2017 HOUSE INDUSTRY, BUSINESS, AND LABOR

HB 1145

2017 HOUSE STANDING COMMITTEE MINUTES

Industry, Business and Labor Committee
Peace Garden Room, State Capitol

HB 1145
1/10/2017
Job #26761

☐ Subcommittee
☐ Conference Committee

Committee Clerk Signature Le Mae Kuch

Explanation or reason for introduction of bill/resolution:

Financial interest between alcohol retailers & manufacturers.

Minutes: Attachments #1-3

Chairman Keiser: Opens the hearing of HB 1145.

Rep Becker: Introduced HB 1145 with a brief overview about the three-tier system for regulation of alcohol sales in North Dakota.

The three tiers are:
1. Manufacturer such as a winery or brewery or distillery
2. Distributor also referred to as the wholesaler
3. Retailer which could be a bar, restaurant, or liquor store

This formation took place sometime post prohibition.

If a person has a bar, restaurant, or liquor store they cannot own a wholesaler or distributor. They also cannot have any kind of ownership interest in a manufacturer. This bill would allow them to do it.

(4:30)
The opposition presumes that if we open it up, we can have ownership in the first and third tier. You would be allowed to sell directly. There is nothing in this bill that allows for that. If you believe in this three-tier system, that middle tier is what protects the flow and protects the consumer. An example, if it is George's Bar and George's Distillery, the distillery would have to sell to a distributor who would then sell to George's bar.

(7:00) Refers to Attachment #1

Rep Kasper: This allows ownership change of the entities in the three-tier system but does not provide for distribution change in the three-tier system.

Rep Becker: Correct.

Rep Laning: How are the microbreweries handling it? They sell on site.

Rep Becker: If you own a distillery, you can open a restaurant on the site of your distillery and sell your spirits at that restaurant. The same is for a winery. When it comes to breweries, there is the taproom license.

Rep Laning: This bill only affects the person who wants to invest in a brewery and possibly wants to own a restaurant. It doesn't change the three-tier distribution method just the ownership ability?

Rep Becker: Correct

Rep Ruby: Would this allow that if you had the retail outlet, you could sell someone else's product?

Rep Becker: Yes.

(11:15)

Michael Seifert~President of the Aurora Borealis Dakota: I've been a CPA in North Dakota for about 25 years. I'm in support of HB 1145. The business I am representing has 80 employees in Bismarck at a retail location with a full liquor license. The next generation is eager to manufacture beer. The law doesn't change other than being able to broaden the scope of investment and grow more manufacturing jobs. The one part of the three-tier system that I don't agree with is, it is an arbitrary driver because the theory of the law was intended to mitigate people. A large company can't control the entire food chain.

Opposition:

(17:10)

Janet Seaworth~Executive Secretary and Legal Counsel for the ND Beer Distributors Association (NDBDA): (Attachment 2).

(31:15)

Rep Becker: You do agree that a manufacturer must sell their product through a distributor to the retailer even if they themselves are the retailer?

Janet Seaworth: If the administrative regulations stay on the books, that would be the case. However, administrative regulations are promulgated pursuant to statute. If the statutes change, I have no confidence that an administrative regulation that would require a retailer to buy from a wholesaler and a wholesaler to buy from a manufacturer would remain.

Rep Becker: Anything can change, none of the manufacturers can sell their product for resale. The laws would also have to change. It is not this law that you are fearful of, it is additional laws that may come to pass?

Janet Seaworth: No, we are very concerned about HB1145 and the lack of independence that wholesalers will have. There won't be independent distributors. A manufacturer can put undue pressure on a distributor to say these are the products that you are going to sell. I don't know how long a distributor could survive if they are not able to carry competitors' products. The issue is the tied house and the ultimate demise of independence within the system.

Rep Becker: You have affirmed that if this bill were to become law, the manufacturers would have to sell to the distributors who would then sell to the retailers even if the retailer has a financial interest in the manufacturer. If this law passes, do you agree with that?

