A Tipsy Balance: Dormant Commerce Clause Limits on a State's Prerogatives Under the Twenty-first Amendment

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Introduction

Since the repeal of Prohibition, the Twenty-first Amendment has been largely understood to allow states the power to regulate the way alcohol is manufactured, distributed, and sold within their jurisdictions.[1] The alcoholic regulatory landscape of the United States is incredibly varied. For example two-thirds of the states have established a private license system that allows private enterprises to purchase and sell alcoholic beverages at each state's discretion.[2] Seventeen states have adopted a state monopoly system of regulation over the wholesale and retail of alcoholic beverages.[3] In *Granholm v. Heald*, the Supreme Court concluded that state alcohol regulations discriminating against out-of-state wineries, by only allowing them to sell to in-state distributors and not directly to the state's consumers (i.e., a three-tier alcohol beverage distribution system), violated the dormant Commerce Clause because the regulation did not impose the same requirement to in-state wineries.[4] Although the Court ruled that the three-tier system was a permissible exercise of state authority under Section 2 of the Twenty-first Amendment, the Court also held that the effect of compelling only out-of-state wineries to pass through the scheme

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1. U.S. CONST. amend. XXI, § 2.
2. *The Control Systems*, NATIONAL ALCOHOL BEVERAGE ASSOCIATION (2016), http://www.nabca.org/States/States.aspx.
3. *Id.*
4. Granholm v. Heald, 544 U.S. 460, 493 (2005).

created an impermissible burden not borne by in-state wineries and, therefore, was unconstitutional.[5]

Post-*Granholm*, courts still attempt to reconcile the tension between state power conferred by the Twenty-first Amendment and potential limitations on those powers imposed by the dormant Commerce Clause. Currently, Pennsylvania's Liquor Code requires out-of-state beer and malt beverage manufacturers to contract with in-state distributors in order to sell their products to Pennsylvania residents.[6] Conversely, in-state manufacturers can sell directly to residents.[7] This advantage essentially creates the same unequal application of the three-tier alcoholic beverage regulatory scheme that was held unconstitutional in *Granholm*.

This note will examine: (1) the United States' history of federal regulation of alcohol; (2) the progression of Twenty-first Amendment jurisprudence and its interplay with potential limits of states' alcohol regulating powers by the dormant Commerce Clause; (3) the procedural history and legal landscape leading up to *Granholm*; (4) the Supreme Court's affirmation of Commerce Clause limits on the Twenty-first Amendment in *Granholm*; (5) the state of dormant Commerce Clause limits post-*Granholm*; (6) how the *Granholm* analysis supports the argument that Pennsylvania's regulation forcing out-of-state beer and malt beverage manufacturers to abide by the three-tier system is similarly burdensome, discriminatory, and in violation of the dormant Commerce Clause; and (7) how three particular justifications for the state's absolute regulatory power under the Twenty-first Amendment are outdated in light of the shift in case law and the growth of e-commerce in the alcohol industry.

I. The United States' History of Federal Regulation of Alcohol

The Anti-Saloon League of America ("ASLA") led a movement of prohibitionism in the United States, which gained momentum after a decades-long campaign.[8] The temperance movement sought to reduce sales of alcoholic beverages across the country.[9] ALSA successfully mobilized Protestant business owners and churches to vote for and support candidates who would enforce prohibitionist legislation.[10] Congress

5. *Granholm*, 544 U.S. at 489.

6. 47 PA. STAT. AND CONS. STAT. ANN. § 4-444 (2016).

7. *Id.*

8. Harry G. Levine, *The Birth of American Alcohol Control: Prohibition, the Power Elite, and the Problem of Lawlessness*, 12 CONTEMP. DRUG PROBS. 63, 66 (1985).

9. *Granholm*, 544 U.S. at 476.

10. Levine, *supra* note 8, at 66.

ratified the Eighteenth Amendment in 1919, which prohibited "the manufacture, sale, or transportation of intoxicating liquors" within the United States.[11] The accompanying legislation, the National Prohibition Act (also known as the Volstead Act), granted federal and state governments the power to enforce the ban that went into effect later that year.[12]

II. Evolution of Alcohol Regulations from the Dormant Commerce Clause to the Twenty-first Amendment

A. Commerce Clause

Article 1 of the Constitution vests in Congress the authority to "regulate Commerce . . . among the several States."[13] This authority "has long been understood to have a 'negative' [or 'dormant'] aspect that denies the States the power unjustifiably to discriminate against or burden the interstate flow of articles of commerce."[14] The Court defined "discrimination" as the "differential treatment of in-state and out-of-state economic interest that benefits the former and burdens the latter."[15] When state laws are challenged under the Commerce Clause, facially discriminatory laws motivated by "simple economic protectionism" are subject to a "virtually per se rule of invalidity" and invoke the strictest scrutiny.[16] If a statute is not facially discriminatory, the state bears the burden of demonstrating that the law "advances a legitimate local purpose" and that such purpose "cannot be adequately served by reasonable nondiscriminatory alternatives."[17] In instances where state laws have legitimate purposes that will only incidentally affect interstate commerce, the Court adopts a slightly more deferential approach.[18] The party challenging the validity of the statute bears the burden of proof to show that

11. U.S. CONST. amend. XVIII, § 1.

12. National Prohibition (Volstead) Act, Pub. L. No. 66-66, 41 Stat. 305, repealed by Liquor Law Repeal and Enforcement Act, ch. 740, § 1, Pub. L. No. 74-347, 49 Stat. 872 (1935); Levine, *supra* note 8, at 66.

13. U.S. CONST. art. I, § 8, cl. 3.

14. Or. Waste Sys., Inc. v. Dep't. of Envtl. Quality of Or., 511 U.S. 93, 98 (1994).

15. *Id.* at 99.

16. City of Philadelphia v. New Jersey, 437 U.S. 617, 624 (1978); *see* Hughes v. Oklahoma, 441 U.S. 322, 337 (1979) ("At a minimum such facial discrimination invokes the strictest scrutiny of any purported legitimate local purpose and of the absence of nondiscriminatory alternatives.").

