

No. 02-1432

UNITED STATES COURT OF APPEALS  
FOR THE FOURTH CIRCUIT

DONALD H. BESKIND, KAREN BLUESTEIN,  
MICHAEL D. CASPER, SR., MICHAEL Q. MURRAY,  
D. SCOTT TURNER, MICHAEL J WENIG, MARY A. WENIG, and  
OAKSTONE WINERY, INC.,

*Plaintiff-Appellee,*

v.

MICHAEL F. EASLEY, in his official capacity as Governor of the  
State of North Carolina; ROY COOPER, Attorney General of North Carolina;  
BRYAN BEATTY, Secretary of the North Carolina Department of Crime Control  
and Public Safety; and ANN SCOTT FULTON, Chairman of the North Carolina  
Alcoholic Beverage Control Commission, all in their official capacities,

*Defendant-Appellants.*

On Appeal from the United States District Court  
for the Eastern District of North Carolina  
Western Division

**BRIEF OF DEFENDANT-APPELLANTS**

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ATTORNEYS FOR DEFENDANT-APPELLANTS

## STATEMENT OF THE ISSUES PRESENTED

1. **Whether North Carolina's permitting its fully regulated local wineries to ship their products directly to purchasers while requiring that wine sold by out-of-state vintners be imported and distributed through the State's three-tier ABC system is a valid regulation within the State's authority, guaranteed by Section 2 of the Twenty-first Amendment, to control the transportation and importation of intoxicants.**
  
11. **Whether, assuming the district court correctly found that the difference in treatment of in-state wineries and out-of-state vintners violates the Dormant Commerce Clause, the court erred in not striking the offending provision rather than enjoining the enforcement of North Carolina's laws prohibiting direct shipment of wines.**

## STATEMENT OF THE CASE

**Plaintiffs bring this action under 42 U.S.C. § 1983 alleging that North Carolina unconstitutional],,, prohibits its residents from ordering wine from out-of-state sources and having the wine shipped directly to their residences within this state. (App. 22 T 2) Six plaintiffs reside within the state. (App. 22 TT 8-16) One plaintiff resides in Grand Rapids, Michigan. (App. 22 T 13) ("Residents") The eighth plaintiff, Oakstone Winery, Inc. ("Oakstone"), is a winery located in Fair Play, California. (App. 22 T 20) Defendants are Michael F. Easley, Governor of North Carolina; Roy Cooper, Attorney General of North Carolina; Bryan Beatty, Secretary of Crime Control and Public Safety; and George Bason, formerly Chairman of the**

**North Carolina Alcoholic Beverage Control Commission.'** Each is sued in his official capacity and is alleged to be responsible for the enforcement of some aspect of the state's ABC laws. (App. 22 ~ 23-27) Defendants are referred to hereinafter collectively as "the State."

Residents allege that but for North Carolina's prohibition against the direct shipment of wine, they would order wine from out-of-state wineries and retailers such as Oakstone. (App. 22 ¶ 29-36) Oakstone alleges that it would like to sell its wine to North Carolina residents and ship its products directly to the purchasers at their respective residences and would do so but for the prohibition against out-of-state direct sales. (App. 22 ¶ 48-49) The prohibition against such out-of-state purchase with direct shipment to the purchaser is effected by the operation of N.C. Gen. Stat. §§ 18B-102.1, -109, and -1114 (ADD 4,19). (App. 22 ¶ 32) These statutes do not apply to local wineries and retailers, which may ship products directly to the consumer in the state pursuant to N.C. Gen. Stat. §§ 18B-1001(3) and (4) and -1101 (ADD. 11, 16). (App. 22 ¶ 38) **Count I of plaintiffs' complaint alleges that the prohibition against direct shipment by out-of-state wine dealers violates the Commerce Clause in three ways: (1) it treats interstate sales and delivery of wine**

**On motion of defendants, Ann Scott Fulton was substituted for George Bason, who retired as Chairman. Ms. Fulton is the interim Chairman. (App. 9, No. 52)**

**differently from intrastate sales and delivery; (2) it discriminates in favor of local wine dealers; and (3) it provides an economic advantage to local dealers. (App. 22 ~ 39)**

**Count II of plaintiffs' complaint alleges that the collective effect of statutes imposing excise taxes (N.C. Gen. Stat. § 105-113.80) (ADD. 20) and regulating the payment of such taxes on wine (and other alcoholic beverages) (N.C. Gen. Stat. § 1813-111 and 105-113.83) (ADD. 5,21) is to violate the Commerce Clause because, under North Carolina law, only North Carolina wholesalers, not individuals or out-of-state dealers, can pay the excise tax. (App. 27) Count III alleges that if it were permitted to do so, Oakstone would make sales to North Carolina residents and ship its products directly to them, and it would comply with all applicable laws and regulations. (App. 27-28)**

**Plaintiffs sought a declaratory judgment that (A) N.C. Gen. Stat. §§ 1813-102.1 -109 and -1114 (ADD. 4, 19) violate the Commerce Clause; (B) N.C. Gen. Stat. § 1813-102 (ADD. 2) violates the Commerce Clause to the extent that it prohibits out-of state wine dealers from shipping their products directly to North Carolina residents; (C) N.C. Gen. Stat. § 105-113.83 (ADD. 21) violates the Commerce Clause because it does not permit out-of-state dealers or state residents to pay the excise tax; and (D) it violates the Commerce Clause for defendants to apply other provisions of North**

**Carolina's ABC laws pertaining to permits, residency requirements, and approved lists of wine in a manner that prohibits out-of-state dealers from shipping wine directly to North Carolina adult residents. Plaintiffs sought an injunction (E) to prohibit defendants from enforcing state laws "which prohibit or punish" out-of-state suppliers from making direct delivery of "alcoholic beverages" to North Carolina residents, and (F) to require North Carolina authorities to accept excise tax payments from out-of-state dealers. Plaintiffs also requested (G) attorneys' fees and costs under 42 U.S.C. § 1988, and (H) such other relief as the Court deems appropriate.**

(App. 22)

**Defendants filed a Joint Answer (App. 32) denying that the allegations of the Second Amended Complaint stated any claim for relief and asserting as defenses that the statutes challenged are permitted by the Twenty-first Amendment, the Wilson Act (27 U.S.C. § 121) (ADD. 22) and the Webb-Kenyon Act. (27 U.S.C. § 122) (ADD. 23).**

**On April 5, 2002, the Honorable Graham C. Mullen, Chief United States District Judge, issued an order granting plaintiffs' Motion for Summary Judgment and enjoining the State from enforcing state ABC laws that prohibit out-of-state wine dealers from directly shipping wines to adult North Carolina residents. The Order was granted without the benefit of a hearing, despite defendants' request for a hearing. The court ruled that N.C. Gen. Stat. §§ 18B-102.1, -109 and -1114 (each of**

**which deals with direct shipment of intoxicants) (ADD. 4, 19) violate the Commerce Clause of the United States Constitution. The court ruled that N.C. Gen. Stat. § 18B-102 violates the Commerce Clause to the extent that it prohibits out-of-state wine dealers from shipping their products directly to North Carolina, while not similarly limiting in-state wineries. Section 105-113.83 was deemed to violate the Commerce Clause by not permitting out-of-state wine dealers and in-state wine buyers to pay the excise tax due on wine sales. Finally, the court ruled the State violates the Commerce Clause when it applies its ABC laws pertaining to permits, residency requirements, and approved lists of wine in a manner that prohibits out-of-state dealers from shipping wine directly to North Carolina adult residents. (App. 124) With consent of the parties, the Order was stayed pending this appeal.**

#### **STATEMENT OF FACTS**

**In North Carolina, the sale, purchase, transportation, manufacture, consumption, and possession of alcoholic beverages is prohibited except as authorized by Chapter 18B of the General Statutes. (App. 83-84) Section 18B-100 provides that**

**[t]his Chapter is intended to establish a uniform system of control over the sale, purchase, transportation, manufacture, consumption, and possession of alcoholic beverages in North Carolina, and to provide procedures to**

**insure the proper administration of the ABC laws under a uniform system throughout the State.**

N. C. GEN. STAT. § 18B-100 (2001). (ADD. 1)

**With one exception, the sale and distribution of all alcoholic beverages in North Carolina is through the "three-tiered" system. The top tier is the manufacturer or importer of the beverage. The middle tier is the assigned North Carolina wholesaler. The bottom tier is the retailer. (App. 8) North Carolina's alcoholic beverage control laws require each entity in the "three tier" system to obtain applicable permits.**

**(1) *Wine Wholesalers.* Section 18B-1107 provides, in part, that a wine wholesaler may,**

**[r]eceive, possess and transport shipments of fortified and unfortified wines [and] [s]ell, deliver and ship wine for purposes of resale to wholesalers or retailers licensed under this Chapter.**