Janet Seaworth: Until the lawsuit is filed, there is a U.S. Supreme Court decision called Granholm v. Heald. In our state we allow small brewers to sell at retail. We allow brew pubs to sell at retail. We allow brew pubs to hold a retail license. We don't allow large brewers to hold a retail license. There would be a concern if we made any changes.

Rep Becker: Do you agree that if this bill becomes law, the way the law would be stated, a manufacturer must sell their product to a distributor who would sell to a retailer even if there is co-ownership between the manufacturer and retailer?

Janet Seaworth: Yes, as the law currently states.

Rep Becker: Do you acknowledge that currently in law, if HB 1145 became law, that the existing law would continue to prevent the manufacturers from selling their product for resale. Therefore, they have to go through a distributor. Do you acknowledge that law currently exists and continues to exist after HB 1145 become law?

Janet Seaworth: No, the wholesaler would not be involved. That question would need to be resolved. If the manufacturer owns that distillery, winery, or retail license that a microbrew pub has, aren't they in fact the retailer?

(38:50)
Rep Becker: They would not be the retailer because you have two entities. It would need a distributor. You indicate that a great deal of pressure would be applied to distributors to do what the manufacturers want. There are 504-04-02 and 504-12, inducement or coercion prohibited and discrimination prohibited. Laws are in the books that will prevent exactly what you are saying will happen.

Janet Seaworth: Yes, that is true because that is part of the regulatory system. Those are part of prohibiting trade practice problems that result in an unlawful influence. With the bill you are allowing that influence.

(41:13)
Rep Becker: I am struggling as I guess we are not on the same wavelength.

Janet Seaworth: I think the disconnect is that it is not about whether you are the distributor or it is not about the independence of the tiers. If you allow a supplier to own a retailer, you have collapsed the three-tier system.

Rep Louser: If a retailer wants to own a taproom they can. Are you referring to that retailer being the taproom owner or a different retail establishment?

Janet Seaworth: Our current law provides for two exceptions to the three-tier system. That would be for brew pubs which are really retailers but they have the special privilege of brewing their own product. There is nothing in the law which limits the number of brewpubs someone could own. I don't know that would be the best to do because your liability would be so huge. We also have exceptions for small brewers to have taprooms. They may also have multiple locations.

(43:50)

Rep Ruby: Can a tap room have a restaurant?

Janet Seaworth: I believe so. I would have to check.

Rep Ruby: Could they have families eat there?

Janet Seaworth: I'm not certain.

Rep Ruby: Can they offer another company's product?

Janet Seaworth: Only their own product.

Rep Ruby: A change like this would allow someone with a restaurant with multiple products to bring their own in as well.

Janet Seaworth: I would assume. There are no limits. It is not only your local folks, it is multinational.

Rep Ruby: The supreme court has looked at the three-tier system. The system is constitutional. Is it true that it is not a not a federal requirement? That is why we have our state laws. States could completely go away from the three-tier rule if they wanted.

Janet Seaworth: That is correct. The regulation of alcoholic beverages is left to the state under the 21st amendment.

(46:40)

Randy Christianson~President-Beverage Wholesalers, Inc: (Attachment 3)

Allowing a manufacturer to own a retail takes us back to pre-prohibition of the tied-house provisions. Beer shipments for 2015 had the top two supplies to the state control 84% of the market. The top five controlled 90.7%.

An unintended consequence of this is it is going to go to the small domestic North Dakota run and owned breweries. If you are in a franchise retail establishment that could end up being owned by a brewer whose products will be put on tap.

Tied-house is a federal rule that went into place to help to help prevent the abuses that happened prior to prohibition of selling alcohol in the U.S.

I've included a reference code federal regulations Title 27, part 6 & 8 which outlines Tied-House (a manufacturer owning a retailer) and some of the abuses that can take place and regulations prohibiting against exclusive outlets.

Also included (on page 12 of Attachment 3) is the path of imported alcohol into the U.S. We have only talked about domestic breweries or distilleries or wineries. If I was a small craft distiller in North Dakota, I would be very concerned about this. There are significant unintended consequences that could happen. The commerce clause doesn't protect an independent second tier. We went from a few hundred brewers in the U.S. 15 years ago to over 4500 today. That is because of the independent tier of the distributor. If alcohol is imported into the U.S., it has to go to the Food and Drug Administration and the Trade & Tax Bureau of the Treasury Department. The labels have to be approved. They have to be registered. There has to be warning and other information on the label. Sometimes retailers get frustrated because they can't get a particular liquor or beer. The reason may be the label isn't registered to be shipped into those states.