17. New Energy Co. of Ind. v. Limbach, 486 U.S. 269, 278 (1988).

18. *City of Philadelphia*, 437 U.S. at 624.

the law discriminates or places a burden on interstate commerce.[19] Any law that discriminates against interstate commerce will be evaluated using a balancing test that weighs whether the burden imposed by the law outweighs the local benefits.[20] If the burden is excessive in relation to the local benefits, the law will be found unconstitutional.[21] If the burden is minimal and the law promotes a substantial state interest, the law will likely survive the Court's scrutiny.[22]

The first dormant Commerce Clause challenge to state regulatory powers of alcohol distribution came in *Thurlow v. Massachusetts*.[23] The Court rejected the notion that the dormant Commerce Clause limited the state's broad authority over the sale of alcohol[24] even when states began banning liquor within their territories.[25] It was not until 1888 in *Bowman v. Chicago & Northwestern Railway Co.* that the Court was presented with a statute that unquestionably regulated interstate commerce.[26] The contested Iowa statute once again raised the question of whether the dormant Commerce Clause overruled the state's authority to regulate the importation of alcohol.[27] The state argued that it had a legitimate purpose to prevent the alcohol from entering its borders—to protect the welfare and morals of its citizens.[28] The Court struck down the statute, ruling that a state's right to regulate the sale of liquor did not give it free reign to violate the dormant Commerce Clause.[29] Rather, its authority only came into effect once it passed through the state's borders.[30]

Prior to the ratification of the Eighteenth Amendment, the Court continued to invalidate other state liquor regulations primarily on two grounds: (1) the Commerce Clause prevented states from discriminating against imported liquor, and (2) states could not pass facially neutral laws that, in its practical effect, placed an impermissible burden on interstate commerce.[31] After *Bowman*, Iowa adopted a statute banning the sale of all

19. *Id.* at 624.
20. Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970).
21. Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456, 471 (1981).
22. *Id.*
23. Thurlow v. Massachusetts, 46 U.S. 504, 586 (1847).
24. *Id.*
25. Mugler v. Kansas, 123 U.S. 623, 671 (1887).
26. Bowman v. Chi. & N. W. Ry. Co., 125 U.S. 465, 474 (1888).
27. *Id.* at 479.
28. *Id.*
29. *Id.* at 500.
30. *Id.*
31. Scott v. Donald, 165 U.S. 58, 101 (1897); *see* Leisy v. Hardin, 135 U.S. 100, 125 (1889).

liquor, regardless of where it was produced or imported.[32] The Court held that as long as the imported liquor remained unopened in its original packaging it was considered an article of interstate commerce and outside of the state's regulatory reach.[33] The state could not prohibit the importation or sale of out-of-state alcohol.[34] This decision was contrary to established precedent,[35] where the Court now created a situation where in-state producers would be put at a competitive disadvantage because the state could burden them with more stringent regulations while out-of-state producers could not be regulated.[36]

B. The Wilson Act Confines States' Authority to Their Borders

Congress passed the Wilson Act ("Wilson") in 1890, allowing states to regulate the sale of liquor "upon arrival" in the state "to the same extent and in the same manner as though such liquids or liquors had been produced" within the state.[37] On one hand, Wilson permitted states to regulate alcohol consumption and distribution within their borders as they wished, yet it required out-of-state liquor to be regulated in the same manner as in-state liquor.[38] However, its language was problematic—an individual may act lawfully in a "wet" state, as they are allowed to sell alcohol, while simultaneously violating laws imposed by a "dry" state.[39] One year later, the Court reaffirmed Wilson's constitutionality in *In re Rahrer*.[40] Upon Wilson's passage, Iowa reinstated the same statute the Court struck down in *Bowman*.[41] The Court once again invalidated the statute and, with a more restrictive interpretation, ruled that the regulations would be imposed at the point of delivery to the consumer and at the point of resale.[42] This meant that states had the power to control the *resale* of imported alcohol once it entered the state but not to ban the importation of alcohol outright, thus protecting the out-of-state shipper from incurring any

32. *Leisy*, 135 U.S. at 124–25.

33. *Id.* at 124.

34. *Id.* at 125.

35. Mugler v. Kansas, 123 U.S. 623, 671 (1887).

36. Bridenbaugh v. Freeman-Wilson, 227 F.3d 848, 852 (7th Cir. 2000).

37. Wilson Act, 26 Stat. 313 (1890) (codified at 27 U.S.C. §121 (2012)).

38. Rhodes v. Iowa, 170 U.S. 412, 423–24 (1898).

39. *Id.* For the purpose of this Note, "wet" state is defined as a state that allows the sale and importation of alcohol, while a "dry" state is defined as a state that prohibits it.

40. *In re* Rahrer, 140 U.S. 545, 562 (1891).

41. *Rhodes*, 170 U.S. at 417–18.

42. *Id.* at 412.

penalties.[43] As a result, the direct delivery liquor trade flourished as out-of-state manufacturers circumvented state regulation because they were allowed to send liquor directly to consumers.[44]

C. Webb-Kenyon Act Expands Wilson Act Powers

In 1913, Congress passed the Webb-Kenyon Act ("Webb-Kenyon") in an attempt to reshift the power to the states.[45] The new legislation was designed to "extend that which was done by the Wilson Act"[46] and "close the direct-shipment gap."[47] Webb-Kenyon clarified that states had the power to prevent the importation of alcohol into any state in violation of those state's laws.[48] When the bill was first brought for approval, President William Taft vetoed it, arguing that it was an impermissible delegation of Congress's Commerce Clause powers.[49] Despite his attempt, Congress overrode the veto.[50] Even with the constitutionality of Webb-Kenyon in question, the Court did not uphold the law until it was challenged in *James Clark Distilling Co. v. Western Maryland Railway Co*.[51]

D. Ratification of the Twenty-first Amendment

The political climate in the United States by the late 1920s markedly changed and there was a growing concern regarding the unenforceability of Prohibition on a national scale. The devastating consequences of the Great Depression undermined two crucial prohibitionist principles: (1) that Prohibition would bring about American prosperity, and (2) that Prohibition would bring order to the growing lawlessness in society.[52]

Legislators struggled to maintain Prohibition as public support was waning. A commission headed by George Wickersham, the U.S. Attorney General under President William Taft, presented a two-page summary of conclusions signed by ten of the eleven commissioners who opposed the repeal of the Eighteenth Amendment.[53] President Hoover released the full

43. Vance v. W. A. Vandercook Co., 170 U.S. 438, 452–53 (1898).

44. *Rhodes*, 170 U.S. at 426.