N. C. GEN. STAT. § 18B-1107 (2001). (ADD. 18)

**(2) *Wine retailers.* Retail activity is governed by Article 10, Chapter 18B. Private retail businesses must obtain an on-premises and/or off-premises wine permit to engage in the retail sale of wine. Section 18B-1001(4) provides that**

**[a]n off-premises unfortified wine permit authorizes the retail sale of unfortified wine ... for consumption off-premises and it authorizes the**

**holder of the permit to ship unfortified wine . . . to individual purchasers ...**

N.C. GEN. STAT. § 1813-1001(4) (2001). (ADD. 11)

**Section 1813-1001(3) (ADD. 11) permits certain private retail businesses, including restaurants, hotels, private clubs, community theaters, and wineries to receive an on-premises unfortified wine permit. This permit authorizes the retail sale of unfortified wine for consumption on-premises and the direct shipment of wine to individual purchasers inside and outside the state.**

**Thus, N.C. Gen. Stat. § 1813-1001(3) and (4) (ADD. 11) permit the holder of a retail wine permit to ship wine directly to individual purchasers. This statute does not limit retailers from directly shipping only North Carolina wines. Rather, individual purchasers such as plaintiff residents, can have wine, imported from around the world, shipped directly to their house from a North Carolina wine retailer.**

**(3) *Manufacturers.* Section § 1813-1101 (ADD. 16) describes the scope of permissible activities of unfortified winery permit holders. Unfortified winery permits authorize the manufacture of unfortified wine, the sale and delivery of wine to licensed wholesalers, and the shipment of the permit holder's wine to individual purchasers.**

**Consistent with the Twenty-first Amendment's prohibitions, out-of-state vendors, including wineries, are prohibited from shipping "any alcoholic beverages directly to any North Carolina purchaser who does not hold a valid wholesaler's permit." N.C. GEN. STAT. §§ 18B-102.1 and -1114 (2001). (ADD. 19) These statutes apply only to shipments of alcoholic beverages into North Carolina directed to North Carolina residents. An out-of-state winery or wholesaler is not prohibited, however, from selling and shipping alcoholic beverages into North Carolina. The out-of-state winery or wholesaler merely need obtain a nonresident wine vendor permit. Section 18B-1114, which governs nonresident wine vendors, provides that**

**[t]he holder of a nonresident wine vendor permit may sell, deliver, and ship unfortified and fortified wine in this State only to wholesalers, importers, and bottlers licensed under this Chapter ... The unfortified and fortified wine must come to rest at the licensed premises of a wine wholesaler in this State before being resold to a retailer. A nonresident wine vendor permit may be issued to a winery [or] wholesaler. . . outside North Carolina.**

**N.C. Gen. Stat. § 18B-1114 (2001). (ADD. 19)**

**North Carolina's alcoholic beverage control laws thereby ensure that North Carolina consumers receive alcoholic beverages only through a distribution system consisting of identified and licensed parties that are accountable to the State.**

**In his affidavit, Chairman Bason set out the major requirements of North Carolina ABC laws:**

- a. the payment of excise taxes on all types of alcoholic beverages (Chapter 105;, Article 2C of the General Statutes) by designated vendors;  
  
the collection and payment of sales taxes on the retail sale of malt beverages and wine (Chapter 105, Article 2C, Part 5 of the General Statutes);
- c. the assignment of brands and territories for wholesale distributors of wine (Article 12 of Chapter 18B of the General Statutes) and wholesale distributors of malt beverages (Article 13 of Chapter 18B of the General Statutes);
- d. licensing of all vendors, both in-state and out-of-state (Article 11 of Chapter 18B of the General Statutes);
- e. the protection of the public against beverages containing harmful or impure substances, beverages containing an improper balance of substances as determined by the Commission, spurious or imitation beverages, and beverages unfit for human consumption (N.C. Gen. Stat. 18B-206) via the registration and analysis of products and their labels (Commission Rules 4 NCAC 2T.0200 through .0400);
- f. enforcement of the ABC laws through the investigation of complaints, and the physical inspection of the premises of vendors licensed by the Commission and the Alcohol Law Enforcement Division of the North Carolina Department of Crime Control and Public Safety, and local law enforcement agencies (N.C. Gen. Stat. 18B-203; Article 5 of Chapter 18B of the General Statutes).

(App. 83)

**Chairman Bason also explained the significant administrative burden and costs that the Commission would incur if it were required to license out-of-state dealers for direct shipment:**

**If the General Assembly were to authorize the Commission to issue license to out-of-state vintners to sell wine to North Carolina residents by catalog or internet sales ... additional personnel would be required to review applicants for licenses, investigate the applicants for compliance with State laws regarding such licenses....**

**It is not possible to estimate with any precision the extent of additional resources that would be required until the nature and scope of the licensing program and how many vintners would likely seek such permits were determined. If the demand is as great as plaintiffs seem to think, then it may be assumed that financial resources must increase in proportion to the number of out-of-state vintners seeking such permit. It can be said with certainty, however, that additional resources will be required.**

**The Commission receives no funding from the General Assembly. It is not likely that the General Assembly would appropriate funds for licensing out-of-state vintners and would expect the Commission to raise the revenue directly from its present sources of revenue. If the fees for licenses or permits to out-of-state vintners were the sole source of revenue to cover increased administrative costs including personnel salaries, it is conceivable that the fees would be so high that it would not be economically practicable for the small vintner to obtain a license.**

**(App. 122-23 ~\$ 2-4)**

**Through the uniform system of wine and beer distribution, the Commission and law enforcement agencies, such as the Alcohol Law Enforcement Division, are quickly able to identify the responsible seller when there is a complaint of an**

unlawful trade practice or of a product that is substandard, damaged, or unsafe. (App.

**86) Chairman Bason explains the importance of maintaining the prohibition on the out-of-state purchase and shipment of alcoholic beverages:**

**It is my belief that the statutory prohibitions against the direct shipping of alcoholic beverages by out-of-state vendors (including wineries, importers, wholesalers and retailers) to individual consumers aids the State of North Carolina, and specifically the Department of Crime Control and Public Safety, the Department of Revenue, and the North Carolina ABC Commission in carrying out their assigned duties and responsibilities under the law to collect excise and sales taxes, enforce the ABC laws, ensure safe products in the retail market place, and promote the orderly distribution of beer and wine through the "three-tier" system, as well as the orderly receipt, storage, sale and distribution of spirituous liquor through the state and local government controlled system of warehousing, delivery and retail stores.**

**It is my further belief that to permit the unregulated sale and direct shipment of alcoholic beverages to individual consumers via mail order and internet websites would frustrate the legitimate purpose of the State of North Carolina in controlling alcoholic beverages as stated in N.C. Gen. Stat. 18B-100.**

(App. 83-84)

**Importantly, North Carolina's ABC system imposes no legal bar to the sale of alcoholic beverages in this state, but rather tightly controls the importation, sale and distribution of such products. In accordance with the Twenty-first Amendment, N.C. Gen. Stat. § 1813-1114 (ADD. 19) allows an out-of-state wine vendor to sell, deliver, and ship their wine to wholesalers, importers and bottlers. This statute merely**

requires that the wine "come to rest" at the premises of a licensed North Carolina wholesaler before being resold to a retailer. Utilizing this system, a North Carolina resident can easily obtain literally thousands of wine products. On the Commission's approved list of wines and malt beverages are over 21,230 wine products, divided among 8,700 brands of wine, and over 1,880 malt beverage products, divided among 1,340 brands. (App. 89)

North Carolina residents are not prevented from obtaining wines from out-of-state sources. If a consumer is unable to find a desired wine among the thousands of varieties and brands of wine available in this state, he or she may request the manufacturer or importer to obtain a non-resident wine vendor permit under N.C. Gen. Stat. §§ 18B-1114 and -902(26) (Add. 19, ). The ease of obtaining a nonresident wine vendor permit and the relatively inexpensive cost of the permit demonstrates that the process is neither complicated nor expensive. (App. 89) A nonresident wine vendor permit, which is a permanent permit, costs only \$100.00. By contrast, the permit to operate a winery in North Carolina costs \$300.00. If the North Carolina winery wishes to sell wine at the winery, they must purchase an additional \$400.00 permit. N.C. GEN. STAT. § 18B-902 (2001). (ADD. 7)

Furthermore, a North Carolina resident can order wine not on the approved list and have the wine shipped directly to his or her residence by a North Carolina

retailer. To do so, the resident simply obtains a "Special Order" permit. Chairman Bason explained how this is done:

**Any individual wishing to obtain products not listed on the Commission's list of approved wines may complete an application for a Wine Special Order and file said application with the Commission. No *fee* is charged for this permit; the sought after wine comes in through [the] three tier system, in that an order is placed with a cooperating retailer and wholesaler; the wholesaler contacts the supplier of the product, whether the desired product is manufactured in-state or out-of-state, or is imported. As the order is filled, the product is shipped to the North Carolina wholesaler, who in turn sells the order to the retailer with whom the consumer has placed the order. The North Carolina retailer may, upon receipt of the product, deliver or ship the filled special order to the customer.**

(App. 87)

Chairman Bason further explained that a North Carolina resident may purchase a large quantity of wine not on the approved list.

