

*In Vino Veritas: Does the Twenty-First Amendment Really  
Protect a State's Right to Regulate Alcohol?  
An Overview of the North Carolina Wine Industry and  
the Continuing Wine Distribution Litigation\**

*I started to appreciate the life of wine, that it's a living thing, that it connects you more to life. I like to think about what was going on the year the grapes were growing. I like to think about how the sun was shining that summer and what the weather was like. I think about all those people who tended and picked the grapes, and if it's an old wine, how many of them must be dead by now. I love how wine continues to evolve; how if I open a bottle the wine will taste different than if I had uncorked it on any other day or at any other moment. A bottle of wine is like life itself—it grows up, evolves, and gains complexity.<sup>1</sup>*

INTRODUCTION

Every wine has a story. North Carolina's wine story began when European explorers like Giovanni de Verrazzano and Sir Walter Raleigh landed on our shores and the grape vine was first cultivated in the New World.<sup>2</sup> Commercial wine production in North Carolina is traced to the founding of the state's first winery in 1835.<sup>3</sup> The Old North State was the leading wine-producing region in the nation by the dawn of the Twentieth Century.<sup>4</sup> It seemed nothing could stop us. But

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1. Virginia Madsen, as Maya, in the motion picture *SEAWAYS* (Fox Searchlight 2004).

2. See N.C. Dep't of Commerce, *Muscadine Grapes*, <http://www.nccommerce.com/en/TourismServices/NurtureWineAndGrapeIndustry/MuscadineGrapes/> (last visited Oct. 18, 2008). No one really knows for sure whether the vine was planted by the first colonists, or by indigenous Native Americans, or whether it was developed naturally and then was cultivated. *America's Oldest Cultivated Grapevine May Have Fed Colonists in 1584*, *CAROLINA UNCORKED*, Summer 2008, at 1, available at [http://www.nccommerce.com/NR/rdonlyres/244E0997-F20C-4FE7-80D0-0F3E367E6E9D/2368/Carolina\\_Uncorked\\_web\\_72208.pdf](http://www.nccommerce.com/NR/rdonlyres/244E0997-F20C-4FE7-80D0-0F3E367E6E9D/2368/Carolina_Uncorked_web_72208.pdf).

3. MFK RESEARCH LLC, *ECON. IMPACT OF N.C. WINE & GRAPES 2005*, at 11 (2007), available at <http://www.nccommerce.com/NR/rdonlyres/BCCD24D8-5263-401B-AC43-984A8968412B/0/EconomicImpactofNorthCarolinaWine2005.pdf>.

4. *Have You Heard North Carolina's Wine Story?*, *CAROLINA UNCORKED*, Winter 2007, at 1, available at [http://www.nccommerce.com/NR/rdonlyres/244E0997-F20C-4FE7-80D0-0F3E367E6E9D/1792/uncorked\\_winter07.pdf](http://www.nccommerce.com/NR/rdonlyres/244E0997-F20C-4FE7-80D0-0F3E367E6E9D/1792/uncorked_winter07.pdf).

Prohibition<sup>5</sup> inflicted a devastating blow to the local wineries.<sup>6</sup> Home-distilled “white lightning,” or Moonshine, was a far more popular enterprise at that time.<sup>7</sup> The state’s wine industry never fully recovered.

Now, almost a century later, wineries across the foothills of North Carolina in the Yadkin Valley American Viticultural Area<sup>8</sup> are producing Cabernet Sauvignon, Cabernet Franc, Merlot, Syrah, Chardonnay, Viognier, Muscadine, and other varietals that are starting to rival the fabled wines of California, Oregon, and Washington. In 2001 the North Carolina General Assembly named Scuppernong, a native Muscadine grape, the state’s official fruit.<sup>9</sup>

The purpose of this Comment is to examine some important legal issues affecting the state’s winemaking industry. In particular, this Comment will address the continuing litigation that the direct shipment of wine to consumers has spawned throughout the country, and the effect of the Twenty-first Amendment on states’ rights to control their own alcohol regulatory schemes. The author also hopes that this Comment will spark more interest in North Carolina wine.

## I. THE NORTH CAROLINA WINE INDUSTRY

The shifting economic landscape in North Carolina is causing the local wine industry to explode. For years tobacco was king. The leafy plants thrive in the state’s rich soil and traditionally provided a promising payday at harvest. But new regulations and increased taxes spawned by the War on Smoking have forced many farmers to look for reliable alternatives. Somehow grapes have begun to rise to the top of the list.

### A. *Economic Impact of North Carolina Wine and Grapes*

Grapes may not replace tobacco anytime soon, but a comprehensive economic impact study released by Governor Mike Easley in 2007 lends a strong sense of credibility to the state’s emerging wine indus-

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5. See U.S. CONST. amend. XVIII, § 1, repealed by U.S. CONST. amend. XXI.

6. See *Have You Heard North Carolina’s Wine Story?*, *supra* note 4, at 1.

7. *Id.*

8. Yadkin Valley became North Carolina’s first federally recognized American Viticultural Area (“AVA”) in February 2003. The Yadkin Valley, <http://www.yadkinvalleywineries.com/yv.html> (last visited Oct. 18, 2008).

9. N.C. GEN. STAT. § 145-18(a) (2007). Confusion exists about the difference between the Scuppernong and the Muscadine; hence, a popular saying is, “All Scuppernongs are Muscadines, but not all Muscadines are Scuppernongs.” N.C. Dep’t of Commerce, *supra* note 2.

try.<sup>10</sup> Here are the facts. North Carolina's grape acreage more than doubled from 2000 to 2005 to 1300 acres in 350 vineyards.<sup>11</sup> During that same time period, total grape production in the state increased by more than seventy percent (70%), enabling North Carolina to become both the tenth largest grape producer and tenth largest wine producer in the nation.<sup>12</sup> In 2005 alone, the state's viticulture industry had a total economic value of \$813 million.<sup>13</sup> Furthermore, the North Carolina wine industry creates more than 5700 jobs, and the state is now home to more than fifty wineries.<sup>14</sup> Strong support by state and regional interest groups combined with rising demand for wine among U.S. consumers should enable North Carolina's wine industry to enjoy continued growth in the future.<sup>15</sup>

### B. *The Three-Tier System of Distribution in North Carolina*

In North Carolina, as in most states, there is a statutorily mandated three-tier system that requires wine producers (first tier) wishing to sell their products in North Carolina to sell and ship only to wholesalers (second tier) located in the state.<sup>16</sup> The wholesalers may then sell to retailers (third tier).<sup>17</sup> In essence, the three-tier system injects a middleman between the producer and the consumer so that no single entity monopolizes the chain from beginning to end.

Although the origins of the three-tier system can be traced back even earlier, modern schemes nationwide are largely a product of the Twenty-first Amendment.<sup>18</sup> The Twenty-first Amendment repealed the

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10. MFK RESEARCH LLC, *supra* note 3.

11. *Id.* at 5.

12. *Id.*

13. *Id.*

14. *Id.*

15. *Id.* at 9-10.

16. N.C. Alcoholic Beverage Control Comm'n, Product Description, <http://www.ncabc.com/product/distribution.aspx> (last visited Oct. 18, 2008).

17. *Id.*

18. An interesting statement of the history of alcohol distribution and the Twenty-first Amendment provides:

Until the early part of the 20th century, the distribution system for alcohol consisted of only suppliers and retailers. The suppliers were typically more profitable, favoring retailers who sold only their own brands. Many local producers had ownership ties to the taverns, and they sold to them on extended credit terms, furnished equipment and supplies, paid rebates for pushing their brands exclusively, etc. Consequently, local brewers engaged in cutthroat competition for control of outlets, and some suppliers pushed retailers to increase sales whatever the social costs. This led to the rise of excessive consumption. In the mid 1800's, there began a call for temperance.

Eighteenth Amendment, thereby terminating Prohibition.<sup>19</sup> The Twenty-first Amendment also provides that “[t]he 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 . . . prohibited.”<sup>20</sup>

Proponents of the three-tier system argue that it effectively balances the state’s concern for the safety and health consequences associated with over-consumption with the public’s demand for a diverse and accessible selection of wines.<sup>21</sup> Acting like a safety net, the three-tier system provides a system of “checks and balances” on the way alcohol is distributed and sold.<sup>22</sup> The three-tier system also helps to ensure that alcohol is not sold to minors or to citizens who elect to live in “dry” counties, and that alcoholic beverage taxes are reliably collected.<sup>23</sup> Finally, it allows smaller retailers to have a more level playing field and gives consumers greater access to more products.<sup>24</sup>

Beneath the overlay of the three-tier system, North Carolina operates as a “permit” state, which means that before any winery or wholesaler may sell or ship alcoholic beverages into the state, it must first apply “for the appropriate permit and pay the required fees.”<sup>25</sup> Furthermore, every applicant for a permit to sell wine at wholesale must also “submit with the permit application a distribution agreement specifying the brands authorized to be sold by the wholesaler and the

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Some states began to implement prohibition laws, which were soon declared unconstitutional or vetoed by state governors. World War I gave the prohibition cause new ammunition. Literature depicted brewers and licensed retailers as treacherously stabbing American soldiers in the back. Prohibitionists argued that raw materials were being diverted from the war effort to an industry that debilitated the nation’s capacity to defend itself. As a result, in January of 1920 Congress enacted the 18th Amendment to the U.S. Constitution: the National Prohibition Act. However, as a result of the lack of enforcement of the National Prohibition Act and the creation of an illegal industry, an increase in crime transpired. The crime rate soon skyrocketed to nearly twice that of the pre-prohibition period. It can be argued that prohibition destroyed legal jobs, created black-market violence, and diverted resources from enforcement of other laws.

A Brief History of the Creation of the Three-Tier System, [http://www.wbwwa.org/three-tier/history\\_system.html](http://www.wbwwa.org/three-tier/history_system.html) (last visited Oct. 18, 2008).