45. 27 U.S.C. § 122 (2016).

46. James Clark Distilling Co. v. W. Md. Ry. Co., 242 U.S. 311, 324 (1917).

47. Granholm v. Heald, 544 U.S. 460, 481 (2005).

48. *Id.*

49. *Id.*

50. Mo. Pac. Ry. Co. v. Kansas, 248 U.S. 276, 279 (1919).

51. *James Clark Distilling Co.*, 242 U.S. at 325 (holding that the Dormant Commerce Clause did not provide immunity to alcohol distributors who violated state laws).

52. Levine, *supra* note 8, at 72

53. *Id.* at 74–75.

report ("Wickersham Report") on January 20, 1931.[54] Although most of the commissioners opposed legalizing alcohol, the Wickersham Report "found widespread disobedience to Prohibition" and suggested that "prohibition could never be enforced" nationally.[55] The newspapers noted the contradictions between the facts in the report and the summary signed by President Hoover.[56] The media's negative treatment of the report echoed the shift in public sentiment against Prohibition and paved the way for its repeal.[57]

Thirteen years later, Congress voted to submit the Twenty-first Amendment for ratification to the state conventions and the House approved it on February 20, 1934, thereby repealing the Eighteenth Amendment.[58] Section 2 of the Twenty-first Amendment prohibits the "transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof . . . ."[59] The question then became whether Section 2 gave states absolute control over the importation of alcohol even if states' laws discriminated against interstate commerce. Initial testimony in congressional debates from Senator John J. Blaine, who spearheaded the repeal of the Eighteenth Amendment, indicated that Congress intended to clarify the purpose of Section 2—to restore power to the states *absolute* control over alcohol traffic via constitutional amendment.[60] In other words, under the Twenty-first Amendment states could choose to remain "dry."

III. Conflicting Interpretations of Twenty-first Amendment Powers and Limits

Supreme Court jurisprudence post-passage of the Twenty-first Amendment favored a fairly permissive interpretation of states' right to regulate even if states' laws implicated the dormant Commerce Clause.[61] In *State Board of Equalization v. Young's Market Co.*, the Court upheld a California regulation mandating a five hundred dollar license fee on out-of-

54. *Id.* at 74.

55. *Id.* at 75.

56. *Id.*

57. *Id.* at 74–75.

58. Levine, *supra* note 8, at 81.

59. U.S. CONST. amend. XXI, § 2.

60. Ethan Davis, *Uncorking a Seventy-Four-Year-Old Bottle: A Toast to the Free Flow of Liquor Across State Borders*, 117 YALE L.J. Pocket Part 133, 137 (2007).

61. Indianapolis Brewing Co. v. Liquor Control Comm'n, 305 U.S. 391, 394 (1939); *see* State Bd. of Equalization v. Young's Mkt. Co., 299 U.S. 59, 64 (1936).

state beer importers.[62] Justice Brandeis unequivocally affirmed the Court's position that Section 2 of the Twenty-first Amendment "confer[red] upon the State the power to forbid all importations which do not comply with the conditions which it prescribes."[63] In cases following *Young's Market Co.*, the Court upheld the states' broad regulatory powers and solidified their authority to place more burdensome trade barriers.[64]

A. Application of Dormant Commerce Clause Limitations

Almost three decades later, despite the precedent set by *Young's Market Co.* and its progeny, the Court softened its stance against enforcing dormant Commerce Clause limits with its decision in *Hostetter v. Idelwild Bon Voyage Liquor Corp*. The Court held that if it were to accept the premise that states' powers under Section 2 were absolute, regardless of whether they infringed upon the Commerce Clause, Congress would have no regulatory power over interstate commerce in regard to liquor.[65] The dissent argued that the exclusion of a proposed section that would have provided Congress with the "concurrent power to regulate or prohibit the sale of intoxicating liquors"[66] illustrated congressional intent to carve out language to confer absolute plenary powers to the states.[67] But "such a conclusion," Justice Stewart firmly stated, "would be patently bizarre and is demonstrably incorrect."[68] The Court further noted that "[b]oth the Twenty-first Amendment and the Commerce Clause are parts of the same Constitution" and each section "must be considered in the light of the other" within the context of each specific case.[69]

Taking it a step further, the Court in *Bacchus Imports, Ltd. v. Dias* "foreclose[d] any contention that [Section] 2 of the Twenty-first Amendment immunize[d] discriminatory direct-shipment laws from Commerce Clause scrutiny."[70] In *Bacchus*, the state of Hawaii had enacted regulations that mandated a twenty percent excise tax on liquor.[71] Alcoholic beverages produced locally in Hawaii were exempted from

62. *Young's Mkt. Co.*, 299 U.S. at 64.

63. *Young's Mkt. Co.*, 299 U.S. at 62.

64. *See Indianapolis Brewing Co.*, 305 U.S. at 391; Ziffrin, Inc. v. Reeves, 308 U.S. 132, 141 (1939).

65. Hostetter v. Idelwild Bon Voyage Liquor Corp., 377 U.S. 324, 332 (1964).

66. *Id.* at 337 (Black, J., dissenting).

67. *Id.*

68. *Id.* at 332.