The retailers are not required to be registered for food facilities under the public health Security and Bioterrorism Preparedness Response Act of 2002. Any food facility like a distributor in the state is required to do that. They are also subject to inspections by the Food and Drug Administration.

Beverage Wholesalers is a North Dakota licensed distributor for both malt beverage and wine and spirits. They are also required to have a federal basic permit. We currently have 981 storekeeping units in stock vs. 250 ten years ago. We also represent 43 suppliers. Inventories that we maintain range anywhere from 1.7 to over 3 million dollars.

Rep Becker: If HB 1145 becomes law, how would we be affected with regard to federal regulations as well as the safety concerns?

(55:00)
Randy Christianson: My personal opinion, there would be a significant impact. You have 4500 breweries, 6,000 wineries, how do you trace back any problems.

Bob Nelson~President of Johnson Brothers Distributors: We collect $3 million in excise taxes. We carry over 5,000 items. We serve over 1200 customers in North Dakota. I agree with Janet and Randy that this is a bill that carries unintended consequences. The understanding of Granholm and the commerce clause and how other business look at this will tear apart the three-tier system. The only thing stable over the years has been the three-tier system. It is a fair and ethical playing field with strict rules monitored at each tier by a different level of the government. If a major brewer or distillery owned pubs like in Europe, those pubs only carry their brands. Those pubs are known for predatory pricing that put people out of business. When the three-tier system goes out of balance and someone gets weaker, that is when problems arise. They sell underneath the market and it causes all kinds of problems.

(59:40)
Rep Ruby: There was a lot of discussion about the large companies and market takeover. Why do the top two companies have almost 84% of the market?

Bob Nelson: I think its marketing and the consumer. The big breweries market share is declining.

Rep Ruby: Why do you think this bill would change that if it is the consumer that is making the choice of different products.

Bob Nelson: That is the way it should be. The consumer should make the choice.

Rep Kasper: The unintended consequences, what about a company like Budweiser could do to disrupt the market in North Dakota by coming in and opening up retail establishments. Because of their size they could change the market and pricing and drive competitors out of business and then end up controlling the market. Is that the concern?

Bob Nelson: Yes, that is the biggest concern. It can also be done on a micro scale. There are powerful players in the retail industry. Our industry at the wholesale tier services every account in North Dakota. We go to every bar, etc. We go to towns where the mail truck doesn't go.

Rep Kasper: The big players could drive out the smaller establishments with their ability to control the market. Are those the unintended consequences?

Bob Nelson: Yes that poses a serious threat to the middle tier because we become less necessary to service the entire market.

Rep Becker: As it stands now, a bar owner can choose to sell only two brands. I can set my own price.?

Bob Nelson: That is correct, but there are some predatory pricing laws in the North Dakota commercial code.

Rep Becker: If I did that, I would probably go out of business because I am only selling two brands. How is that model different from if a large player came in and was only going to sell two products? Isn't it left to the consumer to decide?

Bob Nelson: The question would be if the manufacturer owned the retailer. Perhaps the manufacturer knows that he can sell at a loss for a long time to destroy the market and then monopolize the market. That happens to a lot of industries in America.

Shannon McQuad-Ely~McQuad Distributing: I want to reiterate the statement of the previous testifiers. The three-tier system works. I don't trust the larger suppliers who have been looking for this. Some are looking to skirt the three-tier system. It is important in tax collection in making sure the product quality is good. Walmart is looking to make its own beer. There has to be a way to use the law the way it currently stands to provide for entrepreneurship.

Rep Ruby: Do you think people like variety? Would they go to an establishment and all want the same beer?

Shannon McQuad-Ely: It is happening now. That is why I go to a brew pub.

Rep Dobervich: How does Walmart fit in with this bill? Within COSTCO there is a liquor store where their store brand is sold.

