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## Discarding the North Dakota Dictum: An Argument for Strict Scrutiny of the Three-Tier Distribution System

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## NOTE

# DISCARDING THE *NORTH DAKOTA* DICTUM: AN ARGUMENT FOR STRICT SCRUTINY OF THE THREE-TIER DISTRIBUTION SYSTEM

Amy Murphy\*

*In Granholm v. Heald, the Supreme Court held that states must treat in-state and out-of-state alcoholic beverages equally under the dormant Commerce Clause and established a heightened standard of review for state alcohol laws. Yet in dictum the Court acknowledged that the three-tier distribution system—a regime that imposes a physical presence requirement on alcoholic beverage wholesalers and retailers—was “unquestionably legitimate.” Though the system’s physical presence requirement should trigger strict scrutiny, lower courts have placed special emphasis on Granholm’s dictum, refusing to subject the three-tier distribution system to Granholm’s heightened standard of review. This Note argues that the dictum should be discarded and that courts should carefully scrutinize the three-tier distribution system. Under Granholm’s heightened standard of review, the three-tier distribution system would be found unconstitutional.*

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## INTRODUCTION

From 1920 until 1933, the United States prohibited the manufacture, transportation, and sale of alcohol. In spite of this constitutional mandate, people went to great lengths to obtain alcohol. In turn, the federal government went to even greater lengths to enforce Prohibition. In one memorable example, the Coolidge Administration initiated a poisoning program, aimed at deterring citizens from drinking.<sup>1</sup> Soon after Prohibition began, criminal syndicates started stealing industrial alcohol, which is not intended for human consumption, and selling it to American citizens. The federal government ordered manufacturers to incorporate toxic chemicals such as methyl in the alcohol to render it undrinkable. Undeterred, the syndicates hired chemists to “renature” the alcohol, returning it to its semi-potable, and thus marketable, state.<sup>2</sup> The government again upped the ante, adding more potent levels of chemicals, such as gasoline, mercury salts, ether, and formaldehyde, to the alcohol. The problem with this poisoning program, which lasted through the repeal of Prohibition in 1933, was that it failed to achieve its purpose: people kept drinking the alcohol, even when it made them fatally ill. By Prohibition’s end, an estimated 10,000 people had died from poisoned industrial alcohol.<sup>3</sup>

Prohibition era stories such as the federal poisoning program reveal our country’s uneasy approach to alcohol regulation. Though the failed experiment of Prohibition is one of the United States’ distant memories, vestiges of that era persist in alcohol laws around the country that make the retail sale of alcohol an overly complicated and burdensome process. The three-tier distribution system, which is the most common regulatory system in the United States, is a prime example of the country’s rigorous approach to alcohol regulation.

Because the three-tier system was a reaction to Prohibition,<sup>4</sup> a brief background on the Prohibition Amendment and its repeal is important to understanding the current state of alcohol regulation. In 1919, Congress rati-

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1. Deborah Blum, *The Chemist’s War: The Little-Told Story of How the U.S. Government Poisoned Alcohol During Prohibition*, SLATE (Feb. 19, 2010, 10:00 AM), <http://www.slate.com/id/2245188/>.

2. *Id.*

3. *Id.*

4. FED. TRADE COMM’N, POSSIBLE ANTICOMPETITIVE BARRIERS TO E-COMMERCE: WINE 5–6 (2003), available at <http://ftc.gov/os/2003/07/winereport2.pdf> [hereinafter FTC REPORT].

fied the Eighteenth Amendment to the United States Constitution, prohibiting the manufacture, sale, or transportation of “intoxicating liquors.”<sup>5</sup> By 1933, thirteen years of syndicate-dominated bootlegging, bathtub gin, and speakeasies had led one outspoken proponent of Prohibition, John D. Rockefeller, Jr., to abandon his position. In a letter to the president of Columbia University, which was subsequently published by the *New York Times* on June 7, 1932, Rockefeller acknowledged, “[Prohibition’s] benefits, important and far reaching as they are, are more than outweighed by the evils that have developed and flourished since its adoption . . . .”<sup>6</sup> Congress agreed and enacted the Twenty-First Amendment on December 5, 1933.

The first section of the Twenty-First Amendment (“Section One”) accomplished the goal of erasing the Eighteenth Amendment.<sup>7</sup> The lesser-known, second section of the Twenty-First Amendment (“Section Two”) prohibits the transportation of alcohol into a state in violation of that state’s laws.<sup>8</sup> Section Two represents a compromise. Proponents of Prohibition’s repeal aimed to diminish organized crime, which had flourished during Prohibition, and to generate new tax revenue, which would aid states that were experiencing diminished revenues during the Great Depression.<sup>9</sup>

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5. U.S. CONST. amend. XVIII, § 1, *repealed by* U.S. CONST. amend. XXI (“After one year from the ratification of this article the manufacture, sale, or transportation of intoxicating liquors within, the importation thereof into, or the exportation thereof from the United States and all territory subject to the jurisdiction thereof for beverage purposes is hereby prohibited.”).

6. RAYMOND B. FOSDICK, JOHN D. ROCKEFELLER, JR.: A PORTRAIT 256 (1956). Daniel Okrent notes, however, that just three years earlier the author of the Eighteenth Amendment, Senator Morris Sheppard, still advocated Prohibition, saying, “There is as much chance of repealing the Eighteenth Amendment as there is for a hummingbird to fly to the planet Mars with the Washington Monument tied to its tail.” DANIEL OKRENT, *LAST CALL: THE RISE AND FALL OF PROHIBITION* 330 (2010) (internal quotation marks omitted). Okrent comments that “[it is] a measure of how badly Prohibition had failed that the Twenty-First Amendment—the repeal amendment—was ratified just three years [after Sheppard’s statement].” Interview by Stephen J. Dubner with Daniel Okrent, *What Prohibition Can Teach Us About Marijuana Legalization*, FREAKONOMICS BLOG (Aug. 4, 2010, 11:30 AM), <http://freakonomics.blogs.nytimes.com/2010/08/04/what-can-prohibition-teach-us-about-marijuana-legalization-and-other-tales-from-last-call-author-daniel-okrent/>.

7. U.S. CONST. amend. XXI, § 1 (“The eighteenth article of amendment to the Constitution of the United States is hereby repealed.”). People who celebrate the Twenty-First Amendment are probably reveling in Section One. *See, e.g.*, Allen Katz, *Now Toasting: Happy Repeal Day!*, N.Y. TIMES BLOG (Dec. 5, 2008, 12:36 PM), <http://tmagazine.blogs.nytimes.com/2008/12/05/now-toasting-happy-repeal-day/>.

8. U.S. CONST. amend. XXI, § 2 (“The transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited.”). For a recognition of the paradox of Section Two’s prohibition on certain private conduct, see Laurence H. Tribe, *How To Violate the Constitution Without Really Trying: Lessons from the Repeal of Prohibition to the Balanced Budget Amendment*, 12 CONST. COMMENT 217, 219 (1995) (“To repeat, Section 2 of the Twenty-first Amendment directly prohibits—talk about *prohibition!*!—the conduct that it was apparently meant to authorize the States to prohibit . . .”).

9. OKRENT, *supra* note 6, at 329–55 (describing various motivations for the enactment of the Twenty-First Amendment).

Meanwhile, Congress wanted to grant states the power to structure orderly markets for the sale of alcohol while preserving the option for states to be dry.<sup>10</sup>

The majority of states have used their Section Two powers to impose the three-tier system as their regulatory scheme.<sup>11</sup> This system organizes the actors involved in alcohol's distribution (producers, wholesalers, and retailers) into three tiers and imposes different licensing requirements on them.<sup>12</sup> The three-tier system also requires that wholesalers and retailers have a physical presence in the state in order to sell in state.<sup>13</sup>

Some courts have found that state alcohol laws within the three-tier system discriminate against interstate commerce, violating the dormant Commerce Clause.<sup>14</sup> The latest word from the Supreme Court came in *Granholm v. Heald*, in which the Court announced that state alcohol regulations are constitutional when they treat in-state and out-of-state alcoholic beverages equally.<sup>15</sup> Yet in that same decision the Court stated in dictum that it had "previously recognized that the three-tier system itself is 'unquestionably legitimate.'"<sup>16</sup> This assertion seemingly contradicts *Granholm's* rule because the three-tier system necessarily excludes out-of-state wholesalers and retailers from participating in a state's alcoholic beverage market.<sup>17</sup>

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10. See *Granholm v. Heald*, 544 U.S. 460, 484 (2005) ("The aim of the Twenty-first amendment was to allow States to maintain an effective and uniform system for controlling liquor by regulating its transportation, importation, and use."); RAYMOND B. FOSDICK & ALBERT L. SCOTT, *TOWARD LIQUOR CONTROL* 18, 53 (Harper 1933). For a brief analysis of the disputed legislative history of Section Two, see *infra* note 39.

11. See *Comprehensive Alcohol Regulatory Effectiveness (CARE) Act of 2010: Hearing on H.R. 5034 Before the H. Comm. on the Judiciary*, 111th Cong. 139 (2010) (prepared statement of Tracy K. Genesen, Kirkland & Ellis LLP, on behalf of The Wine Institute) [hereinafter *Hearing on H.R. 5034*]; FTC REPORT, *supra* note 4, at 5.

12. See *infra* notes 22–32 and accompanying text for a more detailed presentation of the three-tier system's structure.

13. See *infra* notes 26–30.

14. See, e.g., *Granholm*, 544 U.S. 460 (striking down state laws that denied out-of-state wineries direct shipment privileges while granting in-state wineries that privilege); *Anheuser-Busch, Inc. v. Schnorf*, 738 F. Supp. 2d 793 (N.D. Ill. 2010) (deeming unconstitutional a law prohibiting out-of-state brewers from obtaining distributors' licenses to function as wholesalers within the state of Illinois).

15. *Granholm*, 544 U.S. at 489 ("State policies are protected under the Twenty-first Amendment when they treat liquor produced out of state the same as its domestic equivalent.")

16. *Id.* (citing *North Dakota v. United States*, 495 U.S. 423, 432 (1990) (plurality opinion)).

17. See *infra* notes 22–32 and accompanying text. Though a few scholars have recently considered this proposition, see, e.g., Kevin C. Quigley, Note, *Uncorking Granholm: Extending the Nondiscrimination Principle to All Interstate Commerce in Wine*, 52 B.C. L. REV. 1871 (2011), none has considered the importance of the *North Dakota* dictum or challenged its application in the dormant Commerce Clause context.

