Case Nos. 03-1116 and 03-1120

IN THE

United States Supreme Court

GRANHOLM, et al. and MICHIGAN BEER & WINE WHOLESALERS ASS'N,

Petitioners,

v.

ELEANOR HEALD, *et al.*,

Respondents.

On Writ of Certiorari To The United States Court of Appeals for the Sixth Circuit

BRIEF FOR WINEAMERICA, COALITION FOR FREE TRADE, FAMILY WINEMAKERS OF CALIFORNIA, STATE VINTNERS ASSOCIATIONS AND GRAPE GROWING ASSOCIATIONS AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

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QUESTION PRESENTED

Does a state's regulatory scheme that permits in-state wineries directly to ship alcohol to consumers but restricts the ability of out-of-state wineries to do so violate the dormant Commerce Clause in light of Section Two of the Twenty-first Amendment?

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INTEREST OF THE *AMICI*

WineAmerica, Inc., the National Association of American Wineries ("WineAmerica"), appears on behalf of more than 800 member wineries from 48 states. WineAmerica represents the interests of American wineries and promotes the advancement of the wine industry.[1] WineAmerica opposes protectionist state laws, which prevent its members from selling their wine across the country.

The following *amici* are trade associations and other organizations representing the interests of wineries: Arizona Winegrowers Association, Association of Maryland Wineries, Coastal Wineries of Southeastern New England, Colorado Wine Industry Development Board, Connecticut Vineyard & Winery Association, Family Winemakers of California, Idaho Grape Growers and Wine Producers Commission, Illinois Grape Growers and Vintners Association, Indiana Winegrowers Guild, Iowa Wine Growers Association, Long Island (NY) Wine Council, Louisiana Winery Association, Massachusetts Winegrowers Association, Missouri Grape & Wine Program, Missouri Vintners Association, North Carolina Winegrowers Association, Oklahoma Grape Growers and Wine Makers Association, Oregon Winegrowers Association, Professional Winemakers Association of Arizona, Rocky Mountain (CO) Association of Vintners & Viticulturists, Seneca Lake (NY) Winery Association, Small Wineries of New York, South Dakota Specialty Producers Association, Vinifera Wine Growers Association, Virginia Wineries Association, Walla Walla Valley (WA) Wine Alliance, Washington Wine Institute, Winegrowers Association of Georgia, WineMichigan, Yadkin Valley (NC) Winegrowers Association.

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[1] In accord with this Court's Rule 37.6, *amici* state that no counsel for party authored this brief in whole or in part, and no person or entity other than *amici* and their counsel made a monetary contribution to the preparation or submission of this brief. Pursuant to Rule 37.3, *amici* state that Petitioners and Respondents granted consent to the filing of this brief.

The following *amici* are trade associations and other organizations representing the interests of grape growers: Allied Grape Growers; California Association of Winegrape Growers; California Farm Bureau Federation; Connecticut Farm Bureau; Connecticut Farm Winery Development Council; Florida Grape Growers Association; Indiana Farm Bureau Inc.; Maryland Grape Growers Association; New York Farm Bureau, Inc.; North Carolina Grape Council; Virginia Farm Bureau Federation; Washington Association of Wine Grape Growers; Winegrape Growers of America.

The Coalition for Free Trade ("CFT") is a non-profit organization dedicated to promoting the right to ship wine directly to consumers throughout the United States. CFT's Board of Trustees is comprised largely of wineries, and the resolution of this matter will affect these wineries' businesses. CFT has a vital interest in preserving the free flow of American wine in interstate commerce.

SUMMARY OF ARGUMENT

This Court has repeatedly acted to further the framers' original vision that the many states, while sovereign, should be united in a single national market, and has applied the dormant Commerce Clause to invalidate protectionist State laws discriminating against businesses in other states. Yet this vision of a more perfect Union remains unrealized for Americans who make and drink wine. Many states, including Michigan, prohibit wineries in other states from shipping their products directly to consumers; instead, they compel out-of-state wineries who wish to sell their wines to consumers to subject themselves to the whims of cartel-like distribution systems. Presenting wineries with daunting economic constraints, and distributors with little incentive to serve wineries' needs, these systems effectively prevent consumers in these states from buying most of the wine labels in this country. By contrast, these states typically allow wineries within their borders to ship directly to consumers. In Michigan, the practical effects of this scheme limit access to the Michigan wine market to a small number of the largest wine producers and prevent Michigan residents from buying most of the different wines made in this country unless they visit the wineries where those wines are made.

The State of Michigan and other litigants argue that Section Two of the Twenty-first Amendment trumps the dormant Commerce Clause and gives Michigan and other states free rein to erect discriminatory barriers to out-of-state wineries. But this Court has ruled that the Twenty-first Amendment does not give States *carte blanche* to adopt protectionist measures. *See Bacchus Imports v. Dias*, 468 U.S. 263 (1984). Michigan's discriminatory barriers are clearly protectionist in nature and deprive most out-of-state wineries of their ability to sell wines to Michigan residents. Such discrimination cannot be justified by the states' legitimate interests under the Twenty-first Amendment.

In accord with the vision of the framers, this Court should affirm the Sixth Circuit and hold that Michigan's restrictions on direct shipping of wine to Michigan consumers by out-of-state wineries is unconstitutional.

