Prepared Statement of
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To the Committee on the Judiciary
House of Representatives
United States Congress

Hearing on H.R. 5034
“The Comprehensive Alcohol Regulatory Effectiveness (CARE) Act of 2010”
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Thank you for the opportunity to appear before you. My name is Stephen Diamond. I am a professor at the University of Miami School of Law where I have taught alcoholic beverage law for the past fifteen years. I have a Ph.D. in American History as well as a J.D., and I have written about the theory and practice of post-Repeal state alcoholic beverage regulation.

H.R.5034 has been criticized for several alleged defects. It has been suggested:

1) that the state alcoholic beverage regulations that it would support serve no public purpose;

2) that Congress lacks the Constitutional authority to enact it;

3) that it marks a sharp break from the role that Congress has previously exercised with regard to state alcoholic beverage regulation;

4) that it does not respect the Granholm decision;

5) and that it flies in the face of a long tradition of general dormant Commerce Clause jurisprudence.

None of these criticisms are valid.

I

I would like to begin by describing very briefly the theory and practice of state alcoholic beverage regulation as it has been implemented since Repeal. The state alcoholic beverage regulatory system that has developed post-Repeal is in theory and practice a sensible one that has worked well. The absence of crisis is evidence of

regulatory success. This was a goal of post-Repeal regulation. The aim was to avoid big swings in regulatory policy which dominated political campaigns and led to a regulatory volatility that encouraged the destructive short-term pursuit of profits by businesses unsure of the security of their legal status. Instead, the aim was to constrain the marketing of alcoholic beverages so as to prevent the stimulation of excessive sale and consequent abuse. The aim was also not overly to restrict availability so as to stimulate illicit and therefore unregulated manufacture, distribution, and sale with consequent abuse. The appetite for drink had to be controlled as did the pursuit of profit in the selling of it. The industry was to resemble a quasi-public utility: that is, highly regulated, with competition limited, to keep the market orderly and stable, to reduce pressure to pursue short-term profits. As a Texas regulator once remarked, the greatest threat to temperance for this reason is the publicly traded corporation, which is under ceaseless pressure to grow.

Rather than implementing either deregulation or intrusive supervision, the three-tier system set up competing economic interests, interests invested in keeping state control effective through preserving their own independence and a level playing field. It had been observed that one reason for the failure of Prohibition was that there were no economic interests – legal ones, that is – invested in Prohibition's success.

In the post-Repeal regulatory scheme, sellers were to be regulated to constrain marketing practices that would encourage over-consumption. Wholesalers were created and regulated in part to reduce pressures on retailers to oversell. Buying and selling were two sides of the same problem. No particular segment of the industry was to feel disproportionately over-regulated. These laws were to create a comprehensive

system: a culture and a climate of control. They were not aimed just at the few. The alcoholic was not the only problem consumer; the gangster was not the only problem seller.

The aim was moderation in drinking, moderation in selling, and moderation in law-making. Has this worked perfectly? Of course not. But it still commands respect and deserves support. H.R. 5034 is a moderate, reasonable effort to preserve this program of moderation.

II

Although state alcoholic beverage regulation is sheltered from challenges by both the Twenty-first Amendment and the Webb-Kenyon Act, Congress can only express its will by amending the latter. I now therefore turn to the sometimes problematic coexistence of state alcoholic beverage regulation and the dormant Commerce Clause leading to the passage of the Webb-Kenyon Act, what Justice Frankfurter described as the "unedifying history" (concurring in Carter v. Virginia, 321 US 131, 142 [1944]) of Supreme Court frustration of state regulatory initiatives and of Congressional efforts to protect them. This requires a review of the passage of the Wilson and the Webb-Kenyon Acts in some detail.

In 1880, in the Leisy case, the Supreme Court struck down an Iowa statute banning the importation of alcoholic beverages as a violation of the dormant Commerce Clause, an early example of the expansion of this Court-made doctrine to limit state law. Chief Justice Fuller noted, however, that the Court was acting in the name of a presumed Congressional intent that such interstate commerce be unrestricted.

Congress, therefore, might grant such laws immunity from the dormant Commerce Clause. In other words, Congress might make clear that its silence had not been intended to condemn particular categories of state regulation. Congress immediately accepted the invitation to clarify its intent, passing the Wilson Act that same year.