Lower courts have reiterated this dictum, which this Note calls “the *North Dakota* dictum”<sup>18</sup> in recognition of the case from which it was quoted, in a number of cases in which out-of-state retailers have contended that they should be able to ship to consumers just as their in-state counterparts can. All courts but one have used the *North Dakota* dictum to dispose of these retailer challenges, shielding the three-tier system from the judicial review mandated in *Granholm*.<sup>19</sup> Relying on the dictum, courts treat the three-tier system as sacrosanct.

This Note argues that the *North Dakota* dictum should not shield the three-tier system from the heightened judicial review mandated in *Granholm*. Part I outlines the structure of the three-tier system and explains the interplay of the Twenty-First Amendment and the dormant Commerce Clause in the *Granholm* decision. Part I also introduces the cases that have relied on the *North Dakota* dictum to foreclose judicial review of the three-tier system, as well as the one district court decision that discarded the dictum to reach a different conclusion. Part II argues that the application of the *North Dakota* dictum to retailers’ dormant Commerce Clause challenges is amiss because *North Dakota* relied on abrogated Supreme Court opinions, which held that the Twenty-First Amendment immunized state alcohol regulations from the limitations of the Commerce Clause. Part III predicts that if the three-tier system were subjected to more rigorous scrutiny, courts would likely find that the three-tier system violates the dormant Commerce Clause and *Granholm*’s mandate that states treat in-state and out-of-state alcoholic beverages equally.

### I. *GRANHOLM V. HEALD*: THE HOLDING AND THE DICTUM

This Part analyzes *Granholm*’s essential mandate and the operation of the *North Dakota* dictum. Section I.A presents the structure of the three-tier system. Section I.B then outlines the conflicting treatment of state alcohol laws under dormant Commerce Clause challenges, which led the *Granholm* Court to clarify that the Twenty-First Amendment does not shield discriminatory state laws from constitutional challenge. Finally, Section I.C introduces the cases involving retailer challenges to the three-tier system, which illustrate the shielding function of the *North Dakota* dictum.

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18. The dictum originates in another Supreme Court decision, *North Dakota v. United States*, 495 U.S. 423 (1990), which this Note analyzes in more depth in Sections II.A–B.

19. Compare *Wine Country Gift Baskets.com v. Steen*, 612 F.3d 809 (5th Cir. 2010) (finding no dormant Commerce Clause violation where the three-tier system barred out-of-state retailers from selling and shipping directly to in-state consumers), *cert. denied*, 131 S. Ct. 1602 (2011), *Arnold’s Wines, Inc. v. Boyle*, 571 F.3d 185 (2d Cir. 2009) (same), and *Brooks v. Vassar*, 462 F.3d 341 (4th Cir. 2006) (finding no discrimination where the three-tier system allowed consumers to personally import one gallon of wine or beer outside the three-tier system but established no limit on the amount of alcohol purchased through the three-tier system), *with Siesta Vill. Mkt., LLC v. Granholm*, 596 F. Supp. 2d 1035, 1039 (E.D. Mich. 2008) (finding a law prohibiting out-of-state retailers from shipping and selling to in-state consumers unconstitutional).

### A. The Three-Tier System

In order to understand *Granholm*'s mandate, it is crucial first to outline the structure of the three-tier system. States that regulate their alcoholic beverage markets through the three-tier system allow private retailers and distributors to sell alcohol to consumers. By contrast, a minority of states follow a "control model," in which the state monopolizes the retail sale and, in some cases, the distribution of alcohol.<sup>20</sup> This Note focuses only on those states that rely on the three-tier system.<sup>21</sup>

Through a "complex set of overlapping state and federal regulations,"<sup>22</sup> the three-tier system excludes out-of-state wholesalers and retailers from participating in a state's alcoholic beverage market.<sup>23</sup> The first tier of the system consists of the producers of alcohol—wineries, distilleries, and breweries.<sup>24</sup> Any individual or entity wishing to sell alcohol in the United States must apply for a basic permit from the Alcohol and Tobacco Tax and Trade Bureau.<sup>25</sup> After obtaining the permit, the producer may sell its products to any wholesaler that is located in the state and has obtained a state license to distribute alcohol.<sup>26</sup> This licensed, in-state wholesaler is a member of the second tier.<sup>27</sup> The wholesaler purchases alcohol products from various producers, keeps records on its purchases, and pays excise taxes to the state.<sup>28</sup> Then, the wholesaler sells its alcohol products to retailers, the third tier of the system.<sup>29</sup> Like wholesalers, retailers must be licensed and retain a

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20. *Three-Tier Distribution System*, S. WINE & SPIRITS, <http://www.southernwine.com/AboutSWS/SWS3Tier/tabid/98/Default.aspx> (last visited Nov. 11, 2011).

21. *Id.*

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

23. *See, e.g., id.* at 469–70 (explaining that Michigan's and New York's three-tier systems required wineries to sell their products to in-state wholesalers); Christopher G. Sparks, Comment, *Out-of-State Wine Retailers Corked: How the Illinois General Assembly Limits Direct Wine Shipments from Out-of-State Retailers to Illinois Oenophiles and Why the Commerce Clause Will Not Protect Them*, 30 N. ILL. U. L. REV. 481, 502–03 (2010) (describing Illinois's three-tier scheme as mandating that all producers of alcohol distribute to in-state wholesalers and all in-state wholesalers sell to in-state retailers, which are the only entities within the system that may sell and ship directly to consumers).

24. *See* FTC REPORT, *supra* note 4, at 5.

25. *Id.*

26. *See id.* For example, Michigan law requires an individual seeking a wholesaler license to have resided in Michigan for at least one year. MICH. COMP. LAWS § 436.1601(1) (2011). The wholesaler may then operate at a licensed premises located in the state of Michigan. MICH. LIQUOR CONTROL COMM'N, DEP'T OF LICENSING & REGULATORY AFFAIRS, MICHIGAN WHOLESALE LICENSE REQUIREMENTS AND GENERAL INFORMATION (2011), *available at* [http://www.michigan.gov/documents/cis/Wholesaler\\_182943\\_7.pdf](http://www.michigan.gov/documents/cis/Wholesaler_182943_7.pdf).

27. *See* FTC REPORT, *supra* note 4, at 5.

28. C. Boyden Gray, Wine & Spirits Wholesalers of Am., *Summary Position Paper Prepared for the Federal Trade Commission Workshop on the Possible Anticompetitive Efforts To Restrict Competition on the Internet*, FED. TRADE COMMISSION 2 (Oct. 8, 2002), [www.ftc.gov/opp/e-commerce/anticompetitive/panel/gray.pdf](http://www.ftc.gov/opp/e-commerce/anticompetitive/panel/gray.pdf).

29. *See* FTC REPORT, *supra* note 4, at 5.

location within the state.<sup>30</sup> Once the alcoholic beverages reach the third tier, consumers may purchase them from retail stores, which collect applicable sales taxes and transfer those taxes to the state.<sup>31</sup> In most cases, both federal and state laws prevent any entity within the three-tier system from occupying more than one tier, which is known as a limit on vertical integration.<sup>32</sup>

Producers, consumers, and retailers have all raised complaints about the three-tier system. Alcoholic beverage producers have trouble accessing particular state markets because the number of producers overwhelms the number of licensed wholesalers distributing within that state.<sup>33</sup> Small wineries, in particular, claim that they are shut out of many markets because wholesalers tend to limit their purchases to wines produced only by the largest wineries.<sup>34</sup> These same dynamics affect consumers, who demand a greater variety of alcoholic beverages in their retail stores.<sup>35</sup> Finally, retailers argue that they should be allowed to ship directly to out-of-state consumers, bypassing the in-state wholesaler (the second tier of the system).<sup>36</sup> Retailers note that while mail-order catalogues and the internet allow businesses to ship most goods across the country, America's alcohol laws prevent such ease in the shipment of alcoholic beverages.<sup>37</sup>

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30. *Id.*; see, e.g., MICH. COMP. LAWS § 436.1305.

31. *Arnold's Wines, Inc. v. Boyle*, 571 F.3d 185, 187 (2d Cir. 2009); Gray, *supra* note 28, at 2.

32. *Granholt v. Heald*, 544 U.S. 460, 466 (2005) (citing 27 U.S.C. § 205, the prohibition on "tied houses"); FTC REPORT, *supra* note 4, at 5. Tied houses were saloons that exclusively sold the products of one brewer; they were popular around the turn of twentieth century and quite profitable for participating retailers and producers. OKRENT, *supra* note 6, at 29–30. The three-tier system's ban on vertical integration was meant to counteract the potential resurgence of tied houses after the repeal of Prohibition. See, e.g., Cal. Beer Wholesalers Ass'n v. Alcoholic Beverage Control Appeals Bd., 487 P.2d 745, 748 (Cal. 1971).

33. *Hearing on H.R. 5034*, *supra* note 11, at 137 (prepared statement of Tracy K. Genesen, Kirkland & Ellis LLP, on behalf of The Wine Institute) ("[C]onsiderable consolidation has occurred in the wholesale tier in recent years[, which] means the vast majority of wineries face an increasingly narrow gauntlet of wholesalers."); FTC REPORT, *supra* note 4, at 6.

34. David Sloane, Am. Vintners Ass'n, *Summary Statement Prepared for the Federal Trade Commission Workshop on the Possible Anticompetitive Efforts To Restrict Competition on the Internet*, FED. TRADE COMMISSION 2 (Oct. 8, 2002), <http://www.ftc.gov/opp/e-commerce/anticompetitive/panel/sloane.pdf>; see also *Hearing on H.R. 5034*, *supra* note 11, at 137 (prepared statement of Tracy K. Genesen, Kirkland & Ellis LLP, on behalf of The Wine Institute) ("[W]holesalers tend to focus almost exclusively on the well-known, high-volume wines to the exclusion of the smaller, lesser-known brands.").

35. See FTC REPORT, *supra* note 4, at 3–4.

36. E.g., *Wine Country Gift Baskets.com v. Steen*, 612 F.3d 809 (5th Cir. 2010), *cert. denied*, 131 S. Ct. 1602 (2011); *Arnold's Wines*, 571 F.3d 185; *Brooks v. Vassar*, 462 F.3d 341 (4th Cir. 2006); *Siesta Vill. Mkt., LLC v. Granholt*, 596 F. Supp. 2d 1035, 1039 (E.D. Mich. 2008).

