

January 2006

WineAmerica Staff Contact: Jenny Mattingley

### **Analysis of the Supreme Court Ruling on the *Granholm* Case**

In May 2005, the Supreme Court ruled on *Granholm v. Heald* regarding the direct shipment of wine. The issue considered by the Court was: “Whether a state’s regulatory scheme that permits in-state wineries directly to ship alcohol to consumers but restricts the ability of out-of-state wineries to do so violates the dormant commerce clause in light of section 2 of the 21st Amendment?” In other words, does the 21<sup>st</sup> Amendment allow states to discriminate against out-of-state wineries in a manner that would clearly violate the Commerce Clause? The Court found discrimination of out-of-state wineries to be unconstitutional and opined that states must create equal shipping conditions. Specifically, the Court declared that the Commerce Clause does not allow for trade barriers such as unequal shipping laws, therefore states can ban or allow direct wine shipments as long as the decision applies equally to in and out-of-state wineries.

Though this ruling was a boon for the wine industry and sent many state legislatures back to examine discriminatory laws, the Supreme Court ruling has left many unanswered questions. The actual ruling did not automatically change any laws or legalize direct shipping across the board. States continue to have the right to regulate their alcohol laws by leveling up or down. Furthermore, while the 21<sup>st</sup> Amendment does not protect state laws that are clearly discriminatory in light of the Commerce Clause, states can make the argument that certain vital interests can only be met through discrimination. In considering the state defense arguments in *Granholm*, the Court considered whether the existing regime “advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives.” The Court also pointed out that “burden is on the State to show that ‘the discrimination is demonstrably justified,’ ” and states must provide concrete evidence to prove their claim. In the *Granholm* case, the Court only identifies which claims are not justified and shed no light on what might be considered a valid case of discrimination.

The *Granholm* case also left unresolved issues of more immediate consequence to the wine industry. The Supreme Court stated that the three-tier system is still a viable method for a state to use to control their alcohol industry: “States may also assume direct control of liquor distribution through state run outlets or funnel sales through the three-tier system. We have previously recognized that the three-tier system itself is ‘unquestionably legitimate’.” Therefore, arguing for a reform of wine laws that do not include wholesalers is not a feasible option.

Another unresolved issue is that of reciprocity. Several states have direct shipping laws that open up their markets only to those states that afford their wineries the same policy. In the *Granholm* ruling, the Court stated that “the current patchwork of laws – some with States banning direct shipments altogether, others doing so for out-of-state wine, and still other requiring reciprocity – is essentially the product of an ongoing, low-level trade war. Using this statement, some groups have threatened to challenge the constitutionality of

reciprocal laws, claiming that reciprocity is also a discriminatory barrier under the Commerce Clause. However, it is not entirely clear from the Court's decision that these claims have merit. There has been no real test of the constitutionality of reciprocal laws, but most legal scholars agree that previous court cases might lead to an unconstitutional ruling if reciprocity is challenged. Many states that have recently enacted direct shipping legislation have chosen to forego this possible outcome by passing permit laws instead, though Minnesota made the decision to strike the reciprocal clause from their statutes and open their state up entirely.

How does all of this affect wineries and what specific challenges is the wine industry facing? The issues brought up in *Granholm* are complex and it is not clear how they will play out in the long term. For now, when considering direct shipping legislation, any new or existing laws must not differentiate between in and out-of-state wineries and it is perhaps better to create a permit system open to wineries from all states or other direct shipping systems. Some compromise must also be found with the wholesalers because the three-tier system is not going away. Certain compromise solutions are being proposed, such as quantity or size limits, though Connecticut is the only state to pass a size-based option as of January 2006.