What became the Wilson Act, as originally proposed, would have proved a much broader shield of state alcoholic beverage law from dormant Commerce Clause challenge than what ultimately was adopted. As originally drafted it read:

> "That no state shall be held to be limited or restrained in its power to prohibit, regulate, control, or tax the sale, keeping for sale, or the transportation as an article of commerce or otherwise, to be delivered within its own limits, of any fermented, distilled, or other intoxicating liquids or liquors by reason of the fact that the same have been imported into such state from beyond its limits, whether there shall or shall not have been paid thereon any tax, duty, or excise to the United States." Vol.21, Cong. Rec., p. 534.

Senator Hiscock objected because this bill, if enacted, "may be invoked by the legislature of a State, not for that purpose, but for the purpose of protecting industries, the distillers, of their own State, the brewers of their own State, the wine-makers of their own State, against those of others, and who doubts it or denies it." Vol.21, Cong. Rec., p. 5090.

Senator Hoar concurred. He summarized the objection:

> "The senator says that he finds the vice in this bill that it will leave the States of the Union free to undertake to regulate or control the traffic in intoxicating liquors

for the purpose of protecting their own industries against the competition of other States or other nations." Vol. 21, Cong. Rec., pp. 5090-5091.

He then offered new language:

"…provided that such prohibition, regulation, control, or tax shall apply equally to all articles of the same character wherever produced." Ibid.

Ultimately, the language passed explicitly witheld approval from discriminating state laws. It is worth noting that the concern about discrimination was focussed on out-of-state "industries", the producers of alcoholic beverages.

As the Granholm opinions described, the Wilson Act was soon interpreted by the Supreme Court in such a way as to make it ineffective in shielding state law. The Court held that "upon arrival in the state" meant upon delivery to the consignee rather than upon crossing the state boundary. The Court did this ostensibly as an interpretation of Congressional intent, but Congress was understandably uncertain whether such interpretation might be Constitutionally compelled. That is: it was then understood – although this view has long been rejected – that Congress could not delegate its power to regulate interstate commerce and it was possible that the Court would interpret the Commerce Clause to define interstate commerce as Constitutionally ending only with delivery to the consignee.

Congress intermittently for several decades considered various proposals in an effort better to shield state regulation without doing so in a way which the Supreme

Court would find unconstitutional. This was, to repeat, a time when Constitutional jurisprudence was not yet clear that the scope of the dormant Commerce Clause – the extent to which Congress could shield state laws from it – was entirely at the discretion of Congress.

In 1912, what became the Webb-Kenyon Act was first considered by Congress. The original bill contained a second section:

> "Sec. 2. That all fermented distilled, or other intoxicating liquors, or liquids, transported into any State or Territory, or remaining therein, for use, consumption, sale or storage therein, shall, upon arrival within the boundaries of such State or Territory and before delivery to the consignee, be subject to the operation and effect of the laws of such State or Territory enacted in the exercise of its reserved police powers, to the same extent and in the same manner as if such liquids or liquors had been produced in such State or Territory, and shall not be exempt therefrom by reason of being introduced in original packages or otherwise." Vol. 49, Cong. Rec., p. 2687.

This section comprised the Wilson Act altered to make clear that "upon arrival" meant at the state boundary rather than to the consignee. It would, like the original Wilson Act, have withheld protection from state laws that discriminated against out-of-state products.

This entire section was eliminated from the Act as enacted. This was not because Congress favored discrimination, but because it was deemed inconsistent with the first section of the bill and because it was feared that the Supreme Court would

reject it. Congress wanted an effective and Constitutional law shielding state regulation more than it feared state discrimination against out-of-state products. There is no expression in the Congressional debates of a concern about possible discriminatory laws. There are repeated demands that state regulations be shielded from dormant Commerce Clause attacks.

The Webb-Kenyon Act was thus not a simple extension of the Wilson Act, but marked a very different approach to the problemof shielding state laws from dormant Commerce Clause challenges. This was set forth clearly by Senator Borah:

> "The prohibition which has been made in the preceeding section [the Webb-Kenyon Act as ultimately enacted] is, in a sense, abrogated in the second [the Wilson Act analogue], and liquor is recognized as an article of commerce. Recognizing it as an article of commerce, and one which may go into a state, then the question is, can you stop it and turn it over to the state before it is finally delivered to the consignee? In the first section you make it a contraband of commerce when it is being shipped for unlawful use. In the second you recognize it as an article of commerce, but turn it over to the state before it is delivered to the consignee. I do not think this aids the law in its efficiency, and I believe it is unconstitutional." Vol. 49, Cong. Rec., p. 702.

