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IN THE UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF CALIFORNIA

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| ORION WINE IMPORTS, LLC and PETER E. CREIGHTON, *Plaintiffs*<br><br>vs<br><br>JACOB APPLESMITH, in his official capacity as Director of the California Dept. of Alcoholic Beverage Control *Defendant* | No. 2:18-cv-01721-KJM-DB<br><br>**PLAINTIFFS' RESPONSE TO AMICUS BRIEF OF CALIFORNIA BEER & BEVERAGE DISTR., AND WINE & SPIRITS WHOL. OF CALIFORNIA**<br><br>Date: February 8, 2019<br>Time: 10:00 am<br>Ctroom: 3<br>Judge: Hon. Kimberly J. Mueller |

**I. Introduction**

Plaintiffs have challenged the constitutionality of a California law regulating wine importers and wholesalers as violating the Commerce Clause and the Privileges and Immunities Clause. The defendant, ABC Director Jacob Applesmith, has filed a motion to dismiss the complaint [Dkt. No. 33], arguing that:

1.The law does not violate either Clause because it does not discriminate against out-of-state interests. It requires every importer regardless of its location to use an in-state distributor. [Dkt. 33-1 at 3-8].

2. Even if it were discriminatory, the law would not violate the Commerce Clause because the Twenty-first Amendment gives states the power to require that wine originating outside the state must be processed by an in-state importer before being distributed through the state's three-tier system. [Dkt. 33-1 at 5-6].

3. The law does not violate the Privileges and Immunities Clause because plaintiffs lack standing and selling wine is not an interest protected by the Clause. [Dkt. No. 33-1 at 7].

Plaintiffs have already filed a response in opposition to the Director's motion which addresses those three issues.. [Dkt. 35].

Two trade associations representing in-state wholesalers have filed an amicus curiae brief supporting the State. [Dkt. 36]. They address only the second of the three issues raised by Director Applesmith. They do not dispute that the law at issue discriminates

against out-of-state importers, and they do not address the Privileges and Immunities Clause at all. They make a single argument that the Twenty-first Amendment allows California to discriminate against out-of-state wine importers and wholesalers. Because their brief presents new arguments and cites additional cases, a response is warranted.

Amici's argument is essentially this: When balancing the Commerce Clause and the Twenty-first Amendment, the Supreme Court has said that the nondiscrimination principle of the Commerce Clause applies to state liquor laws only in the context of laws regulating producers such as wineries. Therefore, states remain free to discriminate against out-of-state interests when regulating other parts of the liquor distribution system such as importers and wholesalers. They derive this argument from three sources:

1. One line of dicta in *Granholm v. Heald* which says that "[w]e have previously recognized that the three-tier system itself is 'unquestionably legitimate.'" 544 U.S. 460, 489 (2005).

2. Several places in *Granholm* where the Court characterizes the Commerce Clause as prohibiting unequal treatment of out-of-state products; e.g., "States may not give a discriminatory preference to their own producers," 544 U.S. at 486, and "State policies are protected ... when they treat liquor produced out of state the same as its domestic equivalent." 544 U.S. at 489.

3. One Eighth Circuit case which held that Missouri could discriminate against nonresidents when issuing licenses to operate in-state wine wholesaling businesses.

*So. Wine & Spirits of Am., Inc. v. Div. of Alcohol & Tobacco Control*, 731 F.3d 799, 809-10 (8th Cir. 2013).

We will address these arguments one by one.

**II. Response to Amici Curiae**

**A. Three-tier systems are "unquestionably legitimate" only if nondiscriminatory**

Five times in their brief, Amici cite the phrase from *Granholm v. Heald,* 544 U.S. at 489, that "the three-tier system in unquestionably legitimate." [Dkt. 36 at 1, 12, 15, 16, 17]. They argue based on this single sentence that if the three-tier system is legitimate, then all state laws regulating the tiers are constitutional, including those (like the ones at issue) that discriminate against out-of-state interests.

