

**UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF KENTUCKY
LOUISVILLE DIVISION**

| | | |
|--|---|--------------------------------|
| HUBER WINERY, et al., |) | |
| |) | |
| Plaintiffs, |) | |
| |) | |
| vs. |) | Civil Action No. 3:05-cv-289-S |
| |) | |
| LAJUANA S. WILCHER, et al. |) | |
| |) | |
| Defendants |) | |
| |) | |
| and |) | |
| |) | |
| WINE AND SPIRITS WHOLESALERS OF KENTUCKY, INC., |) | |
| |) | |
| Intervening Defendant |) | |
| <hr style="width: 40%; margin-left: 0;"/> |) | |

**MEMORANDUM OF LAW IN SUPPORT OF PLAINTIFFS’
MOTION FOR JUDGMENT ON THE PLEADINGS**

ORAL ARGUMENT REQUESTED PURSUANT TO L.R. 7.1(g)

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REQUEST FOR ORAL ARGUMENT

Pursuant to L.R. 7.1(g), Plaintiffs request that the Court schedule an oral argument with respect to the foregoing Motion. Plaintiffs believe an oral argument will assist the Court in understanding the parties' positions and the applicable legal principles, especially in light of the complexities and novel posture of this case.

INTRODUCTION

Plaintiffs, Huber Winery, a division of Huber Orchards, Inc. (“Huber Winery”), William G. Schneider, Jr. (“Schneider”) and John D. Reilly, Jr. (“Reilly”), by counsel, respectfully submit the foregoing Memorandum of Law in support of their Motion for Judgment on the Pleadings against the Defendants, Lavoyed Hudgins (“Hudgins), as the Executive Director of the Kentucky Office of Alcohol Beverage Control (hereafter “Kentucky ABC”) and Lajuana Wilcher (“Wilcher”), as the Secretary of the Kentucky Environmental and Public Protection Cabinet (“Cabinet”),¹ and the Intervening Defendant, Wine and Spirits Wholesalers of Kentucky, Inc. (“Kentucky Wholesalers”).

Based upon the reasons set forth below, Plaintiffs seek a judgment from the Court which: (1) declares unconstitutional certain Kentucky statutes and administrative regulations that both prohibit and punish out-of-state wineries from selling and delivering wine directly to adult Kentucky residents, and commercial carriers and private persons from transporting wine into Kentucky from out-of-state wineries; and (2) permanently enjoins the State Defendants from enforcing such statutes and regulations in violation of the Commerce Clause found in Article I, § 8, cl. 3 of the United States Constitution.

This matter comes before the Court as a result of the May 16, 2005 decision of the United States Supreme in Granholm v. Heald, 544 U.S. ---, 125 S.Ct. 1885, --- L.Ed.2d --- (2005). At issue in this case is the constitutionality of several Kentucky statutes and accompanying administrative regulations which concern the manufacture, sale and delivery of wine vis-a-vis out-of-state manufacturers. Plaintiffs assert these statutes and regulations

¹ Hudgins, Wilcher, the Kentucky ABC and the Cabinet are hereafter collectively referred to as “the State Defendants”.

violate the Commerce Clause of the United States Constitution and the Supreme Court's holding in Granholm because they impermissibly discriminate against out-of-state manufacturers in favor of Kentucky domestic manufacturers. This discrimination results from the fact that Kentucky law prohibits out-of-state manufacturers from making direct retail sales to Kentucky consumers and retailers, but grants such right to domestic manufacturers upon non-uniform terms.