Shannon McQuad-Ely: They are using a manufacturer that puts their label on it. Walmart could come in with their own brewery and ship only to their retail establishments

(1:13:50)
Rep Becker: COSTCO has a contract brewer. So they can strike a good deal with the contract brewer. Their incentives are no different than if they owned the brewery. All of the concerns about monopoly, how would those be different when we are looking at COSTCO having a contract brewer and having a huge bottom line. That underscores what I have been saying. Walmart can sell Walmart beer. That doesn't mean people are going to buy it.

Shannon McQuad-Ely: A contract brewer brews more than just that manufacturer's beer. If they were to own that brewery then I have to go to the Walmart- owned brewery and strike a contract with them as a wholesaler, they give me the provisions under which I am to sell their brands. I in turn sell the product. I as a wholesaler have to sell to everyone. They could run us out of product. The contract situation is different because they are not making their own beer.

(1:16:57)
Dan Sobolik~Vice President for Republic National Distributing Company: We are a wine and spirit wholesaler based in Fargo. We have been in business in North Dakota for over 100 years. I'm in support with the testifiers that are against this bill. My concern is the collection of taxes. If suppliers are able to ship direct to retailers, the tax will have to track all of those so the state does collect the excise tax due on the products.

Rep Ruby: Aren't there Federal laws that report quantities and taxing.

Dan Sobolik: There are state & federal excise taxes.

(1:18:56)
Tom Kelsch~Representing the Anheiser Bush Company: We do not support this bill. We are a supporter of the three-tier system.

Chairman Keiser: I would like someone from the tax department to talk about the collection of tax and if this bill would present difficulty.

(1:20:07)
Blane Braunberger~Compliance Supervisor, State Tax Dept: The tax in question is a wholesale business privilege tax. They report to us monthly. The supplier of the alcohol is also required to report monthly. Then we can do a reconciliation to determine if the state is getting all the revenue that is due. Currently we are getting a little over $9 million per biennium in the wholesale alcohol beverage tax.

Rep Becker: Does this bill affect how the tax is collect, the risks of fraud, and are there any concerns that the department has if this bill becomes law?

Blane Braunberger: We would share some concerns of unintended consequences if larger companies do come in and take ownership interests. As far as the collection of the tax, the wholesaler would still be the responsible payer of the tax.

Rep Becker: When you refer to "unintended consequences", they are not unintended consequences of the bill but are referencing a slippery slope scenario. How would this bill cause concern in the tax department?

Blane Braunberger: There is potential that we wouldn't have the ability in the future to have the reconciliation because you would be bypassing the wholesaler.

Rep Becker: You are falling into the argument of dismantling the three-tier system. We have established that this bill does not do that. If this bill passes as it is, are there concerns.

Blane Braunberger: I would say no tax implication.

Chairman Keiser: Closed the hearing

Rep Becker: Moved Do Pass.

Rep Ruby: Seconded the motion.

A Roll Call vote was taken: Yes 5, No 9, Absent 0.

Do Pass fails.

Rep Sukut: Moved Do Not Pass

Rep Laning: Seconded the motion

A Roll Call vote was taken: Yes 11, No 3, Absent 0.

Do Not Pass carries.

Representative Sukut will carry the bill.

2017 HOUSE STANDING COMMITTEE MINUTES

Industry, Business and Labor Committee
Peace Garden Room, State Capitol

HB 1145
1/11/2017
26772

☐ Subcommittee
☐ Conference Committee

Ellen LeTang

Explanation or reason for introduction of bill/resolution:

Financial interest between alcohol retailers & manufacturers

Minutes: Attachment #1

Chairman Keiser: Opens the hearing of HB 1145.

Rep Boschee: Moves to reconsider HB 1145

Rep Beadle: Seconded the motion

Chairman Keiser: Could you share with us the purpose for reconsideration.

Rep Boschee: I understand there was discussion after we voted and there is an amendment made to take away the fear of bigger organizations coming in and taking over.

Rep Becker: The reason I'm hoping that you will retain a reconsideration is that we can handle this very quickly with a short amendment.

Roll call was taken on HB 1145 for reconsideration, with 14 yes, 0 no, 0 absent, motion carried.

