UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

PATRICK L. BAUDE, et al.,	)	
	)	
Plaintiffs,	)	
	)	
v.	)	Case No. 1:05-cv-0735-JDT-TAB
	)	
DAVID L. HEATH, in his official capacity as Chairman of the Indiana Alcohol and Tobacco Commission,	)	
	)	
Defendant.	)	

BRIEF OF AMICUS CURIAE
WINE AND SPIRITS WHOLESALERS OF INDIANA

Pursuant to the Notice of Briefing Schedule entered on November 28, 2005 (*Docket No. 57*), Wine and Spirits Wholesalers of Indiana, an unincorporated association, hereby submits its amicus curiae brief in response to the plaintiffs' motion for summary judgment.

I. Interest of the Amicus Curiae

Wine and Spirits Wholesalers of Indiana (the "Association") is composed of members holding Indiana wine and liquor wholesalers' permits issued by the Indiana Alcohol and Tobacco Commission ("ATC"). According to its Bylaws, the purpose of the Association is:

> [T]he promotion of the interests of its members, cultivating friendship, good will and business co-operation among them, raising the standards of the industry, co-operating with law-enforcing agencies and carrying out the purposes and policies of the laws of the United States and the State of Indiana, including the prevention of the evasion of taxes, and illicit traffic and transportation in the alcoholic beverage trade.

Bylaws of Wine and Spirit Wholesalers of Indiana, Article I, § 3 (amended 1985).

The Association has a direct and substantial interest in this lawsuit because both the relief sought by plaintiffs and the " enforcement posture" recently adopted by the ATC would effectively dismantle the existing three-tier system of regulating alcoholic beverages in Indiana. If that happens, Association members will lose their ability to buy and sell wine competitively, and will forfeit their long-term investments of good will and market development expenses arising out of their existing contracts with out-of-state wineries.

Having learned the lessons of history from pre-Prohibition America, Indiana, like most other states, established by law a highly structured and regulated three-tier system for producing and marketing alcoholic beverage products. Chief among Indiana legislators' concerns was the desire to maintain societal control over the distribution and availability of alcoholic beverages.

Under this system, producers, wholesalers, and retailers would all be independent of each other and the commodity would be strictly controlled and heavily taxed. Producers sell to licensed wholesalers, who sell to licensed retailers who, in turn, sell alcoholic beverages to the public.

To ensure the economic independence of each tier, distributors and retailers alike are free of ownership or financial control by manufacturers. This is commonly referred to as the restriction against "tied-houses." Wholesalers are strictly prohibited from having an ownership interest in the business of retailing or supplying. This system, with a few minor modifications, has stood the test of time and exists today largely as it was enacted in the 1930s.

The three-tier system in Indiana has four primary goals:

- To ensure and maximize verifiable tax revenues that can be collected efficiently from the alcoholic beverage industry;
- To facilitate state and local control of alcoholic beverages;
- To encourage moderate, legal consumption; and

- To provide an orderly, effective market.

One of the strengths of the three-tier system is its built-in checks and balances. The Indiana Alcohol and Tobacco Commission licenses and regulates more than 10,000 permits for the manufacture, operation, or sale of alcoholic beverages throughout the state. These are regulated by about 65 enforcement agents. Under the Indiana system of regulation, wholesalers can only sell to licensed retailers. The three-tier system is designed to ensure that alcoholic beverages imported into Indiana are channeled through licensed wholesalers, each of whom has been specifically designated by the state to provide appropriate inventory and quality control, proper and prompt tax remittance, and easy and available means of preventing sales to irresponsible licensed persons or entities. Without the safeguards provided by Indiana's wholesalers, many more enforcement agents would be needed to ensure that alcohol is lawfully and safely sold in our state.

While each state has its own set of laws governing the three-tier system, the separation of the three tiers by inserting an independent distributor between the producer and the retailer is a common thread. That system has endured because it assists government in the regulation and control of alcoholic beverages, because it furthers the goal of industry accountability, and because of the value it provides for our citizens and our communities.

II. Summary of Argument

Both the plaintiffs and the ATC have focused primarily on direct sales to consumers (Count I of the Complaint) and not direct sales to retailers (Count II of the Complaint). From the Association's standpoint, the possibility of direct sales to retailers poses a much greater threat to the integrity and enforceability of the state's regulatory system, as well as to the wholesalers' business interests. Neither the plaintiffs nor the ATC has provided the Court with adequate

background or analysis with respect to Count II of the Complaint, so the Association will try to fill that gap.

The Supreme Court in *Granholm* decided one question and one question only – "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?" *Granholm v. Heald*, 125 S. Ct. 1885, 1895, 161 L. Ed. 2d 796 (2005) (emphasis added). The issue of differential regulatory treatment with respect to sales to retailers was not presented to or decided by the Supreme Court.