**For unfortified wine, plaintiffs may order 20 liters [two cases of 750 milliliter size bottles (18 liters) plus 2 additional 750 ml bottles] without a purchase-transportation permit. [7] However, larger quantities of unfortified wine of up to 100 liters, (11 cases of 750 milliliter size bottles plus one additional 750 milliliter bottle) may be ordered via the Wine Special Order with a *purchase transportation permit*. Local ABC boards issue these purchase transportation permits authorizing the larger quantity of wine. *No fee* is charged for the purchase transportation permit, which can be obtained quickly (while you wait).**

**In 2001, N.C. Gen. Stat. § 18B-303(a)(3) (2001) (ADD. 6) was amended to allow individual purchasers, without a permit, to purchase not more than 50 liters of unfortified wine.**

**Thus, with a Wine Special Order permit and a purchase transportation permit, the plaintiffs may order up to 100. liters of any unfortified wine product not currently listed. Admittedly, this process is not quite as quick and easy as Internet or mail order purchases, but plaintiffs are perfectly able to get their'fine wines' this way.**

**(App. 87-88) In essence, North Carolina's ABC laws prohibit only the direct mail, catalogue and internet sales of alcoholic beverages from out-of-state sources to individual residents within the state. A wine producer who is willing to proceed through the three-tier system is not prevented by North Carolina law from selling its products to consumers in this state.**

**North Carolina imposes an excise tax of twenty-one cents on a liter of unfortified wines and twenty-four cents on a liter of fortified wines. The excise tax is paid by the resident wholesaler. In fiscal year 1999-2000, North Carolina collected more than \$10,000,000 in excise taxes in this manner. (App. 103 ~T 1,2) In his affidavit at T 3 (App. 103-04), Mr. Daniel stresses the importance of maintaining the present system for collecting the excise tax on wines and gives his professional opinion of the expected consequences of permitting North Carolina consumers to order from out-of-state sources with direct shipment to the consumers:**

**Unless wine is sold through a wholesaler or importer licensed to do business in this state, there would be no way to assure the collection of the excise tax. If consumers in this state were permitted to purchase wine from out-of-state source with direct shipment to the consumers, the state would have to rely on the consumer to pay the excise tax**

**voluntarily. There would be no accurate way of determining which out-of-state sources were shipping wine directly to consumers in this state. It is reasonable to assume, based on the state's experience with Internet sales of other products, that many consumers would not voluntarily report or pay the excise tax. There would be no accurate and consistent way to determine that a North Carolina resident had ordered wine from an out-of-state sources and had the wine shipped directly to him in this State. It is reasonable to assume that many regular purchasers of wine would buy from the cheapest source available. It is, therefore, reasonable to assume that not just consumers of fine and rare wines would purchase from out-of-state sources, but also those who regularly buy inexpensive or moderately priced table wines. For example, if one were planning a large social event, such as an wedding reception, at which a large amount of wine would be required, the purchaser would go to a source from which he could get the best price. I do know that there are out-of-state sources which do. sell wines and other alcoholic beverages at prices lower than in North Carolina.**

**Mr. Daniel believes that "the present system employed in North Carolina is the most effective and efficient means for assuring that the excise tax this state imposes on wines is collected." (App. 104)**

### **SUMMARY OF THE ARGUMENTS**

**Oakstone, a small California winery, and eight consumers of fine and common wines, filed a broadside complaint, challenging North Carolina's tightly regulated system for the control of the importation and distribution of alcoholic beverages in this state as violative of the Commerce Clause. North Carolina requires that every ounce of alcoholic beverages imported, transported, distributed, and sold within the state be under state control. All products coming in from out of state must come to**

rest at a licensed premises of a wholesaler before being resold to a retailer. For this reason, the State forbids direct shipment of all alcoholic beverages from out of state to consumers within the state. North Carolina permits local wineries to ship directly to consumers because such wineries are completely regulated by the State. Violation of any of the State's ABC laws can result in civil and criminal penalties, including revocation of required permits. Prohibiting local wineries from shipping wine directly to consumers would be an unnecessary measure since the State has complete regulatory control over these businesses. Local wineries must obtain a state permit to produce wines. To sell their own products at retail, they must obtain an additional permit, the same permit required of wine retailers that allows them to ship wine directly to consumers. Thus, the shipment of wines to consumers from both out-of-state and in-state sources is subject to state control and regulation.

North Carolina's three-tier ABC system, which has been in place since 1937 and is generally similar to that in most other states, was established pursuant to the Twenty-first Amendment and federal statutes. The system is non-discriminatory. Plaintiffs' argument that the system violates the Commerce Clause is based on a legal theory of recent vintage, concocted from Supreme Court cases that did not deal with the importation and distribution of alcohol pursuant to the Twenty-first Amendment, but which concern other federal interests, such as those reflected in other provisions

of the Constitution, including the Supremacy Clause.' Those cases do not dilute the Supreme Court's Twenty-first Amendment jurisprudence which has remained consistent in principle since the Amendment's adoption and the Court's earliest decisions interpreting it.

Even though it found only one very small aspect of the State's ABC regulations to violate the Commerce Clause, the district court enjoined the State from prohibiting all out-of-state direct shipments of wine to consumers in this state. The effect of the district court's order is to deregulate out-of-state wine shipments into the state while leaving in-state wine shipments fully regulated by the State. The injunction, on its face, violates Section 2 of the Twenty-first Amendment. Assuming, *arguendo*, it correctly found that the local shipments discriminate against interstate commerce, the district court should have simply declared unconstitutional the offending statutory provision and severed it from the statute so that neither in-state wineries nor out-of-state wine dealers could ship wine directly to consumers in this state.

*See, e.g., Vijay Shanker, Alcohol Direct Shipment Laws, the Commerce Clause, and the Twenty-first Amendment, 85 Va. L. Rev. 353 (1999), implicitly dismissed in Bridenbaugh v. Freeman-Wilson, 227 F.3d 848, 851 (7th Cir. 2000), cert. denied, 532 U.S. 1002 (2001).*

## ARGUMENTS

### STANDARD OF REVIEW

On cross-motions for summary judgment, the district court granted plaintiffs' motion and denied defendants'. The standard of review for each argument is *de novo*. *TFWS, Inc. v. Schaefer*, 242 F.3d 198, 204 (4th Cir. 2001).

I. NORTH CAROLINA'S PERMITTING ITS FULLY REGULATED LOCAL WINERIES TO SHIP THEIR PRODUCTS DIRECTLY TO PURCHASERS WHILE REQUIRING THAT WINE SOLD BY OUT-OF-STATE VINTNERS BE IMPORTED AND DISTRIBUTED THROUGH THE STATE'S THREE-TIER ABC SYSTEM IS A VALID REGULATION WITHIN THE STATE'S AUTHORITY, GUARANTEED BY SECTION 2 OF THE TWENTY-FIRST AMENDMENT, TO CONTROL THE TRANSPORTATION AND IMPORTATION OF INTOXICANTS.

A. THE DISTRICT COURT'S ORDER

Although plaintiffs launched a full-scale assault on North Carolina's ABC system, the district court found the system defective in only one small respect. The court held that by permitting local wineries to ship directly to consumers in this state while out-of-state wineries are not permitted to do so, the State discriminates against interstate commerce.

The district court's legal analysis started off on the wrong foot and never recovered. The court began with a balancing of the Commerce Clause and the Twenty-first Amendment. The court perceived the need for such balancing because

it misread Supreme Court cases, such as *Brown-Forman Distillers Corp. v. New York State Liquor Auth.*, 476 U.S. 57 584 (1986), *Bacchus Imports v. Dias*, 468 U.S. 263 (1984), and one decision of this Court.