ARGUMENT

> "The discovery of a wine is of greater moment than the discovery of a constellation. The universe is too full of stars."
>
> —*Benjamin Franklin*

I. AMERICA'S SMALL WINERIES MEET CONSUMERS' INCREASING PREFERENCES FOR A WIDE VARIETY OF DIFFERENT WINES.

A. Small Wineries Confront A Host Of Challenges In Bringing Wines To Market.

For multi-generational grape growers, family farmers, optimistic entrepreneurs, and even the occasional dilettante, the business of running a winery is a labor of love for the rocky soil, the oaken barrel, and the tinted bottle. Making wine is not for the faint of heart, nor the soft of hand—it is a risky, backbreaking business that requires years of detailed planning and deferred gratification. On top of these physical and mental challenges, winemakers discover when it comes time to sell their produce that they must also overcome the obstacles of discriminatory state laws which exclude them from the market in many states.

The first challenge that would-be vintners face is monetary. On average, starting a winery requires two million dollars. Nor are there any immediate returns to cover loan payments, fund continuing expenses, hire labor, or roll out advertising. Long after the first harvest, their mixture of crushed grapes, sugar and yeast must ferment and age in barrels for up to several years. Accordingly, winemakers find it difficult to finance their businesses, where the first drop of profit will not arrive for years after the first bank payments are due.

The second challenge is to cultivate the grapes. Like any farmer, the winemaker faces a barrage of hazards: from animals and insects—such as gophers, glassy-winged sharpshooters (a fantastically named pest that can decimate entire vineyards), deer, and wild turkeys—to frost, drought, and other calamities. The grape farmer must also don the hat of a geologist to assess the soil to decide when and how to plant; adopt the mind of a botanist to choose when to sow and when to reap; and assume the clipboard of a manager to hire and supervise labor and negotiate with suppliers. Between August and October, the grapes must be harvested during the cool night in order to keep freshly picked grapes from fermenting prematurely before they can be crushed.

A third set of challenges comes with turning the grapes into wine. The winemaker again adopts the precision of a chemist, for the variables in fermenting grapes are legion, and any one of them could make the difference between an award-winning wine and plonk or *vin ordinaire*. Time, temperature, sugar content, the strain of yeast used, the composition of wood barrels—all of these factors are key to the end result, which the winemaker will not know for years to come. Small family wineries hoard their own trade secrets and traditional practices, yet are engines of innovation and paragons of quality.

After the grapes have fermented, the wine has aged and perfected, and finally has been bottled, a wine maker confronts yet another challenge—not animal or vegetable, but legal. Michigan, like other states with similar laws, forbids small wineries from shipping their wines directly to willing Michigan residents unless the winery is located within the state. Wineries on the wrong side of Michigan's borders instead must find a distributor willing and ready to sell their wines in the state—a task so demanding that only a handful of wineries succeed at it.

B. The Number Of Small Wineries In America Has Grown Tremendously In Recent Years, Providing Consumers With A Great And Growing Variety Of Wines.

Despite the hurdles involved in starting a new winery, the wine industry in the United States has changed dramatically in recent years, with explosive growth in the numbers of small wineries across the country. Since 1980, the number of wineries has quadrupled, from 919 to 3,726 in 2004.[2] Most of this growth has been outside Califor-

[2] Except as noted, the figures in this paragraph and the next are derived from data received by WineAmerica from the Treasury Department, which issues permits required to operate wineries.

nia—there are now wineries in all 50 states, and more than half of the nation's wineries are in states other than California. For example, the number of wineries in Texas has jumped from 6 to 91 since 1980.[3] Texas is not alone: in that time, the number of wineries has soared all over the country, from Michigan (21 wineries in 1980 and 90 in 2004) and New York (from 69 to 203) to Washington (from 22 to 323), Oregon (from 36 to 228) and Pennsylvania (from 29 to 99). This new diversity of wineries offers connoisseurs and novices alike unprecedented opportunities to discover and appreciate the artistic skills of vintners from across the country.

The vast majority of wineries are small, farm-based, family-run enterprises. A typical winery occupies 20 acres and produces 4,000 cases of wine annually, either from its own fruit or fruit grown by local farmers. More than 70% of the nation's wineries produce fewer than 10,000 cases yearly, and more than 80% produce fewer than 25,000 cases—a quantity which can be sold entirely through on-site tasting rooms and by direct shipment to consumers via the Internet and other means.[4] Indeed, most wines are "hand sold" through direct contact between a person familiar with the wine (often a winery employee) and the buyer. Except for the largest producers, advertising is too expensive for wine-

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[3] In 1981, 6 Texas wineries produced 24,000 gallons of wine. Twenty years later, 46 Texas wineries produced 1,445,000 gallons of wine. *See Texas Wine and Wine Grape Industry Fact Sheet*, Texas Wine Marketing Research Institute, Sept. 2002, *available at* http://www.hs.ttu.edu/texaswine/PT_4071.pdf.

[4] Conversely, the data reflect that most of the wine consumed in this country is made by a relative handful of large producers. According to Treasury Department data, the 50 largest wineries are responsible for 87% of the wine sold, by volume. As discussed below, these wineries have little difficulty obtaining distributors.

makers. Instead, consumers most often find their wines through one-on-one contact—perhaps through the recommendation of a waiter, a wine-store proprietor, or a friend. Or customers may seek a specific wine because they have read about the wine or visited the winery.