Under Indiana law, the holder of a farm winery permit "is entitled to sell wine by the bottle or by the case to a person who is the holder of a permit to sell wine at either wholesale or retail." I.C. § 7.1-3-12-5(a)(4). There are two categories of wine retailers in Indiana – holders of a "wine retailer's" permit (restaurants), and holders of a "wine dealer's" permit (package stores, grocery stores, and drug stores). Because only an Indiana resident may hold an Indiana farm winery permit, out-of-state wineries are not allowed to sell directly to Indiana wine retailers or wine dealers. Instead, they must sell to a licensed Indiana wholesaler.[1]

In the context of sales to retailers, Indiana wholesalers serve three critical regulatory functions. First, the wholesalers ensure that irresponsible retailers and dealers are denied access to alcoholic beverages. *[Supplemental Affidavit of Phillip Terry, ¶ 6, **Exhibit A** hereto]*. If a wholesaler delivers wine to a retailer or dealer not holding a valid permit, the wholesaler's own permit is subject to suspension or revocation. *[Id., ¶ 5]*. Second, the wholesalers ensure that the excise taxes are collected and remitted to the state. Third, wholesalers facilitate and assist the state in enforcing the obligations of "primary source" permit holders such as out-of-state wine producers. Under the system plaintiffs envision, thousands of out-of-state wineries would

[1] Out-of-state wineries hold what is commonly referred to as a "primary source" permit.

become eligible to act as their own wholesalers in Indiana, but they could not, as a practical matter, be compelled to shoulder the enforcement and tax collection responsibilities of wholesalers.

Plaintiffs are not entitled to summary judgment on Count II of their Complaint for at least three reasons: (1) there are genuine issues of material fact as to whether Indiana's regulatory system actually "burdens" these two winery plaintiffs; (2) there are genuine issues of material fact as to whether Indiana's regulatory system advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives; and (3) if Indiana's regulatory system does violate the Commerce Clause with respect to sales to retailers, the Court should adopt the remedy that would do the least violence to the intent of the legislature – which in this case would mean eliminating the preferential treatment for Indiana farm wineries, rather than effectively repealing the entire three-tier system established by the legislature.

The latter reason is probably the most important reason. The Supreme Court reaffirmed in *Granholm* that the three-tier system is "unquestionably legitimate," and that a state may funnel all sales of alcoholic beverages through the three-tier system. The remedy requested by plaintiffs would effectively dismantle the three-tier system by creating potentially thousands of new farm winery permit holders who would have the privileges of both wholesalers and retailers. By contrast, the Association's proposed remedy would require only one change to existing law, namely, the removal of the words "or retail" from I.C. § 7.1-3-12-5(a)(4).

Although the ATC correctly argues that any remedy adopted by the Court should cause "minimum damage" to the existing system, the ATC also purported to adopt an "enforcement posture" which, if implemented, would cause major damage to the existing system. The ATC does not have the authority to nullify statutory requirements by <u>any</u> type of administrative action, much less by merely announcing a new "enforcement posture" in a brief. Perhaps the ATC's

intention was to try to level the playing field with respect to sales to consumers, but in so doing it has risked opening the floodgates regarding sales to retailers.

Sales to retailers are qualitatively and quantitatively different than sales to consumers. In states where direct shipping to consumers is allowed, direct-to-consumer sales account for a minuscule portion of the total wine sales. If out-of-state suppliers are allowed to sell directly to retailers, then the State of Indiana, with its 65 excise officers, would lose all practical ability to control the distribution of alcohol. *Granholm* and the Commerce Clause do not forbid a state from limiting wholesaler privileges to in-state entities; otherwise, the 21st Amendment would be meaningless. In-state wholesalers have an important responsibility – and a powerful incentive – to cooperate with and assist the state in ensuring that alcoholic beverages are not sold to irresponsible retailers. Out-of-state suppliers have no such incentive and cannot as a practical matter be compelled to carry out a wholesaler's responsibilities.

As for direct sales to consumers, Indiana law does not authorize Indiana farm wineries to ship directly by common carrier to consumers. This is the key distinction between Indiana's regulatory system and the Michigan and New York systems at issue in *Granholm*. Plaintiffs argue that if there is no express statutory or regulatory prohibition, then a farm winery can do whatever it wants. That argument is completely contrary to the purpose and structure of Title 7.1, which allows the sale and delivery of alcoholic beverages only as authorized by that Title. The holder of an Indiana farm winery permit has only those privileges authorized by statute, and direct shipment to consumers is not among them. Because Indiana does not allow in-state or out-of-state wineries to ship directly to consumers, there is no unconstitutional discrimination.

The remedy plaintiffs seek would allow anyone with access to a computer to order wine over the Internet and have it shipped by common carrier directly to their home. While this would be desirable for wine collectors, it would also be desirable for teenagers. Moreover, the

consequences of plaintiffs' position are not limited to wine or wineries. According to plaintiffs' logic, anyone with access to a computer should be able to order Wild Turkey or Jack Daniels either directly from the producer or from an out-of-state retailer. Surely a state is entitled to have reasonable regulations designed to prevent underage drinking, such as requiring alcoholic beverages to be sold to consumers in a face-to-face transaction where age can be verified.

Plaintiffs' counsel recently filed a state court action on behalf of nine Indiana farm wineries, seeking to determine whether Indiana law does or does not allow direct shipping to consumers. Although plaintiffs obtained a preliminary injunction, the court did not find that Indiana statutes allowed direct shipping; rather, the court found that the ATC should have gone through the rulemaking process instead of just announcing a change in its enforcement practices.

At the very least, plaintiffs' state court action demonstrates there is an unsettled question of state law that is critical to this Court's constitutional analysis. Rather than trying to predict what the Indiana appellate courts might do, this Court should abstain from deciding this case until the direct shipping issue is definitively resolved by the state courts.