The court found the difference in the State's treatment of direct shipment by out-of-state wine dealers from in-state wineries is to "present a relatively cut and dry [sic] example of *direct* discrimination against interstate commerce." (App. 135) The court opined that unless the differing treatment was saved by the Twenty-first Amendment, it must be struck down. (App. 135) The court did acknowledge that "[e]fficient administration of tax collection, safety, and the like would certainly balance in favor of retaining the existing general system, were it not for the *exception* for in-state wineries." (Original emphasis) (App. 137) The court said that the State failed to explain the reason for the exception to balance against the interests of the Commerce Clause. (App. 137) The court inexplicably overlooked the State's explanation, which the court itself had noted earlier in its opinion. (App. 129-30) The court commented that "since Defendants devote [d] the filings to justifying the general system and not the exception, economic protectionism is the most likely explanation for the system [exception?] that comes to mind." (App. 138).<sup>4</sup> The court likened the

As noted above, however, the Second Amended Complaint attacked the entire ABC system, and the remedies plaintiffs sought would have dismantled the entire system. *See, e.g.,* Second Amended Complaint, Request for Relief and

**difference in treatment to the excise-tax exemption for local liquors held unconstitutional in *Bacchus*. (App. 138)**

**The court concluded its analysis by reviewing and rejecting the reasoning of Judge Easterbrook in *Bridenbaugh v. Freeman-Wilson*, 227 F.3d 848 (7th Cir. 2000), *cert. denied*, 532 U.S. 1002 (2001). *Bridenbaugh* is the only recent federal circuit court decision on the issue of direct shipment of wine. Rejecting Judge Easterbrook's analysis, the court relied exclusively on its own misreading of Supreme Court cases dealing with the Twenty-first Amendment.**

**The district court then enjoined defendants "from enforcing state laws ... that prohibit or punish out-of-state wine dealers from directly shipping wines to adult North Carolina residents" and required the State "[to] accept excise tax payments from adult residents of North Carolina that are due on wine directly received from out-of-state sources." (App. 143) The court did not enjoin the State's prohibition against residents from ordering wine from out-of-state sources with direct shipment to them. See N.C. GEN. STAT. § 18B-109(a) (2001). (ADD. 4)**

**particularly' E thereof where plaintiffs request "[a]n injunction against Defendants prohibiting them from enforcing the provisions of the North Carolina ABC laws which prohibit or punish the delivery of alcoholic beverages from an out-of-state supplier to an adult North Carolina resident." (App. 28-29). Therefore, defendants were compelled to devote much of their brief and supporting materials to explaining and validating the ABC system.**

**B. SUPREME COURT AND OTHER FEDERAL COURT  
DECISIONS INTERPRETING THE TWENTY-FIRST  
AMENDMENT**

**Because the district court based its analysis on decisions of the Supreme Court and one opinion of this Court interpreting the Twenty-first Amendment, the State will show how the court misinterpreted those decisions. A proper analysis of the issues in this case begins with the text of Section 2 of the Amendment, which the district court completely omitted from its legal analysis. Section 2 provides unambiguously:**

**The transportation or importation into any State, Territory, or possession of the United States for delivery or use herein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited.**

**Most obviously, the Amendment fundamentally and functionally amends the Commerce Clause with respect to commerce in alcoholic beverages. "The wording of § 2 of the Twenty-first Amendment closely follows the Webb-Kenyon and Wilson Acts, expressing the framers' clear intention of constitutionalizing the Commerce Clause framework established under those statutes. This Court's subsequent decisions have confirmed that the Amendment primarily created an exception to the normal operation of the Commerce Clause." (footnote omitted) *Craig v. Boren*, 429 U.S. 190; 205-06 (1976), *reh'g denied*, 429 U.S. 1124 (1977).**

**In one of its first decisions expounding on the meaning of the Twenty-first Amendment, the Supreme Court declared:**

The Twenty-first Amendment sanctions the right of a State to legislate concerning intoxicating liquors brought from without, unfettered by the Commerce Clause. Without doubt a State may absolutely prohibit the manufacture of intoxicants, their transportation, sale, or possession, irrespective of when or where produced or obtained, or the use to which they are to be put. Further, she may adopt measures reasonably appropriate to effectuate these inhibitions and exercise full police authority in respect of them. *Clark Distilling Co. v. Western Maryland Ry. Co.*, 242 U.S. 311, 320; *Crane v. Campbell*, 245 U.S. 304, 307; *Seaboard Air Line Ry. v. North Carolina*, 245 U.S. 298,304; *Samuels v. McCurdy*, 267 U.S. 188, 197-198.

*Ziffrin, Inc. v. Reeves*, 308 U.S. 132, 138 (1939).

In *Hostetter v. Idlewild Bon Voyage Liquor Corp.*, 377 U.S. 324 (1964)

("Hostetter"), the Court discussed at length, but did not retrench from its decision in

*Ziff in, Inc.*

[I]n *Ziff in, Inc., v. Reeves*, 308 U.S. 132, there was involved a Kentucky statute, "along, comprehensive measure (123 sections) designed rigidly to regulate the production and distribution of alcoholic beverages through means of licenses and otherwise. The manifest purpose is to channelize the traffic, minimize the commonly attendant evils; also to facilitate the collection of revenue. To this end manufacture, sale, transportation, and possession are permitted only under carefully prescribed conditions and subject to constant control by the State." *Id.*, at 134. The Court upheld a provision of that "comprehensive measure" which prohibited a domestic manufacturer of liquor from delivering his product to an unlicensed private carrier. The Court noted that "Kentucky has seen fit to permit manufacture of whiskey only upon condition that it be sold to an indicated class of customers and transported in definitely specified ways. These conditions are not unreasonable and are clearly appropriate for effectuating the policy of limiting traffic in order to minimize well-known evils, and secure payment of revenue. The statute declares whiskey removed from

**permitted channels contraband subject to immediate seizure. This is within the police power of the State; and property so circumstanced cannot be regarded as a proper article of commerce." *Id.*, at 139.**

*Hostetter*, 377 U. S. at 330-31.

**More recently, in *North Dakota v. United States*, 495 U.S. 423 (1990), the Supreme Court re-emphasized the substantiality of the state's powers when acting pursuant to the Twenty-first Amendment. The United States sued North Dakota over its requirement that all persons bringing liquor into the state file monthly reports and that liquor shipped from out-of-state to the federal enclave within the state bear a label indicating that the liquor was destined for consumption on the enclave. The Court upheld the regulations. "Given the special protection afforded to state liquor control policies by the Twenty-first Amendment, they are supported by a strong presumption of validity and should not be set aside lightly. *See, e.g., Capital Cities Cable, Inc. v. Crisp*, 467 U.S. at 714." *North Dakota*, 495 U.S. at 433. The Court observed,**

**within the area of its jurisdiction, the State has "virtually complete control" over the importation and sale of liquor and the structure of the liquor distribution system. *See California Retail Liquor Dealers Assn. v. Midcal Aluminum, Inc.*, 445 U.S. 97, 110 (1980); *see also Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691, 712 (1984); *California Board of Equalization v. Young's Market Co.*, 299 U.S. 59 (1936). The Court has made clear that the States have the power to control shipments of liquor during their passage through their territory and to take appropriate**

steps to prevent the unlawful diversion of liquor into their regulated intrastate markets.

*North Dakota*, 495 U.S. at 431.

The Court noted four of its cases where it had struck down state liquor regulations affecting the federal government: *Collins v. Yosemite Park & Curry Co.*, 304 U.S. 518 (1938); *Hostetter v. Idlewild Bon Voyage Liquor Corp.*; *United States v. State Tax Comm'n*, 412 U.S. 363 (1973) (*State Tax Comm'n*); and *United States v. Tax Comm'n of Miss.*, 421 U.S. 599 (1975) (*Miss. Tax Comm'n*). The Court succinctly stated its holding in those cases: "[W]e concluded that the State has no authority to regulate in an area or over a transaction that fell outside of its jurisdiction." *North Dakota*, 495 U.S. at 431.

The district court in the instant case did not even address the *North Dakota* decision, much less distinguish it. Because North Carolina's prohibition against direct shipment of alcoholic beverages from out-of-state regulates the importation and transportation of intoxicating liquors, the prohibition falls squarely within the State's powers under the Twenty-first Amendment and the Supreme Court's *North Dakota* holding.

The two North Dakota regulations fall within the core of the State's power under the Twenty-first Amendment. In the interest of promoting temperance, ensuring orderly market conditions, and raising revenue,

the State has established a comprehensive system for the distribution of liquor within its borders. That system is unquestionably legitimate.

[Id. at](#) 432. In his concurring opinion, Justice Scalia observed without contradiction from any member of the Court that

[t]he Twenty-first Amendment, which prohibits "the transportation or importation into any State ... for delivery or use therein of intoxicating liquors, in violation of the laws thereof," is binding on the Federal Government like everyone else, and empowers North Dakota to require that all liquor sold for use in the State be purchased from a licensed in-state wholesaler.