37. For example, one retailer described alcohol laws as follows:

Unfortunately, as a mail order company, we can't help you on the alcohol side of the equation. I'd be less likely to go to jail if I shipped you a case of crack or a wheelbarrow full of dynamite than if I sent you a bottle of Plymouth Gin. American interstate alcohol laws are draconian.

B. *The Interaction between the Twenty-First Amendment  
and the Dormant Commerce Clause*

Section Two of the Twenty-First Amendment authorizes the states to create alcohol distribution systems such as the three-tier system.<sup>38</sup> The Supreme Court has held, however, that this grant of power to the states does not immunize state laws from other constitutional restrictions.<sup>39</sup> Relevant to this Note, state alcohol laws must accord with the dormant Commerce Clause,<sup>40</sup> a negative constraint inferred from the Commerce Clause that prevents states from enacting and enforcing laws that burden interstate commerce.<sup>41</sup>

Immediately after Prohibition's repeal, the Supreme Court granted states wide latitude to regulate alcohol, holding that Section Two authorized discriminatory state alcohol regulations.<sup>42</sup> In these early decisions the Supreme Court interpreted the Twenty-First Amendment as saving state statutes that would otherwise violate the dormant Commerce Clause.<sup>43</sup> But in subsequent decisions, the Court reversed its earlier stance and concluded that the Twen-

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Mo Frechette, *Cocktails: Ingredient Assistance*, ZINGERMAN'S FALL BUYERS GUIDE (Zingerman's Delicatessen, Ann Arbor, Mich.), Fall 2010, at 52.

38. See *Granholm v. Heald*, 544 U.S. 460, 488 (2005) (citing *Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 110 (1980)).

39. *Id.* at 484–87 (citing cases finding that the Twenty-First Amendment does not immunize state alcohol laws from the First Amendment, the Establishment Clause, the Equal Protection Clause, or the Import-Export Clause). Historically, there have been two competing views regarding the legislative intent of Section Two. One scholar has titled them the “absolutist” and “federalist” views. Absolutists interpret Section Two as a plenary grant of authority to regulate alcohol to the states, free of any external constitutional restrictions. David S. Versfelt, Note and Comment, *The Effect of the Twenty-First Amendment on State Authority To Control Intoxicating Liquors*, 75 COLUM. L. REV. 1578, 1579–80 (1975). Federalists, on the other hand, argue that Section Two was designed to give states the choice to be dry as well as to encourage “federal oversight” of state alcohol laws. *Id.* Because the Supreme Court explicitly found that the Constitution restricts the Twenty-First Amendment in *Granholm*, this debate over legislative intent should have little impact on current litigation.

40. See, e.g., *Arnold's Wines*, 571 F.3d at 191 (“While the Twenty-first Amendment grants the states broad powers to regulate the transportation, sale, and use of alcohol within their borders, it simply does not immunize attempts to discriminate in favor of local products and producers.”); *Anheuser-Busch Inc. v. Schnorf*, 738 F. Supp. 2d 793, 802 (N.D. Ill. 2010).

41. *United Haulers Ass'n v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 550 U.S. 330, 338 (2007) (“Although the Constitution does not in terms limit the power of States to regulate commerce, we have long interpreted the Commerce Clause as an implicit restraint on state authority, even in the absence of a conflicting federal statute.”); Cass R. Sunstein, *Naked Preferences and the Constitution*, 84 COLUM. L. REV. 1689, 1705 (1984) (“The commerce clause is both an authorization to Congress and, more controversially, a self-executing prohibition on certain state actions burdening interstate commerce—the so-called ‘dormant’ commerce clause.” (footnotes omitted)).

42. See, e.g., *Joseph S. Finch & Co. v. McKittrick*, 305 U.S. 395, 398 (1939) (“Since [enactment of the Twenty-First] amendment, the right of a State to prohibit or regulate the importation of intoxicating liquor is not limited by the commerce clause.”), *abrogated by Granholm*, 544 U.S. 460; *State Bd. of Equalization v. Young's Mkt. Co.*, 299 U.S. 59, 62 (1936), *abrogated by Granholm*, 544 U.S. 460.

43. See, e.g., *McKittrick*, 305 U.S. at 398.

ty-First Amendment does not trump the dormant Commerce Clause or other constitutional provisions.<sup>44</sup>

In 2005, the Supreme Court finally resolved whether Section Two blocks Commerce Clause challenges to state alcohol laws. In *Granholm v. Heald*, small wineries challenged the alcohol laws of Michigan and New York.<sup>45</sup> Both states' alcohol industries operate under the three-tier system, and both states had enacted laws granting in-state wineries a method of bypassing the system while denying that privilege to out-of-state wineries.<sup>46</sup> In Michigan, the challenged law required all wineries to distribute their wine through licensed wholesalers located in Michigan, except that approximately forty in-state wineries could ship directly to consumers.<sup>47</sup> While an in-state winery could qualify for the exception, an out-of-state winery wanting to introduce its wine into the Michigan market could only do so by transferring its products through the three-tier system.<sup>48</sup>

New York's scheme differed from Michigan's, but had a similar effect.<sup>49</sup> As in Michigan, New York required all wineries to funnel alcohol into the state through New York wholesalers.<sup>50</sup> However, New York granted an exemption to wineries that wanted to ship wines produced predominantly from New York grapes.<sup>51</sup> This exemption included out-of-state wineries only if they established a location within the state of New York.<sup>52</sup> Though New York's law was not a patent prohibition like Michigan's, the Court recognized that New York's physical presence requirement might make direct shipment of wine impractical.<sup>53</sup>

Michigan and New York argued that Section Two saved their regulations from constitutional scrutiny.<sup>54</sup> But the *Granholm* Court analyzed the varying case law<sup>55</sup> and then followed more modern precedents in deciding that state alcohol regulations are subject to constitutional restrictions.<sup>56</sup> State alcohol laws, therefore, must abide by the dormant Commerce Clause or, as the

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44. See, e.g., *Craig v. Boren*, 429 U.S. 190, 204–05 (1976) (“[T]he Twenty-first Amendment does not save the invidious gender-based discrimination from invalidation as a denial of equal protection of the laws in violation of the Fourteenth Amendment.”); *Hostetter v. Idlewild Bon Voyage Liquor Corp.*, 377 U.S. 324, 332 (1964) (“Both the Twenty-first Amendment and the Commerce Clause are parts of the same Constitution. Like other provisions of the Constitution, each must be considered in the light of the other, and in the context of the issues and interests at stake in any concrete case.”).

45. *Granholm v. Heald*, 544 U.S. 460, 465–68 (2005).

46. *Id.* at 466–67.

47. *Id.* at 469.

48. See *id.*

49. *Id.* at 466.

50. See *id.* at 470.

51. *Id.*

52. *Id.*

53. *Id.* at 466.

54. *Id.* at 476.

55. See *supra* notes 42–44 and accompanying text.

56. *Granholm*, 544 U.S. at 476–81, 486–87.

Court referred to it, “the nondiscrimination principle of the Commerce Clause.”<sup>57</sup>

In *Granholm*, the Court issued a new rule (the “equal treatment rule”): state alcohol laws are constitutional when they treat in-state and out-of-state alcoholic beverages equally.<sup>58</sup> Because the laws of New York and Michigan involved “straightforward attempts to discriminate in favor of local producers,” the laws violated the dormant Commerce Clause.<sup>59</sup>

This holding, however, did not end the inquiry. The Court established a two-part standard of review for determining the constitutional validity of state alcohol laws.<sup>60</sup> After finding the Michigan and New York laws discriminatory, the Court determined whether the states’ alcohol laws “advance[d] a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives.”<sup>61</sup> At this point in the analysis, a state must meet a heavy burden.<sup>62</sup> First, the state must show that the challenged alcohol law promotes at least one of a discrete set of local purposes.<sup>63</sup> Second, the state must explain with concrete evidence why nondiscriminatory laws could not advance those purposes.<sup>64</sup> Throughout this Note, this heightened standard of review outlined by the *Granholm* Court is referred to as strict scrutiny.<sup>65</sup>

*Granholm* dismantled the challenged Michigan and New York laws because the Court found the states’ arguments insufficient to justify the discriminatory treatment of out-of-state wineries.<sup>66</sup> Michigan and New York had asserted that their laws kept alcohol out of the hands of minors, facilitated tax collection, protected public health and safety, and ensured regulatory accountability.<sup>67</sup> The Court recognized all of these local purposes

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57. *Id.* at 487.

58. *Id.* at 489 (“State policies are protected under the Twenty-first Amendment when they treat liquor produced out of state the same as its domestic equivalent.”).

59. *Id.*

60. *Id.* at 488–93.

61. *Id.* at 489 (quoting *New Energy Co. v. Limbach*, 486 U.S. 269, 278 (1988)) (internal quotation marks omitted).

62. See *infra* Section III.A and, in particular, note 154.

63. *Granholm*, 544 U.S. at 489–90.

64. *Id.* at 492–93.

65. Strict scrutiny in the context of the dormant Commerce Clause is distinct from the more familiar strict scrutiny test that applies in a Fourteenth Amendment analysis. See, e.g., *Dep’t of Revenue v. Davis*, 553 U.S. 328, 338 (2008) (“Under the resulting protocol for dormant Commerce Clause analysis, we ask whether a challenged law discriminates against interstate commerce. A discriminatory law is virtually *per se* invalid, and will survive only if it advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives.” (citations omitted) (internal quotation marks omitted)).

66. *Granholm*, 544 U.S. at 492.

67. *Id.* at 489–93.

as legitimate.<sup>68</sup> However, the Court also reasoned that Michigan and New York could use less restrictive means to achieve these goals, such as requiring an adult signature to make delivery of alcohol and instituting direct shipment permits for monitoring and taxing alcohol purchases.<sup>69</sup>

But what about the three-tier system? In brief dictum the Court acknowledged that the three-tier system is “unquestionably legitimate.”<sup>70</sup> However, Justice Stevens, dissenting in *Granholm*, recognized that the three-tier system gives discriminatory preference to in-state retailers and wholesalers.<sup>71</sup> In fact, the structure of the three-tier system necessarily excludes out-of-state wholesalers and out-of-state retailers unless they establish a physical presence in the state.<sup>72</sup> By design, then, the three-tier system not only prefers in-state entities at the second and third tiers but also allows only those in-state entities to compete in the state’s alcoholic beverage market. *Granholm*’s essential mandate—treat in-state and out-of-state alcohol equally—calls into question the lawfulness of the three-tier system.