III. Argument

A. Summary Judgment Standard

A plaintiff seeking summary judgment must introduce supporting evidence that would conclusively establish the plaintiff's right to judgment after trial should the non-movant fail to rebut the evidence. *United Missouri Bank v. Gagel*, 815 F. Supp. 387, 391 (D. Kan. 1993); Vol. 11, *Moore's Federal Practice*, § 56.13[1], pp. 56-135 (3d ed.). The plaintiff's evidence must also negate any affirmative defenses asserted by the non-movant. *Gagel*, 815 F. Supp. at 391. In short, the plaintiff's evidence must be so compelling that no reasonable fact-finder would be free to disbelieve it. Vol. 11, *Moore's Federal Practice*, § 56.13[1], pp. 56-138 (3d ed.). The court must view the facts and all reasonable inferences therefrom in the light most favorable to the

non-moving party. *Payne v. Pauley*, 337 F.3d 767, 770 (7th Cir. 2003). If any doubts remain as to the existence of a material issue of fact, "then those doubts should be resolved in favor of the nonmoving party and summary judgment [should be] denied." *Wolf v. City of Fitchburg*, 870 F.2d 1327, 1330 (7th Cir. 1989).

In addition, it is a "cardinal principle" of statutory interpretation that a court must interpret a statute in a manner that avoids raising constitutional questions if possible. *Indiana Wholesale Wine & Liquor Co., Inc. v. State ex rel. Indiana Alcoholic Beverage Commission*, 695 N.E.2d 99, 106 (Ind. 1998).

B. Plaintiffs Are Not Entitled to Summary Judgment on Their Claim of Discrimination Against Out-of-state Wineries With Respect to Sales to Retailers

In Count II of their Complaint, plaintiffs White Owl Winery and Chateau Grand Traverse allege that Indiana law violates the Commerce Clause by allowing in-state farm wineries to sell directly to Indiana licensed retailers while requiring out-of-state wineries to sell through an Indiana wholesaler. Plaintiffs seek a judgment declaring I.C. § 7.1-3-12-3 and related laws unconstitutional to the extent they impose a residency requirement on the issuance of farm winery permits. In short, the relief plaintiffs seek would make them (and other out-of-state wineries) eligible to act as their own wholesalers in Indiana.

Indiana requires the holder of a farm winery permit to be a continuous and bona fide resident of Indiana for at least one year preceding the date of application. *I.C. § 7.1-3-12-3.* To be eligible for a farm winery permit, the winery must produce wine from grapes produced in Indiana, unless the grapes are "not obtainable" in Indiana. *I.C. § 7.1-3-12-4(a)(1); I.C. § 7.1-3-12-6.* A farm winery's production is limited to 500,000 gallons of wine per year. *I.C. § 7.1-3-12-4(a).* A farm winery is entitled to sell wine "by the bottle or by the case to a person who is the holder of a permit to sell wine at either wholesale or retail." *I.C. § 7.1-3-12-5(a)(4).* In

Indiana, the holders of permits to sell wine at retail are wine "dealers" (package stores, grocery stores, and drug stores) and wine "retailers" (restaurants). *See I.C. § 7.1-3-14 (wine retailer's permits); I.C. § 7.1-3-15 (wine dealer's permits).*

There is no question that Indiana's regulatory system treats in-state wineries differently than out-of-state wineries with respect to sales to retailers. But it does not automatically follow that this system violates the Commerce Clause, and even if it did, the remedy plaintiffs seek would completely dismantle the three-tier system of alcoholic beverage regulation established by the Indiana legislature.

1. If There Is a Constitutional Violation, the Proper Remedy Would Be an Injunction Eliminating the Preferential Treatment for Indiana Farm Wineries

The remedy sought by plaintiffs would allow any winery in the country that produces less than 500,000 gallons of wine per year to be eligible for an Indiana farm winery permit. As holders of an Indiana farm winery permit, these out-of-state wineries would be entitled to, among other things: (a) establish their own "second location" retail outlet; (b) sell wine for carryout on Sunday; and (c) sell wine directly to Indiana wine dealers and wine retailers. *I.C. § 7.1-3-12-5.* There are approximately 3,000 wineries in the United States, and approximately 10,000 licensed wine accounts in Indiana.

Indiana law allows only in-state entities to have the privileges and responsibilities of wholesalers. This restriction serves several legitimate state purposes, including: (a) to assure that all taxes such as excise and sales tax are paid and remitted to the state; (b) to assure that all retailers receiving a delivery are responsible entities that have valid permits and have paid all state taxes; (c) to assure that all persons delivering alcohol have a state-issued permit or are under the supervision of someone who does; and (d) to assure that all persons doing business with retailers are within the jurisdiction of and subject to penalties imposed by the ATC and

Indiana courts. Plaintiffs' proposed remedy would sweep all of this away and allow any winery anywhere in the country to act as its own wholesaler and sell directly to Indiana retailers. Obviously, that would be the polar opposite of what the Indiana legislature intended when it enacted the three-tier system of alcoholic beverage regulation. The proper remedy (if necessary) is the remedy that does the least violence to the intent of the legislature, which in this case would be an injunction eliminating the preferential treatment for Indiana farm wineries.