Rep Becker: (Attachment 1) Christmas tree bill.

Chairman Keiser: Clarification, we are going to take out the overstrike for the brewpub. Is that the proposal?

Rep Becker: Yes

Chairman Keiser: Why do we need to remove the overstrike?

Rep Becker: I don't think the overstrike is necessary anymore.

Rep Louser: Yesterday, I heard in testimony opposing this that a taproom is not a retailer but I also heard that a retailer wants to own a taproom, now they can. Afterwards, I was speaking to some people, I don't know if I understand microbrew pub versus taproom, who can own what, what's considered a retailer, when they are or are not a retailer. Can somebody explain that?

Rep Boschee: The taproom was created first for breweries to start up. Then in 2015, the brewpub, was added to allow a 2nd location or multiple locations to sell but through a wholesaler. It provided different privileges where the taproom can only sell on premise to themselves to the clients there. The state has different licensing requirements that if you want additional licenses with that, you also have to provide food or a restaurant.

Rep Becker: Page 1, lines 8-12 were odd in the way it's structured. You have the three tiers and the way it goes back & forth. It you look at line 8, the manufacturer may not have any financial interest in any wholesale business. That tie is cut; you don't need language that the wholesaler can't have any interest in the manufacturer. So, that tie is cut. Then on line 9, the manufacturer or wholesaler may not have any financial interest in retail. We have now cut the tie between the 1st & 2nd tier, we have cut the tie between 2nd & 3rd. That's all you need there. Continuing, line 11, a retailer may not have any financial interest in any manufacturer not domiciled in this state. Now, the line that would connect the 1st & 3rd tier, is cut except for the carve out where they are both domiciled. I redlined the wholesaler because that is repetitive from line 9. Down to page 2, line 13, I put the language back the way it currently exists in law and added a subsection 7.

You asked why to strike the language on lines 5-8, had Legislative Council been open at 6:00, I would have gone there. I can ask them which is better if this is something we are going to entertain.

Chairman Keiser: If we are going to entertain it, we want to get it right. We will have time this afternoon and ask Legislative Council whether or not that's an issue.

2017 HOUSE STANDING COMMITTEE MINUTES

Industry, Business and Labor Committee
Peace Garden Room, State Capitol

HB 1145
1/11/2017
Job #26806

☐ Subcommittee
☐ Conference Committee

Committee Clerk Signature Pe Mae Kuch

Explanation or reason for introduction of bill/resolution:

Financial interest between alcohol retailers & manufacturers

Minutes: Attachment #1

Chairman Keiser: Opens the hearing of HB 1145 continuing after reconsideration.

Rep Becker: Handout new amendment. (Attachment 1).

When the bill was discussed yesterday, many concerns were presented. Most of the concerns dealt with "what ifs" regarding other areas of law. I agree that the bill as written would allow big business to open in North Dakota. Because I believe that was the reason for some of the "no" votes on the committee I thought an amendment would help.

Replace lines 11 & 12 with the language on the amendment. This would alleviate the concerns of big business.

To address the amounts on the amendment:
The amounts for a microbrew pub export is 310,000 gallons. A winery export limit is 25,000 gallons. A distillery export limit is 25,000 gallons. Tap room production is 775,000 gallons which is 25,000 barrels. We have to consider beer and wine and spirits separately because the production is different. Anheuser-Busch produces 3.9 billion gallons of beer. What is best for North Dakota. We know a tap room can do up to 775,000. Surly Brewing Co. in Minnesota has doubled their production in two years. Last year they were at 1.5 million gallons of annual output. Bell's Brewery is at 15.5 million gallons of production per year.

In deciding the numbers, I chose between the Surly to Bell's range in gallons. This would block the big competitors that would be a problem. It can't be above these production levels. The production levels also pertain to any affiliation of the big companies.

The second part referenced this morning to keep the stricken language on page 2, lines 5-8, should be left as is.

The amendment for the brewpubs is probably not needed because a brewpub can only do 750,000. To put in a limit of 775,000 gallons isn't necessary.