Because personal connections are so important in the sale of wine, tourism is essential for smaller wineries, almost all of which have on-site tasting rooms and draw business from visitors. Through tasting rooms, consumers are exposed to the products of "craft" wineries. Guests sign registers and provide their addresses to receive subsequent mailings. Customers who have discovered and developed relationships with particular wineries often want to continue purchasing those wines, even if they live in or later move to another state. This can be difficult: the shelf space available in retail outlets is necessarily limited, and distributors favor those labels they can sell in large volumes. However, the Internet has made it easier for wine drinkers to obtain less common wines.[5]

Small wineries are important to the rural economy. A typical new family winery will provide regular employment for five to ten people, and will have annual sales of $200,000 to $1.5 million. Wineries also attract tourists, with the corresponding benefits to the areas where they are located.[6] In areas where wineries flourish, restaurants, bed-and-breakfasts, inns, retail boutiques and other farm and craft businesses also succeed. Employment associated

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[5] *See Possible Anticompetitive Barriers to E-Commerce: Wine*, A Report from the Staff of the Federal Trade Commission, July 2003, at 1 ("FTC Report"), *available at* http://www.ftc.gov/os/2003/07/winereport2.pdf.

[6] For every $3 a winery receives in gross revenue from all sources, tourists will add roughly $1 to the local economy. Bill Nelson & Cary Greene, *Components of a Model Winery Law*, Vineyard and Winery Management (Vol. 29, No. 3, May/June 2003).

with small wineries has transformed economically depressed rural communities, such as the Finger Lakes and Hudson Valley districts in New York, southern Oregon, and eastern Washington. To spur this sort of economic growth, Indiana—like other states—recently launched a "wine trail," a network of wineries within a short drive of each other:

> Organizers hope the trail lures more travelers to their stores, where tasting rooms can turn visitors on to unfamiliar wines.
>
> Jim Butler, owner of Butler Winery in Bloomington, said promoting lesser-known grapes can be a challenge for small wineries, many of which lack the money for extensive advertising. But wine trail organizers think they can pool their resources to promote not only the wine they make, but the industry itself.
>
> "People have an interest in trying new things, in new tastes," Butler said.[7]

As Mr. Butler suggested, the spread of wine trails reflects that American consumers have been discovering new wines. The growth in small wineries reflects the maturation of the wine industry and consumers' increasingly sophisticated tastes. While there are many wines to choose from at any price, the diversity of products is greatest at the high end of the market, in which small wineries are most competitive. Premium wine production is characterized by many boutique wineries crafting small lots of wines. By contrast, "value" market segments are dominat-

[7] Jenny Montgomery, *Move over Napa,* Associated Press, July 17, 2004, *at* http://www.msnbc.msn.com/id/5158783.

ed by the larger producers.[8] As wine drinkers grow more sophisticated, they tend to turn to small labels: American wine drinkers increasingly prefer individualistic, handcrafted wines in lieu of commodity-type wines. One measure of consumers' increasing sophistication is the popularity of wine magazines such as *The Wine Spectator*, which reviews more than 10,000 wines each year. Wine tasting and reviewing involves many factors, objective and subjective, and wine reviews often read like an art critic's review of a symphonic performance or a painter's latest work.

Today there are more than 25,000 domestic wine labels, most of which are produced by small wineries. There is heightened interest in reserve wines (made from particular vineyard blocks where the soil produces better grapes), wines based on variations of winemaking technique (unfiltered, unfined, or carbonic maceration, for example), various blends (such as "Meritage"), and fruit wines. A typical winery may make ten to twenty different offerings from each vintage year. Vintners compete with one another by crafting wines that express the character and nature of the particular wine variety and style, as well as the vintner's own interpretation of the varietal ideal. Many consumers have strong opinions about every step in the production of a wine, from the region and location where the fruit is grown, to the variety of grapes used, to the planting of the vine and the harvest of the fruit, to the means of aging and

[8] "Over two-thirds of the large wineries concentrate their business in the under $8 per bottle wine segment, while the small and mid-sized wineries are focused on the fastest-growing wines, over $8 per bottle." *Small wineries lead state's wine growth*, San Francisco Business Times, July 19, 2004, *available at* http://sanfrancisco.bizjournals.com/sanfrancisco/stories/2004/07/19/daily11.html. "Small and mid-size wineries . . . dominate[ ] high-end sales, selling 66 percent of all wine over $15 with a 71 percent revenue share." *Id*.

bottling of the wine. All of these factors affect the ultimate expression of the vintner's efforts, which is why wines made from the same variety of grape (say, a Cabernet Sauvignon) produced by a winery in one state will differ from a wine made from a similar line of grapes by a different winery in another state.

In the wine world, the word "*terroir*," a French term without an adequate English counterpart, has a special power, referring to the aromas and tastes specific to wines of a particular area. *Terroir* depends on the characteristics of a particular vineyard—the interaction of climate, sun exposure, grape variety, water, soil, and local winemaking techniques. A winery producing 10,000 cases annually usually requires fewer than 50 vineyard acres to grow its grapes. Somewhat larger wineries similarly craft wines from the grapes of a single vineyard. Because they attempt to capture something unique about a place, single-vineyard wines can only be made in limited quantities.

A fine wine is a blend of art and science, and *terroir* is only one aspect of what makes wines unique:

> The winemaker, and that includes the winegrower, can maximize or minimize the fruits of nature by his or her skill . . . . [N]eighboring winemakers can make totally different quality wine using virtually the same raw product and the same technology. Chemical analysis of the wines in question may be virtually indistinguishable, yet one wine will have all the definition, vitality, and expression of character that the other lacks. Why does this occur? No doubt there are valid reasons that science may one day establish, but in our current state of ignorance I can only say that it is always the winemakers with passion who are able to produce the finer, more characterful

> wines . . . . Some winemakers have even been known to sleep by their vats during a particularly difficult fermentation, so that they are on hand to make any adjustments immediately if anything goes wrong. From the grower who never hesitates to prune the vine for low yields, yet always agonizes over the optimum time to harvest, to the winemaker who literally nurses the wines through each and every stage of fermentation and maturation, who bottles at precisely the right time and at exactly the correct temperature, the human element is most seriously the joker in the pack when it comes to factors affecting the taste and quality of the wines produced.[9]

Small wineries possess the artistic creativity and the innovative spirit—as well as the economic flexibility—to satisfy this increasing consumer interest in wine variety.