69. *Id.*

70. Granholm v. Heald, 544 U.S. 460, 487–88 (2005).

71. Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 265–66 (1984).

taxation.[72] State legislators found it was in the state's interest to use the tax revenues to "defray the costs of police and other governmental services that the Hawaii Legislature concluded had been increased due to the consumption of liquor."[73] Out-of-state liquor wholesalers sued, arguing that the tax violated the dormant Commerce Clause because it was discriminatory in its purpose and effect, favoring in-state businesses.[74] The Court held that the tax exemptions discriminated against interstate commerce by giving the local Hawaiian liquor industry a commercial advantage.[75] In effect, the tax placed significant economic barriers to competition.[76] The Court relied on its analysis in *Hostetter*, reaffirming that the Twenty-first Amendment did not entirely remove state regulation of alcoholic beverages from the Commerce Clause's reach.[77] The decision created a balancing test weighing the federal interests against the state interests under the Twenty-first Amendment.[78]

Justice Stevens criticized the Court in his dissent for ignoring the precedent set in *Young's Market Co*.[79] He opined that the Twenty-first Amendment foreclosed the wholesalers' Commerce Clause claim and that the Court had previously upheld legislation that imposed similar taxes.[80]

Even if a statute is not discriminatory on its face, it may be discriminatory in its effect.[81] In such cases, states have an opportunity to save such statutes from invalidation by proving that the law "serves legitimate local purposes that could not adequately be served by available nondiscriminatory alternatives."[82] For example, in *Maine v. Taylor*, the Court upheld a discriminatory provision banning importation of baitfish because the state was able to show that the imported baitfish introduced parasites into the existing baitfish population that otherwise did not exist in the state.[83] The state successfully demonstrated that alternatives to the ban were unavailable.[84]

72. *Id.* at 265.
73. *Id.*
74. *Id.* at 266.
75. *Id.* at 276.
76. *Id.*
77. Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 275–76 (1984).
78. *Id.* at 270.
79. *Id.* at 284, 286.
80. *Id.* at 285–86.
81. Maine v. Taylor, 477 U.S. 131, 138 (1986).
82. *Id.* at 151.
83. *Id.* at 148–49.
84. *Id.* at 151.

In subsequent decisions following *Maine*, the Court made clear that the nondiscrimination principle of the dormant Commerce Clause serves economic interests that would otherwise be unprotected.[85] When the state of New York began requiring that a liquor producer file a monthly schedule of prices and attach an affirmation that it would not sell its liquor for lower than the scheduled prices in any other state, the Court held the statute violated the Commerce Clause because it effectively controlled the liquor prices in other states.[86] Such control was not a permissible exercise of States' power under the Twenty-first Amendment even if the statute was not discriminatory in the sense that both in-state and out-of-state liquor producers would have to abide by the affirmation provision.[87] In a later case, the Court emphasized that the Twenty-first Amendment did not "immunize state laws from invalidation under the Commerce Clause when those laws have the practical effect of regulating sales in other States."[88]

IV. *Granholm v. Heald*: The Twenty-first Amendment Does Not Permit Discrimination Against Interstate Commerce

A. Introduction to the Three-Tier System and Prohibition of Direct Shipment

Today, twenty-six states are "closed" states that prohibit most interstate direct shipments.[89] While out-of-state direct shipping violations are misdemeanors in most states, seven states have elevated them to felonies.[90]

The current three-tier system of regulating the distribution of alcohol was developed after the ratification of the Twenty-first Amendment.[91] Under this system, a manufacturer must obtain a permit from the Alcohol and Tobacco Tax and Trade Bureau ("ATF"), which allows them to import alcohol within the United States.[92] The manufacturer then sells its product

85. *See Taylor*, 477 U.S. at 138 (stating that statutes that "only incidentally" burden interstate commerce face less demanding scrutiny).

86. Brown-Forman Distillers Corp. v. N.Y. State Liquor Auth., 476 U.S. 573, 576 (1986) (The affirmation stated, "no higher than the lowest price at which such item of liquor will be sold by such [distiller] to any wholesaler anywhere in any other state of the United States.").

87. *Id.* at 585.

88. Healy v. Beer Inst., Inc., 491 U.S. 324, 342 (1989) (citing *Brown-Forman Distillers Corp.*, 476 U.S. at 585).

89. FED. TRADE COMM'N, POSSIBLE ANTICOMPETITIVE BARRIERS TO E-COMMERCE: WINE 2 (July 2003) [hereinafter FTC Report], http://www.ftc.gov/os/2003/07/winereport2.pdf.

90. *Id.* at 8.

91. *Id.* at 6.

92. *Id.* at 5.

to a wholesaler licensed with the state, which pays excise taxes and delivers the product to retailers.[93] Retailers then sell to consumers and collect sales taxes.[94] By requiring manufacturers to sell through wholesalers, "states hoped to collect taxes more efficiently and to limit alcohol sales to minors."[95]

B. *Granholm v. Heald* – the Dormant Commerce Clause Prevails

In *Granholm*, the Court consolidated two different cases, *Heald v. Engler* and *Swedenburg v. Kelly*, to definitively decide the split over the dormant Commerce Clause issue in these three-tier regulatory schemes.[96] *Heald v. Engler* challenged a Michigan statute that permitted in-state wineries to directly ship to Michigan consumers subject to a licensing requirement but prohibited out-of-state wineries from doing the same, regardless of whether they were licensed.[97] Instead, out-of-state wineries were required to pass through an in-state wholesaler and retailer before their products could reach Michigan consumers.[98] The Sixth Circuit invalidated the law because it violated the dormant Commerce Clause.[99]

The New York statute at issue in *Swedenburg* only differed from the Michigan statute in that it did not ban direct shipments altogether; it required out-of-state wineries to establish presence within the state in order to sell to the state's consumers.[100] The Second Circuit based its decision on the principle that insofar as Section 2 permitted each state to regulate alcohol traffic within its borders, it "primarily created an exception to the normal operation of the Commerce Clause."[101] The court ruled that the state's prohibition of the sale and shipment of wine by unlicensed wineries directly to New York consumers served valid regulatory interests and was not overly burdensome.[102] Under this scheme, out-of-state wineries were required to establish distributing operations in the state in order to directly ship to consumers.[103] Essentially, out-of-state wineries would have to incur

93. *Id.*

94. *Id.*

95. FTC Report, *supra* note 89, at 6.

96. Granholm v. Heald, 544 U.S. 460, 465 (2005) (*Granholm* consolidated Heald v. Engler, 342 F.3d 517 (6th Cir. 2003) and Swedenburg v. Kelly, 358 F.3d 223 (2d Cir. 2004).).

97. *Engler*, 342 F.3d at 519.

98. *Id.*

99. *Id.* at 527.

100. *Granholm*, 544 U.S. at 474.

101. *Swendenburg*, 358 F.3d at 236 (quoting Craig v. Boren, 429 U.S. 190, 206 (1976)).