Janet Seaworth~Legal Counsel North Dakota Beer Distributors Association: I have not had any opportunity to evaluate the amendment. Our understanding was that there would be an amendment to allow just retailers to have an interest. We cannot discriminate between what we allow instate entities to do and what we allow for out-of-state entities. Otherwise there will be a commerce clause violation and would be subject to litigation.

Chairman Keiser: This new language doesn't involve Granholm?

Janet Seaworth: When putting a cap on, is the cap legitimate? We don't allow out-of-state brewers to hold a retail license so that presents an issue. We put a cap on the amount of alcohol a brewpub can manufacture in North Dakota. The intent is that they are small and we can regulate them. The circuit courts are split on whether a cap saves it and makes it constitutional.

Rep Louser: Were the distributors supportive of the taproom legislation?

Janet Seaworth: We were in support of that. We were involved in the drafting to avoid commerce clause problems.

Chairman Keiser: We have a new concept. I will give you time to look over the amendment.

Pat Ward~Representing the Wholesale Liquor Distributors: The amendment we first saw caused us real concerns because it violates the Granholm decision. Volume caps have been litigated too because they are usually designed to protect the local small businesses.

(18:30)
Reads a paragraph from the Granholm decision.

If the legislature passes a law like this, you are subjecting yourself to a constitutional challenge.

(19:50)
Rep Ruby: Aren't the caps actually less burdensome to out-of-state entities? If we had smaller caps it would be less burdensome and less of a conflict?

Pat Ward: Yes, I do agree with you. I think there have been constitutional challenges to volume caps.

Rep Ruby: Your clients will not want any movement in the direction that this bill goes.

Pat Ward: We are comfortable with the way things are.

Rep Becker: When you say there are constitutional concerns and the courts are split, I would appreciate seeing specific cases when you come back. I would want to talk about only volume caps.

Chairman Keiser: We will take up the issue again next week.

2017 HOUSE STANDING COMMITTEE MINUTES

Industry, Business and Labor Committee
Peace Garden Room, State Capitol

HB 1145—Committee Work
1/18/2017
Job #27094

☐ Subcommittee
☐ Conference Committee

Committee Clerk Signature Rae Mae Kuehn

Explanation or reason for introduction of bill/resolution:

Financial interest between alcohol retailers & manufacturers.

Minutes: Attachments 1, 2, 3

Chairman Keiser: Opens the hearing of HB 1145.

Rep Becker: (**Attachment 1**)
This is the bill that allows the first tier to have co-ownership interest in the third tier and vice versa leaving the three-tier system in place because nothing can go from the first tier to third tier without going through the second tier but it does allow the same interest ownership. The concern was that it dismantles the three-tier system. We showed that it doesn't. This was brought back for reconsideration. The concern we are left with is that as the bill was written, the large box stores could come in and if they owned a retail outlet they could somehow squeeze out the distributors. This amendment addresses that the big players with so much power can't come in and do this and squeeze out the distributors. There are two ways to look at it. One was to refer to domicile so it is only North Dakota players that come in. The other was volume caps. The domicile aspect would not have held up because of the interstate commerce clause. So I went with volume caps. There remains a question of constitutionality based on court cases. Mr. Ward had indicated Granholm as a precedent for the concern with commerce. But Granholm didn't pertain to volume caps. Mr. Ward has Family Winemakers of California vs. Jenkins. (**Attachment 2**) I don't think this is a court case which would apply to what we are doing here. The Family Winemakers deals with the aspect of a cap if you are going to bypass the three-tier system.

I added two cases which have two counter examples to Mr. Ward's example.
(**Attachment 3**) The court concluded that the production limit didn't have the practical effect of favoring the state economic interest and did not violate commerce.

Rep Laning: This in no way spills over into the three-tier? Are we dealing just with investment only?

Rep Becker: That is correct. The constituent that brought this to my attention, owns a pizza place and would like to own a brewery. If the brewery becomes successful that he could sell it at the pizza place, he would have to sell it to a distributor who would then resell it.

Rep Beadle: If you are purchasing stock in a supplier like Budweiser, does that go against the financial interest that you would have as a retailer?

Rep Becker: Probably, accordingly to the letter of the law, it's true.