### C. Retailer Challenges to the Three-Tier System

In the wake of *Granholm* several retailers challenged three-tier system laws, but most courts have upheld those laws, using the *North Dakota* dictum to circumvent *Granholm*’s standard of review. In *Arnold’s Wines v. Boyle*, the Court of Appeals for the Second Circuit upheld a provision of New York’s Alcoholic Beverage Code that prohibited out-of-state wine retailers from selling and shipping directly to New York citizens.<sup>73</sup> The plaintiffs in *Arnold’s Wines* claimed that this part of New York’s three-tier system violated the dormant Commerce Clause because it “grants in-state retailers benefits not afforded to out-of-state retailers.”<sup>74</sup> In response, the appellate court noted that this challenge was a “frontal attack”<sup>75</sup> on the three-tier system and that the *Granholm* Court had recognized the three-tier system’s “vital role . . . in the exercise of states’ section 2 powers.”<sup>76</sup> The

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68. *Id.* Other courts have recognized the promotion of temperance and the establishment of orderly market conditions as legitimate local purposes. *See, e.g.*, *North Dakota v. United States*, 495 U.S. 423, 432 (1990) (plurality opinion).

69. *Granholm*, 544 U.S. at 490–93.

70. *Id.* at 489 (“We have previously recognized that the three-tier system itself is ‘unquestionably legitimate.’” (quoting *North Dakota*, 495 U.S. at 432)).

71. *See id.* at 494 (Stevens, J., dissenting) (“The New York and Michigan laws . . . would be patently invalid under well-settled dormant Commerce Clause principles if they regulated sales of an ordinary article of commerce rather than wine.”); *accord* Sparks, *supra* note 23, at 503 (“The three-tier system—by definition and necessity—burdens interstate commerce.”).

72. *See supra* notes 26–30. For an analysis of the constitutionality of a physical presence requirement, *see infra* Section III.B.1.

73. 571 F.3d 185, 186 (2d Cir. 2009).

74. *Arnold’s Wines*, 571 F.3d at 190.

75. *Id.*

76. *Id.*

court deemed the retailers' challenge foreclosed by the *North Dakota* dictum,<sup>77</sup> stating that "if dicta this be, it is of the most persuasive kind."<sup>78</sup>

In two other retailer challenges, the *North Dakota* dictum similarly shielded the three-tier system from the judicial review otherwise mandated in *Granholm*. In *Brooks v. Vassar*, the Court of Appeals for the Fourth Circuit upheld a personal import exception in Virginia's Alcoholic Beverage Code, which allowed Virginians to import one gallon or four liters of out-of-state wine into Virginia without that alcohol having to pass through the state's three-tier system.<sup>79</sup> The plaintiffs' argument centered around the three-tier system's prohibition on out-of-state retailers, which cannot operate in Virginia's alcoholic beverage market unless they establish an in-state presence.<sup>80</sup> Like the Second Circuit, the Fourth Circuit sensed that this claim amounted to a frontal attack on the three-tier system. Accordingly, the court reasoned that "an argument that compares the status of an in-state retailer with an out-of-state retailer . . . is nothing different than an argument challenging the three-tier system itself."<sup>81</sup> Because the *Granholm* Court endorsed the system, the *North Dakota* dictum foreclosed judicial review.<sup>82</sup>

Finally, in *Wine Country Gift Baskets.com v. Steen*, the Court of Appeals for the Fifth Circuit reviewed provisions of the Texas Alcoholic Beverage Code that allowed in-state retailers to make local alcoholic beverage deliveries but prohibited out-of-state retailers from selling and directly shipping to Texas consumers.<sup>83</sup> The appellate court decided these provisions were constitutional.<sup>84</sup> Though the court recognized that *Granholm* mandates a two-part standard of review for state alcohol laws, it found that level of review inapplicable to the retailers' challenge because the three-tier system's structure, the court stated, is a priori constitutional.<sup>85</sup> Further, the *Wine Country* court found that the "compelling"<sup>86</sup> *North Dakota* dictum shielded the three-tier system from *Granholm*'s judicial review.<sup>87</sup> In the end, the court

77. *Id.* at 190–91 (explaining that the "[a]ppellants' argument is therefore directly foreclosed by the *Granholm* Court's express affirmation of the legality of the three-tier system"). The *Arnold's Wines* court also advanced an argument that the three-tier system accords with *Granholm*'s equal treatment rule, a counterargument that this Note takes up *infra* in Section III.B.3.

78. *Arnold's Wines*, 571 F.3d at 191 (quoting *Arnold's Wines, Inc. v. Boyle*, 515 F. Supp. 2d 401, 412 (S.D.N.Y. 2007)) (internal quotation marks omitted).

79. 462 F.3d 341, 354 (4th Cir. 2006).

80. *Brooks*, 462 F.3d at 352.

81. *Id.*

82. *See id.*

83. 612 F.3d 809 (5th Cir. 2010), *cert. denied*, 131 S. Ct. 1602 (2011).

84. *Wine Country*, 612 F.3d at 821.

85. *Id.* at 820 ("When analyzing whether a State's alcoholic beverage regulation discriminates under the dormant Commerce Clause, a beginning premise is that wholesalers and retailers may be required to be within the State.")

86. *Id.* at 816.

87. *See id.* at 819 ("Each tier is authorized by Texas law and approved by the Twenty-first Amendment—so says *Granholm*—to do what producers, wholesalers, and retailers do.")

found no discrimination in Texas's three-tier system because the challenged law was a "constitutionally benign incident"<sup>88</sup> of a lawful system, even though the three-tier system entailed discrimination.<sup>89</sup>

Despite these three appellate court decisions, at least one court has found *Granholm's* essential mandate at odds with its endorsement of the three-tier system. In *Siesta Village Market, LLC v. Granholm*, the District Court for the Eastern District of Michigan struck down a Michigan law that prohibited out-of-state retailers from directly shipping alcoholic beverages to consumers in Michigan.<sup>90</sup> The state of Michigan argued that the Twenty-First Amendment gave it authority to establish the three-tier system.<sup>91</sup> Referring to the *North Dakota* dictum, the court in *Siesta Village* rejected Michigan's argument and explained that though "the [*Granholm*] [C]ourt did state that the three-tier system was an appropriate use of state power, it did not approve of a system that discriminates against out-of-state interests."<sup>92</sup> This contradiction between *Granholm's* equal treatment rule and its "unquestionably legitimate"<sup>93</sup> dictum led the court in *Siesta Village* to discard the dictum.<sup>94</sup>

After the district court determined that the *North Dakota* dictum did not apply to this retailer challenge, it performed the judicial review mandated in *Granholm* and found Michigan's prohibition on out-of-state retailers unconstitutional.<sup>95</sup> Michigan's law, the court reasoned, gave in-state retailers a privilege otherwise denied to their out-of-state counterparts, who could access the Michigan alcoholic beverage market only by opening a location in Michigan and obtaining a retailer's license from the state of Michigan.<sup>96</sup> These requirements imposed an extra burden on foreign retailers.<sup>97</sup> Thus, the court found this part of the three-tier scheme to be discriminatory for its differential treatment of in-state and out-of-state retailers.<sup>98</sup> After this primary holding, the court performed the second part of the *Granholm* test and found that Michigan had not met its burden of producing clear evidence that nondiscriminatory alternatives would fail to promote the state's local purposes.<sup>99</sup> Because *Siesta Village* was decided in the years following *Granholm* (a Michigan case), the court could point to the current direct

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88. *Id.* at 820.

89. *Id.* at 818 ("Such discrimination—among producers—is not the question today . . . . [The three-tier system] has been given constitutional approval.").

90. 596 F. Supp. 2d 1035, 1044–45 (E.D. Mich. 2008).

91. *Siesta Vill.*, 596 F. Supp. 2d at 1039.

92. *Id.*

93. *Granholm v. Heald*, 544 U.S. 460, 489 (2005) (quoting *North Dakota v. United States*, 495 U.S. 423, 432 (1990) (plurality opinion)).

94. *Siesta Vill.*, 596 F. Supp. 2d at 1039.

95. *See id.* at 1039–45.

96. *Id.* at 1040.

97. *Id.*

98. *Id.* at 1039–40.

99. *Id.* at 1041–44.

shipment scheme for wineries—a scheme the state of Michigan instituted in reaction to the *Granholm* holding—as proof that a reasonable, nondiscriminatory alternative to the three-tier system could satisfy Michigan’s administrative needs.<sup>100</sup>

## II. THE ORIGINS OF THE *NORTH DAKOTA* DICTUM

These four retailer challenges to the three-tier system illustrate the *North Dakota* dictum’s shielding function. Once a court invokes the dictum, the three-tier system is saved from strict scrutiny. But when the Eastern District of Michigan disregarded the dictum in *Siesta Village*, the state alcohol law fell as a result.<sup>101</sup> This shielding function, therefore, begs a question: Why is the three-tier system unquestionably legitimate?

*Granholm* itself does not provide any kind of answer. The Supreme Court only briefly mentioned the system’s previously recognized legitimacy before moving on to pronounce the equal treatment rule.<sup>102</sup> An answer to this question requires more in-depth analysis of the dictum itself, originating in an earlier Supreme Court decision, *North Dakota v. United States*.<sup>103</sup> Section II.A examines the Supreme Court decision in *North Dakota*, particularly the sentence that has become the *North Dakota* dictum, for its relevance to dormant Commerce Clause challenges. Then, Section II.B contends that because the decision in *North Dakota* rests on law abrogated or overruled by *Granholm*, its dictum should not apply to the retailers’ dormant Commerce Clause cases. Section II.C addresses the Fifth Circuit’s counterargument that the three-tier system is a caveat to the equal treatment rule. That argument is at odds with *Granholm*’s text and central mandate for heightened review of discriminatory alcohol regulations.

