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GRANHOLM v. HEALD; SWEDENBURG v. KELLY
540 U.S. 460 (2005)

JUSTICE KENNEDY delivered the opinion of the Court.

Like many other States, Michigan and New York regulate the sale and importation of alcoholic beverages, including wine, through a three-tier distribution system. Separate licenses are required for producers, wholesalers, and retailers. See FTC, Possible Anticompetitive Barriers to E-Commerce: Wine 5-7 (July 2003) (hereinafter *FTC Report*). The three-tier scheme is preserved by a complex set of overlapping state and federal regulations. For example, both state and federal laws limit vertical integration between tiers. We have held previously that States can mandate a three-tier distribution scheme in the exercise of their authority under the Twenty-first Amendment. As relevant to today's cases, though, the three-tier system is, in broad terms and with refinements to be discussed, mandated by Michigan and New York only for sales from out-of-state wineries. In-state wineries, by contrast, can obtain a license for direct sales to consumers. The differential treatment between in-state and out-of-state wineries constitutes explicit discrimination against interstate commerce.

This discrimination substantially limits the direct sale of wine to consumers, an otherwise emerging and significant business. *FTC Report* 7. From 1994 to 1999, consumer spending on direct wine shipments doubled, reaching \$ 500 million per year, or three percent of all wine sales. *Id.*, at 5. The expansion has been influenced by several related trends. First, the number of small wineries in the United States has significantly increased. By some estimates there are over 3,000 wineries in the country, more than three times the number 30 years ago, *FTC Report* 6. At the same time, the wholesale market has consolidated. Between 1984 and 2002, the number of licensed wholesalers dropped from 1,600 to 600. The increasing winery-to-wholesaler ratio means that many small wineries do not produce enough wine or have sufficient consumer demand for their wine to make it economical for wholesalers to carry their products. *FTC Report* 6. This has led many small wineries to rely on direct shipping to reach new markets. Technological improvements, in particular the ability of wineries to sell wine over the Internet, have helped make direct shipments an attractive sales channel.

Approximately 26 States allow some direct shipping of wine, with various restrictions. Thirteen of these States have reciprocity laws, which allow direct shipment from wineries outside the State, provided the State of origin affords similar nondiscriminatory treatment. *Id.*, at 7-8. In many parts of the country, however, state laws that prohibit or severely restrict direct shipments deprive consumers of access to the direct market. According to the Federal Trade Commission (FTC), "state bans on interstate direct shipping represent the single largest regulatory barrier to expanded e-commerce in wine." *Id.*, at 3.

The wine producers in the cases before us are small wineries that rely on direct consumer sales as an important part of their businesses. Juanita Swedenburg and David Lucas, two of the plaintiffs in the New York suit, operate small wineries in Virginia (the Swedenburg Estate Vineyard) and California (the Lucas Winery). Some of their customers are tourists, from other States, who purchase wine while visiting the wineries. If these customers wish to obtain

Swedenburg or Lucas wines after they return home, they will be unable to do so if they reside in a State with restrictive direct-shipment laws. For example, Swedenburg and Lucas are unable to fill orders from New York, the Nation's second-largest wine market, because of the limits that State imposes on direct wine shipments.

New York's licensing scheme channels most wine sales through the three-tier system, but it too makes exceptions for in-state wineries. [T]he result is to allow local wineries to make direct sales to consumers in New York on terms not available to out-of-state wineries. Wineries that produce wine only from New York grapes can apply for a license that allows direct shipment to in-state consumers. These licensees are authorized to deliver the wines of other wineries as well, but only if the wine is made from grapes "at least seventy-five percent the volume of which were grown in New York state." An out-of-state winery may ship directly to New York consumers only if it becomes a licensed New York winery, which requires the establishment of "a branch factory, office or storeroom within the state of New York."

Juanita Swedenburg and David Lucas, joined by three of their New York customers, brought suit in the Southern District of New York against the officials responsible for administering New York's Alcoholic Beverage Control Law seeking, *inter alia*, a declaration that the State's limitations on the direct shipment of out-of-state wine violate the Commerce Clause. New York liquor wholesalers and representatives of New York liquor retailers intervened in support of the State.

[NOTE: The Swedenburg and Lucas case was consolidated with a similar case from Michigan, Granholm v. Heald. The Michigan law was somewhat different from New York's, but the Court reached the same result].

We granted certiorari on the following question: "Does 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 the dormant Commerce Clause in light of § 2 of the Twenty-first Amendment?"

Time and again this Court has held that, in all but the narrowest circumstances, state laws violate the Commerce Clause if they mandate "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." This rule is essential to the foundations of the Union. The mere fact of nonresidence should not foreclose a producer in one State from access to markets in other States. States may not enact laws that burden out-of-state producers or shippers simply to give a competitive advantage to in-state businesses. This mandate "reflects a central concern of the Framers that was an immediate reason for calling the Constitutional Convention: the conviction that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation."