The Supreme Court has expressly recognized that the remedy for a Commerce Clause violation is equal treatment, which does not necessarily mean an extension of benefits to the excluded class:

> Accordingly, as Justice Brandeis explained, when the "right invoked is that of equal treatment," the appropriate remedy is a mandate of *equal* treatment, a result that can be accomplished by withdrawal of benefits from the favored class as well as by extension of benefits to the excluded class.

Heckler v. Mathews, 465 U.S. 728, 740 (1984) (emphasis in original; citation omitted). The Court added that a discriminatory government program may be remedied by ending the preferential treatment for others:

> Consistent with Justice Brandeis's explanation of the appropriate relief for a denial of equal treatment, we have often recognized that the victims of a discriminatory government program may be remedied by an end to preferential treatment for others.

Id. at 740, n. 8 (citations omitted).

In *Beskind v. Easley*, 325 F.3d 506 (4th Cir. 2003), a California winery and individual oenophiles challenged North Carolina's Alcoholic Beverage Control laws relating to direct shipment of wine. As in this case, they alleged that allowing in-state wineries to ship directly to North Carolina consumers, but prohibiting California wineries from doing so, violated the Commerce Clause. *Id*. at 509. The district court struck down North Carolina's laws as discriminating against out-of-state wineries and enjoined their enforcement with "the effect that

out-of-state wine manufacturers would be permitted to sell and ship directly to North Carolina residents." *Id*.

On appeal, North Carolina challenged the underlying ruling and the district court's remedy of permitting out-of-state suppliers to ship directly to North Carolina consumers, arguing that "the appropriate remedy is to enjoin the in-state preference rather than strike down the laws prohibiting direct shipment from out-of-state suppliers." *Id*. at 512. Although the Court of Appeals upheld the finding that the treatment of in-state wineries and out-of-state wineries relating to the direct shipment of product to consumers violated the Commerce Clause, it vacated the district court's remedy of allowing out-of-state suppliers to ship directly to North Carolina consumers. The court first observed that the North Carolina legislature was continuing to assert its power to regulate the transportation and importation of alcoholic beverages, as evidenced by statutes providing that alcohol could not be sold or transported except as authorized by statute. *Id*. at 519.[2] For this reason, the court decided to adopt an approach "that least destroys the regulatory scheme" and "disturb[s] only as much of the state regulatory scheme as is necessary to enforce the U. S. Constitution." *Id.* at 519. The court concluded that:

> When applying this "minimum damage" approach, we have little difficulty 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.

This Court should also employ the "minimum damage" approach and strike down only that portion of Indiana's law that has been characterized as discriminatory, which is the legislative grant of authority to in-state wineries to function as wholesalers of their own products

[2] Indiana has very similar statutes. *See I.C. § 7.1-5-1-1; I.C. §7.1-1-1-1(2); I.C. §7.1-1-2-1*. *See* p. 12, *infra*.

and ship directly to retailers. This will cure any constitutional violation and yet maintain the state's three-tier system, which has been specifically recognized by the Supreme Court to be "unquestionably legitimate." *Granholm, supra*, 125 S. Ct. at 1905. *See also Alabama Alcoholic Beverage Control Board v. Henri-Duval Winery L.L.C.*, 890 So. 2d 70, 79 (Ala. 2003).[3]

Like North Carolina, the Indiana legislature has specifically made clear its intention that alcoholic beverages can be sold or transported only as authorized by statute. For example, I.C. § 7.1-5-1-1 makes it unlawful for a person to sell, import, transport, deliver, furnish, or possess alcoholic beverages "for commercial purposes except as authorized in this title." Allowing out-of-state wineries to sell directly to retailers would clearly be sales "for commercial purposes" that are not authorized by Title 7.1. Likewise, a stated purpose of Title 7.1 is "to regulate and limit the manufacture, sale, possession, and use of alcohol and alcoholic beverages." *I.C. § 7.1-1-1-1(2)* (emphasis added). The Indiana legislature also expressly stated that Title 7.1 is "an exercise of the police powers of the state," and that its provisions "shall be liberally construed so as to effectuate the purposes of this title." *I.C. § 7.1-1-2-1*. Thus, as in *Beskind*, this Court in selecting a remedy should defer as much as possible to the intention of the legislature. *Beskind*, 325 F.3d at 519-20. In this case, the Indiana legislature plainly did not intend to adopt the system plaintiffs seek.

2. The ATC Does Not Have the Authority to Contradict Clear Legislative Requirements By Adopting an "Enforcement Posture" in a Brief

On November 21, 2005, the ATC filed a cross-motion for summary judgment together with a Memorandum in support thereof and in opposition to plaintiffs' motion for summary judgment. In its Memorandum, the Attorney General stated that the ATC had adopted an

[3] In *Dickerson v. Bailey*, 336 F.3d 388 (5th Cir. 2003), the court found that striking the in-state privilege would have required the court to substantially revise Texas law, and thus it was more prudent to remedy the inequality by allowing out-of-state wineries to make direct sales. In effect, the *Dickerson* court applied the "minimum damage" approach but reached a different result based on its analysis of the Texas statutes.

"enforcement posture" under which the ATC intends not to enforce two requirements of the Indiana farm winery statute, namely, the requirement that a farm winery permit holder produce its wine from Indiana fruit, and the requirement that a farm winery permit may be issued only to a person who has been a bona fide resident of Indiana for at least one year. *[Docket No. 50, pp. 3, 5-6]*.