### A. *The Constitutional Challenge in North Dakota v. United States*

In *North Dakota v. United States*, the Supreme Court heard a challenge by the federal government to a North Dakota statute. This law mandated that out-of-state alcohol producers affix a label to products intended for sale at military bases within the state and comply with the state’s monthly reporting requirements.<sup>104</sup> On two military bases, which were controlled by the state and federal governments concurrently, the Department of Defense (“DOD”)

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100. The District Court stated as follows:

The State does not suggest any alternatives for regulating wine from out-of-state retailers nor make any showing that such an alternative is unworkable. The State also entertains no discussion about how it regulates wine shipped directly from out-of-state wineries and why the same procedures would be unworkable in regulating shipments from out-of-state retailers.

*Id.* at 1041.

101. See 596 F. Supp. 2d 1035.

102. See *Granholm v. Heald*, 544 U.S. 460, 489 (2005).

103. 495 U.S. 423 (1990) (plurality opinion).

104. *North Dakota*, 495 U.S. at 426.

operated clubs and package stores that sold alcohol to military personnel and their families.<sup>105</sup> In order to reduce its prices, the DOD had established a competitive bidding system, in which it would purchase alcohol from distributors offering the lowest prices, even if the alcohol came from another state.<sup>106</sup> North Dakota's statute thus imposed additional hurdles on out-of-state entities competing for the DOD's bid. Several distilleries and importers, complaining of this burden, refused to sell to the military bases and threatened to increase their prices.<sup>107</sup> In response, the federal government filed suit, arguing that the North Dakota statute attempted to regulate the federal government in violation of the Supremacy Clause as well as that the statute was preempted by federal law.<sup>108</sup>

In a plurality opinion, the *North Dakota* Court pronounced three rulings. First, the Court reasoned that there was a significant risk that alcohol sold directly to the bases might enter the regular consumers' market and disrupt North Dakota's three-tier system.<sup>109</sup> For this reason, the Court found North Dakota's labeling and reporting requirements presumptively valid.<sup>110</sup> Second, the Court determined that the North Dakota laws did not violate the Supremacy Clause because they did not directly interfere with the federal government or discriminate against it.<sup>111</sup> Finally, the Court found no preemption by federal law that would immunize the federal government from the challenged North Dakota laws.<sup>112</sup>

*North Dakota* did not invite a dormant Commerce Clause inquiry. Instead, it dealt with two issues separate from the dormant Commerce Clause's limitation on the Twenty-First Amendment: whether a state had the power to pass an alcohol law that burdened the federal government,<sup>113</sup> and whether federal alcohol laws preempted North Dakota's own alcohol laws.<sup>114</sup> In the context of these issues, the Court stated—in dictum, as in *Granolm*—that the three-tier system was “unquestionably legitimate.”<sup>115</sup> The *North Dakota* plurality went no further in explaining or demonstrating through constitutional analysis why it found the three-tier system

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105. *Id.* at 426–27.

106. *Id.* at 427.

107. *Id.* at 429.

108. *Id.* at 434.

109. *Id.* at 432–33.

110. *Id.*

111. *Id.* at 436–38.

112. *Id.* at 441.

113. *Id.* at 434–39.

114. *Id.* at 439–43.

115. Justice Stevens addressed North Dakota's three-tier system as follows:

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.

legitimate.<sup>116</sup> And though it endorsed the system under the Twenty-First Amendment, it did not mention the dormant Commerce Clause in its endorsement.<sup>117</sup> This exclusion makes sense: the dormant Commerce Clause was not implicated in *North Dakota*, so the Court had no reason to explain its interaction with Section Two of the Twenty-First Amendment.

The Supreme Court's application of the *North Dakota* dictum to its decision in *Granholm*, as well as lower courts' invocation of the dictum to retailer challenges, is suspect. *North Dakota* has little relevance to the dormant Commerce Clause challenge that the Court heard in *Granholm*. Yet the *Granholm* Court cited both *North Dakota*'s plurality opinion and Justice Scalia's concurrence for the assertion that the three-tier system was "unquestionably legitimate."<sup>118</sup> Because the plurality and Justice Scalia came to that conclusion in a case that did not implicate the dormant Commerce Clause,<sup>119</sup> its applicability to retailers' three-tier system challenges is dubious.<sup>120</sup> But its effect is not. The three-tier system is treated as sacrosanct because of one sentence, often repeated, that originated in a case that did not consider the dormant Commerce Clause's limitation on state alcohol laws.

### B. Abrogated Law Underlying the North Dakota Dictum

*North Dakota v. United States* dealt with issues separate from the dormant Commerce Clause questions in *Granholm* and subsequent retailer challenges. Moreover, the very cases *North Dakota* cited in support of the three-tier system's "unquestionable legitimacy"<sup>121</sup> were abrogated by *Granholm*'s holding.

The *North Dakota* Court cited *Carter v. Virginia*<sup>122</sup> and *State Board of Equalization v. Young's Market Co.*<sup>123</sup> in support of the three-tier system's constitutionality. Neither case is good law post-*Granholm*. In *Carter*, the Court heard Commerce Clause challenges to various regulations in Virginia's Alcoholic Beverage Control Act that controlled the transportation of

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116. See *id.* at 432–33.

117. See *id.*

118. *Granholm v. Heald*, 544 U.S. 460, 489 (2005) (internal quotation marks omitted). In *North Dakota v. United States*, Justice Scalia wrote, "The Twenty-first Amendment . . . empowers North Dakota to require that all liquor sold for use in the State be purchased from a licensed in-state wholesaler. Nothing in our Twenty-first Amendment case law forecloses that conclusion." 495 U.S. at 447 (Scalia, J., concurring).

119. See *North Dakota*, 495 U.S. at 434.

120. In *Bainbridge v. Turner*, the Court of Appeals for the Eleventh Circuit analyzed case law taking up the "core concern[s]" of the Twenty-First Amendment. 311 F.3d 1104, 1113 (11th Cir. 2002) (internal quotation marks omitted). The court noted that *North Dakota*—specifically the "unquestionably legitimate" language—offered a "single sentence" from the Supreme Court on an otherwise unaddressed issue, and did so in the context of an "intergovernmental immunity case." *Id.* at 1113–14.

121. See *North Dakota*, 495 U.S. at 432.

122. 321 U.S. 131 (1944).

123. 299 U.S. 59 (1936), abrogated by *Granholm*, 544 U.S. 460.

alcohol through the state.<sup>124</sup> The Court recognized the tension between the Twenty-First Amendment and the Commerce Clause, “a grant of power to Congress to control commerce and . . . a diminution *pro tanto* of absolute state sovereignty over the same subject matter.”<sup>125</sup> It resolved this tension by finding that the Twenty-First Amendment relieved the states of their usual Commerce Clause obligations.<sup>126</sup> Under this reasoning, the Court upheld the regulations against dormant Commerce Clause challenges.<sup>127</sup>

In *Young’s Market*, California wholesalers challenged a regulation that required them to obtain an importer’s license to sell beer produced in other states.<sup>128</sup> The Court recognized that such a regulation would have been struck down prior to the Twenty-First Amendment because it placed a burden on interstate commerce.<sup>129</sup> But because of the Twenty-First Amendment, the Commerce Clause challenge was powerless in this case.<sup>130</sup> The Court upheld the California regulations.<sup>131</sup>

In the wake of *Granholm*, neither *Carter* nor *Young’s Market* has force. *Carter* maintained that the Twenty-First Amendment trumped any Commerce Clause challenges by limiting the Clause’s power over states in the context of state alcohol laws.<sup>132</sup> Yet in *Granholm* the Supreme Court specifically held that the dormant Commerce Clause limited state regulation of alcohol.<sup>133</sup> *Young’s Market* reasoned that the Twenty-First Amendment authorized state regulations burdening interstate commerce.<sup>134</sup> But the *Granholm* Court explicitly repudiated this reasoning in *Young’s Market* because it was “inconsistent” with the Court’s view that the Twenty-First Amendment did not authorize states to pass nonuniform laws in order to discriminate against interstate commerce.<sup>135</sup> In fact, the *Granholm* Court made clear that the Twenty-First Amendment did not “displace the rule that States may not give a discriminatory preference to their own producers.”<sup>136</sup> Because the Court in *North Dakota* relied on these shaky foundations, the *North Dakota* dictum is unpersuasive and should be discarded.

124. *Carter*, 321 U.S. at 132–34.

125. *Id.* at 137.

126. *Id.* (“The [Twenty-First] Amendment has been held to relieve the states of the limitations of the Commerce Clause on their powers over such transportation or importation.” (citing *Indianapolis Brewing Co. v. Liquor Control Comm’n*, 305 U.S. 391 (1939), *abrogated* by *Granholm*, 544 U.S. 460, and *Young’s Mkt.*, 299 U.S. 59)).

127. *Id.* at 137–38.

128. *Young’s Mkt.*, 299 U.S. at 60–61.

129. *Id.* at 62.

130. *Id.*

131. *Id.* at 64.

132. *Carter*, 321 U.S. at 137.

133. *Granholm v. Heald*, 544 U.S. 460, 487–89 (2005) (“The instant cases, in contrast, involve straightforward attempts to discriminate in favor of local producers. The discrimination is contrary to the Commerce Clause and is not saved by the Twenty-first Amendment.”).

134. *Young’s Mkt.*, 299 U.S. 59.

135. *Granholm*, 544 U.S. at 484–86.

136. *Id.* at 486.

### C. *The Fifth Circuit's Counterargument: A Caveat to Granholm*

Assuming the *North Dakota* dictum was inappropriately applied in *Granholm*, the Supreme Court still recognized—and arguably endorsed—the idea that the three-tier system has been labeled “unquestionably legitimate” by the courts.<sup>137</sup> In *Wine Country*, the Fifth Circuit reasoned that by approving of the three-tier system in dictum, the Supreme Court included a “caveat” to its conclusion that the dormant Commerce Clause presents a limitation on states’ alcohol regulations.<sup>138</sup> In fact, the Fifth Circuit went so far as to recognize that the Twenty-First Amendment authorizes discriminatory alcohol regulations that are incidental to the regulations of the three-tier system.<sup>139</sup> Though such a reading of *Granholm* and the *North Dakota* dictum offers a resolution to their fundamental tension, nowhere in *Granholm* did the Supreme Court assert a caveat to its rule. Rather, the Court recited a general rule that regulations dealing with in-state and out-of-state alcohol must be “evenhanded.”<sup>140</sup> Moreover, the Court explicitly held that the challenged New York and Michigan laws were discriminatory, and thus “contrary to the Commerce Clause and . . . not saved by the Twenty-first Amendment.”<sup>141</sup> It is difficult to read *Granholm* as providing a caveat to its equal treatment rule in light of this holding and the Court’s abrogation of *Young’s Market*.