19. U.S. CONST. amend. XXI, § 1.

20. *Id.* § 2.

21. A Brief History of the Creation of the Three-Tier System, *supra* note 18.

22. *Id.*

23. *Id.*

24. *Id.*

25. 4 N.C. ADMIN. CODE 02T.0102(a) (2007).

specific territory in which the product may be sold.”<sup>26</sup> Distribution is further limited to only those brands approved in advance by the North Carolina Alcoholic Beverage Control Commission (the Commission) for sale in North Carolina.<sup>27</sup> Finally, no wholesaler may sell “to any person who does not hold the appropriate retail or wholesale . . . [p]ermit,”<sup>28</sup> and no retail permittee may purchase wine “from anyone other than a licensed wholesaler.”<sup>29</sup>

### C. *The North Carolina Wine Distribution Agreements Act*

North Carolina’s Wine Distribution Agreements Act (the Act) begins in North Carolina General Statute section 18B-1200. The laws are to be “liberally construed and applied to promote its underlying purposes and policies.”<sup>30</sup>

The underlying purposes and policies of [the Act] are: (1) To promote the compelling interest of the public in fair business relations between wine wholesalers and wineries, and in the continuation of wine wholesalerships on a fair basis; (2) To protect wine wholesalers against unfair treatment by wineries; (3) To provide wine wholesalers with rights and remedies in addition to those existing by contract or common law; and (4) To govern all wine wholesalerships, including any renewals or amendments, to the full extent consistent with the Constitution of this state and the United States.<sup>31</sup>

“The effect of [the Act] may not be waived or varied by contract or agreement,” and “[a]ny contract or agreement purporting to do so is void and unenforceable to the extent of the waiver or variance.”<sup>32</sup>

Any North Carolina based winery or non-resident wine vendor permittee that ships a total of 1000 cases into the state per calendar year is required to enter into a distribution agreement with a wholesaler.<sup>33</sup> Each distribution agreement must “designate a sales territory of the wholesaler.”<sup>34</sup> “No winery may enter into more than one agree-

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26. *Id.* at 02T.0102(d).

27. *Id.* at 02T.0601.

28. *Id.* at 02T.0602(a).

29. *Id.* at 02T.0602(b).

30. N.C. GEN. STAT. § 18B-1200(a) (2007).

31. *Id.* § 18B-1200(b)(1)-(4).

32. *Id.* § 18B-1200(c).

33. *See id.* § 18B-1201(4). “‘Agreement’ means a commercial relationship between a wine wholesaler and a winery. The agreement may be of a definite or indefinite duration and is not required to be in writing.” *Id.* § 18B-1201(1).

34. *Id.* § 18B-1203(a).

ment for each 'brand' of wine or beverage it offers in any territory unless the Commission . . . orders otherwise."<sup>35</sup>

Wineries must provide their wholesalers with "at least 90 days prior written notice of any intention to amend, terminate, cancel, or not renew any agreement,"<sup>36</sup> with one exception<sup>37</sup>: "Notwithstanding the terms, provisions, or conditions of any agreement, no winery may amend, cancel, terminate, or refuse to continue to renew any agreement, or cause a wholesaler to resign from an agreement, unless good cause exists . . ."<sup>38</sup> "Good cause" does not include a change in ownership of a winery,<sup>39</sup> but the statute provides a non-exclusive list of what does constitute good cause.<sup>39</sup>

The Act also contains provisions governing the transfer of wholesale businesses.<sup>40</sup> The general rule is that "[n]o winery may unreasonably withhold or delay consent to any transfer of the wholesaler's business or transfer of the stock or other interest in the wholesaleship whenever the wholesaler to be substituted meets the material and reasonable qualifications and standards required of the winery's wholesalers."<sup>41</sup> However, the Act provides special provisions for family transfers.<sup>42</sup> "[F]amily" means the spouse, parents, siblings, and lineal

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35. *Id.* "Brand,' in relation to wines, means the name under which a wine is produced and shall include trade names or trademarks. A brand shall not be construed to mean a class or type of wine, but all classes and types of wines sold under the same brand label shall be considered a single brand. Differences in packaging such as a different style, type or size of container are not considered different brands." 04 N.C. ADMIN. CODE 02T.0101(1) (2007).

36. N.C. GEN. STAT. § 18B-1205(a) (2007).

37. *Id.* § 18B-1205(c) "When the reasons relate to conditions that cannot be rectified by the wholesaler within the 60-day period, the wholesaler may request a hearing before the Commission to determine if the winery has good cause for the amendment, termination, cancellation, or nonrenewal of the agreement. The burden of proving good cause . . . is on the winery.").

38. *Id.* § 18B-1204.

39. *Id.* ("Good cause does include: (1) Revocation of the wholesaler's permit or license to do business in this State; (2) Bankruptcy or receivership of the wholesaler; (3) Assignment for the benefit of creditors or similar disposition of the assets of the wholesaler; or (4) Failure of the wholesaler to comply substantially, without reasonable excuse or justification, with any reasonable and material requirement imposed upon him by the winery, including a substantial failure by a wine wholesaler to: (a) Maintain a sales volume of the brands offered by the winery, or (b) Render services comparable in quality, quantity, or volume to the sales volumes maintained and services rendered by other wholesalers of the same brands within the State.").

40. *Id.* § 18B-1206.

41. *Id.* § 18B-1206(a).

42. *Id.* § 18B-1206(b).

descendants, including those by adoption, of the wholesaler.”<sup>43</sup> In the case of a family transfer, “no winery may withhold consent to, or in any manner retain a right of prior approval of, the transfer of the wholesaler’s business to a member or members of the family of the wholesaler.”<sup>44</sup>

The wholesaler’s remedy for a winery’s violation of the Act’s provisions is the right to bring suit under the Act.<sup>45</sup> “The court may grant injunctive and other appropriate relief, including damages to compensate the wholesaler for the value of the agreement and any good will, to remedy violations of [the Act].”<sup>46</sup> Additionally, the Commission may “[i]ssue an order suspending the shipment of the winery’s products to one or more designated sales territories” or “[i]mpose a monetary penalty up to fifteen thousand dollars (\$15,000) for a first offense and up to thirty-five thousand (\$35,000) for the second offense.”<sup>47</sup> Federal case precedent arising out of North Carolina holds that the remedies under the Act are only available to wholesalers with a current distribution agreement and not to an attempted purchaser of a wine wholesaler.<sup>48</sup>

#### D. *The Direct Shipment of Wine to Consumers in North Carolina*

In 2003, the General Assembly enacted major changes to North Carolina’s wine distribution laws,<sup>49</sup> prompted by a case decided earlier that year by the Fourth Circuit Court of Appeals.<sup>50</sup>

In *Beskind v. Easley*, a California winery and individual oenophiles filed suit challenging the constitutionality of North Carolina’s Alcoholic Beverage Control (ABC) laws as they applied to the direct shipment of wine to consumers.<sup>51</sup> At that time those laws prohibited the importation of wine into North Carolina except through the highly regulated three-tiered system.<sup>52</sup> The plaintiffs alleged that portions of these laws, even though adopted pursuant to the Twenty-first Amendment, were unconstitutional by virtue of the dormant Commerce

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43. *Id.*

44. *Id.*

45. *Id.* § 18B-1207(a).

46. *Id.*

47. *Id.* § 18B-1207(c)(3)-(4).

48. *See Collins Wholesale Distrib. Co. v. E & J Gallo Winery*, 867 F.2d 817, 819 (4th Cir. 1989).

49. *See* N.C. GEN. STAT. § 18B-1001.1 (2007).

50. *See Beskind v. Easley*, 325 F.3d 506 (4th Cir. 2003).

51. *Id.* at 509.

52. *Id.*

Clause.<sup>53</sup> The laws favored local wine producers by permitting them to sell and ship their wine directly to consumers, and correspondingly discriminated against out-of-state producers and sellers, who were required to sell and ship through the more costly three-tier system.<sup>54</sup>

The Fourth Circuit concluded that “[a] facial examination of North Carolina’s ABC laws leaves little doubt that those laws treat in-state manufacturers of wine differently from out-of-state manufacturers of wine, with the undoubted effect of benefiting the in-state manufacturers and burdening the out-of-state manufacturers.”<sup>55</sup> The North Carolina direct shipment scheme therefore violated “a central tenet of the Commerce Clause.”<sup>56</sup> In arriving at its conclusion, the Fourth Circuit essentially adopted the analytical framework applied by the Supreme Court in *Bacchus Imports, Ltd. v. Dias*.<sup>57</sup> Under that framework, the court first determines “whether the purported State regulation violates the Commerce Clause without consideration of the Twenty-first Amendment.”<sup>58</sup> If it does, the court then “look[s] at the State’s Twenty-first Amendment interests and determine[s] ‘whether the principles underlying the Twenty-first Amendment are sufficiently implicated by the [State regulation] . . . to outweigh the Commerce Clause principles that would otherwise be offended.’”<sup>59</sup> When pressed to provide some justification for the discriminatory treatment under the second prong of the *Bacchus* framework, North Carolina failed to identify any sufficient Twenty-first Amendment interest.<sup>60</sup> The Fourth Circuit concluded that North Carolina’s direct shipment provision “cannot credibly be portrayed as anything other than local economic boosterism in the guise of a law aimed at alcoholic beverage control.”<sup>61</sup>

While the Fourth Circuit did, in fact, affirm the decision of the district court that the laws unconstitutionally discriminated against out-of-staters and were not saved by the Twenty-first Amendment, it nonetheless vacated the district court’s remedy of enjoining enforce-

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53. *Id.*

54. *Id.* The “direct shipment” provision at issue in *Beskind* was enacted as part of the 1981 revision to North Carolina’s ABC laws in an effort to support the state’s re-emerging wine industry. *Id.* at 510.

55. *Id.* at 515.