The experience of Oregon reflects these changes in the industry and the tastes of American consumers. Oregon's climate had been seen as poor for grapes, but Oregon's wine industry has blossomed in the last three decades. In 1970, there were fewer than 100 acres of vineyards and only one winery in Oregon; 30 years later, there were 10,500 acres of vinifera vineyards, and now there are 228 wineries.[10] Now, "Oregon has a worldwide reputation for its excellent wines, and its wineries have become a tourist destination, bringing visitors from all over the world to appreciate the beauty and quality of Oregon wine coun-

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9 Tom Stevenson, *The New Sotheby's Wine Encyclopedia* at 24 (DK Publishing Inc. 1997).

10 Edward W. Hellman, *Oregon Viticulture* at 1 (Edward W. Hellman ed., Oregon State University Press 2003). Another individual familiar with the Oregon wine industry recalls half a dozen wineries in those days. The current figure is based on Treasury Department data.

try."[11] Paradoxically, Oregon's climate is "marginal" for growing vinifera grape varieties, but this produces grapes with superior flavor. "It is well established that winegrape varieties, when grown with just enough heat to ripen the fruit, retain their best flavors and varietal characteristics."[12]

Among wine connoisseurs, Oregon is particularly known for Pinot noir. "The wine world at large sat up and took notice in 1988, when Robert Drouhin, the prominent Burgundian negociant, started vineyards and a winery in the Red Hills of Dundee, declaring there were only two places in the world he would grow Pinot noir—Burgundy and Oregon."[13] These days, many people visit Oregon wineries and buy locally made wines, like top-quality Pinot noirs. Oregon wineries depend on direct sales of their wines through both their tasting rooms and by direct shipment. But, as we next discuss, these tourists cannot buy many Oregon wines once they return home.

II. MANY STATES, LIKE MICHIGAN, DISCRIMINATE AGAINST OUT-OF-STATE WINERIES BY PROHIBITING DIRECT SHIPMENTS TO THEIR RESIDENTS.

A few wineries are large enough that they have contracts with distributors who sell their wines in other states, and those wines may be found in stores and restaurants across the country. But the typical winery does not offer enough

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[11] *Id*. at 1.

[12] *Id*. at 72.

[13] *Id*. at 2. Drouhin's arrival followed on the heels of a 1985 tasting at the International Wine Center in New York City at which an "august group of wine tasters was not able to distinguish Oregon Pinot noir from French Burgundy. And, not only was the number-one ranked wine from Oregon, all five of the top ranked wines were from Oregon." *See id.* at 3.

business to interest distributors and must sell its wines directly to consumers—or not at all. Many states bar out-of-state wineries from shipping directly to their residents, instead requiring them to sell to a distributor. As a practical matter, residents of such states cannot purchase most of the wines made in this country unless they visit the wineries.

A. Many States Discriminate Against Out-Of-State Producers By Requiring Those Producers—But Not In-State Producers—To Sell Through The "Three Tier" System.

About half of the states in the Union ban the direct shipment of wine from out-of-state. Most state bans have their roots in legislation enacted soon after the Twenty-first Amendment ended Prohibition. At that time, state legislatures widely adopted a mandatory "three-tier" system of distribution, requiring producers to sell only through in-state licensed wholesalers. In turn, wholesalers supply retailers. In several states, direct shipment is a felony; in another twenty states, it is a misdemeanor.

Most states, including Michigan, permit their own wineries to ship directly to consumers within the state.[14] While state laws previously constrained the development of small wineries, states increasingly have exempted domestic wineries from the mandatory three-tier system, allowing them to sell wine either at tasting rooms, by telephone and the Internet to retail consumers, at wholesale to retailers and restaurants within their states, or to some combination thereof, and to ship wine directly to their in-state customers.

[14] These include California, Washington, Oregon, New York, Ohio, Pennsylvania, Virginia, Texas, Michigan, Missouri, Illinois, Colorado, North Carolina and New Mexico, which together are home to 85% of the country's wineries.

Given the economic benefits associated with the growth of small wineries, it is easy to understand why state governments would want to promote the development of local rural wineries. Indeed, some of the rural areas which have benefited most from a burgeoning wine industry, like the Finger Lakes region of New York and the Leelanau Peninsula of Northern Michigan, are in states with protectionist regimes. Even in New York and Michigan, though, small wineries would benefit from reciprocal access to consumers in other states.

In states that do not exempt out-of-state direct shipments from the three-tier system, thousands of wineries across the country effectively are shut out of the market. Current circumstances fall far short of the national market envisioned by the framers. Under the influence of powerful wholesalers, many of the states with the greatest consumer demand remain essentially closed to direct shipments from out-of-state, including Florida (the second-largest market), New York (#3), New Jersey (#5), Massachusetts (#6), Michigan (#11) and Ohio (#12).[15] Wholesalers focus their marketing efforts on nationally branded products promising the largest profits and the easiest sales, which usually means representing the 50 or 100 largest wineries. As a result, very few of the 25,000 domestic wine labels are available to consumers in these states.