[Id. at](#) 447.

A state's regulation of the sale and distribution of alcoholic beverages within its borders is *the* core of its powers under Section 2 of the Twenty-first Amendment. *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691, 713 (1984). In the exercise of its special powers under Section 2, the states are given "wide latitude" to regulate. *Joseph E. Seagram & Sons, Inc. v. Hostetter*, 384 U.S. 35, 42, *reh'gdenied*, 384 U.S. 967 (1966), cited in *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 108 (1980). For example, Judge Sentelle, writing for the Court of Appeals for the District of Columbia, upheld as a legitimate exercise of Section 2 power legislation that required liquor imported by licensees of alcoholic beverages for sale within the District of Columbia be stored in warehouses located within the District. *Milton S. Kronheim & Co. v. District of Columbia*, 91 F.3d 193 (D.C. Cir.

1996), *cent. denied*, 520 U.S. 1186 (1997). The District argued that the requirement advanced its interests in inspection of imported alcoholic beverages and enforcement of ABC regulations and, further, "that the storage requirement is integral to both maintaining its 'three-tier system of distribution' . . . and discouraging creation of a 'tied house,' in which one firm controls the entire chain of distribution." [Id. at 202](#). Although recognizing that the regulation facially violates the Dormant Commerce Clause and may have been motivated in part by economic protectionism, the court upheld the act on the ground that it "falls squarely within the state's core enforcement powers over alcohol." [Id. at 204](#).

The cases discussed above demonstrate beyond question that the Supreme Court has never watered down the states' power to regulate the importation and transportation of liquor into its borders. When measured against those cases, the district court's misunderstanding of the Supreme Court cases on which it primarily relied, *Brown-Forman*, 476 U.S. 57 and *Bacchus*, 468 U.S. 26 is quite evident.

*Brown-Forman* and its progeny *Healy v. Beer Inst.*, 491 U.S. 324 (1989), concerned the extraterritorial effect of state alcoholic beverage pricing schemes, which pegged local prices at levels no higher than what wholesalers sold their products in other states. The effect of the pricing scheme was to regulate prices in

**other states. Neither of the cases concerned the transportation or importation of alcohol into the state. The Court made this fact unquestionably clear:**

**New York has a valid constitutional interest in regulating sales of liquor within the territory of New York. Section 2 of the Twenty-first Amendment, however, speaks only to state regulation of the "transportation or importation into any State" . . . for delivery or use therein" of alcoholic beverages. That Amendment, therefore, gives New York only the authority to control sales of liquor in New York, and confers no authority to control sales in other States. The Commerce Clause operates with full force whenever one State attempts to regulate the transportation and sale of alcoholic beverages destined for distribution and consumption in a foreign country, *Idlewild Bon Voyage Liquor Corp., supra*, or another State.**

***Brown-Foreman*, 476 U.S. at 585. The Court's discussion of the "two-tiered approach to analyzing state economic regulation under the Commerce Clause," [id. at 578-79](#), which the district court attempted to apply in the present case, preceded its discussion of whether New York's regulation could be saved by the Twenty-first Amendment. Plainly, a state liquor pricing law with extraterritorial effects cannot be said to further the state's interest in the transportation and importation of alcohol into its borders for use therein. The Twenty-first Amendment not being implicated, the only question for the court was whether the state regulation sufficiently fostered a legitimate state interest substantial enough to withstand a Commerce Clause challenge.**

*Bacchus Imports*, relied on by the district court, is not controlling in the instant case. That was a pure case of economic protectionism. The facts are simple. Hawaii imposed a 20% excise tax on liquor sales at the wholesale level, but it exempted its local brandy (okolehao) and local fruit wine from the tax. Wholesalers, who had paid the tax, brought suit in the Hawaii Tax Appeals Court, asserting that the tax violated the Commerce and the Export-Import Clauses, and demanding a tax refund of all excise taxes paid. The tax court held the tax constitutional, and the Hawaii Supreme Court affirmed, holding that the tax did not discriminate against interstate commerce because it was ultimately borne by the Hawaiian taxpayers. On direct appeal to the United States Supreme Court, the Court held that the wholesalers had standing and then proceeded to address the Commerce Clause question. That the only purpose of the exemption was to encourage the development of Hawaii's liquor and fruit wine industries was admitted. 468 U.S. at 271. The state did not even raise the issue of the Twenty-first Amendment until its brief in the Supreme Court. [Id.](#) at 274 n.12.

The Court examined the relationship between the Commerce Clause and the Twenty-first Amendment.

We also there observed that "[both] the Twenty-first Amendment and the Commerce Clause are parts of the same Constitution [and] each must be considered in light of the other and in the context of the issues and interests at stake in any concrete case." [*Hostetter*, 377 U.S.] at 332. Similarly, in *Midcal Aluminum*, *supra*, at 109, the Court, noting that

recent Twenty-first Amendment cases have emphasized federal interests to a greater degree than had earlier cases, described the mode of analysis to be employed as a "pragmatic effort to harmonize state and federal powers." The question in this case is thus whether the principles underlying the Twenty-first Amendment are sufficiently implicated by the exemption for okolehao and pineapple wine to outweigh the Commerce Clause principles that would otherwise be offended. Or as we recently asked in a slightly different way, "whether the interests implicated by a state regulation are so closely related to the powers reserved by the Twenty-first Amendment that the regulation may prevail, notwithstanding that its requirements directly conflict with express federal policies." *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691, 714 (1984).

[Id. at](#) 275-76. The Court concluded that the excise tax violated the Commerce Clause but was "not supported by any clear concern of the Twenty-first Amendment."

[Id. at](#) 276.

*Midcal*, 445 U.S. 97, cited in *Bacchus*, appears to represent a balancing approach that the Court applies when the state's acknowledged virtually complete authority over commerce in alcoholic beverages conflicts with a federal interest in marketplace competition as expressed in the Sherman Act.' The Court first examined whether the state pricing scheme violated the Sherman Act and concluded

*Midcal* is unlike other pricing cases, such as *Brown-Forman* and *Healy*, because there was no allegation that California's pricing system had any extraterritorial effects. The question was whether congressional power to regulate commerce in general could overcome the state's authority under the Twenty-first Amendment. The answer was in some, but not all, instances it could. Contrast the holding in *Midcal* with *North Dakota* where federal authority had to yield to the state's power to regulate the importation and transportation of alcohol.

that scheme did violate the [Act](#). [Id.](#) at 103. The Court then considered whether the Twenty-first Amendment shielded states from the application of the Act. The Court observed that it had never held that Section 2 of the Amendment "freed the States from all restrictions upon the police power to be found in other provisions of the Constitution." [Id.](#) at 108, citing *State Bd. of Equalization v. Young's Market*, 229 U.S. 59, 64 (1936). While recognizing the "wide latitude" of the states to regulate alcohol, the Court noted that "important federal interests in liquor matters survived the ratification of the Twenty-first Amendment," citing as examples cases where the federal interest reflected in other Constitutional provisions prevailed against the Amendment, such as *Department of Revenue v. James Beam Co.*, 377 U.S. 341 (1964), (Export-Import Clause); *Craig v. Boren*, 429 U.S. at 204-209 (Equal Protection); and *Wisconsin v. Constantineau*, 400 U.S. 43 436 (1971) (Due Process); *Midcal*, 445 U.S. at 108. See also, *Capital Cities Cable* (Free Speech); and *Liquormart v. Rhode Island*, 517 U.S. 484 (1996) (Free Speech).

The specific issue addressed by the Court in *Midcal* was "the extent to which Congress can regulate liquor under its interstate commerce power." 445 U.S. at 108. *Midcal* was not a Dormant Commerce Clause case; it was a Supremacy Clause case. Indeed, *Midcal*, carefully read, shows that the balancing of state and federal interests purportedly conducted by the district court in the present case put the cart before the

horse. The *Midcal* Court explained: "Although States retain substantial discretion to establish other liquor regulations, those controls may be subject to the federal commerce power *in appropriate situations.*" [Id. at 110](#) (emphasis added).' In *Midcal*, the Court held that the state interest, as declared by the California courts, was too insubstantial to override the federal policy. The *Midcal* Court noted "[t]he federal interest in enforcing the national policy in favor of competition is both familiar and substantial." *Id.* On the other hand, the state's recognized interest in promoting temperance and orderly markets is not greatly furthered by its resale price maintenance [scheme.](#) [Id. at 112.](#) The Court found "no basis for disagreeing with the view of the California courts that the asserted state interests are less substantial than the national policy in favor of competition." [Id. at 113.](#) See *Battipaglia v. New York State Liquor Auth.*, 745 F.2d 166, 171 (2d Cir. 1984) ("The Supreme Court was obliged to take the case as it found it."), *cert. denied*, 470 U.S. 1027 (1985). The

In *United States Brewers Ass'n, Inc. v. Healy*, 532 F. Supp. 1312 (D. Ct. Conn.), *rev'd on other grounds*, 692 F.2d 275 (2d Cir. 1982), the district court found nothing significant in the fact the *Midcal* Court addressed the Commerce Clause issue before looking at the state's power under the Twenty-first Amendment. "The fact that the Court in *Midcal* began with an analysis of the Sherman Act issue, instead of the twenty-first amendment, is hardly a telling indication of the shift in the Court's perspective on the accommodation of the Commerce Clause and the Twenty-first Amendment between 1966 when *Seagram* was decided and *Midcal* in 1980.' There are any number of good reasons why the Court structured its opinions differently, the most obvious being the fact that they reached opposite conclusions." [Id. at 1326 n. 48](#) (citation omitted).