102. Swedenburg v. Kelly, 358 F.3d 223, 237 (2d Cir. 2004).

103. *Id.*

costs in establishing and maintaining a physical presence in New York, but those same costs were not incurred by in-state wineries.[104] The court held that these effects, however, did not alter the legitimacy of the delegation of authority under Section 2 because the statutory scheme only regulated alcohol within the state.[105] Thus, the court did not find that the regulatory scheme was intended to favor local interests over out-of-state interests.[106] Both in-state and out-of-state wineries were permitted to obtain a license as long as the winery established a physical presence in the state.[107] The court justified its decision, noting "business efficiency must give way to valid regulatory concerns in this unique area of commerce."[108]

This split between the Second and Sixth Circuit highlighted the ongoing tension between state courts and the Supreme Court over whether these alcoholic regulatory schemes solely fell within the ambit of Section 2 of the Twenty-first Amendment.[109] After decades of conflicting precedent, the Court in *Granholm* concluded that the dormant Commerce Clause could limit Twenty-first Amendment powers when it upheld the Sixth Circuit's decision to invalidate Michigan's law and reverse the Second Circuit's decision that upheld the New York statutory scheme.[110] The Court noted it had previously ruled in other Section 2 cases that: (1) state laws that violated other provisions of the Constitution were not saved by the Twenty-first Amendment; (2) Section 2 did not nullify Congress's Commerce Clause powers with regard to alcohol; and (3) state regulation of alcohol was limited by the nondiscrimination principle of the Commerce Clause.[111] In a five to four opinion, Justice Kennedy wrote for the majority, mandating out-of-state wineries while exempting in-state wineries constituted explicit discrimination against interstate commerce. The Court determined that the policy was motivated by economic protectionism and such "[d]iscrimination is contrary to the Commerce Clause and is not saved by the Twenty-first Amendment."[112] Furthermore, Section 2 "does not allow States to regulate the direct shipment of wine on terms that discriminate in favor of in-state producers."[113]

104. *Swendenburg*, 358 F.3d at 237.
105. *Id.* at 237–38.
106. *Id.* at 237.
107. *Id.*
108. Swedenburg v. Kelly, 358 F.3d 223, 238 (2d Cir. 2004).
109. Granholm v. Heald, 544 U.S. 460, 471 (2005).
110. *Id.* at 493.
111. *Id.* at 483.
112. *Id.* at 489.
113. *Id.* at 476.

The Court applied a traditional Commerce Clause analysis in *Granholm*.[114] As with any other facially discriminatory laws, the Court noted that state laws may be saved from invalidation if the state can show that it "advance[d] a legitimate local purpose that [could not] be adequately served by reasonable nondiscriminatory alternatives."[115] The state's two primary justifications for strictly regulating out-of-state wineries were to keep alcohol out of the hands of minors and ensure a more effective mode of tax collection.[116] The Court rejected both arguments, observing that the states provided "little concrete evidence for the sweeping assertion" that they could not effectively collect taxes on direct shipments by out-of-state wineries.[117]

Justices Kennedy and Stevens disagreed on whether alcohol should be regulated as a separate and distinct commodity under the Twenty-first Amendment. Justice Stevens, in his dissent, argued that alcohol was not "an ordinary article of commerce."[118] Justice Thomas' contextually focused dissent admonished the majority for overlooking the language in Webb-Kenyon, which he argued "displace[d] any negative Commerce Clause barrier to state regulation of liquor sales to in-state consumers."[119]

V. Post-*Granholm* Dormant Commerce Clause Limits Are Here to Stay

The focus of litigation in this regulatory space after the *Granholm* decision shifted away from manufacturers and towards retailers who are part of the last tier in the system. Once again, Michigan became a battleground for this issue in *Siesta Village Market, LLC. v. Granholm*.[120] The state's laws prohibited out-of-state *retailers* from shipping directly to consumers unless they maintained a physical location in Michigan and became part of the three-tier system.[121] Retailers claimed that the statute violated the dormant Commerce Clause.[122] The state argued that the current system of distribution allowed it discretion to inspect wholesalers—

114. *Id.*

115. Granholm v. Heald, 544 U.S. 460, 489 (2005) (quoting New Energy Co. of Ind. v. Limbach, 486 U.S. 269, 278 (1988)).

116. *Id.*

117. *Id.* at 492.

118. *Id.* at 494 (Stevens, J., dissenting).

119. *Id.* at 497–98 (2005) (Thomas, J., dissenting).

120. Siesta Village Mkt., LLC. v. Granholm, 596 F. Supp. 2d. 1035, 1037 (E.D. Mich. 2008).

121. *Id.*

122. *Id.*

to ensure that the wine complied with state laws—and repeated the similar argument that the state had a legitimate interest in ensuring that retailers were not selling alcohol to minors.[123] The district court held that the state did not meet its burden of showing that less restrictive nondiscriminatory alternatives to a ban out-of-state wine shipments from retailers were unfeasible.[124] Because out-of-state retailers' only way to have direct access to Michigan consumers was to open a location in the state, this created an extra burden.[125]

A similar challenge arose in Illinois, when out-of-state brewers claimed the Illinois Liquor Control Act of 1934 violated the dormant Commerce Clause because it favored in-state brewers more than out-of-state brewers.[126] The district court held that Illinois could not permit in-state brewers to act as their own distributors while precluding out-of-state brewers from that same privilege.[127] The state could not demonstrate a need for such discrimination and, therefore, Illinois's system violated the dormant Commerce Clause because it prevented out-of-state brewers from competing on equal terms.[128]

In cases where there was equitable treatment of in-state and out-of-state retailers, the courts have upheld the statute's constitutionality.[129] In *Arnold's Wines, Inc. v. Boyle*, retailers brought a claim against the state, arguing that sections 100(1), 102(1)(a), and 102(1)(b) of New York's Alcoholic Beverage Control Law were unconstitutional because they prohibited out-of-state wine retailers from directly selling to in-state consumers.[130] The statutes required that all liquor sold, delivered, shipped, or transported to a New York consumer first pass through a licensed entity in the state.[131] Both in-state and out-of-state products passed through the same three-tier system before reaching the consumer.[132] On appeal, the Second Circuit held that the statutes were a valid exercise of the state's rights under the Twenty-first Amendment because the system treated in-state and out-of-state retailers equitably and did not discriminate against