56. *Id.* (quoting *Bacchus Imps., Ltd. v. Dias*, 468 U.S. 263, 276 (1984)).

57. *Id.* at 513-14.

58. *Id.*

59. *Id.* at 514 (quoting *Bacchus*, 468 U.S. at 275 (third and fourth alterations in original)).

60. *Id.* at 517.

61. *Id.*

ment of the laws so as to avoid completely dismantling the existing three-tier system.<sup>62</sup> The court noted that “[plaintiffs’] right is not to void a law protected by the Twenty-first Amendment but rather to eliminate discrimination in interstate commerce . . . . Any further objection to the State’s proper exercise of its powers under the Twenty-first Amendment must now be taken up directly with the North Carolina legislature.”<sup>63</sup>

Following *Beskind*, the North Carolina legislature decided to “level-up” the playing field by increasing the direct shipment privileges of out-of-state wineries, rather than to follow the Fourth Circuit’s remedy of “leveling-down.”<sup>64</sup> North Carolina law now provides that any in-state or out-of-state winery holding a federal wine manufacturing permit “may apply to the Commission for issuance of a wine shipper permit” authorizing the direct shipment of those brands identified in the application.<sup>65</sup> A wine shipper permittee may sell and ship up to two cases<sup>66</sup> of wine per month “to any person in North Carolina to whom alcoholic beverages may be lawfully sold,”<sup>67</sup> provided any such shipment is made by an approved common carrier.<sup>68</sup>

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62. *Id.* at 519-20. In arriving at this remedy, the court opined:

[W]e can accept a presumption that North Carolina would want to uphold and preserve all of its ABC laws against constitutional challenges. Accordingly, when presented with the need to strike down one or more of those laws as unconstitutional, we can assume that North Carolina would wish us to take the course that least destroys the regulatory scheme that it has put into place pursuant to its powers under the Twenty-first Amendment. . . . When applying this “minimum-damage” approach, we have little difficulty in concluding that it causes less disruption to North Carolina’s ABC laws to strike the single provision—added in 1981 and creating the local preference—as unconstitutional and thereby leave in place the three-tiered regulatory scheme that North Carolina has employed since 1937 and has given every indication that it wants to continue to employ.

*Id.* at 519.

63. *Id.* at 520.

64. See N.C. GEN. STAT. § 18B-1001.1(a) (2007).

65. *Id.* § 18B-1001.1(a) (“A wine shipper permittee may amend the brands of wines identified in the permit application but shall file any amendment with the Commission. Any winery that applies for a wine shipper permit shall notify in writing any wholesalers that have been authorized to distribute the winery’s brands within the state that an application has been filed for a wine shipper permit.”).

66. *Id.* (“A case of wine shall mean any combination of packages containing not more than nine liters of wine.”).

67. *Id.* (“All sales and shipments shall be for personal use only and not for resale.”).

68. *Id.* § 18B-1001.1(c).

Additional provisions apply to any wine shipper permittee that ships more than 1000 cases of wine in a calendar year into North Carolina, mirroring the volume threshold for mandated distribution agreements under the Wine Distribution Agreements Act.<sup>69</sup> These larger quantity shippers must appoint at least one wholesaler to offer and sell their products, if they are contacted by a wholesaler wishing to sell the products.<sup>70</sup> However, wine purchased by North Carolina residents at the winery's premises for shipment back to their home addresses is not included in calculating the 1000 cases per year.<sup>71</sup>

#### E. Cause for Concern?

Wine distribution laws in North Carolina and nationwide have changed more in the past few years than at any other time since Repeal.<sup>72</sup> Despite the impressive economic figures and apparent stability of the three-tier distribution system in North Carolina, the local wine industry could go up in a smoke of litigation just as the state's tobacco industry did. The implications of a recent United States Supreme Court ruling on the direct shipment of wine to consumers are still unfolding.<sup>73</sup> According to one noted commentator, the next frontier of litigation involves "competition in price, distribution efficiency and service at all levels."<sup>74</sup> "For the rest of the US economy . . . restraints of trade are highly disfavored and ultimate purchasers receive the benefits of only lightly regulated market forces."<sup>75</sup> But in the wine industry, both in North Carolina and other states, statutory restraints on freedom of contract are commonplace. This Comment suggests that revolutionary changes may lie on the horizon.

*Granholm v. Heald*, the now-infamous 2005 Supreme Court decision, sounded the death knell for discriminatory direct shipment laws.<sup>76</sup> Soon thereafter, in *Costco Wholesale Corp. v. Hoen*, a federal district court judge applied the *Granholm* precedent to the state of Washington's Like direct shipment, direct distribution implicates the

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69. *Id.* § 18B-1001.1(b); see also *id.* § 18B-1201(4) (defining the term "winery").

70. *Id.* § 18B-1001.1(b).

71. *Id.*

72. Corbin Houchins, *Wine and the Law: Costco Challenges Three-Tier Distribution*, WINE BUS. MONTHLY, Jan. 01, 2004, available at <http://www.winebusiness.com/html/MonthlyArticle.cfm?dataid=29785>.

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

74. Houchins, *supra* note 72.

75. *Id.*

76. See 544 U.S. at 488-89.

76. See *Costco Wholesale Corp. v. Hoen (Hoen I)*, 407 F. Supp. 2d 1247, 1251-52 (W.D. Wash. 2005).

Commerce Clause, which requires that no state discriminate against interstate commerce by imposing greater burdens than those applying to similar goods moving in intrastate commerce.<sup>77</sup>

But direct distribution was just the beginning. Only a portion of the *Costco* case was based on the Commerce Clause.<sup>78</sup> The remainder was grounded in federal antitrust law forbidding unreasonable restraints of trade.<sup>79</sup> However, *Granholm* remains relevant to the question of whether the Twenty-first Amendment will ever save a state regulatory scheme that is otherwise unconstitutional by providing some kind of immunity or acting as an affirmative defense. The ultimate resolution of this issue remains unclear, although as this Comment suggests, the Twenty-First Amendment provides little, if any, protection for states' decisions concerning wine distribution.

## II. GRANHOLM V. HEALD

### A. Facts and Issue Statement

*Granholm v. Heald* was really a consolidation of two appeals from lower court decisions in Michigan and New York.<sup>80</sup> Both states regulated the sale of alcohol using a three-tier distribution system,<sup>81</sup> but one case challenged the constitutionality of regulations governing the sale of wine from out-of-state wineries to consumers in Michigan,<sup>82</sup> and the other case challenged similar regulations in New York which had the same affect on in-state consumers.<sup>83</sup> The real difference between the two states was that under Michigan law, in-state wineries

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77. See U.S. CONST. art. I, § 8, cl. 3.

78. See *Hoen I*, 407 F. Supp. 2d at 1256 (stating that Plaintiff Costco Wholesale Corporation's motion for partial summary judgment was based on its second claim and the related portion of its third claim).

79. See *Costco Wholesale Corp. v. Maleng*, 522 F.3d 874, 884-85 (9th Cir. 2008).

80. 544 U.S. 460, 465 (2005).

81. *Id.* at 466.

82. *Id.* The Michigan law was challenged by a small winery located in California that received orders for wine from consumers in Michigan. *Id.* at 468. The winery alleged that it was unable to fill the orders because the regulations prohibited direct shipment of wine to consumers from out-of-state, and, even if the winery could find an in-state wholesaler to distribute their wine, the price increase created by the three-tiered system would make the sale of the wine economically infeasible. *Id.*

83. *Id.* at 470. The New York law was challenged by several small wineries in Virginia and California that were regularly visited by tourists who purchased bottles of wine during their visits. *Id.* at 468. If visitors from New York wanted to purchase more wine from these wineries after returning home, they would have been prohibited from doing so. *Id.* New York is of particular concern to out-of-state wineries because it is the second largest wine market in the United States. *Id.*

were eligible for a special license which excepted them from the general rule that all wineries must sell to licensed in-state wholesalers,<sup>84</sup> whereas in New York, a similar exception existed for in-state wineries, but the New York law contained a further exception for direct shipment to consumers if the wine was produced solely from grapes grown in New York.<sup>85</sup> Wineries with this “home grown” license were then permitted to ship wine produced by other wineries directly to consumers, but only if that wine was made from at least seventy-five percent (75%) of grapes grown in New York.<sup>86</sup> Additionally, for an out-of-state winery to ship directly to consumers in New York, they had to be a licensed New York winery, even if the content qualifications were met.<sup>87</sup> In practical effect, this meant that the winery had to establish a branch office and warehouse in New York at its own expense, which thereby increased the cost of the wine.<sup>88</sup> The laws of both states thus served as excellent examples of economic protectionism.

The issue before the Supreme 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 violate[s] the dormant Commerce Clause in light of section 2 of the Twenty-first Amendment.”<sup>89</sup> This was essentially the same issue previously resolved by the Fourth Circuit in *Beskind v. Easley*.<sup>90</sup> North Carolina is thus a relatively progressive state in terms of direct shipment litigation.

### B. Commerce Clause Analysis

The *Granholm* Court quickly determined that the Michigan regulatory scheme was discriminatory because the effect of the regulations was to require that out-of-state wine, but not in-state wine, be sold through the three-tier system.<sup>91</sup> This increased the price Michigan consumers paid for wine produced out-of-state.<sup>92</sup> The cost differential, and in some cases the inability to secure a wholesaler for small shipments, effectively barred many smaller wineries from access to the Michigan market.<sup>93</sup>

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84. *Id.* at 469.

85. *Id.* at 470.

86. *Id.*

87. *Id.*

88. *Id.* at 474-75.

89. *Id.* at 471 (internal quotations omitted).

90. *See* 325 F.3d 506, 509 (4th Cir. 2003).

91. *Granholm*, 544 U.S. at 473-74.

92. *Id.* at 474.