Court, therefore, affirmed the decision of the California Court of Appeal "that the Twenty-first Amendment provides no shelter for the violation of the Sherman Act caused by the State's wine pricing program." [Id. at](#) 114.'

The district court in the instant case found guidance for its balancing of interests in this Court's decision in *TFWS, Inc. v. Schaefer*, 242 F.3d 198 (4<sup>th</sup> Cir. 2001), another Sherman Act case. Even though it found a *per se* violation of the Sherman Act, this Court did not hold that the Sherman Act automatically trumped the state's interest but remanded the case for balancing of the competing [interests](#). [Id. at](#) 213. In the instant case, plaintiffs have not pleaded that the Sherman Act was violated. Thus, the district court's reliance on *TFWS* is altogether misplaced.

Judge Easterbrook's cogent opinion in *Bridenbaugh* correctly sums up and applies the Twenty-first Amendment in a case parallel to the one at bar. *Bridenbaugh* was brought by a group of Indiana "oenophiles," who attacked their state's prohibition on the direct shipment of wine to the purchaser by out-of-state wine

In the instant case, the federal interest enforceable under the Supremacy Clause is represented by the Wilson Act (ADD. 22), the Webb-Kenyon Act (ADD. 23), and the recently enacted Twenty-first Amendment Enforcement Act, Public Law No. 106-386, § 2004 (ADD. 24), all of which reinforce the states' power under the Twenty-first Amendment. Given that Congress is empowered to enforce the Commerce Clause, where a state policy regulates the transportation or importation of intoxicating beverages, there is no room, reason, or basis to balance the state's interest against the Dormant Commerce Clause.

retailers. Judge Easterbrook phrased the legal issue as one "pit[ting] the twenty-first amendment, which appears in the Constitution, against the 'dormant commerce clause,' which does not." 227 F.3d 849. Indiana, like North Carolina, employs a three-tiered system to control the importation, distribution, and sale of intoxicating [beverages](#). [Id.](#) at 851. Indiana justifies its system as insuring "orderly market conditions" which regulate competition and facilitate the collection of revenue. But for Section 2 of the Twenty-first Amendment, the system would violate the Commerce Clause. *Id.* "If the product were cheese rather than wine, Indiana would not be able either to close its borders to imports or to insist that the shippers collect its taxes, despite the effect on its treasury.... But § 2 of the twenty-first amendment empowers Indiana to control alcohol in ways that it cannot control cheese." *Id.*

Judge Easterbrook then laid out the historical background that puts the Amendment clearly in focus. The Twenty-first Amendment was adopted to assure the states' control over the importation of intoxicating beverages into their borders. State attempts at regulation had been frustrated by Supreme Court decisions, which held that although a state could control the manufacture of liquor within its borders, *Mugler v. Kansas*, 123 U.S. 623 (1887), the Commerce Clause forbade states from barring the importation of liquor to licensed sellers in the state. *Bowman v. Chicago & Northwestern Ry. Co.*, 125 U.S. 465 (1888). A subsequent attempt to totally ban

**the sale of alcohol was ineffective because the Court held that the resale of liquor imported into the state was still in interstate commerce as long as the liquor remained in its original package. *Leisy v. Hardin*, 135 U.S. 100 (1890). The combined effect of *Mugler* and *Leisy* was to discriminate in favor of out-of-state producers of alcoholic beverages. While states could outlaw the manufacture of alcoholic beverages within their borders, they could not legally prevent the importation into and resale of liquors in their original packages within their boundaries. *Bridenbaugh*, 227 F.3d at 851-52.**

**Congress responded to this anomaly by enacting the Wilson Act, 27 U.S.C.S. § 121 (2002) (Add. 22), to give states control over the importation of alcoholic beverages "to the same extent and in the same manner as though such liquids or liquors had been produced in such State or Territory, and shall not be exempt therefrom by reason of being introduced therein in original packages or otherwise." 227 F.3d at 852. The Supreme Court, however, read the Wilson Act in such a manner as to leave the *Bowman* holding undisturbed. Thus, a state could regulate the intoxicating beverages produced within the state but not such beverages imported into it so long as the beverage remained in the original package. In 1913 Congress enacted the Webb-Kenyon Act, 27 U.S.C.S. § 122 (2002) (ADD. 23), which provided, in pertinent part, that "[t]he shipment or transportation [into a state] ... of any ...**

**liquor . . . [that] is intended, by any person interested therein, to be received, possessed, sold, or in any manner used, either in the original package or otherwise, in violation of any law of such State ... is hereby prohibited."** The act was held constitutional in *Clark Distilling Co. v. Western Md. Ry. Co.*, 242 U.S. 311 (1917). On January 6, 1919, the Eighteenth Amendment was ratified. Prohibition became the law of the land and remained so until the ratification of the Twenty-first Amendment on December 5, 1933. *Midcal*, 227 F.3d at 852-53.

Judge Easterbrook summed up the present status of the law with respect to the states' power to ban the direct importation of liquors into the state by consumers:

**But the twenty-first amendment did not return the Constitution to its pre-1919 form. Section 2 tracks the Webb-Kenyon Act and effectively incorporates its approach into the Constitution. Like the Webb-Kenyon Act, § 2 incorporates state prohibitions into a federal rule; like the Webb-Kenyon Act, § 2 closes the loophole left by the dormant commerce clause, abetted by *Bowman* and *Rhodes*. direct shipments from out-of-state sellers to consumers that bypass state regulatory (and tax) systems. No longer may the dormant commerce clause be read to protect interstate shipments of liquor from regulation; § 2 speaks directly to these shipments. Indeed, all "importation" involves shipments from another state or nation. Every use of § 2 could be called "discriminatory" in the sense that plaintiffs use that term, because every statute limiting importation leaves intrastate commerce unaffected. If that were the sort of discrimination that lies outside state power, then § 2 would be a dead letter.**

[Id. at](#) 853.

C. THE DISTRICT COURT'S ERRONEOUS ANALYSIS

The district court's analytical process led it astray. The first question it should have asked is whether the State's prohibition of the direct shipment of alcohol by out-of-state dealers is a regulation of the importation, distribution and sale of alcoholic beverages. The answer is unequivocally "yes." The second question is whether the State's permitting local wineries, which are under complete state regulation and control, to ship their product directly to the consumer falls within the broad discretionary authority of the State under the Twenty-first Amendment. The answer again is "yes." The analysis should conclude at that point. There is no need to impose additional and redundant restrictions on in-state producers to achieve facially identical treatment with out-of-state producers. There is no direct evidence in this case that the rules for in-state producers were done with protectionism in mind. The State need not further justify a regulation that affects the State's "core" power under the Twenty-first Amendment when the regulation does not intrude on other federal interests. *Capital Cities Cable*, 467 U. S. at 715.

Where the state policy falls within the "wide latitude" of discretion to which the State is entitled when acting pursuant to its Section 2 powers, to further dissect that policy to determine whether it might in some manner incidentally or intentionally discriminate against interstate commerce is to negate the exercise of that discretion.