Senator Kenyon agreed:

> "The first section takes certain liquor out of commerce, and the second section seems to recognize it as being in. There is some incongruity in this." Vol.49, Cong. Rec., p. 830.

The Webb-Kenyon Act, as passed, was vetoed by President Taft because it would permit the states to reassert the authority they had exercised, "before they became States, to interfere with commerce between them and their neighbors." 49 Cong.Rec.4292. Attorney General Wickersham had informed Taft that the Supreme Court would hold the Act unconstitutional because Congress had not declared alcoholic beverages to be "an outlaw of commerce", but instead: "leaves to the varying legislation of the respective States to more or less endow [alcoholic beverages] with qualities of outlawry." 49 Cong.Rec. 4296.

Wickersham was wrong. Congress, of course, easily overrode the veto and the Supreme Court upheld the constitutionality of the Act in Clark Distilling.

Oliver Wendell Holmes was one of two Justices who dissented without opinion to that decision. He explained his reason to a correspondent: "…I dissented in that case, being of opinion that the statute should not be construed to simply substitute the state for Congress in control of interstate commerce in intoxicants – i.e. to permit a state to say although the purpose of the shipment (personal consumption) is one that we permit, we forbid the shipment in interstate commerce – the unlawfulness by state law thus consisting solely in the element of interstate commerce…. I thought the act did not mean more than to say that if on other grounds the shipment would be illegal but for want of power on the part of the state over interstate commerce, the fact of I.C. [interstate commerce] should not interfere. 1 Holmes-Laski Letters, M.Howe, ed. At 54.

III

Given all of this, it is surprising that the Granholm majority declared that the Webb-Kenyon Act was limited by the Wilson Act. Each Act sheltered state law if specific conditions were met. The conditions imposed were very different. Each Act also sheltered state law in very different ways. The Wilson Act redefined the physical terrain of interstate commerce. The Webb-Kenyon Act defined the circumstances in which some products were not entitled to be considered as legitimately in interstate commerce, whatever the physical terrain which the latter encompassed.

Upon Repeal, paragraph two of the Twenty-first Amendment was enacted in part to protect state regulation even if Congress were to repeal the Webb-Kenyon Act. For years, the Court then interpreted the Twenty-first Amendment to be broadly protective of state alcoholic beverage regulation, making superfluous any appeals to Congressional intent to shield it. In Granholm, however, a divided Court limited the scope of the Twenty-first Amendment and also of the Webb-Kenyon Act. The four dissenters, in an opinion by J. Thomas, focused on the Webb-Kenyon Act, possibly to encourage a Congressional response.

That the Granholm Court incorrectly interpreted the Webb-Kenyon Act by reading the Wilson Act into it is irrelevant. Congress must accept the Supreme Court's interpretation of the meaning of the Constitution. That is, it must accept the Supreme Court's interpretation of the effect of the Twenty-first Amendment on dormant Commerce Clause challenges. Congress is not bound by the Supreme Court's interpretation of what Congress meant in enacting the Webb-Kenyon Act.

Parenthetically, Congress is not bound by what it originally enacted in the Webb-Kenyon Act, either as interpreted by the majority or the dissent. In my view, H.R.5034 is actually imposing a stricter standard on state law entitled to immunity from dormant Commerce Clause challenge than was imposed in 1913 and again in 1935 in the Webb-Kenyon Act.

H.R.5034, if enacted into law, would reflect Congressional determination to accept the result in Granholm – that is, a similar case would be decided in the same way – although Congress need not so decide. H.R.5034 would declare that Congress does not wish to shield state laws whose intent is to discriminate against out-of-state producers in favor of in-state ones. Congress would permit dormant Commerce Clause challenges to laws facially or intentionally discriminating against producers. H.R.5034 also would reflect the intention of Congress to shield from challenge requirements that wholesalers and retailers be physically present in the state. H.R.5034 would recognize that such in-state physical presence requirements for wholesalers and retailers are crucial to effective enforcement of state laws designed to maintain a transparent and accountable system for the distribution and sale of alcoholic beverages and have been a critical feature of state law continuously since Repeal.

