The Commerce Clause and the three-tier system: Advances in direct wine shipping

By Kate J. Hardy and Robert K. Carrol

In a significant decision for interstate wine retailers, the U.S. District Court of Eastern Michigan ruled on September 30 that the provisions of the Supreme Court’s 2005 decision in *Granholm v. Heald* apply to retailers, meaning that Michigan’s ban on wine shipments direct to consumers from out-of-state retailers constitutes site-based discrimination and is unconstitutional. This is the second such ruling this year; the first was a U.S. District Court ruling on a similar law in Texas.

In *Granholm*, the Supreme Court declared that it was unconstitutional for states to create site-based discrimination between in-state wineries and out-of-state wineries in the sale of wine direct to consumers. Legislation in both New York and Michigan was held to contravene the Commerce Clause by allowing domestic wine producers to ship to customers in the state, but preventing interstate producers from doing so. Each of these states had created laws bypassing the three-tier system to assist in-state interests in accessing consumers directly without going through the wholesale and retail tiers.

Following that decision, these and the many other states that had similar legislation were forced to make a choice: Either allow all wineries to ship to consumers or prevent even in-state wineries from doing so. In most cases, the market was opened to all wineries. In a number of cases, the legislature introduced creative measures, such as total production volume caps and mandatory consumer visits to the winery, to restrict the eligibility of wineries to direct ship. In a recent development, on October 24, the Court of Appeals for the Sixth Circuit in Tennessee gave its decision in *Jelovsek v. Bredesen*. It held that the local law was discriminatory in that, among other things, it gave only producers using 75-percent locally grown grapes the right to ship directly to consumers. There are also currently pending actions in states, including Arkansas, Delaware, Indiana, Kentucky, Maine, Massachusetts, New Jersey, and Pennsylvania.
Despite the fairly broad language used by the Supreme Court, where the majority opinion speaks of discrimination against “shippers,” the approach generally was to make changes only where wineries were concerned, as that was the limit of the legislation that had been enacted. Generally speaking, the states did not appear to consider the case as having any broader impact than on wineries, and similar restrictions concerning retailers were largely unchanged.

Fast-forward nearly four years and the same governor in Michigan is in court again, defending legislation in the case of *Siesta Village Market v. Granholm*. This time, the challenge was brought by an out-of-state retailer against protectionist legislation, allowing in-state retailers to ship to consumers but creating additional burdens for out-of-state retailers in doing the same. In a decision handed down by Judge Hood in the Eastern District Federal District Court, the plaintiff was successful in its motion for summary judgment against the state and the discriminatory legislation was held to be unconstitutional under the Commerce Clause. The judge ordered the state to cease its prohibition of out-of-state sales and to stop enforcing any of the provisions of the law against out-of-state retailers.

Before the decision, only Michigan retailers were able to ship wine directly to consumers once they were licensed as a “specially designated merchant” (SDM). An out-of-state retailer was not allowed to ship to Michigan consumers unless it established a physical presence in Michigan (thus becoming an in-state retailer) and obtained an SDM license. The judge found that these requirements were burdensome on out-of-state retailers because of the many costs associated with opening a new location in the state. The state’s arguments that allowing direct shipment by out-of-state retailers would make it difficult to collect taxes and control labeling were rejected.

Across the country, 31 states allow retailers to ship direct to consumers, but only 13 of them allow an out-of-state retailer the same privilege (not including Michigan). This second *Granholm* decision is one of three challenges that have now been decided among a crop of retailer suits brought following the first landmark *Granholm* case. It builds on and follows the result in the matter of *Siesta Village Market v. Perry*, brought by the same Florida retailer in the state of Texas, and decided in January of this year. That court also ruled that the challenged legislation was unconstitutional, but created some confusion when it still required an out-of-state retailer to buy from an in-state wholesaler. The *Perry* court specifically elected not to follow the first decided retailer challenge in New York of *Arnold’s Wines, Inc. v. Boyle*. In that case, the court held that the out-of-state retailer’s challenge was a direct challenge to the three-tier system itself and that the 21st Amendment rights of the states circumvented the Commerce Clause. It thus accepted the resulting discrimination as constitutional.

Both *Arnold’s Wines* and *Perry* are under appeal to their respective circuits and the Michigan Attorney General has also now filed notice saying that the latest *Granholm* decision will also be appealed. It will, however, be some time before we see whether the Supreme Court will weigh in on this issue.

Despite the current trend of acceptance of direct shipping, none of the decisions referenced in this article should be seen as challenging the inherent acceptance of the three-tier system and the 21st Amendment. Indeed, the Supreme Court in *Granholm* was very supportive of the continuing relevance of the three tiers in the control of alcohol distribution. It is the states that are opening these doors. By creating exceptions to the tiers for their domestic economic interests, they have come into conflict with the Commerce Clause and have had to extend direct shipping rights to interstate interests as well.
Notwithstanding, with wineries and, increasingly, retailers being able to ship direct to consumers in many states, the question becomes why importers and foreign wineries are not also benefiting from these increased markets. For example, a French wine producer cannot ship direct to a consumer in New York in the same way as his U.S. competitors. Even his importer—a U.S. company with all the appropriate licenses—cannot ship direct to consumers. That producer has no option but to go through the three tiers to gain access to consumers. Not only does this potentially raise Commerce Clause issues within this country, but it also suggests problems at World Trade Organization (WTO) level in the creation of technical barriers to free and equal trade. This, indeed, likely signals the potential future direction of challenges to the unequal treatment of the various players in the beverage alcohol industry that we are seeing now.

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