Although the ATC correctly argued in its Memorandum that any remedy adopted by the Court should cause "minimum damage" to the existing system, the ATC's purported "enforcement posture" would, if implemented, cause major damage to the existing system. As discussed above, if farm winery privileges are extended to all out-of-state wineries that produce less than 500,000 gallons per year, then thousands of wineries would be eligible to sell directly to retailers; to set up their own retail outlets and sell directly to consumers; and to sell for carryout on Sunday.

Under the ATC's "enforcement posture," out-of-state wineries would enjoy wholesaler privileges, but without being subject to the requirements and responsibilities applicable to the members of the Association. Out-of-state wineries will arguably not be required to have a physical facility to receive product and to enable administrative inspection and/or audit; the ability to collect excise taxes will be compromised; and the State's ability to investigate and enforce violations of trade practices would be rendered ineffective. Thousands of wineries will be allowed to operate remotely and to directly sell their product without complying with numerous requirements applicable to Indiana wholesalers including, but not limited to, residency requirements (Indiana Code § 7.1-3-21-3); Sunday sales limitations (Indiana Code § 7.1-3-1-14(a)); credit sale restrictions (Indiana Code § 7.1-5-10-12); gallonage restrictions (Indiana Code § 7.1-3-13-3); stringent premises permitting requirements (Indiana Code § 7.1-3-13-2.5); trade

practice restrictions (e.g., Rule 905 IAC 1-5.2-1); record-keeping requirements (e.g., Rule 905 IAC 1-5.2-2); and advertising limits (e.g., Rule 905 IAC 1-5.2-5).

The Indiana legislature imposed specific requirements that an applicant must satisfy before the ATC can issue a farm winery permit. Those requirements include Indiana residency and the use of Indiana grapes. An administrative agency such as the ATC does not have the authority to nullify specific statutory requirements by rulemaking or any other type of administrative action – much less by announcing a new "enforcement posture" in a court brief. *Shultz v. State*, 417 N.E.2d 1127, 1136 (Ind. Ct. App. 1981); *accord, C & C Oil Co., Inc. v. Indiana Dept. of State Revenue*, 570 N.E.2d 1376, 1381 (Ind. Tax Ct. 1991); *FSSA v. Marion General Hospital*, 677 N.E.2d 1122, 1123-24 (Ind. Ct. App. 1997). As the Court of Appeals explained in *Shultz*:

> A specific legislative yardstick is provided, which cannot be broken or shortened by an administrative regulation. Rules and regulations promulgated by administrative boards must be reasonable, and such boards cannot enlarge or vary, by the operation of such rules, the power conferred upon them by the Legislature, or create a rule out of harmony with the statute. Any regulation which is in conflict with the organic law or statutes of the State is wholly invalid.

Shultz, 417 N.E.2d at 1136.

In this instance, the ATC did not attempt to go through the rulemaking process – although if it had, the rule would have been invalid anyway as contrary to statute. The ATC simply does not have the power to unilaterally repeal statutes in the guise of an "enforcement posture." Under the ATC's logic, the Indiana Gaming Commission could decide to adopt an "enforcement posture" that would allow an applicant to seek a riverboat casino in any county in the state, despite what the gaming statute says. An administrative agency cannot legislate in this manner.

Moreover, the ATC's "enforcement posture," if implemented, would amount to a complete dismantling and repeal of the Indiana three-tier system as applied to wine; a complete

abrogation of the fundamental statutory prohibitions against tied-houses; and the creation of an administrative impossibility for the ATC to comply with its statutory mandate to investigate and enforce industry practices and to collect excise taxes. It would also significantly impair the viability of the Association and its members, and erode the integrity of distribution contracts the Association members have with wine suppliers by creating a market environment encouraging wine importers and suppliers to avoid regulatory control and oversight by eliminating wholesalers from their business plans in Indiana. Although the ATC's "enforcement posture" was likely motivated by a good faith attempt to defend against the plaintiffs' claims, the ATC lacks the authority to do so. Thus, the Court should ignore the ATC's "enforcement posture" and analyze the statutes as written.

3. There Are Genuine Issues of Material Fact as to Whether Indiana's Regulatory System Actually Burdens the Two Winery Plaintiffs

Plaintiffs bear the burden of proving that the differential treatment of in-state and out-of-state economic interests "benefits the former and burdens the latter." *Granholm*, 125 S. Ct. at 1895, *quoting Oregon Waste Systems, Inc. v. Dept. of Environmental Quality of Ore.*, 511 U.S. 93, 99 (1994). The winery plaintiffs in this case have not submitted sufficient admissible evidence to establish that there are no genuine issues of material fact and that they are entitled to judgment as a matter of law.

Plaintiffs submitted no evidence whatsoever with respect to White Owl Winery. As for Chateau Grand Traverse, the Affidavit of Edward O'Keefe merely says that it wishes to ship its wine directly to Indiana retailers and restaurants, provided Indiana law or regulations so permit. *[Docket No. 46, ¶ 8]*. Although plaintiffs assert that Chateau Grand Traverse is effectively "closed out of the Indiana market" (*Docket No. 40, p. 70*), Chateau Grand Traverse has in fact done business in Indiana through a wholesaler for over ten years, and its wines are widely

available in Indiana. *[Affidavit of Thomas Snow, Docket No. 54, ¶ 4]*. There is no evidence that White Owl Winery has ever sought to do business in Indiana through a wholesaler. On this record, the winery plaintiffs have failed to prove that they are actually burdened by the state's differential treatment with respect to sales to retailers.

