assembly should be given the opportunity to make a similar size-based distinction here.

that "ordinarily extension rather than nullification is the proper course," it immediately added that courts must consider the intent of the legislature and "the degree of potential disruption of the statutory scheme." 465 U.S. 728, 739 n.5 (1984). This principle counsels *against* plaintiffs' proposed remedy. Second, in *Dickerson v. Bailey*, the court extended direct-to-consumer shipping rights to out-of-state wineries only because the alternative required the court to "assume the mantle of super legislature, actively rewriting substantial portions of the [Texas Alcoholic Beverage Code]." 336 F.3d 388, 408 (5th Cir. 2003). Here, the opposite is true.[15] Third, in *Huber Winery v. Wilcher*, the court merely extended direct-shipping privileges for small in-state wineries to *equally small* out-of-state wineries because Kentucky "clearly expressed its intent to allow wineries of a certain size" to bypass its three-tier system. 488 F. Supp. 2d 592, 597 (W.D. Ky. 2006).

Finally, plaintiffs cannot support their proposed remedy by offering an alternative interpretation of the Act. (Pls. Mot. Summ. J. (Dkt. 29) at 19-20) Plaintiffs include a footnote in their brief stating that they "vigorously contest" the Commission's interpretation of the Act, but their federal dormant commerce clause claim accepts—and indeed requires—the Commission's interpretation. Plaintiffs chose not to file a state-court action challenging the Commission's construction of the Act, even though a ruling in their favor may have allowed their proposed transaction to proceed without a debate about the appropriate remedy. Their attempt to walk away from that strategic choice by

[15] If the Court finds that the Act violates the dormant commerce clause insofar as it permits in-state but not out-of-state producers to sell to retailers, it can eliminate the problem by striking the italicized language from 235 ILCS 5/5-1: "Class 3. A Brewer may make sales and deliveries of beer to importing distributors, and to non-licensees, *and to retailers provided the brewer obtains an importing distributor's license or distributor's license in accordance with the provisions of this Act.*" (emphasis added)

having this Court interpret the Act raises serious questions about whether this case even belongs in federal court. *See, e.g., Buckley v. Illinois Judicial Inquiry Bd.*, 997 F.2d 224, 229 (7th Cir. 1993) (noting that "a federal court cannot make an interpretation of state law that will bind state courts"); *Waldron v. McAtee*, 723 F.2d 1348, 1352-53 (7th Cir. 1983) (finding abstention appropriate since statute susceptible to interpretation eliminating constitutional issue).[16]

In any event, plaintiffs are incorrect in suggesting that the Illinois General Assembly would prefer a remedy that permits all producers to act as distributors. The Illinois Beer Industry Fair Dealing Act reflects the Illinois legislature's intent to ensure a strong, independent distribution tier. *See* 815 ILCS 720/1 et seq. One of the Act's goals is to "assure[] the beer wholesaler is free to manage its business enterprise" and "independently" set prices. *Id.* at 720/2(A)(i). The Act states that a producer cannot terminate an agreement with its distributor without good cause and prior notification. *Id.* at 720/4. In addition, a producer cannot threaten termination to "induce" or "coerce" a distributor to engage in illegal conduct. *Id.* at 720/5(1). Nor can a producer prohibit a distributor from selling another producer's product, or fix the price at which a distributor may sell its product. *Id.* at 720/5(2), (3). All of this confirms that the legislature's intent would be to preserve Illinois' three-tier system.

[16] Plaintiffs seem to agree. In response to WSDI's motion to intervene, they assert that the Commission's interpretation is the "one…that matters." (Pls. Resp. WSDI Mot. Intervene (Dkt. 53) at 15) They argue that WSDI's statutory construction argument "seeks to bootstrap a pendent state claim into this litigation" and is a "procedural sleight-of-hand barred by the Eleventh Amendment." (*Id.* at 16, citing *Pennhurst State Sch. & Hosp. v. Halderman*, 465 U.S. 89, 106 (1984) ("[I]t is difficult to think of a greater intrusion on state sovereignty than when a federal court instructs state officials on how to conform their conduct to state law.")) Yet, for the same reason, the Court should not entertain plaintiffs' statutory construction argument.

CONCLUSION

For the foregoing reasons, plaintiffs' motion for summary judgment on their commerce clause claim should be denied.

Dated: May 7, 2010

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CERTIFICATE OF SERVICE

The undersigned, an attorney, hereby certifies that on May 7, 2010, he caused copies of the foregoing **Defendants' Response to Plaintiffs' Motion for Summary Judgment on Their Commerce Clause Claim** to be served on all registered counsel via the Northern District of Illinois Electronic Filing System.

*/s/ Michael T. Dierkes*_____
Michael T. Dierkes