93. *Id.*

Turning to the New York laws, the Court first noted that unlike the Michigan scheme, New York did not impose an outright ban on direct shipments by out-of-state wineries, but instead required them to establish a base for distribution operations in the state in order to gain the privilege of direct shipment.<sup>94</sup> The Court rightly concluded that this was merely an indirect method of burdening out-of-state wineries and benefiting in-state wineries.<sup>95</sup>

### C. *Twenty-First Amendment Analysis*

The Court could not rest upon its conclusion that the Michigan and New York laws were facially discriminatory. Despite the fact that state laws discriminating against interstate commerce face a “virtually *per se* rule of invalidity,” the Court also had to examine whether the regulations were saved by the Twenty-first Amendment.<sup>96</sup>

Following a discussion of the history of the Twenty-first Amendment,<sup>97</sup> the Court noted that its more recent cases had confirmed that the Twenty-first Amendment does not supersede other provisions of the Constitution, including the rule that individual states may not give a discriminatory preference to their own producers.<sup>98</sup> The Court then announced that its modern Twenty-first Amendment cases had established three principles: (1) “state laws violating other provisions of the Constitution are not saved by the Twenty-first Amendment;” (2) the Twenty-first Amendment “does not abrogate Congress’s Commerce Clause powers with regard to liquor;” and that (3) “state regulation of alcohol is limited by the nondiscriminatory principle of the Commerce Clause.”<sup>99</sup>

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94. *Id.* For most wineries, the expense of establishing a bricks-and-mortar distribution operation in one state, let alone all fifty, is prohibitive. In fact, not a single out-of-state winery availed itself of New York’s direct shipping privilege. *Id.* at 475.

95. *Id.* at 474. The Court noted that it has “viewed with particular suspicion state statutes requiring business operations to be performed in the home State that could more efficiently be performed elsewhere.” *Id.* at 475 (citing *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 145 (1970)). New York’s in-state presence requirement also ran contrary to the Court’s admonition that states cannot require out-of-state firms to become a resident in order to compete on equal terms. *Id.* (citing *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, 72 (1963)).

96. *Id.* at 476 (quoting *Philadelphia v. New Jersey*, 437 US 617, 624 (1978)).

97. *Id.* at 476-86.

98. *Id.* at 486.

99. *Id.* at 486-87. Commentators have questioned whether the Court’s departure from the “core concerns” test means that it no longer remains a viable option for resolving conflicts between the Twenty-first Amendment and the Commerce Clause. See, e.g., Gregory E. Durkin, Note, *What Does Granholm v. Heald Mean for the Future of the Twenty-First Amendment, the Three-Tier System, and Efficient Alcohol Distribution?*,

In contrast, state policies are protected under the Twenty-first Amendment when they treat alcohol produced out-of-state the same as its domestic equivalent.<sup>100</sup> The Michigan and New York laws, however, involved straightforward attempts to discriminate in favor of local producers in violation of the Commerce Clause and therefore could not be saved by the Twenty-first Amendment.<sup>101</sup>

The final argument considered by the *Granholm* Court was whether the invalidation of the respective regulatory schemes would thereby threaten the validity of the three-tier system.<sup>102</sup> The Court quickly rejected this argument, noting that such a conclusion did not follow from its holding.<sup>103</sup> According to the Court, “[t]he Twenty-first Amendment grants the States virtually complete control over whether to permit importation or sale of liquor and how to structure the liquor distribution system.”<sup>104</sup> The Court concluded by stating that it had previously recognized that the three-tier system itself was “unquestionably legitimate.”<sup>105</sup>

#### D. *Holding*

The *Granholm* Court split five to four.<sup>106</sup> The majority opinion announced by Justice Kennedy<sup>107</sup> held that “the laws in both States discriminate against interstate commerce in violation of the Commerce Clause . . . [and] the discrimination is neither authorized nor permitted by the Twenty-first Amendment.”<sup>108</sup> The majority opinion did analyze the local interests asserted by the States, such as the protection of minors and the generation of tax revenue, but quickly dismissed these interests as insufficient.<sup>109</sup>

Justice Stevens and Justice Thomas both filed dissenting opinions. Justice Stevens was joined only by Justice O’Connor and Justice

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63 WASH. & LEE L. REV. 1095, 1104-10 (2006) (suggesting that the core concerns test has been either completely or partially eliminated).

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

101. *Id.*

102. *Id.* at 488.

103. *Id.*

104. *Id.* (citing *Cal. Retail Liquor Dealers Ass’n v. Midcal Aluminium, Inc.*, 445 U.S. 97, 110 (1980)).

105. *Id.* at 489 (quoting *North Dakota v. United States*, 495 U.S. 423, 432 (1990)).

106. *Id.* at 463.

107. Justice Kennedy’s majority opinion was joined by Justices Breyer, Ginsburg, Scalia, and Souter. *Id.* at 463.

108. *Id.* at 466.

109. *Id.* at 489-90.

Thomas was joined by Chief Justice Rehnquist as well as Justices Stevens and O'Connor.<sup>110</sup>

In his dissent, Stevens argued that ever “since the adoption of the Eighteenth and Twenty-first Amendments the Constitution has placed commerce in alcoholic beverages in a ‘special category’” exempt from the regulations of the Commerce Clause.<sup>111</sup> Stevens alleged that “[t]oday’s decision may represent sound economic policy and may be consistent with the policy choices of the contemporaries of Adam Smith who drafted our original Constitution; it is not, however, consistent with the policy choices made by those who amended our Constitution in 1919 and 1933.”<sup>112</sup>

Justice Thomas, for his part, wrote a much longer dissent accusing the majority of giving the states an “*ad hoc* exception” to regulate alcohol in all circumstances except when they discriminated against out-of-state alcohol products.<sup>113</sup> Thomas argued that the Webb-Kenyon Act<sup>114</sup> immunized from Commerce Clause review the state liquor laws that the majority held unconstitutional.<sup>115</sup> Believing there was no need to interpret the Twenty-first Amendment because, in his mind, the Webb-Kenyon Act resolved these cases, Thomas nonetheless concluded that the state laws were lawful under the plain meaning of the Twenty-first Amendment.<sup>116</sup>

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110. *Id.* at 463.

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

112. *Id.* at 496. Also relevant to Justice Stevens’ position was “the fact that the Twenty-first Amendment was the only Amendment to have been ratified by the people in state conventions, rather than by state legislatures,[ and as such], provid[ed] further reason to give its terms their ordinary meaning.” *Id.* at 497.

113. *Id.* at 500 (Thomas, J., dissenting).

114. 27 U.S.C. § 122 (2000). The Webb-Kenyon Act provides:

The shipment or transportation, in any manner or by any means whatsoever, of any spiritous, vinous, malted, fermented, or other intoxicating liquor of any kind from one State, Territory, or District of the United States, or place noncontiguous to but subject to the jurisdiction thereof, into any other State, Territory, or District of the United States, or place noncontiguous to but subject to the jurisdiction thereof, or from any foreign country into any State, Territory, or District of the United States, or place noncontiguous to but subject to the jurisdiction thereof, which said spiritous, vinous, malted, fermented, or other intoxicating liquor is intended, by any person interested therein, to be received, possessed, sold, or in any manner used, either in the original package or otherwise, in violation of any law of such State, Territory, or District of the United States, or place noncontiguous to but subject to the jurisdiction thereof, is prohibited.

*Id.*

115. *Granolm*, 544 U.S. at 498 (Thomas, J., dissenting).

116. *Id.* at 514.

### E. *Legal Impact*

The impact of *Granholm* was obviously felt in Michigan and New York,<sup>117</sup> but the case also has legal ramifications extending well beyond those borders. Under *Granholm*, states are not required to allow direct shipment, but must either grant or deny it on equivalent terms to both in-state and out-of-state producers. States with regulations barring only out-of-state wineries from shipping products directly to consumers are likely to face successful challenges to those laws, absent legislative changes in accordance with anti-discrimination principles.

More broadly, the decision means that the Commerce Clause trumps a state's right to regulate alcohol under the Twenty-first Amendment if the regulation is discriminatory. State regulations that differentiate between producers, wholesalers, and retailers along a three-tier system survive *Granholm* so long as they apply uniformly to in-state and out-of-state members at each tier.

The interesting part of the *Granholm* decision is not so much the conclusion reached by the Court, but the means used to reach it. The majority appears to disregard the "core concerns test" for analyzing state alcohol regulations previously set forth in *California Retail Liquor Dealers Ass'n v. Midcal Aluminium, Inc.*,<sup>118</sup> which was subsequently reaffirmed in *Bacchus*,<sup>119</sup> as Justice Thomas noted in his dissent.<sup>120</sup> The *Granholm* Court simply considered the legitimacy of the local interests asserted by the states without weighing them against the federal interests.<sup>121</sup> This omission could be viewed as one way in which the courts are stripping the states of their Twenty-first Amendment power. *Granholm* did not explicitly resolve the question of how much power, if

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117. Ironically, following the invalidation of its existing regulatory scheme in *Granholm*, New York adopted a quasi-reciprocal shipping law. "Reciprocity," in relation to wine distribution, means that a state will allow direct shipment to states whose laws confer equivalent privileges. Although reciprocal shipment laws were not at issue in *Granholm*, the Court made it clear that trading areas within the United States and excluding states that do not join the trade group are incompatible with the Commerce Clause. See R. CORBIN HOUCINS, NOTES ON WINE DISTRIBUTION 6, 32 (2008), available at [http://shipcompliant.com/blog/document\\_library/dist\\_notes\\_current.pdf](http://shipcompliant.com/blog/document_library/dist_notes_current.pdf). According to one wine trade organization's website, as of June 1, 2008, three states still maintain reciprocal shipping laws: New Mexico, Iowa, and Wisconsin. Free the Grapes!, [http://www.freethegrapes.org/wine\\_lovers.html#laws](http://www.freethegrapes.org/wine_lovers.html#laws) (last visited Oct. 18, 2008).