STATEMENT OF THE CASE

The Parties

Huber Winery owns and operates a small winery in Starlight, Indiana, approximately 15 miles from Louisville. In conducting its operations, Huber Winery holds all necessary Indiana and federal licenses and permits to manufacture and sell wine in interstate commerce. See Complaint, ¶3. Huber Winery has received numerous requests from residents of Jefferson County, Kentucky to deliver wine to them, and would sell and deliver wine directly to Kentucky consumers at their residences, and to licensed retail Kentucky wine sellers at their places of business, if Kentucky law permitted it to do so. Id. Because of the size of its manufacturing operation, Huber Winery would qualify for all necessary Kentucky licenses would that permit it to ship wine directly to Kentucky residents if it were located in Kentucky. However, because Huber Winery is not located in Kentucky and does not make wine from Kentucky fruit, juices or honey, it is not eligible for such licenses. See Ky. Rev. Stat. § 241.010(22) and (45).

Schneider and Reilly are both individuals who each reside in Jefferson County, Kentucky. See Complaint, ¶4. Both Schneider and Reilly are over the age of twenty-one and reside in areas where the sale and possession of wine is permitted under local option

laws. See Complaint, ¶4. Schneider and Reilly are both regular purchasers and consumers of wine, and would purchase bottled wine from out-of-state wineries and have those wines shipped directly to them to their residences in Jefferson County if Kentucky law permitted them to do so. Id.

Hudgins is the Executive Director of the Kentucky ABC, and Wilcher is the Secretary of the Cabinet. See Complaint, ¶¶ 7 and 8; State Defendants' Answer, ¶¶ 6 and 7. The Kentucky ABC is charged with the duty of both enforcing the Kentucky statutes regulating alcoholic beverages, and adopting administrative regulations to aid in its enforcement functions. See Ky. Rev. Stat. §§ 241.030 and 241.060. The Cabinet is the agency of Kentucky state government charged with oversight of the Kentucky ABC.² See Complaint, ¶ 8; State Defendants' Answer, ¶ 6.

The Kentucky Wholesalers is a Kentucky non-profit corporation consisting of nine licensed liquor wholesalers. See Mot. to Intervene, ¶1. The Kentucky Wholesalers claim that Plaintiffs are seeking to gain a competitive advantage by selling directly to Kentucky consumers while they are statutorily prevented from making such direct sales. Id. at ¶3.

The Kentucky Statutes

Like most other states, Kentucky heralded the 1933 passage of the Twenty-First Amendment³ by adopting a statutory scheme which created a comprehensive three-tiered

² Plaintiffs served a copy of their Complaint upon the Kentucky Attorney General as required by Ky. Rev. Stat. § 418.075(1) on May 16, 2005.

³ The Twenty-First Amendment provides as follows:

Section 1. The eighteenth article of amendment to the Constitution of the United States is hereby repealed.

system for regulating the manufacture, sale and delivery of alcoholic beverages. Under this statutory scheme, a manufacturer may sell its products only through a licensed wholesaler, who in turn may sell only to licensed retailers, who in turn sell to consumers. See Ky. Rev. Stat. §§ 243.020 and 244.167. Kentucky law specifically prohibits the direct sale and shipment of alcoholic beverages, including wine, between manufacturers and consumers, and makes any direct sale and shipment a felony criminal offense. See Ky. Rev. Stat. § 244.165.⁴

There are two exceptions to this general prohibition. The first exception is an administrative regulation, 804 KAR 4:330 §4, by which the Kentucky ABC allows Kentucky residents to receive direct shipment of alcoholic beverages at their home, business or mailing address from out-of-state wineries - - but only if the resident purchased the alcoholic beverages while visiting another state or country. The Kentucky General

Section 2. 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.

Section 3. This article shall be inoperative unless it shall have been ratified as an amendment to the Constitution by conventions in the several States, as provided in the Constitution, within seven years from the date of the submission hereof to the States by the Congress.

⁴ Ky. Rev. Stat. § 244.165 provides that:

(1) It shall be unlawful for any person in the business of selling alcoholic beverages in another state or country to ship or cause to be shipped any alcoholic beverage directly to any Kentucky resident who does not hold a valid wholesaler or distributor license issued by the Commonwealth of Kentucky.

(2) Any person who violates subsection (1) of this section shall, for the first offense, be mailed a certified letter by the department ordering that person to cease and desist any shipments of alcoholic beverages to Kentucky residents, and for the second and each subsequent offense, be guilty of a Class D felony.