Moreover, the Court offered no guidance on how one could follow both *Granholm*’s mandate and the contradictory *North Dakota* dictum. A central tenet of *Granholm* is the standard of review it establishes: a state’s alcohol regulation, once declared discriminatory, will be deemed constitutional only if the state shows through concrete evidence that the regulation “advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives.”<sup>142</sup> By invoking *Granholm*’s *North Dakota* dictum, several courts have been able to sidestep this judicial review and avoid examining whether state alcohol regulations are legally and economically justified.<sup>143</sup> As the Eastern District of Michigan recognized in *Siesta*

137. *Id.* at 489 (“We have previously recognized that the three-tier system itself is ‘unquestionably legitimate.’” (quoting *North Dakota v. United States*, 495 U.S. 423, 432 (1990) (plurality opinion))).

138. *Wine Country Gift Baskets.com v. Steen*, 612 F.3d 809, 818–19 (5th Cir. 2010) (“The legitimizing [of the three-tier system] is thus a caveat to the statement that the Commerce Clause is violated if state law authorizes ‘differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter.’” (quoting *Granholm*, 544 U.S. at 472)), *cert. denied*, 131 S. Ct. 1602 (2011).

139. The Fifth Circuit clarified that the laws of the three-tier system are discriminatory yet constitutional; thus, “[t]he discrimination that would be questionable . . . is that which is not inherent in the three-tier system itself.” *Id.* at 818.

140. *Granholm*, 544 U.S. at 493.

141. *Id.* at 489.

142. *Id.* at 489, 492–93 (quoting *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 278 (1988)) (internal quotation marks omitted).

143. See *Wine Country*, 612 F.3d at 818–19; *Arnold’s Wines, Inc. v. Boyle*, 571 F.3d 185, 190–91 (2d Cir. 2009) (“[The retailers’ challenge] is a frontal attack on the constitutionality of

*Village*, *Granholm*'s essential mandate of evenhanded, nondiscriminatory alcohol regulations and its endorsement of the three-tier system are inherently contradictory.<sup>144</sup>

The better reading of *Granholm* recognizes that the Supreme Court recited the *North Dakota* dictum in an ill-considered fashion. *North Dakota* had no place in *Granholm*'s analysis, first, because *North Dakota* was a Supremacy Clause case—not a dormant Commerce Clause case—and, second, because *North Dakota* relied on law that had no precedential force. For this reason, the dictum should be discarded. Still, the Supreme Court included the dictum for a reason. The Court likely wanted to save from constitutional scrutiny a system that has been in place for nearly eighty years and in which many states have asserted a strong interest. So it grasped at *North Dakota*'s unsupportable proposition to grant the system immunity. In light of the precarious origins of the *North Dakota* dictum, this Note asserts that should the Court decide to preserve the system's constitutionality, it ought to do so through the analysis set out in *Granholm*, and not by bare reliance on the ill-suited dictum from *North Dakota*.

### III. DISCARDING THE DICTUM: HEIGHTENED JUDICIAL REVIEW UNDER *GRANHOLM*

If the *North Dakota* dictum were discarded, courts hearing Commerce Clause challenges to the three-tier system would have to perform the judicial review mandated in *Granholm*. Recent decisions regarding the three-tier system illustrate the arguments that states would likely make to justify the system. And the outcomes in these decisions suggest that states' arguments would fall short of the heavy burden *Granholm* requires. Section III.A outlines the two standards of review in dormant Commerce Clause challenges. Section III.B finds that strict scrutiny should apply to retailer challenges to the three-tier system. Finally, Section III.C reviews recent state defenses of the three-tier system and concludes that, under strict scrutiny and without the protection of the *North Dakota* dictum, the three-tier system would likely be struck down as unconstitutional.

#### A. Two Dormant Commerce Clause Tests

Courts employ one of two levels of analysis when evaluating a state alcohol regulation under a dormant Commerce Clause challenge.<sup>145</sup> If the

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the three-tier system itself. . . . Appellants' argument is therefore directly foreclosed by the *Granholm* Court's express affirmation of the legality of the three-tier system."); *Brooks v. Vassar*, 462 F.3d 341, 352 (4th Cir. 2006).

144. See *Siesta Vill. Mkt., LLC v. Granholm*, 596 F. Supp. 2d 1035, 1039 (E.D. Mich. 2008) (noting that while the *Granholm* Court considered the three-tier system an "appropriate use of state power," the Court "did not approve of a system that discriminates against out-of-state interests").

145. Maureen K. Ohlhausen & Gregory P. Luib, *Moving Sideways: Post-Granholm Developments in Wine Direct Shipping and Their Implications for Competition*, 75 ANTITRUST L.J. 505, 524–28 (2008).

alcohol regulation is evenhanded and presents only an incidental burden on interstate commerce, then a court applies a deferential test known as the *Pike* test.<sup>146</sup> Under *Pike*, a court upholds the challenged regulation unless “the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.”<sup>147</sup>

On the other hand, if a court finds that a state alcohol regulation discriminates against interstate commerce, the court applies strict scrutiny.<sup>148</sup> Courts find discrimination when a state law “mandate[s] ‘differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter.’”<sup>149</sup> If a court determines that a law is discriminatory, then the court must strike the law down unless it advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives.<sup>150</sup> Legitimate local purposes have included promoting temperance, ensuring orderly market conditions, and raising revenue.<sup>151</sup> Courts have also approved local-option laws to allow localities to be dry and to prevent underage drinking.<sup>152</sup> To successfully defend a discriminatory alcohol regulation, a state must also provide concrete evidence that nondiscriminatory alternatives are unworkable.<sup>153</sup> In practice, this burden on states is a heavy one.<sup>154</sup>

### B. Strict Scrutiny Should Be Applied to the Three-Tier System

If courts discarded the *North Dakota* dictum, then they would have to apply one of the two dormant Commerce Clause tests to the three-tier system. The strict scrutiny review prescribed in *Granholm* is the appropriate standard of review. This Note supports this assertion in three ways: first, by

146. *Id.* at 526.

147. *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).

148. *Ohlhausen & Luib*, *supra* note 145, at 524–25; *see also Granholm v. Heald*, 544 U.S. 460, 476 (2005) (“State laws that discriminate against interstate commerce face ‘a virtually *per se* rule of invalidity.’” (quoting *City of Phila. v. New Jersey*, 437 U.S. 617, 624 (1978))).

149. *Granholm*, 544 U.S. at 472 (quoting *Or. Waste Sys., Inc. v. Dep’t of Env’tl. Quality*, 511 U.S. 93, 99 (1994)).

150. *Id.* at 489.

151. *North Dakota v. United States*, 495 U.S. 423, 432 (1990) (plurality opinion).

152. *See, e.g., Cherry Hill Vineyards, LLC v. Hudgins*, 488 F. Supp. 2d 601, 619–22 (W.D. Ky. 2006), *aff’d*, 553 F.3d 423 (6th Cir. 2008).

153. *Granholm*, 544 U.S. at 492–93.

154. *Id.* at 490 (“Under our precedents, which require the ‘clearest showing’ to justify discriminatory state regulation, [the states’ unsupported assertions that their laws would prevent minors from accessing alcohol and facilitate tax collection are] not enough.” (citing *C & A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 393 (1994))); *see also Anheuser-Busch, Inc. v. Schnorf*, 738 F. Supp. 2d 793, 808 (N.D. Ill. 2010) (“Satisfying this standard is no easy feat.”); *Siesta Vill. Mkt., LLC v. Granholm*, 596 F. Supp. 2d 1035, 1041 (E.D. Mich. 2008) (recognizing that *Granholm* requires a state to show concrete evidence, rather than sweeping assertions, to justify the challenged regulation); *Ohlhausen & Luib*, *supra* note 145, at 524–25 (illustrating that *Granholm* imposes a high standard on the state).

reviewing the case law declaring laws that impose economic burdens on out-of-state entities unconstitutional; second, by contrasting the retailers' challenges with challenges to state satellite taxes, which do not contain an explicit physical presence requirement; and third, by recognizing the broad scope of *Granholm's* mandate, which the Second Circuit neglected in its *Arnold's Wines* decision.

### 1. Strict Scrutiny Applies

The three-tier system necessarily excludes out-of-state retailers and wholesalers unless they open an in-state location and obtain the necessary license to operate within the state.<sup>155</sup> Such a scheme is discriminatory under the definition provided in *Granholm*.<sup>156</sup> Moreover, the court in *Siesta Village* noted that courts are particularly suspicious of regulations that require "an entity to maintain residency in the home state 'in order to compete on equal terms' with in-state businesses."<sup>157</sup> In *Siesta Village*, the court applied strict scrutiny to Michigan's three-tier system because it discriminated against out-of-state retailers by placing an extra burden on them.<sup>158</sup> Because each state's three-tier system operates in a similarly localized fashion, the system as it exists in each state imposes this extra burden on out-of-state participants.<sup>159</sup>

Courts hearing challenges to the three-tier system should apply strict scrutiny rather than the more deferential *Pike* test. *Pike* would apply if a court found that the three-tier system's physical presence requirement were not discriminatory. But the *Granholm* Court cited numerous decisions for the proposition that when a law requires an out-of-state business to establish an in-state location in order to compete in that state's market, the law is facially or patently discriminatory and triggers strict scrutiny.<sup>160</sup> In other

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155. See *supra* notes 26–32 and accompanying text.

156. *Granholm*, 544 U.S. at 472 ("The mere fact of nonresidence should not foreclose a producer in one State from access to markets in other States." (citing *H.P. Hood & Sons, Inc. v. Du Mond*, 336 U.S. 525, 539 (1949))); *id.* at 475 ("New York's in-state presence requirement runs contrary to our admonition that States cannot require an out-of-state firm 'to become a resident in order to compete on equal terms.'" (quoting *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, 72 (1963))).

157. *Siesta Vill.*, 596 F. Supp. 2d at 1039–40 (E.D. Mich. 2008) (citing *Granholm*, 544 U.S. at 475, *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 145 (1970), and *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, 72 (1963), for this proposition); see also *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 145 (1970) ("[T]he Court has viewed with particular suspicion state statutes requiring business operations to be performed in the home State that could more efficiently be performed elsewhere. Even where the State is pursuing a clearly legitimate local interest, this particular burden on commerce has been declared to be virtually *per se* illegal.").