118. 445 U.S. 97, 110 (1980).

119. 468 U.S. 263, 275-76 (1984).

120. See *Granholm*, 544 U.S. at 524 (Thomas, J. dissenting).

121. *Id.* at 489-92 (majority opinion).

any, the Twenty-first Amendment gives states to regulate the flow of alcohol within their borders. *Granholm* is also silent on the intersection of the Twenty-first Amendment and constitutional provisions other than the Commerce Clause. These remaining issues were addressed in the *Costco* case, to which we now turn.

### III. FEDERAL DISTRICT COURT GIVES NOVEL INTERPRETATIONS TO FEDERAL ANTITRUST LAW IN *COSTCO* CASE

#### A. Overview

The *Costco* case got underway while *Granholm* was still pending before the Supreme Court. Unlike the High Court's direct shipment case, *Costco* directly challenged mandated middle tiers in wine distribution and other anti-competitive aspects of alcoholic beverage laws.<sup>122</sup> Costco Wholesale Corporation (Costco)<sup>123</sup> filed suit against the Washington State Liquor Control Board (LCB),<sup>124</sup> and shortly thereafter the Washington Beer and Wine Wholesalers Association (WBWWA)<sup>125</sup> intervened as a co-defendant.<sup>126</sup> In essence, Costco's suit aspired to clear away most impediments to getting wine onto retail shelves in the most efficient manner and at the lowest cost.

Costco's complaint contained several parts. One part, and probably the most uncontroversial, challenged state laws that required out-

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122. See *Costco Wholesale Corp. v. Hoen (Hoen I)*, 407 F. Supp. 2d 1247 (W.D. Wash 2005).

123. Costco is the number one wine retailer in the United States. Lisa Shara Hall, *Costco On Top: The International Grocery Giant Has Become the Number One Wine Retailer in the US*, WINE BUS. MONTHLY, Oct. 15, 2003, available at <http://www.winebusiness.com/html/MonthlyArticle.cfm?dataid=27915>.

124. The Washington State Liquor Control Board's mission is to "[p]romote public safety by preventing the misuse of alcohol and tobacco through controlled retail and wholesale distribution, licensing, regulation, enforcement and education." Wash. State Liquor Control Bd., General Information, <http://www.liq.wa.gov/general.asp> (last visited Oct. 18, 2008).

125. The "About" page of WBWWA states that, "the Washington Beer & Wine Wholesalers Association was founded in 1934 as a trade association for Washington's beer and wine distributors [whose] members include nearly fifty distribution companies who represent approximately 3,000 jobs in [Washington]." Wash. Beer & Wine Wholesalers Ass'n, About the Washington Beer & Wine Wholesalers Association, <http://www.wbwwa.org/about/about.html> (last visited Oct. 18, 2008). Further, WBWWA supports Washington's "three-tier system of beer and wine distribution [and] works to protect the independence of Washington's distributors." *Id.*

126. *Costco Wholesale Corp. v. Hoen (Hoen III)*, No. C04-360P, 2006 WL 1075218, at \*1 (W.D. Wash. Apr. 21, 2006), *aff'd in part and rev'd in part*, *Costco Wholesale Corp. v. Maleng*, 522 F.3d 874 (9th Cir. 2008).

of-state wineries to sell only to wholesalers while local wineries were allowed to sell directly to retailers. Another part called into question a series of closely-related restraints of trade common in many states' alcohol distribution laws. The last part presented yet another opportunity in the long and thus far unsuccessful judicial search for an overriding Twenty-first Amendment interest that would permit states to violate contrary federal laws when regulating alcohol. In other words, *Costco* contained both constitutional and anti-trust issues. Each will be addressed in turn.

*B. Constitutional Issues: Direct Distribution to Retailers*

Like North Carolina, the state of Washington adheres to a three-tier system in its regulation of the sale and distribution of alcoholic beverages. At the time *Costco* filed suit, Washington prohibited wine producers from selling their products directly to retailers.<sup>127</sup> Alcohol products had to pass through a middle tier before reaching the retailer.<sup>128</sup> The Washington legislature created an exception to this rule for in-state wineries, providing that any domestic winery with the appropriate license could also act "as a distributor and/or retailer" of the products it produced.<sup>129</sup> In effect, the law enabled in-state wineries to self-distribute their products directly to retailers, thereby foregoing the middle tier, whereas out-of-state wineries did not enjoy this privilege.

Once the *Granholm* decision was handed down by the Supreme Court, cross motions for summary judgment were filed by the parties in the *Costco* case.<sup>130</sup> Naturally, District Court Judge Marsha Pechman began her analysis with a detailed discussion of *Granholm*.<sup>131</sup> *Costco* argued that *Granholm* was directly applicable and required a finding that Washington's direct shipment policies were unconstitutional.<sup>132</sup> In contrast, the LCB and WBWWA (the Defendants) attempted to distinguish *Granholm*, seizing on the distinction between direct shipment to consumers and direct distribution to retailers.<sup>133</sup> Defendants further argued that the challenged laws merely allowed in-state wineries to serve as distributors for their own products, suggesting that this practice was constitutional since the state treated all wine sold to

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127. *Hoeh I*, 407 F. Supp. 2d at 1249.

128. *Id.*

129. *Id.*

130. *Id.* at 1248.

131. *See id.* at 1249-50.

132. *Id.* at 1249-51.

133. *Id.* at 1251-52.

retailers the same, wherever it was produced, since retailers could only buy from those distributors who were licensed by the State.<sup>134</sup> Judge Pechman did not find the Defendants' argument persuasive:

The central question in both *Granholm* and in this case is whether a state can discriminate against out-of-state producers. Allowing in-state producers to sell beer and wine directly to retailers, while withholding that privilege from out-of-state producers, presents the same type of discrimination against interstate commerce that the Court in *Granholm* held to be unconstitutional. *Granholm* does not suggest that it may be constitutionally permissible for states to discriminate against out-of-state producers in sales to retailers, but not in sales to consumers.<sup>135</sup>

Judge Pechman then searched for a legitimate local purpose that could not adequately be served by any reasonable non-discriminatory alternatives in an attempt to justify Washington's discrimination against interstate commerce.<sup>136</sup> Defendants had offered two such purposes: ensuring orderly distribution and facilitating tax collection.<sup>137</sup> In response, Costco pointed out that these were the same purposes offered by Michigan and New York in the *Granholm* case, which had been rejected by the Supreme Court because these objectives could be alternatively achieved through evenhanded licensing or permit requirements.<sup>138</sup> Finding both proffered justifications to be "speculative and conclusory at best," Judge Pechman granted Costco summary judgment on the direct distribution portion of its complaint.<sup>139</sup>

Judge Pechman then cited *Beskind v. Easley*, the 2003 Fourth Circuit direct shipment case, for the proposition that "Washington ha[d] at least one non-discriminatory alternative to [its] current regulatory scheme address[ing its] concerns about . . . orderly distribution . . . and . . . tax collection."<sup>140</sup> The state could "level-down" the playing field by revoking the self-distribution privileges granted to in-state producers.<sup>141</sup>

Turning its attention to the appropriate remedy, the district court applied the "minimum damage" approach articulated in *Beskind* to invalidate the offensive provisions rather than extending the exception

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134. *Id.* at 1251.

135. *Id.* at 1252.

136. *Id.*

137. *Id.* at 1252.

138. *Id.* at 1253.

139. *Id.* at 1253-54.

140. *Id.* at 1254 (citing *Beskind v. Easley*, 325 F.3d 506, 515 (4th Cir. 2003)).

141. *Id.*

to all producers.<sup>142</sup> Judge Pechman stayed the enforcement of her order so that the Washington legislature would have time to act.<sup>143</sup> Shortly thereafter, the Washington state legislature “leveled-up” the direct shipping privileges and promulgated guidelines for out-of-state wineries seeking to obtain a “direct distribution endorsement” for their certificates of approval.<sup>144</sup> Such an endorsement is required for shipment to any Washington wholesaler.<sup>145</sup>

### C. Antitrust Issues: Pricing Requirements and Ancillary Restraints

In addition to the direct distribution claim, Costco also argued that several of Washington’s statutes and regulations were “anti-competitive and benefit[ed] wholesalers at the expense of retailers and consumers.”<sup>146</sup> Specifically, Costco’s claims were directed at: (1) prohibited volume discounts on the sale of beer and wine; (2) uniform price requirements; (3) credit sales; (4) price posting requirements; (5) price holding requirements; (6) minimum markup requirements; (7) delivered pricing requirements; (8) retailer-to-retailer sales prohibitions; and (9) central warehousing bans.<sup>147</sup> Similar restraints of trade exist in some form or variation in roughly half the states, including North Carolina.<sup>148</sup> For members of the wine industry this was the true crux of the *Costco* case. The ultimate resolution of these issues was nervously anticipated nationwide.

At the December 2005 summary judgment proceeding, Costco argued that the Sherman Act preempted the Washington statutes and regulations.<sup>149</sup> Judge Pechman declared that Costco’s motion really involved four separate issues: (1) “whether the challenged policies are irreconcilably in conflict with federal antitrust law;” (2) “whether the challenged policies are unilateral or hybrid;” (3) “whether the challenged policies are immune from antitrust scrutiny under the state action immunity doctrine;” and (4) “whether the challenged policies may be upheld as a valid exercise of the state’s powers under the

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142. *Id.* at 1255-56 (citing *Beskind*, 325 F.3d at 519).

143. *Id.* at 1256.

144. R. Corbin Houchins, *Costco Trial Begins: A Showdown on 21st Amendment Powers*, WINE BUS. INSIDER, Mar. 20, 2006, available at <http://www.winebusiness.com/ReferenceLibrary/webarticle.cfm?dataId=42238>.

145. *Id.*

146. *Hoehn I*, 407 F. Supp. 2d at 1237.

147. *Id.* at 1237-38.