Assembly created the second exception to this statutory scheme by establishing two new specific classes of domestic wineries. These special wineries are permitted to make direct shipment of wine provided they satisfy certain conditions - - conditions which are designed to hinder out-of-state wineries from competing with Kentucky domestic wineries.

Ky. Rev. Stat. § 243.155 provides for the licensing of a type of winery which is classified as a “small winery”⁵. In general, small wineries are those wineries which offer

⁵ Ky. Rev. Stat. § 243.155 provides in pertinent part that:

(1) A small winery license shall authorize the licensee to perform the following functions without having to obtain separate licenses, except that each off-premises retail site shall be separately licensed:

(a) Manufacture wines and bottle wines produced by that small winery in an amount not to exceed fifty thousand (50,000) gallons in one (1) year;

(b) Serve on the premises or at off-premise retail sites complimentary samples of wine produced by it in amounts not to exceed six (6) ounces per patron per day, if the small winery or off-premise retail site is located in wet territory;

(c) Sell by the drink or by the package on premises, at off-premise retail sites, and at fairs, festivals, and other similar types of events, wine produced on the premises of the small winery or produced by a licensed farm winery, at retail to consumers if all sales sites are located in wet territory;

(d) Sell and transport wine produced on the premises of the small winery to wholesale license holders and to retail package or retail drink license holders, if the wine has been offered for sale to wholesale license holders and the wine is sold at the wholesale price to the retail package or retail drink license holders;

(e) Consume on the premises wine produced by the small winery or a licensed farm winery and purchased by the drink or by the package at the licensed premises, if the small winery is located in wet territory; and

(f) Ship to a customer wine produced by a small winery or a farm winery if:

1. The wine is purchased by the customer in person at the small winery;
2. The wine is shipped by licensed common carrier; and
3. The amount of wine shipped is limited to two (2) cases per customer.

(2) In accordance with administrative regulations promulgated by the board, the holder of a small winery license or farm winery license, upon affidavit filed with the board that grapes, grape juice, other fruits, other fruit juices, or honey produced in Kentucky are not obtainable, may apply for a permit to import these products. The burden of proof shall be upon the applicant to show that the grapes, grape juice, other fruits, other fruit juices, or honey are not available from any other source within the Commonwealth of Kentucky.

* * *

a limited annual production (no more than 50,000 gallons) of wine made exclusively from Kentucky grown fruits or Kentucky produced juices. See Ky. Rev. Stat. § 241.010(45). In addition, Ky. Rev. Stat. § 243.156 provides for the licensing of a type of domestic winery which is classified as a “farm winery”⁶. Farm wineries are wineries located exclusively in

⁶ Ky. Rev. Stat. § 243.156 provides that:

(1) A farm winery license shall authorize the licensee to perform the following functions without having to obtain separate licenses:

(a) Manufacture wines and bottle wines at a winery located on a Kentucky farm with a producing vineyard, orchard, or similar growing area, in an amount not to exceed twenty-five thousand (25,000) gallons in one (1) year;

(b) Serve on the premises or at an off-premise retail site complimentary samples of wine produced by it in amounts not to exceed four (4) ounces per patron per day, if the farm winery or off-premise retail site is located in wet territory;

(c) Sell wine produced on the premises of the farm winery or produced by a licensed small winery by the drink or by the package at retail to consumers, if the farm winery or off-premise retail site is located in wet territory and the wine produced by the small winery is made with Kentucky products;

(d) Sell and transport wine produced on the premises of the farm winery to wholesale liquor license holders and to retail package or retail drink license holders, if the wine has been offered for sale to wholesale license holders and the wine is sold at the wholesale price to the retail package or retail drink license holders;

(e) Serve complimentary samples or sell wine produced on the premises of the farm winery at another farm winery or small winery sales site, if the other farm winery or small winery sales site is located in wet territory;

(f) Consume on the premises wine produced by the farm winery or a small winery and purchased by the drink or by the package at the licensed premises, if the farm winery is located in wet territory;

(g) Sell by the drink or by the package wine produced by the farm winery or a licensed small winery at a fair, festival, or other similar type of event, if the event is held in a wet territory; and

(h) Ship to a customer wine produced by a farm winery or a small winery if:

1. The wine is purchased by the customer in person at the farm winery;
2. The wine is shipped by licensed common carrier; and
3. The amount of wine shipped is limited to two (2) cases per customer.