**That is exactly what the D.C. Circuit recognized and refused to do in *Kronheim*, and that is why the *Kronheim* case was decided correctly.**

**If, however, this Court should consider it necessary to balance the Commerce Clause against the Twenty-first Amendment in this case, the Court must keep in mind that state policy is due great deference in the area of regulating the importation, transportation, distribution, and sale of intoxicants, and that such regulation is presumptively valid. Further, the State has presented substantial evidence in support of the importance of the regulatory structure to the control of alcohol and the collection of taxes.**

**Moreover, the first inquiry must be whether a difference in treatment does in fact discriminate against interstate commerce. In the instant case, the district court declared the difference in treatment of in-state wineries and out-of-state wine dealers was discriminatory. But the court overlooked a fundamental distinction. A wine dealer located outside the State is qualitatively different from a winery located within the state. It is analytically crucial to recognize that distinction. Nothing in the Constitution requires that entities that are different be treated in the same manner. See *GMC v. Tracy*, 519 U.S. 278, 298 (1997) ("Conceptually, of course, any notion of discrimination assumes a comparison of substantially similar entities." (footnote omitted)). The district court found that the State had presented ample justification for**

its ABC system and its tight regulation of the importation, transportation, distribution, and sale of alcoholic beverages (App. 133), but declared the State had not offered an explanation for the different treatment of out-of-state wine dealers and in-state wineries (App. 137); The court, however, had previously noted the defendants' explanation

that requiring out-of-state wineries to submit to the three-tier system's requirements assists the ABC Commission and law enforcement in policing trade violations and determining the source of substandard or dangerous products (See Def.'s [Mem. Supp. Summ. I](#) at 17 (citing Bason [Res. at](#) 6 [App. 85-86])). To explain why they rigidly apply this system to out-of-state, but not in-state, wineries, they argue that the "state has control over licensed local wineries that it does not have over other dealers in other states." *Id.*; (Def. Mem. Opp. Pl.'s [Mtn. Summ. I](#) at 9 [App. 6, #31].) They argue that licensing out-of-state wineries in the manner of in-state wineries would involve significant administrative costs. *See id.*

(App. 129-30)

Products manufactured out-of-state must "come to rest" in this state in order for the State to gain administrative control over their importation, distribution, and sale, N.C. Gen. Stat. § 18B-1114 (ADD. 19), and to facilitate the collection of excise taxes, N.C. Gen. Stat. § 105-113.83 (ADD. 21). Products produced within the state are from the outset "at rest" in the state before they are put into the stream of commerce. Such products, from the moment of their production, are under the

**control of the state. It is not necessary to impose additional burdens on its local wineries merely in the name of symmetry.**

**The State explained that it has control over licensed local wineries that it does not have over dealers in other states. Control is the very core of the State's Section 2 power. *Capital Cities Cable*, 467 U.S. at 713. If a local winery violates this state's ABC laws or fails to pay taxes on its products, its license can be revoked. Suspected violations of state ABC laws by local manufacturers, retailers, and wholesalers may be investigated by agencies such as the ABC Commission and the Alcoholic Law Enforcement Division; and when a violation is found, the violator is subject to civil and possibly criminal penalties, including the revocation of its license.**

**The ability of the State to control alcoholic beverage importation, transportation, and sales necessitates the use of enforcement tools such as inspections and audits. Control requires the examination of books and records to determine if vendors are correctly reporting their sales and tax liability. Inspections and audits simply cannot be accomplished via mail, telephone or computers, and require on-site visits and physical examination of inventory, records, and reports by auditors and law enforcement officers. In-state wineries, wholesalers, and retailers can be inspected with ease. Obviously, North Carolina cannot maintain such supervisory and regulatory control over dealers located outside the state. Even though the State**

licenses out-of-state sellers, compliance with North Carolina laws is virtually on a voluntary basis.' Indeed, it is problematic whether the State could compel out-of-state dealers to collect the taxes due. *See Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). Judge Easterbrook observed in *Bridenbaugh* the difficulty of forcing buyers of alcoholic beverages to obey the law and enforcing criminal sanctions against them.

Laws forbidding purchases from sellers that lack Indiana permits are devilishly difficult to enforce, however, for the same reason states have insuperable problems collecting their use taxes when people buy from out-of-state vendors that do not collect sales taxes. Noncompliance is almost impossible to detect, and rampant civil disobedience ensures that a handful of prosecutions would not be effective. Private gains from violating the laws vastly exceed the anticipated legal penalties. Sellers and shippers of alcohol are fewer in number, facilitating enforcement.

*Bridenbaugh*, 227 F.3d at 850.

The district court discounted the State's explanation that its complete regulatory control over its local wineries, including the power to revoke licenses of

Judge Easterbrook noted that out-of-state sellers of wine quit shipping to Indiana consumers when the present Indiana statute was adopted. These sellers admitted they never paid Indiana excise taxes. 227 F.3d at 854. Because of the difficulties states were experiencing with illegal shipments of alcoholic beverages, Congress recently enacted the "Twenty-first Amendment Enforcement Act," Public Law No. 106-386, § 2004 (ADD. 24), which amends the Webb-Kenyon Act to empower state attorneys general to seek an injunction in federal court against the illegal shipment of intoxicating liquor. *See, e.g., Florida Dep't of Bus. Regulation v. Zachy's Wine & Liquor*, 125 F.3d 1399, 1405 (11th Cir. 1997) ("[T]he State does not have an implied federal cause of action under the Webb-Kenyon Act."), *cert. denied sub nom. Florida Dept of Bus. Regulation v. Rochambeau Wine & Liquors*, 523 U.S. 1067 (1998).

**any winery (or any other dealer in alcoholic beverages) justifies the difference in treatment. The State has no similar plenary control over out-of-state dealers. The State proffered the affidavit of the former chairman of the ABC Commission regarding the significant administrative burden and cost that would be incurred if the State were to undertake to license out-of-state dealers to ship wine directly to customers in this state. See supra at 12. (App. 122-23).**

**Further, the State offered the testimony of William M. Daniel, Director of the Corporate, Excise and Insurance Tax Division of the State Department of Revenue (App. 102), quoted supra at 16-17. Mr. Daniel explained why it was impossible for the State to control the collection of the excise tax if out-of-state direct shipments of wine (or any other alcoholic beverage) were allowed. Protecting revenue derived from the trade in alcoholic beverages is a legitimate state interest. North Dakota, 495 U.S. at 432. The district court misinterpreted Mr. Daniel's words as an indication that he "is concerned with protecting the competitive position of North Carolina wineries as against out-of-state wineries." Irrespective of the district court's misconstruing Mr. Daniel's statements, the State offered ample reasons for not permitting direct shipment of alcoholic beverages, including wine, to consumers in the state.**

The notion that imported intoxicants must be treated exactly the same way as local alcoholic products was rejected in *Young's Market*, 299 U.S. at 62, where Justice Brandeis, writing for a unanimous court, said:

The Amendment which "prohibited" the "transportation or importation" of intoxicating liquors into any state "in violation of the laws thereof," abrogated the right to import free, so far as concerns intoxicating liquors. The words used are apt to confer upon the State the power to forbid all importations which do not comply with the conditions which it prescribes. The plaintiffs ask us to limit this broad command. They request us to construe the Amendment as saying, in effect: The State may prohibit the importation of intoxicating liquors provided it prohibits the manufacture and sale within its borders; but if it permits such manufacture and sale, it must let imported liquors compete with the domestic on equal terms. To say that, would involve not a construction of the Amendment, but a rewriting of it.

[Id. at](#) 62.

The State has explained that the basis for the difference in treatment is the need for control, not economic protectionism. Two district courts have held that permitting local wineries to ship directly to consumers is not constitutionally invalid.

In *Bainbridge v. Bush*, 148 F. Supp. 2d 1306 (M.D. Fla. 2001), the court noted that Florida permits its local wineries, but not out-of-state wine dealers, to ship directly to consumers and took this fact into account in its [analysis](#). [Id. at](#) 1314. The court held that

the discriminatory nature of Florida's statutory scheme, when considered from the perspective of out-of-state wineries, violates the

**dormant commerce clause. However, because the Florida statutory scheme implicates the "core concerns" of the Twenty-first Amendment, it is a valid exercise of Florida's power even as applied to out-of-state wineries.**

***Id.* at 1315. Significantly, and correctly, the Florida district court did not find it necessary for the state to validate the direct shipment difference separately from Florida's overall ABC scheme. What the district court said of Florida's ABC system may be said with equal force of North Carolina's: "[T]he Florida statutory scheme is supported by legitimate core concerns of the Twenty-First Amendment, regulates only liquor which is shipped into Florida, and does not interfere with the ability of other states to exercise their powers under the Twenty-First Amendment." *Id.* See also, *Heald v. Engler*, No. 00-CV-71438-DT (E.D. Mich. Oct 1, 2001), where the court also considered the direct shipment by local wineries as one provision of the general regulatory scheme and found the entire system to be constitutional. Slip op. at 10.9 (ADD. 28)**

**The State is aware that in *Bolick v. Roberts*, No. 3:99CV755 (E.D. Va. Mar 29, 2002), *appeal docketed*, No. 02-1367 (4th Cir. 2002), the court reached a decision similar in part to that in the present case; specifically, that the difference in treatment of in-state wineries and out-of-state vintners discriminates against interstate commerce. Further, the Virginia court refused to follow Judge Easterbrook's reasoning in *Bridenbaugh*. North Carolina suggests that *Bridenbaugh*, *Bainbridge* and *Heald* are the better reasoned opinions, which this Court should follow.**

In *House of York, Ltd. v. Ring*, 322 F. Supp. 530 (S.D.N.Y. 1970), Judge Friendly, writing for a three judge court, rejected a challenge to New York's direct shipment laws. In rejecting plaintiffs' argument, states allowing individuals to carry with them liquor purchased out-of-state while not allowing individuals to order liquor from out-of-state sources with direct shipment to them violated the Equal Protection Clause of the Fourteenth Amendment, the court found it unnecessary to "speculate on the many possible reasons a state might have for exempting personally carried articles" but recognized that convenience of administration, including the ability to inspect intoxicants personally carried into the state, was a valid reason for the [distinction. \*Id.\* at 536.](#)

As demonstrated above, the district court's flawed analysis led to its erroneous conclusion. The court erred in denying the State's Motion for Summary Judgment. This Court must correct that error by reversing the district court, dissolving the injunction, and dismissing the action.

