

FREE COMMERCE IN WINE: TRAPPED IN A LEGAL WEB

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Introduction – The Internet and the Right of Access to Wine

The Internet revolution is expanding markets and consumer choices around the world. Are wine consumers, wine producers and wine merchants going to be permitted to participate? That question is before the federal judiciary in cases pending in Texas, Indiana, New York, Virginia, Michigan and Florida. So far, the proponents of free trade are winning: In Indiana and Texas, district court decisions invalidating state-created market access restrictions are now on appeal. *Bridenbaugh, et.al. v. O'Bannon, et.al.* ND Ind., No. 98-cv-464, December 10, 1999 decision appealed to Seventh Circuit Dec. 31, 1999; *Dickerson, et. al. v. Bailey, et.al.* No.99-cv-1247, Feb 11,2000 decision appealed to Fifth Circuit. The remaining cases are in the early pleading stages.

The lawsuits acknowledge the authority granted each state under the 21st Amendment to entirely ban wine sales or to exercise complete state control of traffic in wine. They also assert that the states cannot use their authority to direct that wine be sold only by certain classes of favored competitors, such as private, state-licensed distributors. In other words, once a state determines that wine can be sold within its borders by non-governmental entities, the Commerce Clause of the U.S. Constitution requires the states to provide in-state and out-of-state sellers with equal access to its citizens.

U.S consumers seeking the opportunity to purchase wines unavailable in their home states are bringing tremendous pressure on Prohibition-spawned state-law-based exclusionary barriers to entry into local wine markets. These barriers are being exposed as the economic protectionism they surely were always intended to be. Resolution of these cases will undoubtedly lead to fundamental shifts in the economic and legal dynamics of U.S. wine distribution and may ultimately cause the present Balkanized system of alcoholic beverage regulation to be reformed.

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Does this matter in the battles yet to be fought over the evolving role of the Internet as a commercial platform? You bet. Consumer access to foreign markets, and foreign merchant access to local markets, are the key issues here. Every court test develops a precedent that will help shape product delivery and access mechanisms for myriad products and services in the decades to come.

The Web of Restrictions on Market Access for Wine

Prohibition, the federal government's "Noble Experiment," was expressly repealed in 1933 by the 21st Amendment to the U.S. Constitution. The first section of the 21st Amendment made it clear that the United States as a whole was no longer going to be "dry." The second section of the 21st Amendment left that option to the various states by prohibiting the transportation or importation of intoxicating liquors into any state "in violation of the laws thereof."

Clearly, this broad language was designed to promote abstinence or temperance. Most states utilized it instead to justify the creation of a mandatory "three tier system" where winemakers and other "manufacturers" of wine, beer or spirits (tier 1) must first register with each state and then sell their products in that state only to state-licensed distributors (tier 2) who in turn can only sell to in-state retailers (tier 3). Thus, two layers of mandatory in-state middlemen are placed in between a wine maker and the ultimate consumer in each of those states. If in-state distributors choose not to carry a particular wine, the retailers in that state cannot sell it and the consumer cannot buy it.

In the decades since the repeal of Prohibition, a maze of exclusionary restrictions on market access developed to supplement the three-tier system and ensure that consumers could not look to other states for different wines or better prices. These sophisticated restrictions go far beyond simple prohibitions on direct delivery of wine from out of state to a consumer.

"Primary source" laws require that wine be purchased within a state only from the original producer or his authorized agent. These laws prohibit purchases from other sources, such as out-of-state retailers, collectors selling through wine auctions or distributors in other markets.²

"Franchise" laws refer not only to a distributor's statutory right to be the exclusive seller of branded wines in its "territory," but also to restrictions on a supplier's

² 26 states have some form of wine primary source laws. Florida's is typical: shipments of wine into Florida must come from "a licensed primary American source of supply." The "primary American source of supply" must be the manufacturer or primary importer. [Florida Statutes § 564.045(1) and (4)].

termination rights unless onerous conditions (often including state regulatory agency approval) are met. Out-of-state producers risk locking the future of their brand into one distributor in a “franchise” state if even one consensual sale is made through that distributor.³

“At rest” laws require that wine from out of state physically arrive at (and often remain at) the premises of a middle-tier distributor before moving through the chain of distribution to a retailer. The retailer, in turn, often must hold the wine before shipping it to a consumer. Out-of-state sellers cannot access local markets directly if wine can only be moved through local state licensed distributors and retailers.⁴

“Tied-House” laws prohibit vertical integration of the wine industry through common ownership of licenses on all three tiers. Ironically, tied-house laws were originally intended to protect retailer independence and consumer choice. They now operate in most states to protect the middle tier and limit consumer product choices to only those wines that the local middle tier chooses to offer.⁵

Consumers, The Commerce Clause and the 21st Amendment

Fortunately for wine consumers, 21st Amendment jurisprudence has continued to evolve over the last seven decades. The simplistic states-rights approach utilized in the late 1930's in the *Young's Market* line of cases⁶ to justify the impediments to inter-state commerce outlined above has been abandoned by most if not all courts. Today, a state regulation must be justified by a 21st Amendment “core power” and

³ 23 states have various wine “franchise laws” on their books, from simple “good cause” requirements for termination to elaborate statutory schemes governing every aspect of the distribution relationship. Georgia, for example, requires exclusive territories. One shipment to a GA distributor grants a monopoly on the brand to the distributor. The distributor may only be terminated if the State Liquor Commission approves after a hearing. [GA Regulations: §560-2-5-.02]. Many small wine producers’ fear shipping to a Georgia distributor for fear that they will become prey to the Georgia system.