123. *Siesta Village*, 596 F. Supp. 2d at 1041.
124. *Id.* at 1044.
125. *Id.* at 1039.
126. Anheuser-Busch, Inc. v. Schnorf, 738 F. Supp. 2d 793, 795 (N.D. Ill. 2010).
127. *Id.* at 817.
128. *Id.*
129. Arnold's Wines, Inc. v. Boyle, 571 F.3d 185, 187 (2d Cir. 2009).
130. *Id.*
131. *Id.*
132. *Id.* at 191.

out-of-state products or manufacturers.[133] Because the regulatory scheme evenhandedly regulated the importation and distribution of alcohol within the state, the statute did not violate the dormant Commerce Clause.[134]

VI. Pennsylvania's Current Regulatory Regime for Beer and Malt Beverages Is Unconstitutional

Section 1-101 of the Pennsylvania Liquor Code ("PLC") establishes the Commonwealth's three-tier system of licensing and distribution of alcoholic beverages.[135] Section 4-444 of the PLC regulates the importation and sale of malt or brewed beverages from out-of-state manufacturers.[136] Out-of-state manufacturers are prohibited from selling directly to consumers and instead must first sell their products to in-state distributors.[137] The distributors then sell the product to retailers, whom in turn sell the products to Commonwealth consumers.[138] The purpose of this system is

> [T]o avoid the overly aggressive marketing and sales practices of the pre-Prohibition era, to generate tax revenues that can be efficiently collected from the beer distribution industry, to facilitate state and local control of alcoholic beverages, and to encourage moderate consumption. [139]

Accordingly, businesses involved in each tier of the system are required to obtain a license through the Pennsylvania Liquor Control Board ("PLCB").[140]

However, this is not the case for manufacturers licensed in-state, who are granted privileges that are not available to manufacturers operating outside of Pennsylvania.[141] A licensed in-state manufacturer is permitted to not only sell malt or brewed beverages to consumers at its licensed facility,

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133. *Id.*

134. *Id.* at 192.

135. 47 PA. STAT. AND CONS. STAT. ANN. §§ 1-101–8-803 (2016).

136. *Id.* § 4-444.

137. *Id.*

138. *Id.*

139. LEGISLATIVE BUDGET AND FINANCE COMMITTEE, STUDY OF THE ECONOMIC IMPACT OF THE BREWERY INDUSTRY IN THE COMMONWEALTH 5 (2003) [hereinafter LBFC Report], http://lbfc.legis.state.pa.us/Resources/Documents/Reports/456.pdf.

140. *Id.*

141. *Id.*

but also is allowed to designate itself as a distributor for its products within the state, essentially permitting direct delivery and sales to the state's consumers and licensed retailers.[142] In contrast, an out-of-state manufacturer is required to sell its product to an importing distributor with designated geographic territories for any distribution within Pennsylvania.[143] These distributors "may only purchase, receive, resell, or deliver malt or brewed beverages in strict compliance with the distributor's territorial franchise agreements."[144] This restriction means that retailers may only purchase beer produced out-of-state from distributors whom are licensed to sell products in a limited geographic area.[145]

The PLC previously restricted the shipment of wine from out-of-state wineries.[146] After the *Granholm* ruling, the PLCB issued an "advisory," putting the state on notice that in-state wineries could no longer sell or ship wine directly to consumers.[147] This ban on direct shipments was challenged in *Cutner v. Newman*.[148] In *Cutner*, the district court found the Pennsylvania statutory scheme, regulating out-of-state wineries, unconstitutional under *Granholm*. The court also found the "present restrictions against out-of-state wineries cannot constitutionally be enforced" but clarified that the order only applied to wine and did not affect the validity of statutes regulating other types of alcoholic beverages.[149]

In the Legislative Budget and Finance Committee Report ("LBFC Report") examining the Commonwealth's regulatory landscape post-*Granholm*, the LBFC noted that while *Granholm* and *Cutner* specifically addressed the disparate treatment of in-state and out-of-state wineries, similar statutes regulating malt and brewed beverages have yet to be challenged.[150] At a legislative committee meeting, the PLCB Deputy Chief Counsel testified that "it would be safe to assume that a similar analysis would be used by the courts if they were asked to review the manner in which malt and brewed beverages are sold and distributed" in Pennsylvania.[151] The state all but admitted that changes should be made to bring the state into compliance with the *Granholm* decision. The LBFC

142. LBFC Report, *supra* 139, at 6.
143. *Id.* at 8.
144. *Id.*
145. *Id.* at 8.
146. *Id.* at 10.
147. *Id.*
148. Cutner v. Newman, 398 F. Supp. 2d 389 (E.D. Pa. 2005).
149. *Id.* at 391.
150. LBFC Report, *supra* note 139, at 10.
151. *Id.*

Report recommended amending the PLC to allow all manufacturers to self-distribute, thereby eliminating the disparate treatment of in-state and out-of-state manufacturers.[152]

A. The Same Dormant Commerce Clause Limits Apply to Beer and Malt Beverages

The LBFC Report highlighted a vulnerable area of regulation that has yet to be contested in court. Pennsylvania legislators have done little to address the dormant Commerce Clause issue as it pertains to beer and malt beverage since *Granholm*'s passage. Only one bill has been introduced in the Pennsylvania House of Representatives.[153] That bill was subsequently tabled indefinitely.[154] With a reputation of being one of the strictest control states in the nation, Pennsylvania is unlikely to change unless the judiciary forces it to do so. In the past decade, efforts to privatize the state liquor industry in Pennsylvania have been met with stiff opposition.[155] Just recently, the state's Governor, Tom Wolf, vetoed House Bill 466, a piece of legislation that would have amended the PLC to phase out state run wine and liquor stores and allow private beer, wine, and liquor distributors to sell alcohol with a license.[156]

Despite states' reluctance, it is clear that the courts are firmly asserting dormant Commerce Clause limitations on this particular issue. The first step in the two-tiered Commerce Clause analysis announced by the Court in *Brown-Forman* is determining whether the contested statute is facially discriminatory.[157] If a state law "directly regulates or discriminates against interstate commerce, or when its effect is to favor in-state economic interests," it will generally be struck down "without further inquiry."[158] The *Granholm* Court clearly stated that "discrimination is neither authorized nor permitted by the Twenty-first Amendment"[159] and that "state regulation of alcohol is limited by the nondiscrimination principle of

152. LBFC Report, *supra* note 139, at 11.

153. H.R. 291, 2009 Leg., Reg. Sess. (Pa. 2010) (a proposed bill requiring *all* brewers to utilize the three-tier system), http://www.legis.state.pa.us/cfdocs/billInfo/bill_history.cfm?syear=2009&sind=0&body=H&type=B&bn=291.