(2) A licensed farm winery may establish one (1) off-premise retail sales outlet, if it is located in wet territory.

Kentucky which are limited to an even smaller annual production allowance (no more than 25,000 gallons) of wine than small wineries. See Ky. Rev. Stat. § 241.010(22). Similar to a small winery, Kentucky law requires a farm winery to manufacture its wine exclusively from Kentucky grown fruits or Kentucky produced juices.

Kentucky law allows the operators of a small winery or farm winery the luxury of bypassing the wholesaler element of the typical three-tiered system and selling directly either to consumers or licensed retailers. However, this benefit comes with a caveat - - the small winery **must** utilize Kentucky grown/produced fruit or juices, and the farm winery **must** be both located in Kentucky and utilize Kentucky grown/produced fruit or juices. See Ky. Rev. Stat. §§ 241.010(22) and (45), 243.155(2) and 243.156(1)(a) and (3). Because an out-of-state winery cannot satisfy these requirements, the only way for it to gain access to Kentucky consumers is to sell its product through a Kentucky wholesaler, or hope that Kentucky consumers happen to visit such winery while traveling outside the Commonwealth.

The Granholm Decision

The issue of whether a state may use the regulatory authority granted by the Twenty-First Amendment to allow domestic wineries to sell directly to consumers while not according the same benefit to out-of-state wineries has been the subject of much debate among the federal circuits in recent years. The U.S. Supreme Court seized upon the

(3) All of the fresh fruits, fruit juices, or honey used to manufacture wine at a farm winery shall be grown or produced in the Commonwealth of Kentucky.

* * *

opportunity to bring finality to this recurring issue by granting *certiorari* in Granholm v. Heald, *supra*.

In Granholm, the Supreme Court considered Commerce Clause challenges to the Michigan and New York statutory schemes regulating the manufacture, sale and delivery of wine. These statutes were similar to Kentucky's in that they allowed properly licensed domestic manufacturers to sell directly to consumers, but denied out-of-state manufacturers the ability to obtain similar licenses. Instead, out-of-state manufacturers were forced to sell only through licensed domestic wholesalers.

Consumers in Michigan and New York, as well as out-of-state manufacturers, challenged each state's respective regulatory scheme as violating the Commerce Clause of the United States Constitution because it imposed economic burdens upon out-of-state wineries to which domestic manufacturers were not subjected. The Alcohol Beverage Control officials in both Michigan and New York countered that Section 2 of the Twenty-First Amendment to the United States Constitution granted them nearly unlimited authority to regulate the manufacture, sale and delivery of alcoholic beverages within their respective states, even in a manner which overtly discriminated against interstate commerce. The New York officials further argued that New York's regulatory scheme was even-handed under its law because out-of-state manufacturers were not prohibited from establishing a local manufacturing facility which would allow direct sales to New York residents. The out-of-state manufacturers countered that forcing them to establish manufacturing facilities in another state as a condition of making direct sales within such state was economically infeasible given their small size and lack of economic power, and was an impermissible "local processing" rule prohibited by the Commerce Clause.