Exploiting states' authority to regulate alcohol, wholesalers with inordinate political power have used their clout to collect economic rents. Some state laws set excessively high barriers to wholesaler entry or provide franchise protection to distributors. This diminishes competition. In Florida, for example, to obtain and keep a wholesale license, a business must rent or own a warehouse, own outright an

15 *Adams Wine Handbook 2004*.

inventory with a minimum cost of $100,000, and sell to at least 25% of the licensed vendors in the county.[16] In Georgia, the state requires that wholesalers be given exclusive authority to wholesale a brand, which can only be changed or terminated by a showing of cause, and with the approval of the state liquor commission. In Massachusetts, specific vehicles—instead of businesses—must be licensed to deliver shipments of alcohol, frustrating delivery by large companies such as UPS and FedEx.[17]

In recent years, wholesalers have worked vigorously to block direct shipping. Wholesalers and local producers have political clout with state legislators and regulators; of course, wineries located in other states do not.

B. Without Direct Shipping, Out-Of-State Wineries And Consumers Cannot Do Business With Each Other.

A winery seeking access to consumers in a state barring direct shipment has only one real option—to obtain a wholesaler to distribute its products.[18] Most cannot do so,

[16] In 1997, Florida made it a felony to ship wine directly to Florida consumers and restricted the issuance of wholesaler licenses. In a letter recommending veto of the legislation, Florida Attorney General Robert A. Butterworth characterized the measure as legislation allowing Florida's alcoholic beverage industry "to tighten its vise grip on the distribution of alcoholic beverages. . . . [A bill which] is the perfect tool for the vested interests who seek additional control over the marketplace, at the expense of competition and consumer choice. The legislation is anticompetitive, it is hostile to Florida consumers, and [it is] self-protective." May 19, 1997 letter from A.G. Robert A. Butterworth to Florida Governor Lawton Chiles.

[17] *See* FTC Report at 15.

[18] Ohio suggests that producers also can establish retail outlets, but for most wineries this would be prohibitively expensive. Brief of *amici* Ohio and other States in Support of Petitioners at 20.

and even those that do learn that the three-tier system serves them—and consumers—poorly.

1. Most small wineries cannot get distributors to carry their wines.

Small wineries are unlikely to find wholesalers willing to distribute their wines. Most fundamentally, this is because small wineries cannot offer distributors sales volume comparable to that of the largest winemakers. Even when they are willing to sacrifice a substantial proportion of their profit margin for the sake of getting their wines distributed to consumers, most American wineries rarely succeed in obtaining distributors.[19] By denying shelf space to small products that impose higher handling costs, the wholesaler creates more shelf space or bottle "faces" for products which turn over more quickly.

Given the considerable consolidation which has occurred among wholesalers and distributors in recent years, small wineries also face an increasingly narrow gauntlet of wholesalers. As the number of small wineries has exploded, the number of wholesalers has dwindled. For most other industries, the distribution system can be illustrated by an inverted funnel with a small number of suppliers at the narrow end, a greater number of distributors at the point where the funnel begins to open, and a still larger number of consumers at the base.[20] In contrast, wine's distribution system is shaped like an hour-glass, with many producers,

[19] Wholesalers recognize that this fact is inconvenient as a political matter, and have made gestures at addressing the problem. At the recent convention of the Wines & Spirits Wholesalers of America, a special booth was provided to assist small wineries seeking wholesalers. Though several members of WineAmerica attempted to take advantage of this assistance, not one was successful.

[20] FTC Report at 4.

many consumers, and only a few distributors between them. Wholesalers tend to focus almost exclusively on the well-known, high-volume wines to the exclusion of the smaller, lesser-known brands.[21] Concentration among distributors has not alleviated this problem and may exacerbate it.

And that is only part of the story. Wholesalers rarely generate retail demand for the products of small wineries. That responsibility also falls to the winery and also can be prohibitively expensive.

Having no access to wholesalers, wineries cannot meet the demand for their product from interested consumers who reside in states barring direct shipment. Popular wineries without national distribution are located across the nation in states as diverse as North Carolina, Georgia, Missouri, Texas, Washington, Virginia, Oregon, and New York. These wineries are major tourist attractions that individually welcome from 50,000 to 1,000,000 visitors per year from around the nation. Yet because of laws barring the direct shipment of wine in many states, including Michigan, these popular wineries cannot distribute their products in more than a handful of states.

2. If a small winery does find a wholesaler, its difficulties are not over.

Even for the rare small winery that succeeds in gaining the representation of a wholesaler, the hard fact is that the winery is likely to realize little or no profit from out-of-state sales. Wholesalers ordinarily do little in exchange for the high costs they charge small wineries. The cost of using a wholesaler is overwhelming from a small winery's perspective and saps its entire profit, or more. Yet the small

[21] *Id*. at 45-59.

winery provides negligible income to the wholesaler, which has little incentive to market products which contribute only a small fraction of its total revenue.

Wholesalers are not motivated to aggressively market the products of small wineries, from whom they realize comparatively minimal gross profit. Moreover, because most wine is "hand sold," and because a wholesaler's sales personnel never comes into direct contact with the ultimate customer, the influence of wholesalers on the marketing of the sorts of wines produced by small wineries is dramatically limited. Not surprisingly, wineries that succeed in obtaining wholesalers often complain that the wholesaler fails to maintain contact with restaurants or wine shops after making an initial sales call. Some wineries learn that restaurants have stopped selling their wines because the wholesaler has told the restaurant the wine is unavailable even though the wholesaler actually has the wine in stock. As a result, wineries with wholesalers often find they must incur additional marketing expenses, further draining their narrow margins. For example, wineries must bear the costs of expensive marketing trips to build retailer interest. In *Swedenburg*, the costs to a winery of supporting a wholesaler's operation—exclusive of the wholesaler and retailer's mark-ups—were estimated at approximately $4.00/bottle if only 100 cases are sold, and $8.00/bottle if only 50 cases are sold.[22] Small wineries find that, as a practical matter, they must incur these costs for the wholesalers to sell their wines.