154. *Id.*

155. Andrew Staub, *Liquor Privatization Faces Uncertain Future After Passing House*, PENNSYLVANIA WATCHDOG (Mar. 2, 2015), http://watchdog.org/217578/paindy-liquor-privatization-faces-uncertain-future-after-passing-house/.

156. *Id.*

157. Brown-Forman Distillers Corp. v. N.Y. State Liquor Auth., 476 U.S. 573, 578–79 (1986).

158. *Id.* at 579.

159. Granholm v. Heald, 544 U.S. 460, 466 (2005).

the Commerce Clause."[160] Further inquiry into whether the regulation unduly burdens interstate commerce is not required because such a law is subject to a "virtually per se rule of invalidity."[161]

Similarly, the regulatory regime as codified in section 4-444 of the PLC is identical to the wine distribution scheme at issue in *Granholm* and is facially discriminatory towards out-of-state beer and malt beverage manufacturers. As noted above, the Pennsylvania statute does not mandate in-state manufacturers of malt and brewed beverages to distribute their product through an importing distributor, yet it requires out-of-state manufacturers to do so.[162] Such disparate treatment may give in-state manufacturers a competitive advantage, as they may distribute directly to retailers without bearing the financial costs associated with entering into contractual relationships with separate distributors.[163] Because the statute is discriminatory on its face and in its practical effects, the statute should be invalidated under the dormant Commerce Clause.

Even if section 4-444 of the PLC survives the "virtually per se rule of invalidity," a statute that has a discriminatory effect may be permitted if it serves a legitimate state purpose that cannot be achieved by less restrictive and nondiscriminatory means.[164] However, assuming Pennsylvania advances the same Twenty-first Amendment justifications as the previous cases have (e.g., temperance and effective tax collection), a court would likely hold the statute unconstitutional because the state could operate non-discriminately by requiring in-state manufacturers to abide by the same regulatory scheme instead of creating significant economic barriers on market access to out-of-state manufacturers. The focus of the analysis is not on the constitutionality of the state's regulatory system itself, but rather how that system constitutionally operates—that is, how these disparate requirements can have discriminatory effects on commerce. The Court in *Granholm* emphasized that the three-tier system itself is constitutionally permitted.[165] In fact, a state may be allowed to regulate and control interstate alcohol commerce by requiring out-of-state producers to adhere to the system so long as the restrictions are equally applied within the state.[166] Thus, just as the Court in *Granholm* found that Michigan's regulatory regime granted benefits to in-state wineries at the expense of

160. *Granholm*, 544 U.S. at 487.
161. *See* Brown-Forman Distillers Corp., 476 U.S. at 579.
162. 47 PA. STAT. AND CONS. STAT. ANN. § 4-444 (2016).
163. LBFC Report, *supra* note 139, at 10.
164. Maine v. Taylor, 477 U.S. 131, 138 (1986).
165. Granholm v. Heald, 544 U.S. 460, 489 (2005).
166. *Id.*

out-of-state wineries, it should find Pennsylvania's beer and malt beverage scheme equally invalid.

Moreover, using the canons of statutory interpretation in order to harmonize conflicting interpretations of Section 2 of the Twenty-first Amendment, the Court can look to the statute's legislative history and context (or lack thereof). As Justice Stevens suggested in his dissent in *Granholm*, if Congress truly had intended for alcohol to be a special category of commodities to remain outside the reach of the Commerce Clause, then it would have said so explicitly. This is particularly because Congress had many opportunities to do so through legislation both before and after the ratification of the Twenty-first Amendment.[167] Justice Kennedy's opinion followed the exhaustive legislative history of the Twenty-first Amendment, noting that the language in Section 2 closely aligned with both Wilson and Webb-Kenyon.[168] Webb-Kenyon "expresses no clear congressional intent to depart from the principle . . . that discrimination against out-of-state goods is disfavored."[169] Webb-Kenyon did not propose to repeal Wilson, which contains express language about nondiscrimination.[170] The Court was very clear in *Clark Distilling* that Webb-Kenyon was meant to be an extension of Wilson.[171] If Congress truly intended to authorize states to discriminate against out-of-state goods by passing Webb-Kenyon, then it could have explicitly repealed Wilson.[172]

Although an argument can be made that the Twenty-first Amendment may supersede the Commerce Clause on grounds that the latest enacted provision will prevail, courts must read allegedly conflicting "statutes to give effect to each if [it] can do so while preserving their sense and purpose."[173] Courts will apply the most recent rule only "if the later act covers the whole subject of the earlier one and is clearly intended as a substitute."[174] Following Justice Stewart's analysis in *Hostetter*, courts and state legislatures should not read Section 2 of the Twenty-first Amendment separately from the Commerce Clause, but rather they should read them in light of one another.[175] Both provisions can be reconciled because states still hold the power to regulate alcohol within the confines of their borders.

167. *Id.* at 496–97 (Stevens, J., dissenting).

168. *Id.* at 484.

169. *Granholm*, 544 U.S. at 482.

170. *Id.* at 483.

171. James Clark Distilling Co. v. W. Md. Ry. Co., 242 U.S. 311, 323–24 (1917).

172. Granholm v. Heald, 544 U.S. 460, 483 (2005).

173. Watt v. Alaska, 451 U.S. 259, 267 (1981).

174. Posadas v. Nat'l City Bank of N.Y., 296 U.S. 497, 503 (1936).

175. Hostetter v. Idelwild Bon Voyage Liquor Corp., 377 U.S. 324, 332 (1964).

A state could impose a licensing system aimed at regulating out-of-state distribution, as long as it equally regulates both in-state and out-of-state distribution.

