# Still Looking for Granholm's Limits

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Anyone hoping the intermediate appellate court reversed in *Granholm* had become pro-commerce would have been disappointed by the July 1st decision of the Second Circuit in *Arnold's Wines, Inc. v. Boyle.*

At issue was whether a state permitting its local retail licensees to ship directly to consumers might constitutionally deny out-of-state retail licensees equivalent access. The Court of Appeals reached the less than crystalline conclusion that discrimination against interstate sellers is permissible under the 21st Amendment "insofar as it requires that all liquor sold within the State of New York pass through New York's three-tier regulatory system."

Judge Wesley, writing for an essentially undivided three-member panel, asserts that the locals-only licensing system "allows the state to oversee" (1) financial relationships among manufacturers, wholesalers, and retailers," which relate to state tied-house statutes limiting vertical integration, and (2) the prices and other terms of sale, which the state purports to regulate with the objective of averting overconsumption and disorderly marketing. He also notes that New York claims the system allows the state to collect taxes more efficiently than with alternative systems and to prevent sales to minors.

One cannot accurately maintain that the challenged licensing system "allows" those regulatory objectives in the sense of being necessary to achieve them. It is even less defensible to assert that *location discrimination* in *applying* a licensing system is necessary to oversee financial relationships and sales terms, to collect taxes with acceptable efficiency, or to prevent underage purchases. Thus, the court cannot escape the question whether less discriminatory means exist --unless it takes the discrimination entirely out of *Granholm*'s analysis of discriminatory laws. Most of the opinion is an attempt to do just that.

To circumvent the nondiscriminatory means issue, Judge Wesley articulates the "narrow *Granholm*" 21st Amendment-Commerce Clause theory: "It is only where states create discriminatory exceptions to the three-tier system, allowing in-state, but not out-of-state, liquor to bypass the three regulatory tiers, that their laws are subject to invalidation based on the Commerce Clause." His opinion recognizes (or carves) an exception to the equal access principle, based on the famous *North Dakota* statement that the 21st Amendment "empowers [a state] to require that all liquor sold for use in the State be purchased from a licensed *in-state* wholesaler" (emphasis supplied), even though that text appears in *Granholm* only as a "see also" citation that is not part of the *Granholm* holding and is also dictum in *North Dakota* itself. He does not overtly consider whether *Granholm*'s undoubted assertion of the legitimacy of three-tier systems includes the qualification (arguably inherent in the *Granholm* holding) that such systems may not employ location discrimination unless it is necessity-justified by some purpose other than perpetuation of the system itself. Without inclusion of that qualifier, it is easy to stop analyzing the *Granholm* opinion for effects on tiered distribution when one reaches its quotation from *North Dakota*.

Thus, *Arnold's Wines* puts us squarely into the fundamental uncertainty about *Granholm*: Are only what the majority calls "valid" or "generally applicable" (*i.e.*, location-nondiscriminatory) restrictions permissible, even in areas of traditional state's rights under the 21st Amendment, as Justice Thomas says disapprovingly in his dissent, or is there something special about passage of title through a wholesaler that provides *ipso facto* legitimacy to location discrimination between in-state and out-of-state resellers of the product?

Clearly in the second camp, the *Arnold's Wines* majority opinion advances two propositions as rationales for its decision:

> 1. The "three-tier system" means goods physically moving through all three tiers, the lower two of which are located in the same state as the consumer who purchases the goods. A ruling requiring equal access to the same consumers by out-of-state retailers is therefore an attack on the three-tier system, which would not be consistent with *Granholm*, because the majority in that case said the three-tier system is unquestionably legitimate.
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> 2. New York's law "treats in-state and out-of-state liquor evenhandedly" once it is in the state's three-tier system, and "thus complies with *Granholm*'s nondiscrimination principle." Equal treatment of *products* by allowing them all, regardless of original site of manufacture, to pass through the three-tier system, satisfies Commerce Clause requirements, even if the law prohibits interstate sellers to reach the same consumers as local sellers. The dormant Commerce Clause protects goods, not merchants.

In a concurring opinion, Judge Calabresi agrees with his colleagues' reasoning, but adds an eloquent originalist plea for judicial caution in "updating" constitutional provisions that (unlike, *e.g.*, due process of law) are not drafted loosely with an implied invitation to reinterpret them as society changes. One has the impression he wishes he could have restrained the impetuosity of the *Granholm* majority. He was, in any event, determined not to extend that opinion's 2005 update of the 21st Amendment beyond his panel's delimited reading.