Of course the margins collected by wholesalers and retailers also take money from the wineries, preventing small wineries from recouping their investment. When wine is

[22] Affidavit of Simon Siegl in Support of Swedenburg Plaintiffs' Motion for Summary Judgment at ¶¶ 15-17, A. 3537-3538.

sold through the three-tier system, the winery typically nets less than half of the retail price of a bottle of wine. Almost half of the margin is retained by the retailers and wholesalers. For a bottle of wine selling for $20.00 at retail, the retailer usually will collect about $6.50 and the wholesaler usually will collect about $3.00. After other selling expenses, a small winery will net less than $10.00 per bottle, from which the marketing costs described above must also be deducted. The ultimate net, from $2.00 to $6.00, is almost always less than the winery's cost of production. In contrast, where direct shipment is allowed, a winery selling $20.00 bottles of wine will receive a net of about $19.00 per bottle.[23]

Barred from directly shipping to states governed by the three-tier system, and effectively prevented from selling their wines through wholesalers, most American wineries are excluded from the market in states mandating the three-tier system. At the same time, many such states permit domestic producers to ship wine directly to their residents. While these protectionist regimes undoubtedly serve in-state distributors and producers, they stand in the way of the national market envisioned by the Constitution's drafters.

III. THE DISCRIMINATORY STATE LAWS AT ISSUE HERE VIOLATE THE FUNDAMENTAL PRINCIPLES ANIMATING THE COMMERCE CLAUSE.

For almost two hundred years, this Court has applied the Commerce Clause to promote the development of a national market. As Justice Johnson observed: "If there was any one object riding over every other in the adoption of the constitution, it was to keep the commercial intercourse among the States free from all invidious and partial

[23] *See id*. Typically, wineries sell at the full retail price and collect an additional charge for shipping.

restraints." *Gibbons v. Ogden*, 22 U.S. 1, 290 (1824) (concurring opinion). The founders understood that the grant of power to Congress in the Commerce Clause "grew out of the abuse of the power by the importing States in taxing the non-importing, and was intended as a negative and preventive provision against injustice among the States themselves."[24] As Justice Jackson famously wrote:

> 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.

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

To these ends, this Court has applied the dormant Commerce Clause to "prohibit[ ] economic protectionism—that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors." *New Energy Co. v. Limbach*, 486 U.S. 269, 273 (1988). "Thus, where simple economic protectionism is effected by state legislation, a virtually *per se* rule of invalidity has been erected. The clearest example of such legislation is a law that overtly blocks the flow of interstate commerce at a State's borders." *Philadelphia v. New Jersey*, 437 U.S.

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[24] *See* James Madison, 4 *Letters and Other Writings of James Madison* 14-15 (J.B. Lippincott & Co. 1865) *available at* http://press-pubs.uchicago.edu/founders/documents/a1_8_3_commerces19.html.

617, 624 (1978) (citations omitted). "The Court has consistently found parochial legislation of this kind to be constitutionally invalid . . . ." *Id.* at 627 (describing cases in which "a presumably legitimate goal was sought to be achieved by the illegitimate means of isolating the State from the national economy").

If the founders were concerned about isolation and economic warfare that might take place in a nation without a Commerce Clause, the current patchwork of state wine regulations proves that their fears were prescient. Because the framers' vision of a seamless economic union is not a reality when it comes to interstate shipment of wine, states regularly engage in *de facto* reprisals against other states' protectionist wine laws. Just as Michigan has closed its market to direct shipping from Iowa, so Iowa—through its reciprocity laws—has closed its doors to Michigan wine. But for the Commerce Clause, one might expect all state trade laws to take the form of tit-for-tat reprisals and restrictions.

In applying the dormant Commerce Clause to void protectionist measures, this Court has looked past pretextual defenses. For example, the Court affirmed the entry of a permanent injunction barring the State of Arizona from requiring a cantaloupe grower to build new packing sheds in Arizona instead of shipping the fruit across the California border for packing, concluding that the threat to the reputation of other Arizona cantaloupe growers was incommensurate with the burdens of requiring the grower to go into the packing business. *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 145-46 (1970). As *Pike v. Bruce Church* reflects, this "Court has viewed with particular suspicion state statutes requiring business operations to be performed in the home State that could more efficiently be performed elsewhere." *Id.* at 145.

There is no real dispute that the discriminatory measures adopted by Michigan and other states cannot survive a traditional Commerce Clause analysis. These measures constitute plain economic protectionism, burdening out-of-state wine producers and benefiting in-state distributors and producers.

IV. THE TWENTY-FIRST AMENDMENT DOES NOT JUSTIFY DISCRIMINATION AGAINST OUT-OF-STATE WINERIES.

A. Under This Court's Decision In *Bacchus*, Discrimination Must Implicate The Principles Underlying The Twenty-first Amendment.

Michigan, like other states that discriminate against out-of-state producers, tacitly acknowledges that its regulatory regime conflicts with two centuries of Commerce Clause jurisprudence, but argues nonetheless that the Twenty-first Amendment frees the states of traditional dormant Commerce Clause restraints.