148. See R. Corbin Houchins, *Free at Last? Wine Trade After Costco*, WINE BUS. MONTHLY, Jun. 15, 2006, available at <http://www.winebusiness.com/html/MonthlyArticle.cfm?dataId=43356>.

149. *Hoehn I*, 407 F. Supp. 2d at 1238.

Twenty-first Amendment to the United States Constitution, even if the policies are in conflict with the Sherman Act.”<sup>150</sup> Due to the complexity of this analysis, each issue will be addressed sequentially in the following subsections.

1. *Irreconcilable Conflict with the Sherman Antitrust Act and the Hybrid Versus Unilateral Restraint Analysis*

When courts speak of federal antitrust law, the Sherman Act is typically at the forefront of the discussion. The Sherman Act (the Act) provides that “[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.”<sup>151</sup> The Act further provides that “[e]very person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony.”<sup>152</sup> The Supreme Court has noted that “[a]ntitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise.”<sup>153</sup>

Costco bore the burden of proof with respect to the first two issues raised by its motion for summary judgment, namely, whether the challenged laws were irreconcilably in conflict with the Sherman Act and whether such laws were unilateral or hybrid.<sup>154</sup> Costco argued that other courts found per se violations of the Sherman Act in laws similar to those challenged in Washington.<sup>155</sup> Specifically, Costco pointed to *Miller v. Hedlund*,<sup>156</sup> where the Ninth Circuit characterized Oregon’s posting, holding, and delivered pricing requirements (similar to those at issue in Washington) as per se antitrust violations.<sup>157</sup> Costco also noted that other courts, including the Fourth Circuit in *TFWS, Inc. v. Schaefer*,<sup>158</sup> found bans on volume discounts to be per se violations.<sup>159</sup>

Judge Pechman found Costco’s argument persuasive, stating that “Washington’s posting, holding, minimum mark-up, delivered pricing,

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150. *Id.*

151. 15 U.S.C. § 1 (2000).

152. *Id.* § 2.

153. *United States v. Topco Assocs.*, 405 U.S. 596, 610 (1972).

154. *Hoehn I*, 407 F. Supp. 2d at 1238.

155. *Id.* at 1239.

156. 813 F.2d 1344 (9th Cir.1987).

157. *Hoehn I*, 407 F. Supp. 2d at 1239.

158. 242 F.3d 198 (4th Cir. 2001).

159. *Hoehn I*, 407 F. Supp. 2d at 1239.

uniform pricing, ban on volume discounts, and ban on credit sale requirements are irreconcilably in conflict with federal antitrust law.”<sup>160</sup> But further analysis remained.

Turning to the second issue involving unilateral or hybrid restraints of trade, Judge Pechman noted that:

State laws may be condemned under the Sherman Act only if they are “hybrid” restraints, as opposed to “unilateral” restraints. A “unilateral” restraint is one that is unilaterally imposed by the state government to the exclusion of private control. . . . By contrast, a “hybrid” restraint arises where “nonmarket mechanisms merely enforce private marketing decisions.” [Therefore,] [w]here private actors are granted a “degree of private regulatory power” that the state merely enforces, a hybrid restraint arises.<sup>161</sup>

Looking at Washington’s regulatory scheme as a whole, Judge Pechman quickly determined it amounted to a hybrid restraint on trade.<sup>162</sup> In reaching this conclusion, she noted that “other courts, including the Ninth Circuit in *Miller v. Hedlund*, ha[ve] found that similar regulatory schemes constitute[ ] hybrid restraints of trade.”<sup>163</sup> Therefore, the challenged laws could properly be condemned under the Sherman Act pending the resolution of the remaining two issues in the analysis.

## 2. *Rejection of the Antitrust Immunity Defense*

Despite the fact that Washington’s regulatory scheme was found to be a hybrid restraint of trade in conflict with federal antitrust law, the issue remained as to whether Defendants could establish any affirmative defenses. Defendants argued for the dismissal of Costco’s antitrust claims on the grounds of antitrust immunity.<sup>164</sup> Judge Pechman confirmed that “[t]o establish antitrust immunity, Defendants must satisfy two elements: (1) the challenged restraint must be

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160. *Id.* at 1242. The court requested supplemental briefing on the central warehousing ban and the retailer-to-retailer sales ban. *Id.* In her supplemental order, Judge Pechman concluded that neither of these issues were appropriate for summary judgment and that both of these issues would be decided at trial. See *Costco Wholesale Corp. v. Hoen (Hoen II)*, No. C04-360P, 2006 WL 1805575 (W.D.Wash. Mar. 7, 2006), *aff’d in part and rev’d in part*, *Costco Wholesale Corp. v. Maleng*, 522 F.3d 874 (9th Cir. 2008).

161. *Hoen I*, 407 F. Supp. 2d at 1243 (internal citations omitted).

162. *Id.*

163. *Id.* at 1243 (citing *Miller v. Hedlund*, 813 F.2d 1344 (9th Cir. 1987)).

164. *Id.* Antitrust immunity was first established in *Parker v. Brown*, 317 U.S. 341 (1943) and *Cal. Retail Liquor Dealers Ass’n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980).

one clearly articulated and affirmatively expressed as state policy; and (2) the policy must be actively supervised by the State itself.”<sup>165</sup>

On these two elements Judge Pechman found Costco’s argument more compelling.<sup>166</sup> Neither party contended “that Washington [did] not review the reasonableness of prices charged by wholesalers.”<sup>167</sup> Similar to the fact situation in *Midcal*, Washington set and enforced the prices that were established by private entities.<sup>168</sup> Defendants offered insufficient evidence that the state actually monitored market conditions or engaged in periodic re-examination of the challenged restraints.<sup>169</sup> As a result, Judge Pechman found that the “active supervision” requirement was not satisfied, and it was therefore unnecessary to reach the “clearly articulated” requirement.<sup>170</sup>

### 3. *Twenty-First Amendment Defense*

Judge Pechman began her analysis of Washington’s asserted Twenty-first Amendment defense by noting that “[e]ven if challenged restraints are irreconcilably in conflict with the Sherman Act, hybrid in nature, and not subject to antitrust immunity, they may nonetheless be shielded by the Twenty-first Amendment . . . .”<sup>171</sup> However, the district court order appears somewhat confused as to the appropriate analysis to determine when the Twenty-first Amendment defense applies.

Judge Pechman first cited the United States Supreme Court’s decision in *Midcal* for the proposition that “[t]he Twenty-first Amendment grants the States virtually complete control over [whether to permit importation or sale of liquor and] how to structure the liquor distribution system.”<sup>172</sup> The district court then noted that the Ninth Circuit had previously opined in *Miller* that:

When there is a conflict between the powers granted to the states by the Twenty-first Amendment and the pro-competition federal policies expressed in the Sherman Act, the issue 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, not-

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165. *Hoen I*, at 1243-44 (quoting *Midcal*, 445 U.S. at 105) (internal quotations omitted).

166. *Id.* at 1244.

167. *Id.*

168. *Id.*

169. *Id.*

170. *Id.* at 1244-45.

171. *Id.* at 1245.

172. *Id.* (quoting *Cal. Retail Liquor Dealers Ass’n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 110 (1980)).

withstanding that its requirements directly conflict with express federal policies.”<sup>173</sup>

Judge Pechman then paid lip service to the “core concerns” test announced by the High Court in *North Dakota v. United States*,<sup>174</sup> as well as to the Fourth Circuit’s “three-part framework for analyzing a Twenty-first Amendment defense” from *TFWS*,<sup>175</sup> without providing much analysis under either methodology.<sup>176</sup>

Ultimately, Judge Pechman recognized that “there is no bright line between federal and state powers over liquor . . . . The competing state and federal interests can be reconciled only after careful scrutiny of those concerns in a ‘concrete case.’”<sup>177</sup> Finding that Defendants had raised material issues of fact by virtue of their proffered expert testimony regarding the existence of a Twenty-first Amendment defense,<sup>178</sup> Judge Pechman denied Costco’s motion for summary judgment and the case proceeded to trial.<sup>179</sup>

#### 4. *Still Searching for a Twenty-First Amendment Defense*

Following a week-long trial in March 2006, the district court issued its Findings of Fact and Conclusions of Law on April 21, 2006.<sup>180</sup> Judge Pechman framed the issues as “whether the challenged restraints are effective in advancing the state’s core interests under the Twenty-first Amendment and whether the state’s interests outweigh the federal interests in promoting competition.”<sup>181</sup>

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173. *Id.* (quoting *Miller v. Hedlund*, 813 F.2d 1344, 1352 (9th Cir. 1987)) (internal citations omitted).

174. *North Dakota v. United States*, 495 U.S. 423, 432 (1986) (noting that core concerns of the states under the Twenty-first Amendment include “promoting temperance, ensuring orderly market conditions, and raising revenue . . .”).

175. *TFWS, Inc. v. Schaefer*, 242 F.3d 198 (4th Cir. 2001).

176. *Hoen I*, 407 F. Supp. 2d at 1245.

177. *Id.* (quoting *Miller*, 813 F.2d at 1352).

178. The expert report of Dr. Kenneth Casavant, an economist, “examines how Washington’s policies serve to achieve Twenty-first Amendment goals.” *Id.* at 1246. Similarly, the expert report of Dr. Frank Chaloupka “concludes that the Washington statutes and regulations at issue in this case result in retail prices for beer and wine that are higher than they would be in the absence of these policies and that these higher prices lead to significant reductions in alcohol consumption.” *Id.* (internal citations and quotations omitted).

179. *Id.* at 1246.

180. *Costco Wholesale Corp. v. Hoen (Hoen III)*, No. C04-360P, 2006 WL 1075218 (W.D. Wash. Apr. 21, 2006), *aff’d in part and rev’d in part*, *Costco Wholesale Corp. v. Maleng*, 522 F.3d 874 (9th Cir. 2008).

181. *Id.* at \*1.