The rule prohibiting state discrimination against interstate commerce follows also from the principle that States should not be compelled to negotiate with each other regarding favored or disfavored status for their own citizens. States do not need, and may not attempt, to negotiate with other States regarding their mutual economic interests. Rivalries among the States are thus kept to a minimum, and a proliferation of trade zones is prevented.

Laws of the type at issue in the instant cases contradict these principles. They deprive citizens of their right to have access to the markets of other States on equal terms. The perceived necessity for reciprocal sale privileges risks generating the trade rivalries and animosities, the alliances and exclusivity, that the Constitution and, in particular, the Commerce Clause were designed to avoid. State laws that protect local wineries have led to the enactment of statutes under which some States condition the right of out-of-state wineries to make direct wine sales to in-state consumers on a reciprocal right in the shipping State. Prior to 1986, all but three States prohibited direct-shipments of wine. The current patchwork of laws -- with some States banning direct shipments altogether, others doing so only for out-of-state wines, and still others requiring reciprocity -- is essentially the product of an ongoing, low-level trade war.

The New York regulatory scheme does not ban direct shipments altogether. Out-of-state wineries are instead required to establish a distribution operation in New York in order to gain the privilege of direct shipment. This, though, is just an indirect way of subjecting out-of-state wineries, but not local ones, to the three-tier system. New York and those allied with its interests defend the scheme by arguing that an out-of-state winery has the same access to the State's consumers as in-state wineries: All wine must be sold through a licensee fully accountable to New York; it just so happens that in order to become a licensee, a winery must have a physical presence in the State. There is some confusion over the precise steps out-of-state wineries must take to gain access to the New York market, in part because no winery has run the State's regulatory gauntlet. New York's argument, in any event, is unconvincing.

The New York scheme grants in-state wineries access to the State's consumers on preferential terms. The suggestion of a limited exception for direct shipment from out-of-state wineries does nothing to eliminate the discriminatory nature of New York's regulations. In-state producers, with the applicable licenses, can ship directly to consumers from their wineries. Out-of-state wineries must open a branch office and warehouse in New York, additional steps that drive up the cost of their wine. For most wineries, the expense of establishing a bricks-and-mortar distribution operation in 1 State, let alone all 50, is prohibitive. It comes as no surprise that not a single out-of-state winery has availed itself of New York's direct-shipping privilege. 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." *Halliburton Oil Well Cementing Co. v. Reily* (1963).

We have no difficulty concluding that New York discriminates against interstate commerce through its direct-shipping laws.

State laws that discriminate against interstate commerce face "a virtually *per se* rule of invalidity." *Philadelphia v. New Jersey* (1978). The Michigan and New York laws by their own terms violate this proscription. The two States, however, contend their statutes are saved by § 2 of the Twenty-first Amendment, which provides:

"The transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited."

The States' position is inconsistent with our precedents and with the Twenty-first Amendment's history. Section 2 does not allow States to regulate the direct shipment of wine on terms that discriminate in favor of in-state producers.

Before 1919, the temperance movement fought to curb the sale of alcoholic beverages one State at a time. The movement made progress, and many States passed laws restricting or prohibiting the sale of alcohol. In a series of cases before ratification of the Eighteenth Amendment the Court, relying on the Commerce Clause, invalidated a number of state liquor regulations.

These cases advanced two distinct principles. First, the Court held that the Commerce Clause prevented States from discriminating against imported liquor.

Second, the Court held that the Commerce Clause prevented States from passing facially neutral laws that placed an impermissible burden on interstate commerce. For example, in *Bowman v. Chicago & Northwestern R. Co.* (1888), the Court struck down an Iowa statute that required all liquor importers to have a permit.

[The Court then discussed in detail Congressional actions designed to provide states the authority to regular importation of alcohol. The Court concluded that none of the laws or any of its decisions gave states the right to discriminate against non-state producers].

The ratification of the Eighteenth Amendment in 1919 provided a brief respite from the legal battles over the validity of state liquor regulations. With the ratification of the Twenty-first Amendment 14 years later, however, nationwide Prohibition came to an end. Section 1 of the Twenty-first Amendment repealed the Eighteenth Amendment. Section 2 of the Twenty-first Amendment is at issue here.

Michigan and New York say the provision grants to the States the authority to discriminate against out-of-state goods. The history we have recited does not support this position. To the contrary, it provides strong support for the view that §2 restored to the States the powers they had under [prior statutes]. "The wording of § 2 of the Twenty-first Amendment closely follows the [prior statutes], expressing the framers' clear intention of constitutionalizing the Commerce Clause framework established under those statutes." *Craig v. Boren*, 429 U.S. 190, 205-206 (1976).