⁴ 31 states have some form of “at-rest” requirement for wine. Most at-rest requirements are express. However, many are “implied” by the three-tier licensing scheme and enforced by the state alcoholic beverage authorities on that basis. In Delaware, for example, the requirement is express and wine arriving in the state must be unloaded at the distributor’s premises and physically stored for at least 72 hours. Del.Stat. § 501(f).

⁵ Possibly as a result of the above restrictions, the middle/distributor tier in most states has undergone dramatic consolidation in recent decades. In Florida, for example, three large distributors handle the bulk of the wine sold in that state.

⁶ *State Board of Equalization of Cal. v. Young's Market Co.*, 299 U.S. 623 (1936) was the first in a series of 1930's cases establishing that State law was paramount in the area of liquor regulation.

balanced against other provisions of the Constitution. The “core powers” include the state's right to ban all alcohol and go dry.⁷ Arguably, also included are: (1) the state's right to be the merchant itself;⁸ (2) The state's right to protect minors.; and (3) The state's obligation to promote temperance.

Case law now holds that the 21st Amendment cannot be used as a pretext for violating other Constitutional rights. For example, constitutional rights arising under the 14th Amendment Equal Protection guarantee,⁹ the Supremacy Clause,¹⁰ and the First Amendment¹¹ have all been found to outweigh the 21st Amendment. Balancing 21st Amendment-based state laws against the Commerce Clause, on the other hand, requires an analysis of the state interest and how the state enforces that interest. *Brown-Foreman Distillers Corp. v. New York State Liquor Authority*, 476 U.S. 573 (1986). The Supreme Court in *Brown-Foreman* focused upon the legitimacy of the state's interest (i.e., does the state interest relate to a core 21st Amendment power?) and whether or not that interest is sufficient to overcome the burden on interstate commerce (i.e., are there effective, but less restrictive, alternatives?).

In the context of this controversy over access to out-of-state wines, the wine consumer is well positioned to test the system. Wine consumers and collectors consider fine wines to be unique –like works of art. This is reflected in the cost of, and demand for, premium wines from different states and countries. Variations in varietal designation, vintage year, vineyard location, varietal blending, winemaking style and limitations on availability all contribute to wine's uniqueness. National and international rating systems rank thousands of different wines every year. Wines are *not* fungible, which makes arbitrary restrictions on access all the more unpalatable to fine wine consumers. This is the force driving the recent lawsuits. Its potency is shown by the recent Texas court decision, which focused on the fact that the Houston plaintiffs couldn't get wines made in Altus, Arkansas. The Texas court also gave short shrift to the temperance arguments raised as justification.¹²

⁷ Dry areas exist in many local communities in dozens of states. Even today, local option elections are regularly held in different communities seeking to lift (or reapply) bans on the sale of alcoholic beverages.

⁸ At least 19 states have some commercial role in the distribution of wine, beer or spirits.

⁹ *Cooper v. McBeath*, 11 F.3d 547 (5th Cir. 1994), cert. denied, 512 U.S. 1205 (1994)

¹⁰ *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980)

¹¹ *44 Liquormart, Inc. v. Rhode Island*, 517 U.S. 484 (1996)

¹² “The Court finds that there is no temperance goal served by the statute since Texas residents can become as drunk on local wines or on wines of large out-of-state suppliers able to pass into the state

Consumer standing is the most important development in the pending cases. The Texas and Indiana courts balanced adult consumers' rights to access lawfully produced out-of-state wine against in-state commercial interests' attempts to restrict market access to only those wine products they control. Those courts have held that protecting local markets from out-of-state competition has nothing to do with 21st Amendment core powers and does not constitute a legitimate state interest.

Alternative direct distribution systems exist that satisfy the state's interests of licensing those permitted to sell wine, protecting minors, collecting taxes and promoting temperance.¹³ The battles over direct shipping are not being so fiercely fought to capture the small market share represented by the wine collector (although that market is growing steadily). The battles are being fought to block direct out-of-state market access completely. Once the markets in the challenged states are opened, protected in-state interests correctly fear it will be impossible to close them.

Conclusion – the Real Battles Are Yet to Come.

The tangled restrictions that have built up since the 1933 repeal of Prohibition have evolved into substantial state-erected barriers to normal commerce in wine, let alone free trade in wine. Wine production, regulated by the federal and various state governments, is unquestionably lawful. Wine consumption and possession by adults is also unquestionably lawful, even in dry areas where wine cannot be sold. Adult residents of major-market states in the United States (including New York, Florida, Texas, Indiana, Michigan and Virginia) are denied access to a great many cult, small-production and allocated premium wines readily available to adult residents of relatively free-market states such as California, Oregon and Illinois.

Protection of minors, temperance, tax collection and protection of public health and welfare are all used to justify restrictions on access to the national and international wine market. These arguments could at any time be used to justify similar restrictions upon entire classes of other products to protect local markets from the impact of the Internet. Only by balancing the interests of consumers against truly legitimate state interests can interstate commerce be protected. That is what is at

through its distribution system, and available in unrestricted quantities, as those that, because of their sellers' size or Texas wholesalers or retailers' constraints, are in practical effect kept out of the state by the statute." *Dickerson, et. al. v. Bailey, et.al.* Slip Op. at 42.

¹³ "Reciprocity" statutes that permit direct shipment of non-commercial amounts of wine between merchants and out-of-state residents currently exist between twelve states, and various permit and import rights exist in another seven. These effective direct delivery systems have been cited as evidence in the pending lawsuits that less restrictive alternatives do exist.

stake as the current cases go to higher courts. Stay tuned because the battles have only just begun.

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