Congress is actually in H.R.5034 imposing under its Commerce Clause power the only plausible interpretation of the result in Granholm. Producer-level discrimination is rejected, yet the three-tier system, with mandated physical presence for the middle and bottom tier to effectuate a transparent, accountable, and stable system of distribution and sale, is protected. The Granholm dissenters did not think that this

distinction was logical. We must remember, however, that they believed that the physical presence requirement could also be imposed at the producer level.

Under H.R.5034, discrimination without regulatory justification in favor of in-state producers would not survive. However, the system by which states have regulated the distribution and sale of alcoholic beverages for over seventy-five years would. H.R.5034 does not flout decades of judicial decisions. It conforms to and respects the accumulated judicial and regulatory experience since Repeal. It reflects the fact that the physical presence requirement for wholesalers and retailers has been universally accepted since Repeal, unchallenged until very recently.

Removing protection from state laws which facially or intentionally discriminate against out-of-state producers does not permit clever, yet formally even-handed, laws to avoid challenge. If they were enacted only to discriminate, they are vulnerable. That most laws that differentiate s by size might survive challenge is not surprising. As Judge Easterbrook reminded us in Baude v. Heath, 538 F.3d 608 (7th Cir. 2008), the dormant Commerce Clause does not prohibit distinctions between big and small. Merely artful even-handedness whose purpose was to discriminate would not, however, survive. In a magisterial and persuasive article, "The Supreme Court and State Protectionism", 84 Mich.L.Rev. 1091(1986), Professor Regan has demonstrated that the Supreme Court has never used the dormant Commerce clause to overturn a state law purely because of perceived discriminatory effects. There has always been a concommitant finding either of facial or intentional discrimination.

It should now be clear why H.R.5034 also seeks to amend the Wilson Act. The Wilson Act should have been irrelevant. Since the Court in Granholm, however, used it to interpret the Webb-Kenyon Act, the Court might use it again when interpreting H.R.5034, since Congress, if it did not amend the Wilson Act, might be deemed to have tacitly consented to this. H.R.5034, however, attempts to be a comprehensive expression of Congressional intent with regard to the effect of the dormant Commerce Clause on state alcoholic beverage regulation. The expression of Congressional will is to be completely embodied in the language of the amendment to the Webb-Kenyon Act. Amending the Wilson Act assures that this be the case.

IV

It is useful to remember that state laws mandating physical presence for distributors and retailers, the core of what is the three-tier system, are still protected from dormant Commerce Clause challenge by the Twenty-first Amendment. The Granholm Court made this explicit with regard to a physical presence requirement for distributors, quoting with approval Justice Scalia's concurring words to this effect in North Dakota. This quotation immediately follows explicit approval for the North Dakota Court's statement that the three-tier system is "unquestionably legitimate." [At p.489].

Moreover, the holding of the North Dakota plurality presupposes the legitimacy of the three-tier system, with physical presence requirements for distributors and retailers. This is because the Supremacy Clause inquiry in North Dakota was whether the State was discriminating against the federal government because some other retailer – which is what the United States was for purposes of the litigation -- was better treated. The

plurality held that, as a retailer of intoxicating liquors, the federal government was no worse off that any other such retailer selling to consumers in North Dakota. This was because all other retailers had to buy from licensed in-state North Dakota wholesalers and the federal government had the option of doing so. Only because of this requirement could the plurality be assured that there was no retailer receiving better terms and conditions of sale than those available to the federal government if the federal government bought from licensed in-state wholesalers.

The possibility of sales by out-of-state retailers, operating under different rules than those of North Dakota, was not even considered by the Court, probably because out-of-state retailers were not part of the mandated three-tier system through which North Dakota funneled alcoholic beverages. At a minimum, North Dakota requires that any retailer buy from an in-state wholesaler. See North Dakota, 495 U.S. at 439, noting that the North Dakota "system applies to all liquor retailers in the state", and that "liquor retailers are required to buy from state licensed wholesalers".

Two Circuit Courts, the Second, in Arnold's Wine v. Boyle, 571 F.3d. 185 (2009), and the Fifth, in Wine Country Gift Baskets v. Steen, 612 F.3d 809 (2010), have since held that the Twenty-first Amendment, as interpreted by the Supreme Court in Granholm, does protect a physical presence requirement for retailers from dormant Commerce Clause challenge.