This is a different argument than the one made by Director Applesmith, who contends that the law is not discriminatory in the first place, because every importer who wants to sell wine in California is required to use an in-state distributor. [Dkt. 33-1 at 3-6]. Amici argue to the contrary that California's ban against out-of-state importer/ wholesalers selling directly to retailers is discriminatory, but permitted by the Twenty-first Amendment. The Court should therefore not consider the argument raised by Amici. Federal courts generally do not consider arguments that were not advanced by a party, especially those that contradict the party's contentions. Doing so could disrupt the party's litigation strategy, adds to the burden facing parties and the court, and an amicus lacks standing to raise a new issue on its own. *See Burwell v. Hobby Lobby Stores, Inc*., 134

S.Ct. 2751, 2776 (2014); *U.S. v. Wahchumwah,* 710 F.3d 862, 868 (9th Cir. 2013). The argument is without merit in any event, which is probably why Director Applesmith did not waste time arguing it. There are four reasons.

First, saying that the three-tier system is legitimate tells us nothing about whether specific laws regulating the tiers are constitutional. It cannot possibly stand for the principle that *all* laws regulating a wholesaler are valid. Clearly a state could not discriminate in the issuance of liquor licenses based on race, religion or gender. Neither can they discriminate based on state of residency, because all such discrimination is constitutionally prohibited.

Second, the sentence appears in *Granholm* unaccompanied by any discussion, explanation, analysis or reasoning, and does not actually say anything about discriminatory state liquor laws. That is not the way the Supreme Court announces its holdings.

> We resist reading a single sentence unnecessary to the decision as having done so much work. In this regard, we recall Chief Justice Marshall's sage observation that "general expressions, in every opinion, are to be taken in connection with the case in which those expressions are used. If they go beyond the case, they may be respected, but ought not to control the judgment in a subsequent suit when the very point is presented for decision.

*Arkansas Game & Fish Com'n v. U.S.*, 568 U.S. 23, 35 (2012) (citation omitted).

Third, Amici are taking the phrase out of context, thereby distorting its meaning. The phrase appears in *Granholm* only after an extended discussion of prior case law and the Court's conclusion that the nondiscrimination principle applies to state regulation of

alcohol. 544 U.S. at 486-88. In context, the Court was only clarifying that its holding did not cast into doubt the constitutional authority of states to make basic decisions about what kind of liquor distribution system to create. The Court says that

> A State [may choose] to ban the sale and consumption of alcohol altogether..., 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."

544 U.S. at 488-89. There is not the slightest indication that the Court meant that discriminatory regulations at the wholesaler tier were exempt from its extensive prior discussion concluding that the nondiscrimination principle applied to liquor laws. *See Lebamoff Enterprises, LLC v. Rauner*, 909 F.3d 847, 854-55 (7th Cir. 2018).

Fourth, the case where the "unquestionably legitimate" sentence comes from -- *North Dakota v. U.S.,*495 U.S. 423 (1990)-- was a plurality opinion in a Supremacy Clause case about liquor sales on military bases that involved neither the Commerce Clause nor retailers nor discrimination and therefore cannot possibly be precedent that discriminatory wine retailer laws are immune from Commerce Clause scrutiny. *Arkansas Game & Fish Com'n v. U.S.*, 568 U.S. at 35. Indeed, the *Granholm* Court cautioned against this very interpretation.

> The States argue that any decision invalidating their direct-shipment laws would call into question the constitutionality of the three-tier system. This does not follow from our holding [that] discrimination is contrary to the Commerce Clause and is not saved by the Twenty-first Amendment.

*Granholm*, 544 U.S. at 488-89.

Residency requirements just give economic protection to local businesses and protect them from competition. They are a type of local processing rule, which the Supreme Court has repeatedly condemned. *E.g., C & A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 391 (1994). The Court views "with particular suspicion state statutes requiring business operations to be performed in the home State that could more efficiently be performed elsewhere." *Pike v. Bruce Church, Inc.,* 397 U.S. 137, 145 (1970).

**B. The nondiscrimination principle applies to all forms of commerce, not just production**

Amici's second argument is that the nondiscrimination principle of the Commerce Clause applies only when a state is discriminating against out-of-state *products and producers*. Therefore, California is free to discriminate against out-of-state importers and wholesalers because they are distributing other companies' products, not their own. This, too, is an argument not made by Director Applesmith, who denies rather than justifies discrimination. This argument is also without merit.