Opposition to bill and amendment:

Pat Ward~Represents the Wholesale Liquor Distributors: The Granholm case is a U.S. Supreme Court Decision. That decision in 2005 talked about the Dormant Commerce Clause with restraints on trade and specifically legislative attempts to favor local businesses over out-of-state businesses.

The conflict in the Circuits that Rep. Becker is talking about is between the Black Star Farms case and a First Circuit case from Massachusetts called Family Winemakers. The Family Winemakers case is a volume cap case. The cap was 30,000 gallons of wine. **(Attachment 2)** The court said it was discriminatory because all the wineries in-state were below that cap and the ones out-of-state were above the cap.

There could be a constitution challenge to this statute. Another problem with this bill is that it addresses the situation of the manufacturer owning a retailer or a retailer owing a manufacturer but I don't think it prevents the big retailer from coming in.

Chairman Keiser: Then all of the carve outs that we created are in violation.

Pat Ward: I think some are. Yes, they could be challenged.

Rep Becker: Do you agree that the Family Winemakers case with its cap pertains to a means by which you can circumvent the three-tier system. It allowed the manufacturer to ship directly to the retailer and it had the constraints of the volume caps. Is that true?

Pat Ward: Yes. One of the components is that it did allow shipments to retail as well as to private purchasers. I think it was invalidated because of the cap.

Rep Becker: In testimony you said you supported the carve outs.

Pat Ward: I don't think I said I supported it.

Rep Ruby: You didn't support it.

Rep Louser: If this bill were to not pass and the child of your constituent wants to open a brewery, when the father passes away, he would not be able to leave his restaurant to his son.

Pat Ward: I would have to do research on that. There are ways to reposition for inheritance.

Janet Seaworth~Executive Secretary and Legal Counsel for the ND Beer Distributors Association (NDBDA): The amendment would still allow a manufacturer to have a direct interest in a retailer because it doesn't address the overstrike on line 9. Although the bill is amended to allow a retailer to have an interest in a manufacturer that doesn't manufacture in excess of the 5 million gallons of beer, that would allow Wal-Mart to own every brewery in this country except for about 20 or 21. There are 4,000 producing breweries in this country.

Also, the amendment was trying to avoid discriminatory language but you could have a commerce clause violation under Granholm in several ways. One is if the language says only "in state." There can also be a violation if the effect is discriminatory. That is our concern here. If this bill is challenged, what would be the remedy? Courts have two remedies when they find discrimination. They can either extend the exception or they would nullify the exception which means nobody will get to. A volume cap will not save you. In Illinois in 2010 the court chose the nullification remedy. Then the in-state brewers lost their privilege to distribute in the state. This litigation is very expensive. It is about a four or five figure fee. When the state loses, the state pays.

Rep Becker: On page 1, line 9, that is not in the amendment. Taking that off I'm not sure of the specific concern. That is the essence of the bill.

Janet Seaworth: If you don't remove the overstrike for "manufacturer" on line 9, then you are allowing a manufacturer to have an interest in a retailer. The thought was to limit it to in-state retailers having an interest in a manufacturer but that is not what these amendments do. Current law says that a manufacturer may not have a financial interest in any retail. The bill removes that and would allow a manufacturer. The amendments don't address that.

Rep Becker: The other concern is of Walmart owning many breweries. In the amendments, it's one total aggregate. They could own any number of manufacturing facilities as long as the sum production total of all facilities if under the cap.

Janet Seaworth: The way I read the amendment, the retailer may own a manufacturer. It is all the affiliates of that manufacturer that would be added up to the 5 million but there are 4,000 different breweries in this country.

Chairman Keiser: We could put in the aggregate. A company could own five separate manufacturers, separate corporations. Each manufacturer could produce up to the limit.

Rep Becker: My assumption was when it said "the combined amount." That's fine if it is the situation.

Janet Seaworth: The distributors have supported the growth of the craft industry. We want to agree on how to do that without violating existing law.

Rep Becker: Do you support the statutes for the carve outs of the distilleries, wineries, and breweries?

Janet Seaworth: I believe I have answered the question. We support the amendments and carve outs that we came to agreement to.