The aim of the Twenty-first Amendment was to allow States to maintain an effective and uniform system for controlling liquor by regulating its transportation, importation, and use. The Amendment did not give States the authority to pass nonuniform laws in order to discriminate against out-of-state goods, a privilege they had not enjoyed at any earlier time.

Our more recent cases, furthermore, confirm that the Twenty-first Amendment does not supersede other provisions of the Constitution and, in particular, does not displace the rule that States may not give a discriminatory preference to their own producers.

The modern §2 cases fall into three categories.

First, the Court has held that state laws that violate other provisions of the Constitution are not saved by the Twenty-first Amendment. The Court has applied this rule in the context of the

First Amendment; the Establishment Clause; the Equal Protection Clause; the Due Process Clause; and the Import-Export Clause.

Second, the Court has held that §2 does not abrogate Congress' Commerce Clause powers with regard to liquor. The argument that "the Twenty-first Amendment has somehow operated to 'repeal' the Commerce Clause" for alcoholic beverages has been rejected. *Hostetter*. Though the Court's language in *Hostetter* may have come uncommonly close to hyperbole in describing this argument as "an absurd oversimplification," "patently bizarre," and "demonstrably incorrect," the basic point was sound.

Finally, and most relevant to the issue at hand, the Court has held that state regulation of alcohol is limited by the nondiscrimination principle of the Commerce Clause. "When a state statute directly regulates or discriminates against interstate commerce, or when its effect is to favor in-state economic interests over out-of-state interests, we have generally struck down the statute without further inquiry." *Brown-Forman*.

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. "The 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." *Midcal*. A State which chooses to ban the sale and consumption of alcohol altogether could bar its importation; and, as our history shows, it would have to do so to make its laws effective. States may also assume direct control of liquor distribution through state-run outlets or funnel sales through the three-tier system. We have previously recognized that the three-tier system itself is "unquestionably legitimate." *North Dakota v. United States*. State policies are protected under the Twenty-first Amendment when they treat liquor produced out of state the same as its domestic equivalent. The instant cases, in contrast, involve straightforward attempts to discriminate in favor of local producers. The discrimination is contrary to the Commerce Clause and is not saved by the Twenty-first Amendment.

Our determination that the Michigan and New York direct-shipment laws are not authorized by the Twenty-first Amendment does not end the inquiry. We still must consider whether either State regime "advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." *New Energy Co. of Ind.*. The States offer two primary justifications for restricting direct shipments from out-of-state wineries: keeping alcohol out of the hands of minors and facilitating tax collection. We consider each in turn.

The States, aided by several *amici*, claim that allowing direct shipment from out-of-state wineries undermines their ability to police underage drinking. Minors, the States argue, have easy access to credit cards and the Internet and are likely to take advantage of direct wine shipments as a means of obtaining alcohol illegally.

The States provide little evidence that the purchase of wine over the Internet by minors is a problem. Indeed, there is some evidence to the contrary. A recent study by the staff of the FTC found that the 26 States currently allowing direct shipments report no problems with minors' increased access to wine. This is not surprising for several reasons. First, minors are less likely to consume wine, as opposed to beer, wine coolers, and hard liquor. Second, minors who decide to disobey the law have more direct means of doing so. Third, direct shipping is an imperfect

avenue of obtaining alcohol for minors who, in the words of the past president of the National Conference of State Liquor Administrators, “want instant gratification.” Without concrete evidence that direct shipping of wine is likely to increase alcohol consumption by minors, we are left with the States’ unsupported assertions. Under our precedents, which require the “clearest showing” to justify discriminatory state regulation, this is not enough.

Even were we to credit the States’ largely unsupported claim that direct shipping of wine increases the risk of underage drinking, this would not justify regulations limiting only out-of-state direct shipments. As the wineries point out, minors are just as likely to order wine from in-state producers as from out-of-state ones. In addition, the States can take less restrictive steps to minimize the risk that minors will order wine by mail.

The States’ tax-collection justification is also insufficient. Increased direct shipping, whether originating in state or out of state, brings with it the potential for tax evasion.

New York and its supporting parties also advance a tax-collection justification for the State’s direct-shipment laws. While their concerns are not wholly illusory, their regulatory objectives can be achieved without discriminating against interstate commerce. In particular, New York could protect itself against lost tax revenue by requiring a permit as a condition of direct shipping. This is the approach taken by New York for in-state wineries. The State offers no reason to believe the system would prove ineffective for out-of-state wineries. Licensees could be required to submit regular sales reports and to remit taxes. Indeed, various States use this approach for taxing direct interstate wine shipments, and report no problems with tax collection. This is also the procedure sanctioned by the National Conference of State Legislatures in their Model Direct Shipping Bill.