**II. IF THE DISTRICT COURT CORRECTLY FOUND THAT THE DIFFERENCE IN TREATMENT OF IN-STATE WINERIES AND OUT-OF-STATE VINTNERS VIOLATES THE DORMANT COMMERCE CLAUSE, THE COURT ERRED IN NOT STRIKING THE OFFENDING PROVISION RATHER THAN ENJOINING THE ENFORCEMENT OF NORTH CAROLINA'S LAWS PROHIBITING DIRECT SHIPMENT OF WINES.**

**If it should agree with the district court that the State's differing treatment of in-state wineries and out-of-state vintners violates the Dormant Commerce Clause, this Court must yet reverse the district court's Order. The Order effectively eradicates the Twenty-first Amendment with respect to the importation of wine into this state and reduces the State to collecting only such excise taxes that internet and catalogue wine purchasers voluntarily choose to pay. Instead of declaring five statutes unconstitutional as applied, the court should simply have severed the offending clause from N.C. Gen. Stat. § 1813-1101 (ADD. 16) so that neither out-of-state wine dealers nor in-state wineries could ship directly to consumers.**

**The district court's Order eviscerates the Twenty-first Amendment insofar as that Amendment safeguards North Carolina's right to regulate the transportation and importation of wines by out-of-state dealers. If the Order stands, the State can no more regulate direct shipments of wine by gigantic wine warehouse dealers than it can by little wineries like Oakstone.**

Furthermore, the Order leaves North Carolina subject to the voluntary payment of taxes by wine consumers. In *Bridenbaugh*, Judge Easterbrook commented,

states have insuperable problems collecting their use taxes when people buy from out-of-state vendors that do not collect sales taxes. Noncompliance is almost impossible to detect, and rampant civil disobedience ensures that a handful of prosecutions would not be effective. Private gains from violating the laws vastly exceed the anticipated legal penalties. Sellers and shippers of alcohol are fewer in number, facilitating enforcement.

227 F.3d at 850. Plaintiffs' expert witness in the instant case, *Bridenbaugh*, bluntly acknowledges that until the states recently began to enforce their direct shipment laws, vintners commonly ignored state prohibitions against direct shipment. (App. 70-71, ~ 11-13) Thus, plaintiffs' evidence itself proves that the State is well-advised not to rely on voluntary compliance.

If the district court were correct in finding a violation of the Dormant Commerce Clause, this Court must nonetheless set aside the relief ordered, which declares unconstitutional five statutes, enjoins the State from prohibiting the direct importation of wine, and requires the State to accept voluntary payments of excise taxes by consumers. This Court should remand the case with instructions to the district court to strike N.C. Gen. Stat. § 18B-1101 (c) that permits in-state wineries to ship directly to consumers, thus putting in-state wineries and out-of-state wine dealers

**on equal footing. This is the approach followed by North Carolina courts when confronted with similar situations. <sup>10</sup>**

**Severability is a matter of state law. *Leavitt v. Jane L.*, 518 U.S. 137, 139 (1996). In *Fulton Corp. v. Faulkner*, 345 N.C. 419, 481 S.E.2d 8, *reh g denied*, 345**

<sup>10</sup> **The process is quite simple and can be accomplished without affecting other portions of the statute or the general statutory scheme:**

**§ 18B-1101. Authorization of unfortified winery permit (2001).**

**The holder of an unfortified winery permit may:**

**(1) Manufacture unfortified wine;**

**(2) Sell, deliver and ship unfortified wine in closed containers to wholesalers licensed under this Chapter as authorized by the ABC laws, except that wine may be sold to exporters and nonresident wholesalers only when the purchase is not for resale in this State;**

**and atitside this State;**

**(4) Furnish or sell "short-filled" packages, on which State taxes have been or will be paid, to its employees for the use of the employees or their families and guests in this State;**

**(5) Regardless of the results of any local wine election, sell the winery's wine for on- or off-premise consumption upon obtaining the appropriate permit under G. S. 18B-1001.**

**A sale under subdivision (4) shall not be considered a retail or wholesale sale under the ABC laws.**

N.C. 761, 485 S.E.2d 47 (1997), a portion of the intangibles tax statute was found to be unconstitutional, and the North Carolina Supreme Court held that the unconstitutional portion should be severed and the balance of the statute enforced.

The State's Supreme Court has explained that the doctrine of severability rests on the "fundamental principle that a statute may be constitutional in one part and unconstitutional in another and that if the invalid part is severable from the rest, the portion which is constitutional may stand while that which is unconstitutional is stricken out and rejected." *State v. Fredell*, 283 N.C. 242, 245, 195 S.E.2d 300, 302 (1973) (quoting 16 AM. JUR. 2D *Constitutional Law* §§ 181-182 (1964)).

North Carolina has established a two-pronged test for severability that requires both prongs to be satisfied for severability to be applied. The two prongs consist of (1) whether the remaining portions of the statute are capable of being enforced on their own; and (2) whether there is legislative intent to enforce the remainder, "particularly ... whether that body would have enacted the valid provisions if the invalid ones were omitted." *State ex rel. Andrews v. Chateau X, Inc.*, 296 N.C. 251, 259, 250 S.E.2d 603, 608 (1979); *see also Pope v. Easley*, 354 N.C. 544, 548, 556 S.E.2d 265, 268 (2001); *In re Appeal of Springmoor, Inc.*, 348 N.C. 1, 13, 498 S.E.2d 177, 184-85 (1998).

Subsection (3) is an amendment to the original N.C. Gen. Stat. § 18B-1101. Severing the subsection will not affect the remainder of the statute; thus, the first prong of the test is satisfied. The second prong, regarding legislative intent to have the remainder of the statute enforced even if the clause in question is omitted, is also satisfied as is shown by the fact that the amendment which permits direct shipment by local wineries was added years after the enactment of the original statute. Striking the offending provision does not affect the remainder of the statute or other provisions of the ABC laws.

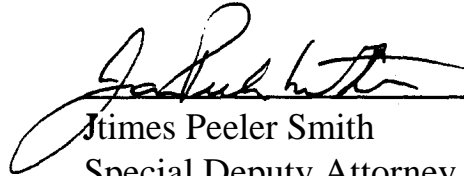
It is, therefore, manifest that the district court's remedy was grossly disproportionate to the wrong it identified. Furthermore, the district court committed egregious error in ordering a remedy that is unconstitutional in itself because it substantially eradicates the State's authority guaranteed by the Twenty-first Amendment. Should it agree that permitting local wineries to ship directly to customers while not permitting out-of-state vendors to do so violates the Commerce Clause, this Court should set aside the relief ordered by the district court and remand this case with instructions to sever the offending portion of N.C. Gen. Stat. § 1813-1101.

## **CONCLUSION AND REQUEST FOR ORAL ARGUMENT**

**For the foregoing reasons, this Court should reverse the Order of the district court and remand the case with instructions to dismiss the action. If this Court should, however, find that the difference in treatment between in-state wineries and out-of-state vintners discriminates against interstate commerce, the Court should set aside the relief ordered by the district court, remand the case, and direct the district court to hold unconstitutional N.C. Gen. Stat. § 18B-1101(3), which permits local wineries to ship wine directly to customers, and to grant the State's motion for summary judgment as to all other claims asserted. The State requests oral argument in this appeal.**

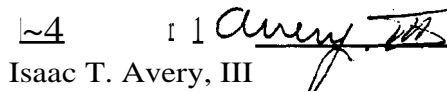
Respectfully submitted, this **12** day of June, 2002.

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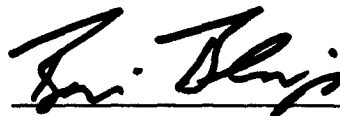
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