First, it is based on the false premise that *Granholm's* holding was limited to out-of-state producers. It was not. The Court said that "[s]tates may not enact laws that burden out-of-state producers *or shippers* simply to give a competitive advantage to in-state businesses." 544 U.S. at 472. It said that "*state regulation of alcohol* is limited by the nondiscrimination principle of the Commerce Clause," 544 U.S. at 487, without limiting that holding to state regulation of products and producers. As the Seventh and Sixth Circuits have noted, the reason much of the language in *Granholm* discusses

discrimination against producers was because that was the case before it. *Lebamoff Enterp., Inc. v. Rauner,* 909 F.3d at 857; *Byrd v. Tenn. Wine & Spirits Retailers Assoc.*, 883 F.3d 608, 621-22 (6th Cir. 2018), *cert. granted* 2018 WL 3496882 (Sept. 27, 2018). Neither the Supreme Court nor the Ninth Circuit has ever said in any context that states are more free to discriminate against out-of-state importers and wholesalers than out-of-state producers. The nondiscrimination principle applies to the entire stream of commerce, including producers, trucking companies, retailers, and (as relevant to this case) importers. *E.g., Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64 (1963) (oil well equipment); *Philadelphia v. N.J.*, 437 U.S. 617 (1978) (waste). Indeed, the case that first articulated the nondiscrimination principle 195 years ago did not involve producers, but boat companies shipping goods and passengers across the Hudson River. *Gibbons v. Ogden*, 22 U.S. 1, 231 (1824) (Johnson, J., concurring).

Second, Amici ignore the fact that *Granholm* is not the Supreme Court's only case involving state laws regulating out-of-state liquor interests. Even if *Granholm* were limited to producers, the Court specifically applied the Commerce Clause to shippers and importers of alcohol in *Healy v. Beer Inst.,* 491 U.S. 324, 326-27 (1989) (price regulations on importers shipping beer into Connecticut). Orion Imports is an importer and shipper, and the nondiscrimination principle applies to it under *Healy*..

Third, Amici point to no language that actually says that the nondiscrimination principle applies only to producers and not to importers or wholesalers. They are

essentially arguing that the failure of the Court to discuss importers and wholesalers in *Granholm* is to be treated as a *sub silentio* holding that they are not protected by the nondiscrimination principle. The Supreme Court does not announce important constitutional doctrine this way, and cautions that phrases in its prior cases are not precedent on issues that were not before it. *See Cooper Industries, Inc. v. Aviall Services, Inc*., 543 U.S. 157, 170 (2004) (statements about matters not ruled on do not constitute precedent); *Texas v. Cobb*, 532 U.S. 162, 169 (2001) (no constitutional holding is to be inferred from the fact that the Court did not address an issue); *U.S. v. Neifert-White Co.*, 390 U.S. 228, 231 (1968) (language in an opinion cannot be taken as a decision upon a point which the facts of the case did not present).

**C. The other Circuits are inconsistent**

Finally, Amici rely heavily on a single Eighth Circuit case that upheld a residency requirement for owning an in-state wholesaling business even though residency rules have traditionally been considered discriminatory. *So. Wine & Spirits of Am., Inc. v. Div. of Alcohol & Tobacco Control*, 731 F.3d 799 (8th Cir. 2013). The case is not directly on point, because it concerned the residence of the owners of a wholesale business that would be physically located in the state rather than the requirement that all wholesale businesses must be physically located in the state. This is an important distinction, because *Granholm* explicitly found unconstitutional a New York law requiring business premises to be located in the state. It said that

> We have "viewed with particular suspicion state statutes requiring business operations to be performed in the home State that could more efficiently be performed elsewhere." ... 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."

544 U.S. at 475 (citations omitted). There is no Ninth Circuit case that addresses the matter.

Amici attempt to leverage this one case into a generally accepted rule that states may discriminate against out-of-state wholesalers by claiming that "every federal court of appeals to address the issue agrees that the Twenty-First Amendment protects state law discriminating against out-of-state wholesalers [and] requiring wholesalers ... to have a physical presence" in the state. Doc. 36 at 9-10, 12-13. The statement is false and misleading. It is false because the Seventh Circuit has ruled to the contrary that the nondiscrimination principle does apply to wholesaler licensing rules. *Baude v. Heath*, 538 F.3d 608, 611-12 (7th Cir. 2008) (rule barring out-of-state wineries with wholesaler licenses from competing against in-state wholesalers). It is misleading because the Fifth, Sixth and Seventh Circuits have not followed the Eighth Circuit's conclusion, but have rejected it. *Lebamoff Enterp., Inc. v. Rauner,* 909 F.3d 854-56; *Byrd v. Tenn. Wine & Spirits Retailers Assoc.*, 883 F.3d at 621-22; *Cooper v. Texas ABC*, 820 F.3d 730, 743 (5th Cir. 2016) ("We thus expressly decline to follow *Southern Wine).*

The circuits are not in agreement. They have been inconsistent about whether to extend the nondiscrimination principle discussed in *Granholm* from wineries to other

business entities engaged in commerce in alcoholic beverages such as wholesalers and retailers, which is probably why the Supreme Court granted certiorari in *Byrd*. Most cases have concerned retail licenses.