In striking down the respective Michigan and New York statutes, the Supreme Court laid down a firm rule that a state may not use the broad regulatory authority otherwise granted by Section 2 of the Twenty-First Amendment to insulate protectionist economic measures which discriminate against out-of-state manufacturers in favor of domestic manufacturers.⁷ According to the Court, it is unconstitutional for a state “to allow in-state wineries to sell directly to consumers in that State but prohibit out-of-state wineries from doing so, or, at least, to make direct sales impractical from an economic standpoint.” 125 S.Ct. at 1891-92. In other words, a state may not “grant in-state wineries a competitive advantage over wineries located beyond the State’s borders.” *Id.*

After finding the Michigan and New York regulatory schemes unduly discriminated against out-of-state manufacturers, the Court focused much of its remaining discussion on the pre-Prohibition and post-Prohibition jurisprudence concerning the regulation of alcoholic beverages vis-a-vis the Commerce Clause. Following a lengthy discussion of this jurisprudence, the Court articulated its position that Section 2 of the Twenty-First Amendment did not give states sweeping power, but simply “restored to the States the

⁷ The Supreme Court’s decision in *Granholm* affirmed the ruling of the Sixth Circuit which had struck down as unconstitutional the Michigan statutes prohibiting the direct shipment of wine from out-of-state wineries but allowed direct shipping by in-state wineries [see *Heald v. Engler*, 342 F.3d 517 (6th Cir. 2003)], and reversed the ruling of the Second Circuit which upheld the constitutionality of the New York statutes prohibiting direct wine shipments by out-of-state producers on the basis of the Twenty-First Amendment [see *Swedenburg v. Kelly*, 358 F.3d 223 (2nd Cir. 2004)].

powers they had under the Wilson and Webb-Kenyon Acts”⁸ prior to Prohibition. 125 S.Ct. at 1902. Accordingly, the Court determined:

“[t]he aim of the Twenty-first Amendment was to allow States to maintain an effective and uniform system for controlling liquor by regulating its transportation, importation, and use. **The Amendment did not give States the authority to pass nonuniform laws in order to discriminate against out-of-state goods**, a privilege they had not enjoyed [prior to Prohibition]” (Emphasis added).

Id. The Court determined that some of its earlier post-Prohibition cases “did not take account of this history and were inconsistent with this view. Id. The Court’s holding in Granholm thus abrogated its prior decisions in State Bd. of Equalization of Cal. v. Young’s Market Co., 299 U.S. 59, 57 S.Ct. 77, 81 L.Ed. 38 (1936); Mahoney v. Joseph Triner Corp., 304 U.S. 401, 58 S.Ct. 952, 82 L.Ed. 243 (1938); Indianapolis Brewing Co. v. Liquor Control Comm’n, 305 U.S. 391, 59 S.Ct. 254, 83 L.Ed. 243 (1939); Ziffrin, Inc. v. Reeves, 308 U.S. 132, 60 S.Ct. 163, 84 L.Ed. 128 (1939); and Joseph S. Finch & Co. v. McKittrick, 305 U.S. 395, 59 S.Ct. 256, 83 L.Ed. 246 (1939).

The Court further opined that the Michigan and New York regulatory schemes could not be saved under the broad regulatory authority granted under Section 2 of the Twenty-First Amendment because the statutes at issue were not necessary to promote the core values of the Twenty-First Amendment (general temperance, prevention of underage drinking, and facilitating tax collection). The Court found these core principles could be

⁸ See Wilson Act [Act of Aug. 8, 1890, ch. 728], 26 Stat. 313 (codified at 27 USCA § 121) and Webb-Kenyon Act [Act of Mar. 1, 1913, ch. 90], 37 Stat. 699 (codified at 27 USCA §§ 122, 122a and 122b).

“achieved through the alternative of an evenhanded licensing requirement.” 125 S.Ct. at 1905.

In sum, the Supreme Court’s holding in Granholm now means that a state statutory scheme of regulating the manufacturer, sale and delivery of alcoholic beverages will pass constitutional muster only if it accords the same benefits and treatment to out-of-state manufacturers as it does to domestic manufacturers.⁹ “State policies are protected under the Twenty-First Amendment when they treat liquor produced out-of-state the same as its domestic equivalent.” 125 S.Ct. at 1905. Thus, requiring out-of-state manufacturers to pass their products through a separate wholesaler and retailer, but allowing domestic manufacturers to sell directly to consumers, has the impermissible effect of giving in-state wineries a competitive advantage. Such a scheme also impermissibly raises the cost of out-of-state manufacturers and excludes from the market those small out-of-state manufacturers that cannot find a wholesaler.