4. There Are Genuine Issues of Material Fact as to Whether Indiana's Regulatory System Advances a Legitimate Local Purpose That Cannot Be Adequately Served By Reasonable Nondiscriminatory Alternatives

Even if Indiana law regarding sales to retailers discriminates against interstate commerce, the Court still must consider whether the state system "advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." *Granholm*, 125 S. Ct. at 1905, *quoting New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 278 (1988). The Supreme Court in *Granholm* addressed this issue in the context of direct sales to consumers only – not direct sales to retailers. Allowing the direct sale of wine to consumers, while not desirable, would not radically transform the nature of the alcoholic beverage business or threaten to dismantle the three-tier system. Allowing the direct sale of wine to retailers would do just that.

The permit system advocated by plaintiffs is not reasonable or workable. In theory, there could be thousands of new out-of-state farm winery permit holders, with no practical way for the state's 65 excise officers to verify their financial reporting or police their sales and deliveries to retailers. The current system is designed so that the in-state wholesalers perform numerous tax collection and enforcement functions that the ATC would otherwise have to perform with its own resources. The potential harm from unregulated and untaxed sales is much greater at the producer-to-retailer level than at the producer-to-consumer level, because of sheer quantity, higher profit potential, and many other factors.

It is critical to the state's system that certain permit holders, such as wholesalers, be domiciled in the state. Because in-state wholesalers are subject to the state's enforcement

powers, they can and do help ensure that irresponsible retailers – such as those who have been cited for public nuisance, or have served minors or intoxicated persons, or have failed to pay sales taxes – are cut off from access to alcoholic beverages. *[Supplemental Affidavit of Phillip Terry, ¶ 6, **Exhibit A** hereto]*. Likewise, licensed in-state wholesalers facilitate and assist the state in enforcing the obligations of "primary source" permit holders such as out-of-state wineries. For example, when the ATC wanted to enforce its (former) anti-profanity rule against "Fat Bastard Chardonnay" and "Arrogant Bastard Beer," it simply contacted the wholesaler and asked that it cease distribution of those labels until the issue was resolved. *[Id., ¶ 7]*. Under plaintiffs' proposed system and the ATC's "enforcement posture," the state's ability to cut off alcohol to irresponsible retailers and to enforce industry standards against out-of-state producers would be eviscerated.

Granholm specifically recognized that states could "funnel sales through the three-tier system." 125 S. Ct. at 1905. If all wine producers, regardless of location, are allowed to act both as their own wholesalers with respect to sales to retailers, and as their own retailers with respect to sales to consumers, then in reality there is nothing left of the three-tier system as applied to wine sales. That cannot be what the Supreme Court intended when it recognized in *Granholm* that the three-tier system was "unquestionably legitimate." 125 S. Ct. at 1905.

5. Granholm Applies Only to Direct Sales to Consumers for Personal Use

By recognizing that a state could "funnel sales through the three-tier system," the Supreme Court in *Granholm* recognized that a state could legitimately require all traffic in alcoholic beverages to pass through in-state wholesalers and retailers. Even plaintiffs do not contend that a state system requiring all wine sales to be funneled through the three-tier system would unconstitutionally discriminate against out-of-state wholesalers and retailers. Thus, under *Granholm*, a state may lawfully limit wholesaler privileges to in-state entities. Indeed, the

Granholm Court cited *North Dakota v. United States*, 495 U.S. 423, 432 (1990), and quoted Justice Scalia's concurring opinion that "The Twenty-first Amendment … empowers North Dakota to require that all liquor sold for use in the State be purchased from a licensed in-state wholesaler". *Granholm*, 125 S. Ct. at 1905, *quoting* 495 U.S. at 447.

In applying *Granholm*, it is important to understand that the distinction drawn by the Court between producer-to-consumer direct shipments on the one hand, and wholesale and retail transactions on the other, was based on the historical underpinnings of its Twenty-first Amendment jurisprudence. This jurisprudence included the case law whereby shipments from out-of-state suppliers to consumers were historically treated as beyond the purview of a state's regulatory power, which led to the enactment of the Wilson and Webb-Kenyon Acts.[4] Accordingly, the *Granholm* Court deemed shipments from producers to consumers for personal use as uniquely outside the three-tier system, because it has always viewed them as such. And, based on this historical distinction, *Granholm* reconciled its holding regarding consumers with its holding that a three-tier system requiring licensed in-state wholesalers and in-state retailers is absolutely protected under the Twenty-first Amendment.