Some courts have followed the general principle announced in *Bacchus*, *Healy* and *Granholm* that state liquor laws are subject to the nondiscrimination principle of the Commerce Clause. The Seventh Circuit applied it to state laws allowing in-state but not out-of-state retailers to ship wine to Illinois consumers. *Lebamoff Enterprises, Inc. v. Rauner*, 909 F.3d at 852. The Fifth Circuit applied the nondiscrimination principle to a durational residency rule for retail licenses. *Cooper v. Texas ABC*, 820 F.3d at 742-43. The Eastern District of Michigan applied it to a law allowing in-state but not out-of-state retailers to sell wine over the internet. *Lebamoff Enterprises, LLC v. Snyder*, __ F. Supp. 3d ___, 2018 WL 4679612 at *4-5 (E.D. Mich. 2018).

Other courts have declined to extend the nondiscrimination principle to laws regulating retailers and wholesalers. Like the Eighth Circuit, the Second Circuit refused to extend the nondiscrimination principle to laws regulating wine retailers. It upheld a New York law giving in-state wine retailers exclusive rights to make home deliveries. It held that *Granholm* was limited to its facts and applied only to laws regulating wineries. *Arnold's Wines v. Boyle,* 571 F.3d 185, 189-91 (2d Cir. 2009). It criticized *Granholm* as "judicial activism." *Id.* at 197-98 (Calabresi, concurring).

The Sixth Circuit took a compromise position in which some state laws are subject to

the nondiscrimination principle and others are not, depending on whether they regulate an "inherent" aspect of a state's three-tier system. It relied on language from *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691, 714 (1984) (which did not involve the nondiscrimination principle), that the question in each case is "whether the interests implicated by a state regulation are so closely related to the powers reserved by the Twenty-first Amendment that the regulation may prevail, notwithstanding that its requirements directly conflict with express federal policies." *Accord Wine Country Gift Baskets.com v. Steen*, 612 F.3d 809, 819 (5th Cir. 2010). This approach has been criticized as unworkable by the Seventh and Eighth Circuits. The Eighth Circuit said that '[t]here is no archetypal three-tier system from which the "integral" or "inherent" elements of that system may be gleaned." *So. Wine & Spirits of Am., Inc. v. Div. of Alcohol & Tobacco Control*, 731 F.3d at 810. The Seventh Circuit agreed, noting that Illinois had 30 categories of liquor licenses. A legal standard that allowed a state to discriminate with respect to some licenses whose operations are deemed basic to the integrity of the three-tier system, but not others, would be unworkable. *Lebamoff Enterprises, LLC v. Rauner*, 909 F.3d at 853. The district court in *Lebamoff Enterprises, LLC v. Snyder*, __ F. Supp. 3d ___, 2018 WL 4679612 at *3 similarly found the idea unworkable, noting that Michigan had long since "departed from a hermetically-sealed three-tier system." So, too, in California, which has 80 different licenses, including ones for fishing party boats, airplanes, and hospitals. See https://www.abc.ca.gov/permits/

licensetypes.html (visited Dec. 10, 2018).

A majority of Circuits have rejected the Second and Eight Circuits' parsimonious reading of *Granholm.* They have instead followed the Supreme Court's admonition that state regulation of alcohol is limited by the nondiscrimination principle of the Commerce Clause, which requires states to justify any discrimination against out-of-state interests by proving that no less discriminatory alternative will adequately advance its regulatory interests. *Granholm v. Heald*, 544 U.S. at 489-93. That determination requires concrete evidence, and cannot be made at the motion-to-dismiss stage.

**III. Conclusion**

Director Applesmith's motion to dismiss the Second Amended Complaint should be denied and the case allowed to proceed to the fact development stage.

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Respectfully submitted,
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CERTIFICATE OF SERVICE

I hereby certify that on the 29th day of January, 2019, I electronically filed the foregoing document with the Clerk of the Court using the CM/ECF system. All participants in the case are registered CM/ECF users and will be served through that system.

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