To the contrary, this Court has rejected Michigan's construction of the Twenty-first Amendment, ruling instead that it must be considered in conjunction with other constitutional provisions. "Both the Twenty-first Amendment and the Commerce Clause are parts of the same Constitution. Like other provisions of the Constitution, each must be considered in the light of the other, and in the context of the issues and interests at stake in any concrete case." *Hostetter v. Idlewild Bon Voyage Liquor Corp.*, 377 U.S. 324, 332 (1964). Thus, in *Bacchus Imports v. Dias*, this Court explained that "one thing is certain: The central purpose of the [Twenty-first Amendment] was not to empower States to favor local liquor industries by erecting barriers to competition." 468 U.S. at 276. Rather, under

Bacchus, the question is "whether the principles underlying the Twenty-first Amendment are sufficiently implicated . . . to outweigh the Commerce Clause principles that would otherwise be offended." *Id.* at 275.

B. The Experience Of States That Permit Interstate Direct Shipping Demonstrates That Restrictive Shipment Laws Are Not Closely Related To The Purposes Of The Twenty-first Amendment.

Michigan and other states argue that the Twenty-first Amendment was intended to ensure that the states could collect tax revenue, and that states have a legitimate interest in preventing underage drinking.[25] But these goals are not furthered by the discrimination at issue here, as demonstrated by the experience of the states that do not impose discriminatory burdens on non-resident winemakers.

1. Many states permit direct shipping from other states.

About half of the states, with 42% of the nation's population, allow some form of interstate direct shipment of wine to their residents.[26] Thirteen states permit the shipment of wine from other states directly to in-state consumers so long as the state of origin also permits direct shipment from the receiving state. In those states,[27] a consumer who is neither a minor nor visibly intoxicated may receive, typically, two cases of wine per month, for person-

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[25] Brief for the Petitioners at 19-20; Brief of *amici* Ohio and other States in Support of Petitioners at 22-24.

[26] Forty states, with 87% of the population, allow consumers to receive wine shipped from within the state.

[27] California, Colorado, Hawaii, Idaho, Illinois, Iowa, Minnesota, Missouri, New Mexico, Oregon, Washington, West Virginia and Wisconsin.

al use and not for resale. Ten other states require that out-of-state shippers obtain permits before shipping directly to consumers.[28] The so-called "shipper permit" legislation in effect in these states requires all shippers to be licensed by the state in which the consumer receives the wine. The state may collect a fee for the permit and may require the shipper to report regularly and pay taxes.

2. States permitting direct shipping do not have problems collecting taxes.

States which permit direct shipping have found means of satisfying other tax and regulatory goals. As the FTC Staff explained: "Several states that allow interstate direct shipping also collect taxes from those shipments. By requiring out-of-state suppliers to obtain permits, states such as New Hampshire have sought to achieve voluntary compliance with their tax laws. Most of these states report few, if any, problems with tax collection."[29] Indeed, WineAmerica supported new direct shipment legislation passed in Virginia, North Carolina and South Carolina requiring out-of-state wineries to obtain a permit and to collect and remit the appropriate sales and use and excise taxes for all wine shipped into those states. Wineries which obtain a permit agree, *inter alia*, to submit to the state's jurisdiction and to collect and remit taxes. Other states with reciprocity agreements forego taxing interstate direct shipments altogether."[30]

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[28] Georgia, Louisiana, Nebraska, Nevada, New Hampshire, North Carolina, North Dakota, South Carolina, Texas and Virginia.

[29] FTC Report at 4.

[30] *Id*. at 4.

Winemakers respect state concerns that out-of-state shippers will operate beyond the reach of state laws, and are willing to submit themselves to the regulations of the states to which they ship. Wineries have authored and subscribed to their own code of self-governance, the Wine Industry Code for Direct Shipping (the "Code"). Among other things, the Code (1) allows direct shipping only to locations where such shipping is legal and to persons who may legally consume wine; (2) requires all shipments to be conspicuously labeled so that carriers can deny delivery to unauthorized persons, such as minors; (3) provides that wineries generate reports to the authorities of the receiving state including their total shipping statistics and tax information; (4) mandates that wineries train their employees to appreciate the responsibilities of direct shipping. In addition, the wine industry has collaborated with the National Conference of State Legislators to create a Model Direct Shipping Bill ("MDSB"). The MDSB contains many of the Code's provisions. It also mandates the licensure of out-of-state wineries under the receiving state's laws, thereby establishing a zone of jurisdiction over participating wineries, and sets limitations on the quantity of wine to be sent to any one person. As instruments of self-regulation and cooperation with authorities, the Code and the MDSB demonstrate wineries' willingness to be regulated.

In any event, if a state were to decline to collect excise taxes through a permitting system, the foregone revenues would be minimal. Wine is a bulky, heavy product with high shipping costs. Direct shipment offers a significant price advantage only for fairly expensive wines (i.e., $20 per bottle and up), which constitute a small share of the overall market in table wine.[31] The volume of total wine

[31] FTC Report at 24-25.

sales dwarf direct shipments, given that so many nationally branded wines are readily available at lower cost and with greater convenience from a neighborhood store. In New Hampshire's experience, direct shipment has amounted to about one-third of one percent of the total market for table wine.[32] Even if the volume were half again as large, lost excise taxes in Michigan would be about $37,000 a year, and lost excise taxes in New York would be about $42,000.[33] Likewise, in comparison to the magnitude of other lost sales- and use-tax revenue, the portion attributable to the direct shipment of wine would be miniscule.[34]

In those states which have adopted liberal direct-shipping regimes, the wine industries have prospered, in part

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[32] New Hampshire has had a permit direct shipment program for over three years, currently with some 312 permittees. Interstate direct shipments into New Hampshire for the fiscal year ending in June 2004 approximated only 0.32% of table wine sales.