In short, plaintiffs' broad reading of *Granholm* is not warranted. If plaintiffs were correct, then any out-of-state package store or wholesaler should be able to ship directly to Indiana consumers, because in-state package stores and wholesalers can deliver directly to Indiana consumers. *Granholm* does not compel the conclusion that because Indiana allows

[4] The Wilson and Webb-Kenyon Acts were passed to eliminate this anomaly: "The Court thus recognized that the [Webb-Kenyon] Act was an attempt to eliminate the regulatory advantage, *i.e.*, its immunity characteristic, afforded imported liquor under *Bowman* and *Rhodes*." *Id*. at 1901. As the Court explained, the early pre-Prohibition cases held that, under the old "original-package doctrine," a shipment from an out-of-state supplier to a consumer remained an article in interstate commerce and could not be regulated by the State. *Id*. at 1898. Congress attempted to remedy this anomaly by enacting the Wilson Act, which was intended to allow states to regulate imports on the same terms as domestic alcoholic beverages. Cases following the Wilson Act, however, continued the anomaly with respect to shipments to consumers for personal use. As the *Granholm* court explained, "the Court [in *Vance* and *Rhodes*] made clear that the Wilson Act did not authorize States to prohibit direct shipments for personal use." *Id*. at 1899 (citing *Vance v. W. A. Vandercook Co.*, 170 U.S. 438, 18 S. Ct. 674, 42 L. Ed. 1100 (1898), and *Rhodes v. Iowa*, 170 U.S. 412, 18 S. Ct. 664, 42 L. Ed. 1088 (1898)).

limited wholesaler privileges to in-state wineries, it must allow wholesaler privileges to all wineries regardless of location.

C. Plaintiffs Are Not Entitled to Summary Judgment on on Their Claim of Discrimination Against Out-of-state Wineries With Respect to Direct Sales to Consumers

1. Indiana Law Does Not Allow Direct Shipment of Wine to Consumers

The ATC's brief correctly points out that, unlike the state laws at issue in *Granholm*, Indiana law has never authorized the direct shipment of wine to consumers by in-state producers or out-of-state producers. Thus, Indiana does not discriminate against out-of-state producers with respect to direct sales to consumers.

Plaintiffs argue that because there is no statute or regulation that expressly prohibits direct shipping to consumers by farm wineries, and because other types of permit holders may "deliver" wine to consumers' homes, then farm wineries are entitled to "ship" wine to a consumer's home by common carrier.

As a matter of statutory construction, plaintiffs have it exactly backwards. Title 7.1 prohibits the sale and transportation of alcoholic beverages "except as authorized in this title"; moreover, its purpose is to "regulate and limit" the sale, possession, and use of alcoholic beverages. *I.C. § 7.1-5-1-1; I.C. § 7.1-1-1-1(2).*

The statutory scheme includes many different types of permits, each of which has its own set of privileges and responsibilities. The scope of an Indiana farm winery permit is set forth at I.C. §§ 7.1-3-12-3 through 7. There are separate statutory chapters for wine wholesaler permits (I.C. § 7.1-3-13), wine retailer (restaurant) permits (I.C. § 7.1-3-14), and wine dealer (package stores, drug stores, grocery stores) permits (I.C. § 7.1-3-15). The holders of a wine wholesaler permit, a wine retailer permit, and a wine dealer permit are expressly authorized by statute to "deliver" (not "ship") wine to consumers under certain conditions. *See I.C. § 7.1-3-13-3(a); I.C.*

§ 7.1-3-14-4(c); I.C. § 7.1-3-15-3(d). There is no such statutory authorization for the holder of a farm winery permit. When the legislature wanted to authorize home delivery, it expressly said so.

Moreover, "delivery" (by a permit holder) is not the same as "shipment" (by common carrier). For example, I.C. § 7.1-3-15-3(d) provides that "delivery" to a customer's residence by a package store "may only be performed by the permit holder or an employee who holds an employee permit." The farm winery statute does not authorize even home delivery by the permit holder, much less direct shipment to consumers by common carrier.

2. The ATC's Alleged Lack of Enforcement Is Unproven and Irrelevant

Plaintiffs have submitted two largely inadmissible affidavits and a hodgepodge of unauthenticated documents from the 1970s as "evidence" that the ATC knowingly and continuously approved direct shipment to consumers between December 1978 and May 2005. This evidence, even if admissible, would prove nothing other than that UPS received application forms in December 1978 which, if completed and approved, would enable UPS to transport alcoholic beverages within the State of Indiana. No one disputes that UPS holds a "carrier permit" that enables it to transport alcoholic beverages between wholesalers and retailers. But it does not follow that the ATC, then or now, ever expressly approved UPS to ship wine directly to consumers' homes. The evidence from the ATC and the Excise Police is to the contrary. *[Affidavit of Bart Herriman, **Exhibit B** hereto, ¶¶ 3-6; Heath Affidavit, Docket No. 51, ¶¶ 6-8; Huskey Affidavit, Docket No. 52, ¶ 9]*.

In any event, even if the ATC were somehow "estopped" from enforcing the law (at least without adopting a rule), that does not mean that the law itself has changed for purposes of this Court's constitutional analysis. Regardless of whether the farm wineries may have detrimentally

relied on the ATC's alleged lack of enforcement, Indiana law still does not authorize farm wineries (or anyone else) to ship wine by common carrier directly to a consumer's residence.

3. The Remedy Plaintiffs Seek Would Make Underage Drinking Easier and Disrupt the Regulatory Scheme

The remedy plaintiffs seek would allow anyone with access to a computer to order wine over the Internet and have it shipped by common carrier directly to their home. Indiana's prohibition on direct shipping to consumers prevents easy, anonymous access by minors to alcoholic beverages ordered over the Internet. *[Heath Affidavit, Docket No. 51, ¶ 13]*. The requirement of a face-to-face transaction fosters a regulatory environment in which the age and identification of consumers can be verified. *[Id., ¶ 14]*. Direct shipping in response to Internet, telephone, or mail orders would significantly constrain the ability of the Indiana Excise Police to prevent access to alcohol by minors. *[Huskey Affidavit, Docket No. 52, ¶ 9]*.