For the most part, the court found that “these restraints are either ineffective or only of minimal effectiveness in promoting temperance, ensuring orderly markets, or raising revenue” and therefore were not preserved by the Twenty-first Amendment.<sup>182</sup> However, the ban on retailer-to-retailer sales was found to be a unilateral restraint, unlike the other restraints at issue in the case, because “this policy does not grant a degree of private regulatory power to private actors.”<sup>183</sup> “A restraint imposed unilaterally by government does not become concerted action within the meaning of the Sherman Act simply because it has a coercive effect upon parties who must obey the law.”<sup>184</sup> This was the only antitrust issue on which Defendants won at trial.<sup>185</sup>

“[H]aving considered the evidence, testimony, and arguments presented by the parties,” Judge Pechman concluded:

- (1) The following state restraints are preempted by the federal Sherman Act and are not shielded by the Twenty-first Amendment:
  - (a) Policies that require beer and wine distributors and manufacturers to “post” their prices with the state and to “hold” those prices for a full month;
  - (b) Policies that require beer and wine distributors to charge uniform prices to all retailers;
  - (c) Prohibitions on selling beer and wine to retailers on credit;
  - (d) Prohibitions on volume discounts for beer and wine sales;
  - (e) Policies that require beer and wine distributors to charge the same “delivered” price to all retailers, regardless of the actual delivery costs;
  - (f) Prohibitions on central warehousing of beer and wine by retailers; and
  - (g) Policies that require a 10% minimum mark-up on sales of beer and wine from producers to wholesalers, as well as a 10% minimum mark-up on sales of beer and wine from distributors to retailers.<sup>186</sup>

In the final analysis of the district court decision, it is clear that Judge Pechman introduced a rigorous, and in many ways novel, application of federal antitrust law to state restraints on trade. Defendants promptly appealed to the Ninth Circuit.<sup>187</sup>

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182. *Id.* at \*10.

183. *Id.* at \*9.

184. *Id.* (quoting *Fisher v. City of Berkeley*, 475 U.S. 260, 266 (1986)).

185. *Id.*

186. *Id.* at \*1.

187. *Costco Wholesale Corp. v. Maleng*, 522 F.3d 874 (9th Cir. 2008).

#### IV. NINTH CIRCUIT GIVES CONSERVATIVE DEFERENCE TO STATE LAW IN *COSTCO*

##### A. Overview

On appeal, the Ninth Circuit Court of Appeals rejected almost everything about the district court's decision that was novel under federal antitrust law, thereby transforming the *Costco* case into an expression of conservative deference to state law.<sup>188</sup> Judge O'Scannlain wrote the opinion for the unanimous three-judge panel.<sup>189</sup> Following an overview of the Twenty-first Amendment, the nature of the parties, and the procedural history, the court stated that "the 'threshold question' in this appeal is whether Washington State's plan for pricing wine and beer is preempted by the Sherman Act."<sup>190</sup>

##### B. *Sherman Act Preemption and Severability Analysis*

In answering the "threshold question," the Ninth Circuit noted that it was "confronted immediately with two distinct methodological problems."<sup>191</sup> The first was whether the challenged restraints should be analyzed individually or collectively as an entire "conspiracy."<sup>192</sup> This inquiry is essentially a severability analysis.<sup>193</sup> The Ninth Circuit concluded that "for reasons to be explained, the issue of severability in this case is intimately tied to the question of whether the restraints herein challenged are 'hybrid' or 'unilateral' restraints."<sup>194</sup> The court therefore would "deal with the procedural issue of severability in resolving the merits of the appeal."<sup>195</sup>

The other methodological problem arose "because of the uncertain relationship between the 'active supervision' inquiry . . . and the 'hybrid/unilateral' inquiry . . . ."<sup>196</sup> The Ninth Circuit noted that "the Supreme Court has not provided clear guidance in defining the relationship," but concluded that "in this case . . . there is such substantial overlap between the active supervision and hybrid inquiries that they

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188. Posting of R. Corbin Houchins to ShipCompliant Blog, <http://shipcompliantblog.com/blog/2008/01/30/dulling-the-cutting-edge/> (Jan. 30, 2008, 10:21 EST).

189. *Maleng*, 522 F.3d at 885.

190. *Id.* (quoting *Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 102 (1980)).

191. *Id.* at 886.

192. *Id.*

193. *See id.*

194. *Id.*

195. *Id.*

196. *Id.*

effectively merge.”<sup>197</sup> The court then opined that “[i]n the case of a facial challenge to a state regulation . . . a determination of whether a restraint is hybrid will largely answer the question of whether the state actively supervises the restraint.”<sup>198</sup> Upon review of the applicable case law, the Ninth Circuit concluded that “state statutes or local ordinances creating unsupervised private power in derogation of competition are subject to preemption.”<sup>199</sup>

The Ninth Circuit first applied these principles to Costco’s cross-appeal of the district court’s conclusion that the retailer-to-retailer sales ban constituted a “unilateral” restraint of trade that is not subject to preemption by the Sherman Act.<sup>200</sup> The Ninth Circuit agreed with the district court, stating that “[n]o further action is necessary by the private parties because the anti-competitive nature of this restraint is complete upon enactment; the conclusion must follow, therefore, that the restraint is unilateral.”<sup>201</sup> Furthermore, the court viewed the retailer-to-retailer sales ban “as a fundamental component of the State’s ‘unquestionably legitimate’ three-tier distribution system.”<sup>202</sup>

Next, the Ninth Circuit examined the district court’s conclusions that the central warehousing ban was a component of Washington’s entire regulatory scheme and was a hybrid restraint.<sup>203</sup> Disagreeing on both counts, the Ninth Circuit noted that the central warehousing ban was “fundamentally different from the other challenged restraints” because it did not “constitute an ‘element’ of price at the distributor level and is therefore not subject to the distributor’s discretion.”<sup>204</sup> As a result, both the central warehousing ban and the ban on retailer-to-retailer sales were unilateral restraints not preempted by the Sherman Act.<sup>205</sup>

Analyzing the remaining restraints proved a more difficult task for the Ninth Circuit panel. Turning to the requirement that wholesalers post their prices and adhere to those prices for at least thirty days, the court examined two familiar cases that previously addressed similar post-and-hold schemes: *Miller v. Hedlund* and *TFWS, Inc. v. Schaefer*.<sup>206</sup> Respectively, the Ninth and Fourth Circuits found that the

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197. *Id.* at 887.

198. *Id.* at 888.

199. *Id.* at 889.

200. *Id.*

201. *Id.* at 890.

202. *Id.* at 890 n.10 (quoting *Granholt v. Heald*, 544 U.S. 460, 489 (2005)).

203. *Id.* at 891.

204. *Id.*

205. *Id.* at 892.

206. *See id.* at 892-93.

post-and-hold systems at issue before them were hybrid, *per se* restraints of trade in violation of the Sherman Act.<sup>207</sup> Despite one contrary ruling from the Second Circuit,<sup>208</sup> the Ninth Circuit concluded from the case precedent that Washington's post-and-hold pricing system was a hybrid restraint of trade.<sup>209</sup> The Ninth Circuit also found the post-and-hold restraint to be a *per se* violation of the Sherman Act.<sup>210</sup> Thus, "unless it is otherwise saved by the doctrine of state immunity or by the Twenty-first Amendment, Washington's post-and-hold scheme is preempted."<sup>211</sup>

Before addressing the applicability of antitrust immunity or other defenses, the Ninth Circuit turned to the remaining restraints—the minimum mark-up, volume discount ban, credit ban, uniform pricing requirement, and delivered pricing requirement.<sup>212</sup> Initially, the court was confronted by "the preliminary problem of whether these provisions should be examined separately or as part of a single antitrust conspiracy whose goal is to stabilize prices at supra-competitive levels."<sup>213</sup> Again the court looked to case precedent, first observing how, without significant analysis, the *Miller* court "appeared to lump the challenged volume discount ban in with Oregon's post-and-hold provision."<sup>214</sup> Then the Ninth Circuit noted that "[t]he Fourth Circuit's decision in *TFWS* provides little guidance on this issue but also considered the restraints in tandem."<sup>215</sup> Seemingly unsatisfied with either approach, the *Costco* court "confront[ed] principles of severability to consider whether, in the absence of the publication of prices and the State's enforcement of adherence to those published prices, any of the pricing restraints might otherwise be considered legitimate, unilateral acts of the sovereign state."<sup>216</sup> Of course, the court also questioned the uncertainty attendant to such an analysis: "What would a scheme without a post-and-hold requirement look like? What would be its economic effect? Would the State want such a scheme?"<sup>217</sup>

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207. *Id.*

208. *See Battipaglia v. N.Y. State Liquor Auth.*, 745 F.2d 166, 173, 176-79 (2d Cir. 1984).

209. *Maleng*, 522 F.3d at 894.

210. *Id.* at 895.

211. *Id.* at 896.

212. *Id.*

213. *Id.*

214. *Id.*

215. *Id.* at 897.

216. *Id.* at 898.

217. *Id.*

The Ninth Circuit ultimately concluded that “[i]n the absence of a requirement that a firm adhere to its published price . . . the volume discount ban, the delivered pricing ban, and the ban on credit sales would all be considered unilateral restraints imposed by the State, with no degree of discretion delegated to private individuals.”<sup>218</sup> Although finding it to be “a slightly more difficult question,” the court also concluded that the minimum mark-up and uniform pricing requirements, in the absence of the post-and-hold requirement, survive Sherman Act preemption as unilateral restraints.<sup>219</sup> Thus, if the post-and-hold provision could be severed, all the remaining restraints could be upheld as unilateral restraints not subject to preemption under the Sherman Act.