ARGUMENT

I. STANDARD FOR JUDGMENT ON THE PLEADINGS.

In Hasken v. City of Louisville, 173 F.Supp.2d 654 (W.D. Ky. 2001), this Court articulated the appropriate standard for addressing a party’s motion for judgment on the pleadings. According to this Court, “[f]or purposes of a motion for judgment on the pleadings, all well-pleaded material allegations of the pleadings of the opposing party must be taken as true, and the motion may be granted only if the moving party is nevertheless clearly entitled to judgment.” Id. at 658, quoting Southern Ohio Bank v. Merrill Lynch,

⁹ Although the holding in Granholm may be read to encompass the state statutes regulating the manufacture, sale and delivery of all alcoholic beverages, Plaintiffs here seek to apply such holding only to those Kentucky statutes and regulations which regulate the manufacture, sale and delivery of wine.

Pierce, Fenner & Smith, Inc., 479 F.2d 478, 480 (6th Cir.1973). The Motion will only be granted "when no material issue of fact exists and the party making the motion is entitled to judgment as a matter of law." Id.

Despite this strict standard, a judgment in favor of Plaintiffs based upon the parties' respective pleadings is nevertheless appropriate because the dispositive issue (the constitutionality of several Kentucky statutes and regulations pertaining to the manufacture, sale and delivery of wine) purely involves a matter of law which the Court can determine from the face of the parties' pleadings, the subject statutes and the holding in Granholm. See Schmauch v. Honda of America Mfg., Inc., 311 F.Supp.2d 631(S.D. OH. 2003) and Wisconsin Realtors Association v. Ponto, 233 F.Supp.2d 1078, 1080 (W.D. Wisc. 2002).

II. KY. REV. STAT. §§ 243.032 AND 244.165 IMPERMISSIBLY DISCRIMINATE AGAINST OUT-OF-STATE VINTNERS WITH RESPECT TO THE MANUFACTURE, SALE AND DELIVERY OF WINE TO KENTUCKY CONSUMERS AND RETAILERS IN VIOLATION OF THE COMMERCE CLAUSE AND GRANHOLM.

Plaintiffs' cause of action is grounded in their claims that Ky. Rev. Stat. §§ 243.032 and 244.165 violate the Commerce Clause of the United States Constitution because these statutes discriminate against out-of-state wineries with respect to the direct sale of wine to Kentucky consumers and retailers. They prohibit out-of-state, but not in-state, wineries from selling directly.

As the Supreme Court noted in Granholm, "[s]tate laws that discriminate against interstate commerce face "a virtually per se rule of invalidity." 125 S.Ct. at 1897, quoting Philadelphia v. New Jersey, 437 U.S. 617, 624, 98 S.Ct. 2531, 57 L.Ed.2d 475 (1978). Despite the State Defendants' arguments to the contrary in their Answer, the fact that the Kentucky statutory scheme treats out-of-state manufacturers differently than Kentucky

manufacturers is clearly discernable from the face of these statutes. On its face, the Kentucky regulatory scheme discriminates against out-of-state wineries by virtue of the fact that licensure is dictated by the winery's manufacturing situs and/or the content of the winery's product.

The fact these licensure conditions pose undue burdens on out-of-state wineries, if not an insurmountable economic hurdle, is no accident. Plain and simple, these licensure conditions are designed with a single purpose - - to favor domestic wineries and promote Kentucky products to the detriment of out-of-state products.