Moreover, the consequences of plaintiffs' position are not limited to wine or wineries. According to plaintiffs' logic, if an Indiana distillery could sell its whiskey directly to consumers, then any person with access to a computer should be able to place an Internet order with the producer of Wild Turkey or Jack Daniels, and have the product shipped directly to their home.

In addition, federal law allows direct interstate shipment of wine only when the FAA has restricted passenger airline traffic, and only under the following conditions: (a) the wine was purchased while the purchaser was physically present at the winery; (b) the purchaser of the wine provided the winery verification of legal age to purchase alcohol; (c) the shipping container in which the wine is shipped is marked to require an adult's signature upon delivery; (d) the wine is for personal use only and not for resale; and (e) the purchaser could have carried the wine

lawfully into the state to which the wine is shipped. 27 U.S.C. § 124. Plaintiffs' proposed remedy has no such safeguards.

Although Indiana treats in-state and out-of-state wineries equally with respect to direct shipment to consumers, Indiana farm wineries can sell their wine directly to consumers at the winery premises and at an ATC-approved second location. By definition, out-of-state wineries do not have an Indiana winery location, and are not allowed to have a "second location" for sales to consumers. This discrepancy might explain why the ATC adopted its purported "enforcement position" that would make out-of-state wineries eligible for Indiana farm winery permits.

In *Bridenbaugh v. Freeman-Wilson*, 227 F.3d 848 (7th Cir. 2000), *cert. denied* 532 U.S. 1002 (2001), the court upheld Indiana's anti-shipping statute on the ground that all wine sales have to be channeled through Indiana permit holders, thus enabling equal collection of the excise tax, which is what the 21st Amendment was designed to do. 227 F.3d at 854. As a result, plaintiffs (and now the ATC) are trying to expand the definition of a farm winery permit holder to encompass all wineries regardless of location.

There is, however, another way, which is to focus on what a farm winery is allowed to do, instead of who should be eligible for a farm winery permit. The logic of *Beskind v. Easley* should also be applied to direct sales to consumers; that is, the remedy that would cause "minimum damage" to the existing system is to eliminate the preferential treatment for Indiana farm wineries. *Beskind*, 325 F.3d at 519-20. In this case, that means an injunction prohibiting Indiana farm wineries from selling to consumers at a "second location." That would eliminate any discrimination with respect to consumer sales, because any winery regardless of location would be able to sell to consumers at the winery premises.

4. In the Alternative, This Court Should Abstain from Deciding This Case Until the Indiana Appellate Courts Resolve the Unsettled State Law Question

On November 17, 2005, plaintiffs' counsel filed a state court action on behalf of nine Indiana farm wineries, seeking to determine whether Indiana law does or does not allow direct shipping to consumers.[5] In that case, plaintiffs argued that because farm wineries have retailer privileges, and because other wine retailers can deliver wine to a consumer's home, farm wineries had the statutory right to ship directly to consumers. Although plaintiffs succeeded in obtaining a preliminary injunction, the trial court did not find that Indiana law allowed direct shipping; rather, the trial court found that because the statute neither expressly prohibited nor expressly allowed direct shipping, the ATC should have gone through the rulemaking process instead of announcing a change in its enforcement practices by letter. *[See plaintiffs' proposed conclusions of law, p. 5, ¶ 21; defendants' proposed findings of fact and conclusions of law, p. 7, ¶ 8; trial court findings of fact and conclusions of law, p. 3, ¶ 9, attached hereto as* ***Exhibits C, D, and E*** *respectively]*.

This state court action demonstrates that there is an unsettled question of state law which is critical to this Court's constitutional analysis. Rather than trying to predict what the Indiana appellate courts might do, this Court should abstain from deciding this case until the direct shipping issue is definitively settled by the Indiana appellate courts. If plaintiffs prevail, then their analogy to *Granholm* becomes more persuasive. If the ATC prevails, then plaintiffs in this case would have to try to prove discrimination based on direct sales to consumers, not direct shipment to consumers. On this point, the Association agrees with the ATC that abstention is appropriate under either *Railroad Comm'n of Texas v. Pullman Co.*, 312 U.S. 496 (1941) or *Colorado River Water Conservation District v. United States*, 424 U.S. 800 (1976).

[5] *S. L. Thomas Family Winery, Inc., et al. v. Heath, et al.*, Cause No. 49D06-0511-PL-045032.

Conclusion

The Association respectfully requests the Court to deny plaintiffs' motion for summary judgment as to both Count I and Count II of their Complaint. If, however, this Court finds a constitutional violation, then the remedy should be to eliminate the preferential treatment for Indiana farm wineries. In the alternative, the Court should abstain from deciding this case until the Indiana courts resolve the issue of whether Indiana law allows direct shipping by common carrier to consumers' homes.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on the 8th day of December, 2005, a copy of the foregoing was filed electronically. Notice of this filing will be sent to the following parties by operation of the Court's electronic filing system. Parties may access this filing through the Court's system.

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