[33] In Michigan, total table wine sales in 2003 were reported to be about 14.5 million gallons. *Adams Wine Handbook 2004.* The Michigan excise tax on wine is $0.51 per gallon (10.2¢ per bottle or $1.21 per case). If 0.5% of total table-wine sales were directly shipped to consumers without the collection of any excise taxes, the lost revenue would approximate $37,050 per year. A similar analysis for New York shows a potential revenue loss from 0.5% of 44 million gallons at $0.19 per gallon approximating $41,800 dollars per year.

[34] Based on conservative assumptions (i.e., an estimate that direct sales would be 0.5% of total table wine sales, an average price of $20/bottle, and no collections through a permit system or use tax payments by state residents), lost sales and use taxes would amount to $581,000 yearly in Michigan and $1.4 million yearly in New York. To lend perspective, revenue losses in New York from all remote sales total about $1.35 billion yearly, and the corresponding figure in Michigan is about $600 million. Donald Bruce & William Fox, *State and Local Sales Tax Revenue Losses from E-Commerce: Updated Estimates*, Center for Business and Economic Research, Sept. 2001, *available at* http://cber.bus.utk.edu/ecomm/ecom0901.pdf.

because of the enhanced access to consumers in states with like regimes. This has been the experience of Oregon, which adopted its new regime in 1989. In turn, these economic benefits return more moneys to the state from other taxes and sources of revenue.

3. Discrimination against direct shipment from out-of-state wineries does not promote moderation or curb underage drinking.

Putative state interests in promoting moderation or curbing underage drinking cannot justify the erection of protectionist barriers against out-of-state producers. Discriminatory provisions like Michigan's have nothing to do with discouraging the consumption of wine by the general public or minors—at best, such provisions merely prompt consumers to purchase wines made in or shipped within Michigan.

Moreover, the contention that permitting direct shipment will encourage underage drinking is baseless. There is no credible evidence that the availability of direct shipment of wine poses a meaningful risk to minors seeking to obtain alcohol. Rather, the significant sources of alcohol to underage drinkers tend to be peers, adults, and commercial outlets. A.C. Wagenaar & T.L. Toomey, et al., *Sources of Alcohol for Underage Drinkers*, Journal of Studies on Alcohol, 57(3) 325-333 (1996). The report by the FTC staff found that "[t]he states that permit interstate direct shipping generally report few or no problems with shipments to minors."[35] Such states have found various ways to avoid such problems. "Some states have applied the same types of safeguards to online sales that already apply to bricks-and-mortar retailers, such as requirements that package delivery companies obtain an adult signature at the time of delivery.

[35] FTC Report at 4.

Some states also have developed penalty and enforcement systems to provide incentives for both out-of-state suppliers and package delivery companies to comply with the law."[36]

C. Consumers Benefit When Direct Shipping Is Permitted.

Wine consumers understand the benefits to them of direct shipping, and are concerned with restrictions on their ordinary rights to engage in interstate commerce. For example, Free the Grapes is a national grassroots coalition composed of wineries and over 300,000 consumer members.[37] This growing army of angry consumers has organized to fight the discrimination that prevents them from benefiting fully from the promises of a national marketplace. These citizens of Michigan, Ohio, Florida—indeed, all fifty states—are ready and willing to engage in otherwise legal and encouraged commercial transactions with the family winemaker.

The FTC staff confirmed what these consumers know, concluding "[a]fter extensive review, . . . that states . . . significantly enhance consumer welfare by allowing the direct shipment of wine to consumers."[38] The benefits to consumers include better selection of wine and cheaper prices. The FTC determined that direct shipment made wines available to consumers who otherwise would have virtually no access to them. "Consumers can purchase many wines online that are not available in nearby bricks-and-mortar stores."[39] A survey the FTC conducted in

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[36] FTC Report at 4. *See generally id.* at 26-38 & App. B.

[37] *See* Free the Grapes! *at* http://www.freethegrapes.org.

[38] FTC Report at 3.

[39] FTC Report at 3.

McLean, Virginia, determined that 15% of a sample of "highly popular" wines available online were not available from wine stores within ten miles.[40] For small wineries, whose offerings are not frequently purchased and may not be available at all, that statistic surely understates the problem. The FTC staff acknowledged as much, noting testimony that "unambiguously reveals that, by banning interstate direct shipments, states seriously limit consumers' access to thousands of labels from smaller wineries."[41]

In addition, the availability of direct shipping makes wine less expensive. The FTC staff concluded that "consumers can save money by purchasing online," particularly in the purchase of more expensive wines.[42] According to the McLean study, "if consumers use the least expensive shipping method, they could save an average of 8-13% on wines costing more than $20 per bottle, and an average of 20-21% on wines costing more than $40 per bottle."[43]

CONCLUSION

There is great and growing demand for the products of America's small wineries, which are eager to meet it, but discriminatory laws in many states prevent most wineries from selling to willing consumers. These laws owe to the clout of distributors and the invisibility of non-resident wineries in state legislatures. For the public, these laws raise prices and decrease selection. For wineries, these

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[40] *Id*. at 3.

[41] *Id*. at 3.

[42] *Id*. at 3.

[43] *Id*. at 3.

laws Balkanize and erect barriers to the national market. Such laws limit the viability of many wineries across this country. The dormant Commerce Clause does not tolerate discriminatory burdens of this kind, and the Twenty-first Amendment does not excuse them. *Amici* urge this Honorable Court to affirm the decision of the United States Court of Appeals for the Sixth Circuit.

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That on 9/23/2004 deponent caused to be served 3 copy(s) of the within

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