Michigan and New York benefit, furthermore, from provisions of federal law that supply incentives for wineries to comply with state regulations. The Tax and Trade Bureau (formerly the Bureau of Alcohol, Tobacco, and Firearms) has authority to revoke a winery’s federal license if it violates state law. Without a federal license, a winery cannot operate in any State. In addition the Twenty-first Amendment Enforcement Act gives state attorneys general the power to sue wineries in federal court to enjoin violations of state law.

These federal remedies, when combined with state licensing regimes, adequately protect States from lost tax revenue. The States have not shown that tax evasion from out-of-state wineries poses such a unique threat that it justifies their discriminatory regimes.

In summary, the States provide little concrete evidence for the sweeping assertion that they cannot police direct shipments by out-of-state wineries. Our Commerce Clause cases demand more than mere speculation to support discrimination against out-of-state goods. The “burden is on the State to show that ‘the *discrimination* is demonstrably justified,’” *Chemical Waste Management, Inc. v. Hunt* (1992). The Court has upheld state regulations that discriminate against interstate commerce only after finding, based on concrete record evidence, that a State’s nondiscriminatory alternatives will prove unworkable. Michigan and New York have not satisfied this exacting standard.

States have broad power to regulate liquor under § 2 of the Twenty-first Amendment. This power, however, does not allow States to ban, or severely limit, the direct shipment of out-of-state wine while simultaneously authorizing direct shipment by in-state producers. If a State

chooses to allow direct shipment of wine, it must do so on evenhanded terms. Without demonstrating the need for discrimination, New York and Michigan have enacted regulations that disadvantage out-of-state wine producers. Under our Commerce Clause jurisprudence, these regulations cannot stand.

We affirm the judgment of the Court of Appeals for the Sixth Circuit; and we reverse the judgment of the Court of Appeals for the Second Circuit and remand the case for further proceedings consistent with our opinion.

Justice Stevens, with whom Justice O'Connor joins, dissenting.

Congress' power to regulate commerce among the States includes the power to authorize the States to place burdens on interstate commerce. Absent such congressional approval, a state law may violate the unwritten rules described as the "dormant Commerce Clause" either by imposing an undue burden on both out-of-state and local producers engaged in interstate activities or by treating out-of-state producers less favorably than their local competitors. A state law totally prohibiting the sale of an ordinary article of commerce might impose an even more serious burden on interstate commerce. If Congress may nevertheless authorize the States to enact such laws, surely the people may do so through the process of amending our Constitution.

The New York and Michigan laws challenged in these cases would be patently invalid under well settled dormant Commerce Clause principles if they regulated sales of an ordinary article of commerce rather than wine. But ever since the adoption of the Eighteenth Amendment and the Twenty-first Amendment, our Constitution has placed commerce in alcoholic beverages in a special category. Section 2 of the Twenty-first Amendment expressly 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 hereby prohibited."

Today many Americans, particularly those members of the younger generations who make policy decisions, regard alcohol as an ordinary article of commerce, subject to substantially the same market and legal controls as other consumer products. That was definitely not the view of the generations that made policy in 1919 when the Eighteenth Amendment was ratified or in 1933 when it was repealed by the Twenty-first Amendment. On the contrary, the moral condemnation of the use of alcohol as a beverage represented not merely the convictions of our religious leaders, but the views of a sufficiently large majority of the population to warrant the rare exercise of the power to amend the Constitution on two occasions. The Eighteenth Amendment entirely prohibited commerce in "intoxicating liquors" for beverage purposes throughout the United States and the territories subject to its jurisdiction. While § 1 of the Twenty-first Amendment repealed the nationwide prohibition, § 2 gave the States the option to maintain equally comprehensive prohibitions in their respective jurisdictions.

In the years following the ratification of the Twenty-first Amendment, States adopted manifold laws regulating commerce in alcohol, and many of these laws were discriminatory. So-called "dry states" entirely prohibited such commerce; others prohibited the sale of alcohol on Sundays; others permitted the sale of beer and wine but not hard liquor; most created either state monopolies or distribution systems that gave discriminatory preferences to local retailers and distributors. The notion that discriminatory state laws violated the unwritten prohibition against

balkanizing the American economy--while persuasive in contemporary times when alcohol is viewed as an ordinary article of commerce--would have seemed strange indeed to the millions of Americans who condemned the use of the "demon rum" in the 1920's and 1930's. Indeed, they expressly authorized the "balkanization" that today's decision condemns. Today'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.

[T]he text of the Twenty-first Amendment is a far more reliable guide to its meaning than the unwritten rules that the majority enforces today.