Because “[t]he lodestar of severability is legislative intent,” one question remained in the court’s severability analysis: “whether the Washington legislature would have enacted these sections independently even if it knew that the post-and-hold requirement was invalid.”<sup>220</sup> The Ninth Circuit concluded that “the district court’s treatment of the regulatory scheme, in which it viewed everything through the prism of the post-and-hold requirement, actually turns Washington’s regulatory system on its head.”<sup>221</sup> By concluding that the uniform pricing requirement, as opposed to the post-and-hold provision, was the “relevant center” upon which all of the other restraints revolved, the court was satisfied that “the post-and-hold provision [could] be excised from the remaining restraints in a way that the legislature would have intended.”<sup>222</sup>

The final consideration was whether the post-and-hold provisions found to be subject to preemption under the Sherman Act were protected by the State’s powers under the Twenty-first Amendment.

### C. *Twenty-First Amendment Defense*

At the end of its lengthy opinion, the Ninth Circuit devoted only a few pages to the potential applicability of a Twenty-first Amendment defense.<sup>223</sup> For the most part, the Ninth Circuit’s statements of applicable law in this area mirrored those of the district court. The Ninth Circuit adopted the three-fold analysis under *TFWS*: (1) “‘examine the expressed state interest and the closeness of that interest to those protected by the Twenty-first Amendment,’” (2) “inquire ‘whether, and to

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218. *Id.*

219. *Id.* at 899.

220. *Id.* at 900 (internal quotations omitted) (alteration in original).

221. *Id.*

222. *Id.*

223. *See id.* at 901.

what extent, the regulatory scheme serves its stated purpose in promoting temperance,” and (3) “balance Washington’s identified interests (to the extent that the interests are furthered by the regulatory scheme) against the established federal interest in promoting competition under the Sherman Act.”<sup>224</sup>

Under the first inquiry, the Ninth Circuit declared that it had “no doubt that the district court correctly concluded that temperance was a valid and important interest of the State under the Twenty-first Amendment.”<sup>225</sup> However, the Ninth Circuit found Washington’s asserted interest in the promotion of orderly markets to be overly amorphous and “discern[ed] no clear error in the district court’s conclusion that the restraints were minimally effective in promoting this interest.”<sup>226</sup>

The Ninth Circuit then undertook a review of the district court’s findings with respect to the state’s interest in promoting temperance.<sup>227</sup> The court accepted the district court’s acknowledgment that “Washington has one of the lowest rates in the country for per capita ethanol consumption per drinker, even though Washington ranks well above the national average in terms of the percentage of the population who consume alcohol.”<sup>228</sup> The court then noted that the district court “rejected this ‘moderation’ as a basis for affording Twenty-first Amendment immunity because it found ‘no persuasive evidence’ that the challenged restraints were the cause . . . [and] that there was little empirical evidence documenting the relationship between such pricing schemes and consumption.”<sup>229</sup> As a result, the Ninth Circuit could not say that it was “left with the definite and firm conviction that a mistake has been committed with respect to the district court’s findings of fact” and therefore concluded that they were not clearly erroneous.<sup>230</sup> Since the State “failed to demonstrate that the post-and-hold requirement is effective in promoting temperance,” the Ninth Circuit agreed with the district court that “the state’s interests do not outweigh the federal interest in promoting competition under the Sherman Act.”<sup>231</sup> The court held that “[b]ecause the State failed to carry

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224. *Id.* at 902 (quoting *TFWS, Inc. v. Schaefer*, 242 F.3d 198, 213 (4th Cir. 2001)).

225. *Id.*

226. *Id.*

227. *Id.* at 902-03.

228. *Id.* at 903 (quoting *Costco Wholesale Corp. v. Hoen (Hoen III)*, No. C04-360P, 2006 WL 1075218, at \*6 (W.D. Wash. Apr. 21, 2006)).

229. *Id.* (quoting *Hoen III*, 2006 WL 1075218, at \*6).

230. *Id.* (internal quotations omitted).

231. *Id.* (quoting *Hoen III*, 2006 WL 1075218, at \*10).

its burden on the Twenty-first Amendment defense, the post-and-hold scheme is not saved from preemption under the Sherman Act.”<sup>232</sup>

CONCLUSION: WHAT DOES IT ALL MEAN FOR NORTH CAROLINA?

The re-emergence of the North Carolina wine industry and the removal of trade barriers in the United States are both distinctly works in progress. The effects of recent judicial and legislative changes in wine distribution laws are disparate among the states, if not chaotic, and further uncertainty can be expected during this period of transition toward greater uniformity. Fortunately for North Carolinians, our state’s wine distribution laws appear to be relatively stable, and oenophiles are reaping the benefits of a liberalized direct shipment regime.

The immediate effect of the *Costco* case, at least within the footprint of the Ninth Circuit,<sup>233</sup> is threefold: (1) those states cannot require suppliers to post prices and hold them unchanged for thirty days without actively supervising them for reasonableness; (2) those states may nonetheless enforce other restraints commonly existing within price posting schemes such as quantity discount bans, credit sales bans, minimum mark-ups and uniform pricing; and (3) those states may enforce bans on both retailer-to-retailer sales bans and central warehousing.

Costco did not appeal the Ninth Circuit decision to the United States Supreme Court, but that does not mean the ruling is forever etched in stone. Growing conflict between the circuit courts could trigger Supreme Court review within the next few years. For instance, the Ninth Circuit decision departed from the Fourth Circuit’s analysis in *TFWS* by finding that the post-and-hold requirement, as opposed to the uniform pricing requirement, was the crux around which the other regulations were based.<sup>234</sup>

It is also interesting to note that the Washington Liquor Control Board, acting through a task force established in 2006, found some of its own requirements to be overly anticompetitive.<sup>235</sup> The task force recommended elimination of the price posting, mandatory mark-up, ban on volume discounts, and ban on credit sale requirements.<sup>236</sup>

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232. *Id.* at 904.

233. The Ninth Circuit includes Alaska, Arizona, California, Hawaii, Idaho, Nevada, Oregon, Washington, Guam, and the Northern Mariana Islands.

234. *Maleng*, 522 F.3d at 899.

235. Eric Arnold, *Costco Loses Long Fight to Reform Wine Distribution Laws*, WINE SPECTATOR ONLINE, Feb. 4, 2008, <http://www.winespectator.com/Wine/Features/0,1197,4245,00.html>.

236. *Id.*

Costco and its lawyers should at least rest easy knowing that the organization on the other side of the courtroom was aware of the problems inherent in its own system.

In terms of Commerce Clause jurisprudence, *Costco's* reading of *Granholm* will undoubtedly stand. That portion of the district court's ruling was not appealed to the Ninth Circuit. One post-*Costco* question is whether states with mandated middle tiers, such as North Carolina, may refuse distributor licenses to businesses on the grounds that they are located out-of-state. There is no logical basis for distinguishing between producers and wholesalers who want to reach retailers in other states, so it seems likely that courts will continue to preserve the states' right to require that "every drop" of alcohol is filtered through a middle tier. Whether that right proceeds from the Twenty-first Amendment or is an exercise of the state's police power remains unsolved. Assuming such a right does exist, under the *Granholm* and *Costco* line of reasoning, a state would be constitutionally prohibited from mandating that the wholesaler be located in-state. This could mean the emergence of a national wholesale market in alcoholic beverages. Although a national wholesale market might bring lower prices to consumers, such a large-scale reduction of trade barriers could mean the end of smaller production "boutique" wineries that depend on certain protectionist measures to turn a profit.

In the field of federal antitrust law, it remains unclear whether the Twenty-first Amendment can ever override the Sherman Act. What *Costco* suggests, when read in conjunction with other antitrust cases, is that distribution systems of private licenses, such as the one in North Carolina, may be subject to antitrust scrutiny, do not enjoy state immunity merely because the organizational structure is dictated by the state, and are not shielded by the Twenty-first Amendment simply because the article of commerce is alcohol.

Compliance with the *Costco* opinion raises many interesting administrative issues upon which the Ninth Circuit offered no guidance. For example, assuming a state wishes to retain certain pricing restraints, the same or similar to those upheld by the Ninth Circuit, how could the state operate such a system without the illegal "post-and-hold" requirement? Would a hold period significantly shorter than thirty days be permissible? Assuming price posting is not an option under any circumstances, enforcement of other restraints would be dependent upon investigation in the same manner as other trade laws.

The Ninth Circuit did very little to expand our understanding of the Twenty-first Amendment, leaving in place the district court's defini-

tion of the Section Two defense and the finding that it had not been proven. *Costco* therefore adds another court to the lengthy roster of those that have searched for an overriding Twenty-first Amendment interest but failed to find one, even after lengthy trials and appeals. It may be time for courts to conclude that such an overriding interest does not exist. At the very least, states should consider whether litigating in the face of longstanding federal policy is worth the time and expense.

For more information about wine distribution and interstate direct shipment, there are numerous publications and blogs available online. Notable sites include ShipCompliant,<sup>237</sup> Free the Grapes,<sup>238</sup> The Wine Institute,<sup>239</sup> and Wine Business.com.<sup>240</sup> For information about North Carolina wine in particular, check out NCwine.com<sup>241</sup> and visitNC.com.<sup>242</sup>

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237. ShipCompliant: Wine Shipping Blog, <http://shipcompliantblog.com> (last visited Oct. 18, 2008).

238. Free the Grapes!, <http://www.freethegrapes.org> (last visited Oct. 18, 2008).

239. The Wine Inst., <http://www.wineinstitute.org> (last visited Oct. 18, 2008).

240. Wine Bus., Home Page for the Wine Industry, <http://www.winebusiness.com> (last visited Oct. 18, 2008).

241. North Carolina Vineyard & Winery Locator, <http://www.ncwine.com> (last visited Oct. 18, 2008).

242. Savor NC Wine, Find NC Wineries & Vineyards, Upcoming Wine Events Across North Carolina, [http://www.visitnc.com/what\\_to\\_do\\_wine.asp?s=fw](http://www.visitnc.com/what_to_do_wine.asp?s=fw) (last visited Oct. 18, 2008).