VII. Twenty-first Amendment Justifications Are Outdated and Arguments for Deregulation

A. Temperance and the State's Interest in Preventing the Sale of Alcohol to Minors

States have argued that allowing direct shipment or sale of alcohol would increase the incidence of underage drinking because beer is more accessible than wine.[176] Although this may be a valid interest, the courts have noted that there are ways to serve such interests without violating the dormant Commerce Clause.[177] Less restrictive requirements, such as an adult signature and identification checks for acceptance of delivery, can help keep alcohol out of the hands of minors and still allow brewers to efficiently deliver products to adult consumers.[178]

B. Economic Protectionism and the Three-Tier System Hinders Growth of the Beer Industry

Pennsylvania's reluctance to push through legislation that would conform its current regulations to *Granholm* is likely motivated by economic protectionism. The craft brewing industry in Pennsylvania is booming and has added as much as two billion dollars into the state's economy.[179] But such regulations substantially limit direct out-of-state sale of wine to consumers.[180] "According to the Federal Trade Commission ('FTC'), '[s]tate bans on interstate direct shipping represent the single largest regulatory barrier to expanded e-commerce . . . .'"[181] Laws similar to the type at issue in *Granholm* deny citizens equal access to other states' markets.[182] As a result, these regulations may unintentionally create trade rivalries amongst states in favor of exclusive alliances within the state—a consequence that the Commerce Clause was designed to avoid.[183] Interestingly, the *Granholm* Court did not split along its typical ideological

176. *Granholm*, 544 U.S. at 489–90.
177. *Id.* at 483–84.
178. FTC Report, *supra* note 89, at 26–29.
179. LBFC Report, *supra* note 139, at 17.
180. Granholm v. Heald, 544 U.S. 460, 467 (2005).
181. *Id.* at 468.
182. *Id.* at 473.
183. *Id.*

lines. Justice Stevens dissented, while Justices Kennedy and Scalia broke from their conservative counterparts and joined the liberal majority.[184] Still, Justice Scalia did not take the opportunity to affirm plenary state power over alcohol importation, perhaps instead acknowledging that free and less regulated commerce would be more beneficial to states' economies as the popularity of e-commerce continues to grow.

Instead of clinging to exclusivity, Pennsylvania would be better served eliminating the three-tier system for all brewers and producers. Eliminating the cost of contracting with third parties at each tier would be more beneficial for small craft brewers who often cannot compete with larger manufacturers due to exorbitant overhead costs.[185] This shift would promote more economic competition, which would likely drive down costs for consumers, while still bringing in tax revenue for the state as increased sales could mean increased revenue.

C. Effective Tax Collection on Alcohol Sales

Efficient and effective tax collection is often lauded as one of the most important reasons for strict alcohol regulation.[186] Nonetheless, taxation on its own may not be a sufficient justification for keeping the three-tier system or enacting the type of restrictive statutes currently in place in Pennsylvania. The Court's decisions in *Bacchus* and *Granholm* articulated that these justifications do not outweigh a discriminatory ban against interstate importation of wine.[187] The potential for tax evasion exists whether direct shipping occurs within the state or out of the state.[188] Michigan employed a tax scheme that required sellers of wine to obtain a license to sell within the state and submit a wine tax report each month, detailing all wine sold or imported into the state during that time period.[189] In fact, other states have employed similar licensing and self-reporting schemes and have had no reported problems with tax collection.[190] In Pennsylvania, the malt beverage tax is borne by Pennsylvania

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184. *Granholm*, 544 U.S. at 464.

185. David Scott, *Don't Forget the Beer Pennsylvania Must Reform its Beer: Distribution Laws to Comply with the Supreme Court's Landmark Decision in* Granholm v. Heald, COMPETITIVE ENTERPRISE INST. (May 28, 2013), https://cei.org/sites/default/files/David%20Scott-%20Don't%20Forget%20the%20Beer.pdf.

186. Heald v. Engler, 342 F.3d 517, 527 (6th Cir. 2003); *see* Swedenburg v. Kelly, 358 F.3d 223, 228 (2d Cir. 2004).

187. Granholm v. Heald, 544 U.S. 460, 492 (2005).

188. *Id.* at 491.

189. *Granholm*, 544 U.S. at 491.

190. FTC Report, *supra* note 89, at 38–40.

consumers.[191] The tax is levied on all malt or brewed beverages sold in Pennsylvania regardless of whether it was produced inside or outside of the state.[192] In addition, Pennsylvania also collects licensing fees for the privilege of selling malt or brewed beverages in the state.[193] If, under the three-tier system, these licensing and self-reporting safeguards were adequate enough to combat tax evasion, it would be hard to argue that they would not have the same effect if states permitted direct shipment.[194]

States have a valid concern about potential noncompliance with state regulations. Yet, there are federal remedies that could fill in the regulatory gap and incentivize manufacturers to comply. The ATF issued a ruling stating that compliance with the Twenty-first Amendment was a condition for maintaining a federal alcohol permit under the Federal Administration Act ("FAA"), and a violation of the FAA could result in revocation or suspension of a federal permit.[195]

Conclusion

America's rich and controversial history with alcohol has shaped part of this country's legislative core. The struggle between the federal and state government to assert their plenary powers over commerce and alcohol led to two constitutional amendments and a tumultuous back and forth between Supreme Court precedence lasting decades. The Supreme Court's decision in *Granholm* firmly placed dormant Commerce Clause limits on a state's Twenty-first Amendment powers to regulate alcohol when a state's statute is facially discriminatory against interstate commerce.

In a post-*Granholm* regulatory landscape, Pennsylvania's current distribution system is unconstitutional given that its statute places an impermissible burden on out-of-state beer and malt beverage manufacturers in favor of in-state manufacturers. Regardless of geographic location, allowing all beer and malt beverage manufacturers to distribute and sell their products directly to consumers would not only bring the state into compliance with *Granholm* but also promote free enterprise and fairer, unencumbered access to the market.

191. LBFC Report, *supra* note 139, at 29.

192. *Id.*

193. *Id.* at 35.

194. Granholm v. Heald, 544 U.S. 460, 491 (2005).

195. ATF Ruling 2000-1 (2000), http://www.ttb.gov/rulings/2000-1.htm.