Relatively short in comparison to the complexity of the issues, the majority opinion does not address a number of questions raised by its stated rationales.

In the first place, it is not at all clear that Judge Wesley's three-tier system is the same thing as the three-tier system declared legitimate in *Granholm*. The *Grahholm* majority unmistakably implies there are such things as constitutional systems funneling all wine sales through local wholesalers, but is silent (to the exasperation of Justice Thomas) on how they would operate without producing impermissible favoritism toward local versus interstate commerce. One court has already attempted to resolve the conundrum by preserving a state requirement that sales go through a locally licensed wholesaler, but requiring the state to process retail license applications without location discrimination. If one adds drop shipment to that scenario, it becomes possible to run all sales through an in-state distributor (who would presumably also be responsible for tax and price reporting) and avoid location discrimination in access to local consumers.

Ultimately, the first rationale rests on the court's pronouncement that unequal access to customers by retailers is "part of the three-tier licensing structure" (*vice* distribution system) established in New York. When the court concludes that exemption of unequal access from Commerce Clause scrutiny is established by that proposition, it is

committing what a logician would call a mereological fallacy. That is, assuming the state's licensing structure could be part of a three-tier system, it does not follow that special exempted status accorded three-tier systems applies to each part of it. That logical gap would exist even if the *North Dakota* dictum were established law, and even if one further assumed that all members of the class "three-tier systems" were exempt from the dormant Commerce Clause.

With respect to the second rationale, the Court of Appeals may have made a bold departure from the conceptual underpinnings of Commerce Clause jurisprudence in its attempt to diminish *Granhom*'s scope. Most judges and commentators have assumed that the Commerce Clause is intended to protect commerce, not merely choice of manufacturing site. It is, of course, entirely proper for a court to attempt to limit a disliked precedent to its specific facts, but drawing the line at products, excluding protection of downstream merchants, seems extreme.

Judge Wesley may have been forced to an extreme position to support his assertion that the facts before him were in "stark contrast" to those of *Granholm.* Viewed from another angle, the distance between the cases does not appear so great. Mrs. Swedenburg's wines and those of the other *Granholm* plaintiffs had equal rights with New York wines to direct delivery to New York consumers from bricks-and-mortar locations within New York. That may not be so easy to distinguish from the *Arnold's Wines* plaintiffs' equal right to sell to New York consumers through bricks-and-mortar wholesalers and retailers within New York. One need not read *Granholm* very broadly to conclude that if the former was invalid, the validity of the latter is at least questionable.

Because the court seems to believe no nondiscriminatory means inquiry is necessary, its reference to state purposes may be only a makeweight. However, it is worth noting that the listed objectives themselves are not all necessarily legitimate. If the purpose of tied-house laws is to prevent supplier interests in New York retailers, regulation of sales by those retailers within New York is sufficient. Only if New York's objective is to prevent such interests in retailers located in other states is it necessary to "oversee" the financial relationships of those sellers. That objective, however, raises significant issues of extraterritoriality. In a 1989 beer pricing case, the Supreme Court enunciated limits on state legislation, 21st Amendment notwithstanding, short of regulating conduct that occurs entirely outside the state (which would appear to include financial relationships among entities in another state, whether or not one of them sells into the state) or causing a patchwork of different requirements for businesses engaged in interstate commerce (as seems the case, given the widely differing requirements of state tied-house laws). Those limitations suggest that tied-house oversight of out-of-state sellers is a not legitimate purpose that can be advanced to justify discrimination. Worse, extraterritorial effect of state laws is ordinarily considered not merely discrimination against, but direct state regulation of, interstate commerce --an unconstitutional invasion of the federal sphere that cannot be rendered legal by laudable purpose.

In sum, *Arnold's Wines* is a forceful formulation of the narrow *Granholm* position, with a forthright end run around less-discriminatory-means analysis. Its clarity emphasizes the developing differences among federal circuits in understanding that landmark case. While it is doubtful the Supreme Court has much appetite for revisiting *Granholm*, divergent interpretations at the intermediate level slowly increase the probability of high court review.

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