158. *Siesta Vill.*, 596 F. Supp. 2d at 1040 ("[T]he added burden of opening a new location in Michigan is differential and discriminatory treatment of out-of-state interests.").

159. See *supra* Section I.A.

160. *Granholm*, 544 U.S. at 472–76 (citing *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, 72 (1963); *H.P. Hood & Sons, Inc. v. Du Mond*, 336 U.S. 526, 539 (1949); and *Ward v. Maryland*, 79 U.S. (12 Wall.) 418 (1871)). *Granholm* cites other cases, too, for the broader proposition that the Court tends to strike down state alcohol statutes whose effects

circumstances, the Court has closely scrutinized similar laws because they advantage local interests and disadvantage out-of-state businesses. For example, the Court has applied strict scrutiny where a New Jersey law prohibited other municipalities from importing waste into the state to dispose of it,<sup>161</sup> where a Hawaii tax exemption for alcohol produced in the state was intended to and did promote economic protectionism,<sup>162</sup> and where a Massachusetts tax assessed on all milk products entering the state benefitted only in-state dairy farmers.<sup>163</sup> The three-tier system, and more specifically its physical presence requirement, falls into this category of facially discriminatory laws.

## 2. Challenges to the Satellite Tax: A Helpful Analogy

Another recent line of dormant Commerce Clause cases informs the analysis of the appropriate standard of review in challenges to the three-tier system. DIRECTV and other satellite broadcasting companies brought several unsuccessful state court challenges to “satellite taxes,” which are imposed on satellite companies but not on cable companies.<sup>164</sup> The satellite companies contended that satellite taxes discriminate against interstate commerce because they favor the cable companies that employ state citizens and whose services involve in-state equipment.<sup>165</sup> They claimed that these taxes penalize satellite companies for not making as large an economic investment in a state,<sup>166</sup> since satellite companies can deliver their services without a physical presence in a state.<sup>167</sup> Every federal and state court that has heard these cases has upheld the satellite tax.<sup>168</sup>

The decisions rejecting these dormant Commerce Clause challenges align on several key points that expose why courts hold that the satellite tax is constitutional and, by extension, why courts should not find the three-tier system constitutional. First, courts find that cable companies are not obvi-

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advantage the economic interests of the state over the economic interests of other states. *Id.* at 487–88 (citing *Healy v. Beer Inst.*, 491 U.S. 324 (1989); *Brown-Forman Distillers Corp. v. N.Y. State Liquor Auth.*, 476 U.S. 573 (1986); and *Bacchus Imps., Ltd. v. Dias*, 468 U.S. 263 (1984)).

161. See *City of Phila. v. New Jersey*, 437 U.S. 617 (1978).

162. See *Bacchus Imps., Ltd. v. Dias*, 468 U.S. 263 (1984). The *Bacchus* Court stated that a finding of economic protectionism could be made based on the purpose or the effect of a state law. *Id.* at 270.

163. See *W. Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 202 (1994) (“For over 150 years, our cases have rightly concluded that the imposition of a differential burden on any part of the stream of commerce—from wholesaler to retailer to consumer—is invalid, because a burden placed at any point will result in a disadvantage to the out-of-state producer.”).

164. *E.g.*, *DIRECTV, Inc. v. Treesh*, 487 F.3d 471 (6th Cir. 2007); *DIRECTV, Inc. v. State*, 632 S.E.2d 543 (N.C. Ct. App. 2006); *DIRECTV, Inc. v. Levin*, 941 N.E.2d 1187 (Ohio 2010); see also *Litigation Update*, STOP SATELLITE TAX NOW!, [http://stopstallitax.com/litigation\\_update.php](http://stopstallitax.com/litigation_update.php) (last visited Nov. 11, 2011).

165. *Treesh*, 487 F.3d at 476; *Levin*, 941 N.E.2d at 1192.

166. *Treesh*, 487 F.3d at 476.

167. *Levin*, 941 N.E.2d at 1192.

168. *Id.* at 1194.

ously local compared to satellite companies.<sup>169</sup> Second, courts reason that cable companies and satellite companies provide their customers different goods.<sup>170</sup> Finally, and most relevant to the retailer challenges to the three-tier system, courts conclude that the differential tax treatment of satellite companies vis-à-vis cable companies is attributable to the distinct natures of the two types of broadcasting services and not to geographic location.<sup>171</sup> As the Supreme Court of Ohio explained, “the sale of satellite broadcasting services is subject to tax regardless of whether the provider is an in-state or out-of-state business and without considering the amount of local economic activity or investment . . . that the satellite companies bring to Ohio.”<sup>172</sup> Because these laws proscribe differential treatment due not to physical presence or absence but rather to the varying modes of service, courts find no dormant Commerce Clause violations in satellite taxes.

These satellite tax cases are instructive because they reveal the factors courts look to in determining whether a state law has an impermissible physical presence requirement. Applying the reasoning of these cases to the three-tier system cuts in favor of finding discriminatory physical presence requirements in three-tier system’s laws. Unlike the satellite taxes, the three-tier system clearly distinguishes between in-state wholesalers and retailers and their out-of-state counterparts.<sup>173</sup> Further, these discrete sets of entities both sell the same goods—alcoholic beverages—and offer the same modes of service, distribution, and retail sales. Finally, and most importantly, the satellite tax cases differ from retailer challenges to the three-tier system because the three-tier system’s laws distinguish between in-state and out-of-state entities based on the location of their operations. The moment an out-of-state retailer establishes a brick-and-mortar store in a state, the retailer can obtain a license and begin selling alcohol as a member of the state’s three-tier system.<sup>174</sup> Because the system requires a physical presence

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169. *E.g., id.* at 1196 (finding that both cable and satellite companies are interstate entities); *DIRECTV, Inc. v. State*, 632 S.E.2d at 548 (“[Cable and satellite companies] both utilize in-state and out-of-state equipment and facilities in providing service to North Carolina subscribers and both own property within the State of North Carolina.”).

170. *Treesh*, 487 F.3d at 480 (finding that cable and satellite companies sell different goods because they provide different types of broadcasting); *Levin*, 941 N.E.2d at 1195 (recognizing distinct technological modes of broadcast in cable and satellite services).

171. *Treesh*, 487 F.3d at 481; *DIRECTV, Inc. v. State*, 632 S.E.2d at 547 (finding that the satellite law “does not make any geographical distinctions”); *Levin*, 941 N.E.2d at 1195.

172. *Levin*, 941 N.E.2d at 1195. I intentionally gloss over the argument that Ohio’s distinction between satellite and cable company modes of service may be a proxy for excluding out-of-state businesses in a manner that the dormant Commerce Clause doctrine should still find offensive. This argument is persuasive, and *DIRECTV* cited authorities propounding this argument in its petition for certiorari to the Supreme Court. Petition for Writ of Certiorari at 15–19, *DIRECTV, Inc. v. Levin*, No. 10-1322 (Apr. 27, 2011), 2011 WL 1594681, at \*15–19. Because the three-tier system contains explicit physical presence requirements, an analysis of the proxy theory of discrimination is not crucial to this Note’s argument.

173. *See supra* notes 22–32 and accompanying text.

174. *See supra* note 30 and accompanying text.

in the state, the system discriminates against interstate commerce and should receive strict scrutiny.

### 3. *Arnold's Wines*: A Misguided Analysis

In *Arnold's Wines*, the Court of Appeals for the Second Circuit resisted analysis of the physical presence requirement contained in New York's three-tier system. After determining that the *North Dakota* dictum foreclosed judicial review of New York's three-tier system, the Second Circuit offered an alternative argument for finding that the three-tier system was in accordance with *Granholm's* equal treatment rule. Because "New York requires that all liquor—whether originating in state or out of state—pass through the three-tier system,"<sup>175</sup> the Second Circuit found that the system adheres to the dormant Commerce Clause. In other words, since New York's regulations controlled both in-state and out-of-state alcohol, the system had no discriminatory effect.

The Second Circuit's reasoning in *Arnold's Wines* is flawed for two reasons. First, the argument is facile. It proves nondiscrimination simply by rejecting the notion that a single law applied to two sets of entities could illegally burden one set of entities and not the other. Yet courts recognize disparate impact in state laws that facially apply in an equal fashion to in-state and out-of-state goods. For example, similar reasoning did not save New Jersey's law banning trash collected outside the state from entering its landfill space, even though the law controlled New Jersey trash and trash from the city of Philadelphia.<sup>176</sup> Likewise, this reasoning failed to justify a Massachusetts law that taxed all milk dealers operating in the state but provided a share of the fund created by the tax only to Massachusetts milk producers.<sup>177</sup> *Granholm* struck down laws that discriminated in favor of local participants in the alcohol industry and disadvantaged their out-of-state counterparts.<sup>178</sup> A law does not pass *Granholm's* equal treatment test just because all alcohol in the market is subject to it. Rather, *Granholm* and the dormant Commerce Clause doctrine prohibit differential treatment of in-state and out-of-state market participants.<sup>179</sup>

Nor does a law pass *Granholm's* test merely because all producers in the first tier are subject to the system. The Second Circuit made its second mistake in limiting the scope of *Granholm's* mandate to alcohol products and producers.<sup>180</sup> *Granholm's* language exposes the holding's universal scope; the Court expressed disfavor with laws that "mandate 'differential treatment

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175. *Arnold's Wines, Inc. v. Boyle*, 571 F.3d 185, 191 (2d Cir. 2009).

176. *See City of Phila. v. New Jersey*, 437 U.S. 617 (1978).

177. *See W. Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994).

178. *See Granholm v. Heald*, 544 U.S. 460, 473–74 (2005).

179. *See supra* notes 160–163.