If lower tier physical presence requirements are Constitutionally compelled, why should Congress act? The answer is that the Granholm decision has encouraged some litigants to attempt further to erode the Twenty-first Amendment protections given to

states. Congress cannot alter judicial reinterpretation of the Twenty-first Amendment, but it can, under its Commerce Clause powers, draw the line it wishes and define the terms under which state alcoholic beverage regulation will be immune from dormant Commerce Clause challenge. The uncertainty that the Granholm decision has created has discouraged some states from defending what are valid and useful laws. Congress can end this uncertainty.

V

Statements have been made that H.R.5934 flies in the face of decades of dormant Commerce Clause jurisprudence. These are false. First, as Clark Distilling made clear, state alcoholic beverage regulation and Congressional efforts to support it constitute a special category. The Court concluded its opinion:

> "The fact that regulations of liquor have been upheld in numberless instances which would have been repugnant to the great guarantees of the Constitution but for the enlarged right possessed by government to regulate liquor, has never, that we are aware of, been taken as affording the basis for the thought that government might exert an enlarged power as to subjects to which, under the constitutional guarantees, such enlarged power could not be applied. In other words, the exceptional nature of the subject here regulated is the basis upon which the exceptional power exerted must rest and affords no ground for any fear that such power may be constitutionally extended to things which it may not, consistently with the guarantees of the Constitution, embrace."

Second, there is no one yardstick by which to measure the scope of the dormant Commerce Clause. The Supreme Court concedes this. In the so-called canonical expression of dormant Commerce Clause doctrine, in Brown-Forman v. N.Y.S. Liquor Authority, 476 US 573, 578-79 (1986), the Court immediately concedes that it has proved impossible to apply the doctrine consistently and confidently. This is not a bad thing. The Court has, in effect, wisely refrained from treating the dormant Commerce Clause as one-dimensional. The Court has looked to many factors when it finds that no discrimination has been demonstrated and that state law should therefore be upheld. In Exxon v. Maryland, vertically integrated out-of-state sellers challenged a prohibition against petroleum producers or refiners operating service stations within the state. They argued that this ban discriminated against them in favor of in-state retailers. The Court rejected the claim, declaring that the dormant Commerce Clause protected interstate commerce, not the business strategies of particular out-of-state sellers. In General Motors v. Tracy, 519 U.S. 278 (1997), the challenger asserted that Ohio's taxation of natural gas companies violated the dormant Commerce Clause. All sellers of natural gas, whether in-state or out-of-state, were taxed unless they met the definition of a "natural gas company". Only Ohio-regulated utilities called "local distribution companies" [LDCs] did so. The Court first warned against facile predictions as to whether overall benefits and burdens favored in-state or out-of-state entities.

The Court then held the LDC's to be different from out-of-state sellers, thus negating the intentional discrimination dormant Commerce Clause claim. It did this because failing to do so "could subject LDC's to economic pressure that in turn could threaten the preservation of an adequate customer base to support continued provision

of bundled services to the captive market. The conclusion counsels against taking the step of treating the bundled gas seller like any other, with the consequent necessity of uniform taxation of all gas sales." At 309

The Court thus distinguished in-state sellers in a highly regulated market from unregulated, out-of-state sellers serving only large Ohio customers. It did so because a contrary finding would endanger the state's effort to assure adequate provision of natural gas to all customers. Such reasoning would likewise support distinguishing regulated physically present in-state wholesalers and retailers from unregulated out-of-state ones

In Kentucky v. Davis, 533 U.S. 328, the Court rejected a dormant Commerce Clause challenge to a state tax exemption only for its own bonds. The Court rejected the claim, feeling "apprehension" about indulging in "unprecedented … interference" [the Court redacting its own language in United Haulers] with "a traditional government function." [At p.342]. Physical presence requirements for wholesalers and retailers have long and widely been used. They have not been the object of debate in the past and have only recently been challenged.

VI

H.R. 5034 is congruent with the views of the Granholm majority. The minority thought Congress had also protected physical presence requirements at the producer level. All members of the Court thought that physical presence requirements for distributors and retailers are Constitutionally protected. It is also congruent with the views of the dormant Commerce Clause offered in other cases in which the Supreme

Court has shown a reluctance to intrude into areas traditionally or extensively regulated by the states.

In conclusion, H.R.5034 helps sustain an effective system for the regulation and sale of alcoholic beverages. It is the prerogative of Congress to do this. Congress has acted previously to support state alcoholic beverage regulation. It should do so again.

Thank you for your consideration.