A. Discrimination Based Upon Situs of Manufacturing Location.

The Kentucky regulatory scheme grants domestic wineries access to Kentucky consumers on preferential terms which impermissibly and unfairly discriminate against out-of-state wineries. This is evidenced by the fact that Kentucky law grants the privilege of direct sale and shipment depending upon a winery's manufacturing situs. Under Kentucky law, an in-state farm winery is permitted the luxury of bypassing the three-tiered distribution system and make direct retail sales.¹⁰ In order to gain the same privilege, out-of-state wineries are instead required to establish a manufacturing operation in Kentucky. See Ky. Rev. Stat. §§ 241.010(22) and 243.156(1)(a). This requirement, though, is just Kentucky's indirect way of subjecting out-of-state wineries, but not local ones, to the three-tier system.

As the Supreme Court noted in Granholm, a state may not compel an out-of-state company "to become a resident in order to compete on equal terms." 125 S.Ct. at 1897,

¹⁰ Kentucky Wholesalers admit in their Answer that the Kentucky ABC will not grant a small winery or farm winery license to any winery not located in Kentucky. See Kentucky Wholesalers Answer, ¶7.

quoting Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64, 72, 83 S.Ct. 1201, 10 L.Ed.2d 202 (1963). The Court recognized and acknowledged the obvious economic realities facing small wineries in its statement that “[f]or most wineries, the expense of establishing a bricks-and-mortar distribution operation in 1 State, let alone all 50, is prohibitive.” 125 S.Ct. at 1897.

The same holds true with respect to Huber Winery and other similarly situated small wineries across the United States. As the Court observed in Granholm, “there are over 3,000 wineries in the country . . . more than three times the number 30 years ago....” 125 S.Ct. at 1892. During this same time, however, the number of licensed wholesalers has decreased from 1,600 to 600. Id. The result of this inverted balance is that “small wineries do not produce enough wine or have sufficient consumer demand for their wine to make it economical for wholesalers to carry their product.” This economic reality forces small wineries to either bear the economic burden of establishing a manufacturing operating in numerous states or find itself excluded from a large segment of potential customers. This is the very type of economic discrimination which the Commerce Clause intended to prohibit.

The claims asserted by the Kentucky Wholesalers in their Answer do not change the fact that the Kentucky statutory scheme improperly discriminates against out-of-state wineries. The Kentucky Wholesalers, an amalgamation of wine and spirits wholesalers, comprise the middle tier of the Kentucky three-tier liquor distribution system. However, the statutes pertaining to the small wineries and farm wineries which are the subject of this action permit such wineries to by-pass the middle tier of the Kentucky liquor distribution system of which the Kentucky Wholesalers purport to represent. Thus, the interests which

the Kentucky Wholesalers claim to protect have absolutely nothing to do with the Plaintiffs' attempt to establish that Kentucky's regulatory scheme impermissibly discriminates against small, out-of-state wineries. A finding, therefore, that Ky. Rev. Stat. §§ 243.032 and 244.165 violate the Commerce Clause and Granholm will not allow Plaintiffs to gain any advantage or privilege which the United States Constitution does not require. It will require that they be treated the same as in-state wineries.

B. Discrimination Based Upon Product Content.

In addition to its restrictive in-state presence requirement, Kentucky law discriminates against out-of-state wineries by use of another protectionist hurdle as a condition of licensure - - requiring the use of Kentucky grown/produced fruits and juices. Under Kentucky law, an out-of-state winery would be ineligible to operate as either a "small winery" or "farm winery" license, unless that winery utilizes Kentucky grown/produced fruit or juices. See Ky. Rev. Stat. § 241.010(45).