180. *See Arnold's Wines*, 571 F.3d at 191 ("Because New York's three-tier system treats in-state and out-of-state liquor the same, and does not discriminate against out-of-state products or producers, we need not analyze the regulation further under Commerce Clause principles.").

of in-state and out-of-state economic *interests*.’<sup>181</sup> The *Granholm* Court spoke in terms of alcohol products and producers because the subjects of the New York and Michigan cases were laws regulating wineries.<sup>182</sup> But the rule enunciated in *Granholm* could not apply solely to products and producers because the goal of the dormant Commerce Clause is, as *Granholm* makes clear, avoiding the “economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation.”<sup>183</sup> At each tier, the three-tier system affects both in-state and out-of-state participants. An alcohol regulation that treats in-state and out-of-state wholesalers or retailers differently produces the same illegal burden on interstate commerce as did the laws in *Granholm*.<sup>184</sup>

### C. *The Three-Tier System Fails under Strict Scrutiny*

Once a court determines that the three-tier system discriminates against interstate commerce, it will uphold the system only if the state demonstrates that the system furthers legitimate local purposes and produces concrete evidence that other nondiscriminatory alternatives are insufficient.<sup>185</sup> In other words, the state must prove “the need for discrimination.”<sup>186</sup>

Examining recent state arguments defending laws that are part of the three-tier system makes clear that states have not produced compelling arguments to justify the system’s discriminatory aspects. This Note focuses on two cases, *Siesta Village Market, LLC v. Granholm* and *Anheuser-Busch, Inc. v. Schnorf*, because they reveal the sorts of arguments states would make in support of the three-tier system.

In *Siesta Village*, the District Court for the Eastern District of Michigan applied strict scrutiny to Michigan’s three-tier system and found Michigan’s

181. *Granholm*, 544 U.S. at 472 (emphasis added) (quoting *Or. Waste Sys., Inc. v. Dep’t of Envtl. Quality*, 511 U.S. 93, 99 (1994)); see also *Siesta Vill. Mkt., LLC v. Granholm*, 596 F. Supp. 2d 1035, 1039 (E.D. Mich. 2008) (“[*Granholm*] did not approve of a system that discriminates against out-of-state interests.”); Andre Nance, Note, *Don’t Put a Cork in Granholm v. Heald: New York’s Ban on Interstate Direct Shipments of Wine Is Unconstitutional*, 16 J.L. & Pol’y 925, 946–47 (2008) (arguing that *Granholm*’s concern was with broader economic protectionism and implicates all tiers of the three-tier system).

182. *Granholm*, 544 U.S. at 465.

183. *Id.* at 472 (quoting *Hughes v. Oklahoma*, 441 U.S. 322, 325–26 (1979)) (internal quotation marks omitted).

184. The *Siesta Village* court illustrated this burden:

The only way for an out-of-state retailer to obtain such a license and ship directly to consumers in Michigan is to maintain a location in the state. This requirement is burdensome on out-of-state retailers because there are many costs associated with opening a new location in Michigan that may not be viable for retailers like *Siesta Village*. As noted in [*Granholm*], the expense of establishing a bricks-and-mortar operation in one state, let alone in all 50 states, is prohibitive. In-state retailers, on the other hand, have open access to the Michigan market at no additional cost.

596 F. Supp. 2d at 1040 (citation omitted).

185. *Granholm*, 544 U.S. at 489, 492.

186. *Id.* at 493.

justifications insufficient.<sup>187</sup> Michigan argued that it could not efficiently enforce its tax and labeling laws if out-of-state retailers were granted access to a state market.<sup>188</sup> But, the Michigan court objected, this argument was nearly identical to New York's and Michigan's arguments that had failed in *Granholm*.<sup>189</sup> Further, Michigan did not explain why self-reporting and submission of sales reports, which the *Granholm* Court deemed a sufficient nondiscriminatory alternative, would not remedy difficulties in enforcing tax laws against out-of-state retailers.<sup>190</sup> Finally, the state raised the concern that it could not ensure compliance with its underage drinking laws but failed to show why an adult signature requirement, which applies to wineries' direct shipments, could not also apply to retailers' direct shipments.<sup>191</sup>

Another recent decision, *Anheuser-Busch, Inc. v. Schnorf*,<sup>192</sup> provides further proof that states are unable to justify the three-tier system under strict scrutiny. In *Schnorf*, the District Court for the Northern District of Illinois struck down a regulation that permitted in-state brewers to obtain a wholesaler's license but prohibited out-of-state breweries from doing the same.<sup>193</sup> The court cited *Granholm* for the proposition that a law discriminates against interstate commerce if "by its own terms it regulates disparately out-of-state and in-state economic interests and favors the in-state interests."<sup>194</sup> It went on to find the Illinois regulation discriminatory because it restricted out-of-state breweries from selling their products on equal terms with their in-state counterparts.<sup>195</sup>

In *Schnorf*, Illinois offered the same arguments that New York and Michigan had offered in *Granholm*, and again the court rejected them.<sup>196</sup> The state argued that allowing large, out-of-state breweries to compete as wholesalers in the Illinois market would frustrate its goal of promoting

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187. *Siesta Vill.*, 596 F. Supp. 2d at 1040–44.

188. The court described Michigan's argument as follows:

[T]he State is constantly checking on Michigan wholesalers to make sure they are complying with state law. Out-of-state retailers like Siesta Village purchase their wine from non-Michigan retailers [sic]. Consequently, when they sell it to Michigan consumers, the State will not be able to regulate these sales because they will not go through the important "funnel" of Michigan wholesalers.

*Id.* at 1042.

189. *Id.*

190. *Id.*

191. *Id.* at 1043.

192. 738 F. Supp. 2d 793 (N.D. Ill. 2010).

193. *Schnorf*, 738 F. Supp. 2d at 817.

194. *Id.* at 803.

195. *Id.* at 808.

196. *Id.* at 809–10 ("[T]he arguments that Defendants present are similar, if not identical, to those that have been presented and rejected in other alcohol beverage discrimination cases."). The *Schnorf* court cited *Granholm* as well as other three-tier system cases in support of this assertion, including *Action Wholesalers Liquors v. Oklahoma Alcoholic Beverage Laws Enforcement Commission*, 463 F. Supp. 2d 1294 (W.D. Okla. 2006), and *Costco Wholesale Corp. v. Hoen*, 407 F. Supp. 2d 1247 (W.D. Wash. 2005). 738 F. Supp. 2d at 809.

temperance and competition. Second, Illinois asserted an argument that its regulation promoted tax collection and reduced the risk of tax evasion.<sup>197</sup>

But these arguments had several flaws. The court noted that Illinois failed to explain why allowing in-state breweries to operate as wholesalers promoted temperance.<sup>198</sup> Moreover, Illinois offered no explanation for why nondiscriminatory alternatives would not also promote temperance.<sup>199</sup> Finally, the court rejected the tax-related claims because Illinois provided no concrete evidence of its assertions and did not explain why nondiscriminatory laws would not achieve the same goals.<sup>200</sup>

These responses by the courts in the Eastern District of Michigan and the Northern District of Illinois recognize the realities of today's marketplace. For example, direct shipment schemes do not inhibit state taxation because companies have developed methods to permit direct shipment while still collecting state taxes.<sup>201</sup> Though studies posit the "possibility" of tax collection problems under a direct shipment scheme, no state that allows wineries to ship their products directly has reported tax leakage.<sup>202</sup> Direct shipment, then, does not prevent the states from monitoring and taxing alcohol as it enters the state by a nontraditional route. Granted, this is the kind of policy debate that Justice Stevens criticized in his *Granholm* dissent.<sup>203</sup> But in light of the dormant Commerce Clause limitations on state laws passed pursuant to the Twenty-First Amendment, this is just the kind of policy review that the Constitution requires courts to take up: Is the state's discrimination needed?<sup>204</sup>

*Siesta Village* and *Schnorf* suggest the types of recycled arguments states would make in defense of the three-tier system. Extrapolating from these two cases, courts applying strict scrutiny would likely find that states' justifications for the discriminatory three-tier scheme are inadequate. It would be prudent for states to begin considering alternative regulatory schemes that would assure an orderly market, promote temperance and the collection of

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197. *Schnorf*, 738 F. Supp. 2d at 809.

198. *Id.* at 810.

199. *Id.* at 809–10 (“[E]ven if the need to promote temperance and competition were advanced by barring all out-of-state brewers from distributing beer, the argument would fail because Defendants do not attempt to prove that non-discriminatory means would be unworkable to accomplish the State’s objectives.”).

200. *Id.*

201. See, e.g., *Sales Tax Requirements*, AMAZON.COM, <http://www.amazon.com/gp/help/customer/display.html?nodeId=468512> (last visited Nov. 11, 2011) (outlining Amazon.com’s procedures for collecting state taxes on direct shipment purchases and transferring them to the states). Post-*Granholm*, many states now allow out-of-state wineries to ship directly to consumers, and the states collect taxes on these sales. PETER FRANCHOT, COMPTROLLER OF MD., DIRECT WINE SHIPMENT REPORT 33–34 (2010)

202. FRANCHOT, *supra* note 201, at 33.

203. *Granholm v. Heald*, 544 U.S. 460, 494 (2005) (Stevens, J., dissenting) (“Today many Americans, particularly those members of the younger generations who make policy decisions, regard alcohol as an ordinary article of commerce . . .”).

204. *Id.* at 493.

state taxes, and deter underage drinking, while allowing out-of-state retailers to ship their products directly to consumers. Indeed, the *Granholm* Court offered several suggestions to New York and Michigan, whose alcohol laws it deemed discriminatory: evenhanded permit requirements for wineries wanting to engage in direct shipping, electronic background checks and self-reporting, regular submission of sales reports, adult signatures for alcohol deliveries, and increased reliance on federal licensing laws to encourage participants in the market to obey state regulations.<sup>205</sup> These same suggestions could be implemented in a scheme that allowed out-of-state retailers to participate in a state's alcoholic beverage market.

#### CONCLUSION

*Granholm* stands for two important propositions. First, the Twenty-First Amendment does not shield states from dormant Commerce Clause limitations in the alcohol context. Second, courts should subject discriminatory alcohol laws to strict scrutiny. Rather than blindly repeating the inapposite *North Dakota* dictum, courts should open up the three-tier system to judicial review. Under strict scrutiny, the three-tier system would likely fall, and states would have to correct the discriminatory aspects of the system. It would behoove state legislatures to develop new regulatory schemes that comply with the dormant Commerce Clause and *Granholm*'s equal treatment rule. Though it may seem a drastic course to dismantle a system that has been in place for seventy-five years, the Constitution mandates such a result.

Our country twice experimented on a large scale with alcohol regulation. The first experiment, Prohibition, has been largely condemned. The second, its repeal, gave birth to the three-tier system. But in effect, the three-tier system has resulted in another prohibition—a prohibition on efficient direct shipment and online sales of consumer goods that are mainstays of our economy. In the wake of *Granholm*, courts should subject this outdated and discriminatory scheme to more searching judicial review.

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205. *Id.* at 490–92.