This is not the first instance in which a state has attempted to permit preferential treatment of domestic wineries by imposing licensing restrictions based upon the use of indigenous products. In Loretto Winery, Ltd. v. Gazzara, 601 F.Supp. 850 (S.D.NY 1985), *aff'd and modified as to remedy sub nom. Loretto Winery, Ltd. v. Duffy*, 761 F.2d 140 (2nd Cir. 1985), a New York federal court declared unconstitutional a New York liquor statute which provided for special licenses allowing grocery retailers to sell a low-alcohol wine made exclusively from New York grapes. The Court found this requirement discriminated against out-of-state wine producers in violation of the Commerce Clause because:

“the New York ABC Law in effect excludes for sale in retail grocery stores any 6% wine product not produced exclusively from New York grapes. Only those firms that sell wine products

from 100% New York grapes may reap the benefits of easier market access allowed by the new legislation. As a result, growers and packagers of foreign grapes are placed at a competitive disadvantage.”

601 F.Supp. at 859.

Undaunted by their defeat in Loretto, New York also enacted the legislation at issue in Granholm which required licensed farm wineries to manufacture wine exclusively from grapes or other fruits or agricultural products grown or produced in New York. This restriction met the same fate in Granholm as the prior restriction in Loretto.

Clearly, Kentucky has not dictated that small wineries and farm wineries use Kentucky grown/produced fruit and juices as a means of evenhandedly promoting a legitimate local concern with a merely incidental effect on interstate commerce. To the contrary, Kentucky law dictates this condition as a means of discriminating against out-of-state products solely because of their origin. Ky. Rev. Stat. §§ 243.032 and 244.165 should be declared unconstitutional because they are discriminatory by not allowing out-of-state wineries to compete on equal terms with Kentucky labeled wines. This clearly a protectionist measure warranting a *per se* rule of invalidity under the Commerce Clause. The companion statutes limiting the issuance of winery licenses to Kentucky wineries using Kentucky fruit, juices or honey, Ky. Rev. Stat. §§ 241.010(45), 243.155 and 243.156, are similarly invalid.

C. The Kentucky Statutes At Issue Are Not Necessary To Promote The Core Values of the Twenty-First Amendment.

Finally, Ky. Rev. Stat. §§ 243.032 and 244.165 cannot be saved under the Twenty-First Amendment because they are not necessary to promote its core values. These statutes do not seek to limit or eliminate the free flow of wine in Kentucky, they only make

sure that only Kentucky wine flows freely. This is an economic protectionist purposes. Although Kentucky may legitimately foster the growth of small domestic wineries in Kentucky as a means of promoting economic growth, it may not “throw out the baby with the bathwater” in the way it treats out-of-state wineries. The drafters of the United States Constitution included the Commerce Clause for a specific reason - - to prohibit states from using its laws as a means of creating a favorable economic climate for domestic goods while imposing an unfavorable economic climate for foreign goods. See Pennsylvania v. West Virginia, 262 U.S. 553, 43 S.Ct. 658, 67 L.Ed. 1117 (1923) and Philadelphia v. New Jersey, *supra*.

In light of Granholm, the Court should enter a judgment in favor of Plaintiffs finding that Ky. Rev. Stat. §§ 243.032 and 244.165 impermissibly discriminate against out-of-state manufacturers with respect to the manufacture, sale and delivery of wine in violation of the Commerce Clause. Accordingly, the Court’s judgment should permanently enjoin the State Defendants from enforcing these statutes to prohibit: (1) out-of-state wine manufacturers who comply with all other facets of Kentucky law from selling and shipping directly to Kentucky residents and retailers, and (2) Kentucky residents and retailers from purchasing and receiving shipment of wines from such out-of-state manufacturers.

CONCLUSION

Kentucky discriminates against out-of-state wineries. It prohibits them from selling wine directly to Kentucky consumers and retailers, while simultaneously granting this privilege to its domestic wineries upon preferential terms. As this scheme violates both the Commerce Clause and the holding in Granholm on its face, the parties’ respective pleadings evidence an absence any disputed material facts or any basis which negates

their right to a judgment as a matter of law. Accordingly Plaintiffs respectfully move the Court to enter an Order granting them a judgment on the pleadings, and permanently enjoining the State Defendants from enforcing Kentucky's regulatory scheme vis-a-vis out-of-state wineries.

Respectfully submitted,

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CERTIFICATE OF SERVICE

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