Rep Becker: When someone uses the fear of court cases as a means to say vote "no", did you testify when you were up supporting these other bills? Did you express that concern for those bills as well?

Janet Seaworth: Yes, we always have. Since Granholm came down, it is very clear that you cannot discriminate against out of state entities to the benefit of in-state. My job is to educate. It is not to strike fear into legislators.

Chairman Keiser: How did we come up with these numbers for the production of alcohol?

Rep Becker: I looked at something reasonable that was so far under the production of the types of entities that opposition had concerns about but yet above a simple mom and pop shop. What we are striving to do is to allow North Dakota entrepreneurs to be successful.

Chairman Keiser: Janet can you comment of the volumes.

Janet Seaworth: I can comment of the beer volume. When a court would look at this they will say, "What is the volume of manufacturers in North Dakota?" Our biggest brewer in North Dakota is Fargo Brewing Company. In 2015 they brewed 6,054 barrels. That is roughly 187,000 gallons. You can see the discrepancy to have a cap at five million gallons.

Rep Becker: I believe our tap house carve out is 750,000 gallons. It wouldn't make sense to have something at a level that we have a carve out that you can retail at your own facility. It would make sense that your carve out would be above because it is actually more restrictive. You can't bypass the distributors.

Rep Dobervich: Do producers of beer, liquor, and wine pay a price to the distributors to distribute or do the distributors purchase the beer from them?

Janet Seaworth: The distributors buy the product from the manufacturer. When it is an especially popular craft brand, we are seeing a movement to have distributors pay for the privilege of distributing the product.

(36:14)
Rep Dobervich: If a family is making the beer and owns the restaurant, the brewery would need to be in a separate name/owner from the restaurant. Then they could circumvent this and get the beer to their restaurant without violating the tier system. Correct?

Janet Seaworth: Yes, there are ways to do it. We allow it now. They are called brew pubs. The only thing keeping someone from owning a brewery and a retailer separately is their unwillingness to use a distributor. You would be limited in gallons. You can brew and hold a retail license.

Pat Ward: The 250,000 gallons of wine is the equivalent of 105,000 cases of wine. The

5 million gallons of beer is the equivalent of 2.2 million cases of beer. The limits for distilleries and wineries are 25,000 gallons production per year.

Rep Becker: The 25,000 is not for production The taprooms have a 750,000-gallon limit. The other is for shipment or self distribution.

Chairman Keiser: Closed the hearing.

Rep Ruby: Moved the amendment 17.0285.01001

Rep Bosch: Seconded the motion

Voice Vote taken. Motion carried.

Rep. Becker: If this bill could be better because of this "aggregate."

Chairman Keiser: We should go to legislative council and get it written.
We will add the "aggregate" language to it.

Rep Becker: Moved to further amend

Rep Bosch: Seconded it.

Voice Vote taken. Motion carried

Rep Becker: Moved to further amend. Change the 5 million gallons to 3 million gallons. It would be the same ratio as it is with our carve outs.

Chairman Keiser: To clarify, the only change would be on the beer from 5 to 3 million gallons.

Rep Louser: Seconded the motion

Voice Vote taken. Motion carried.

Rep Becker: Moved Do Pass as amended.

Rep C. Johnson: Seconded the motion.

Roll Call vote was taken: Yes 8, No 6, Absent 0.

Do Pass as amended carries.

Representative Louser will carry the bill.

17.0285.01001
Title.

Prepared by the Legislative Council staff for
Representative Rick C. Becker
January 17, 2017

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1145

Page 1, line 11, remove the overstrike over "~~manufacturer~~"

Page 1, line 11, after "~~or~~" insert "producing in excess of two hundred fifty thousand gallons [946353 liters] of wine or distilled spirits or five million gallons [18927059 liters] of beer annually or any"

Page 1, line 11, after the period insert "The production limits in this section pertain to the combined amount of production produced by all affiliates of the manufacturer or manufacturer ownership whether the affiliation is corporate or by management, direction, or control."

Renumber accordingly

1/19/17 DP

17.0285.01002
Title.02000

Adopted by the Industry, Business and Labor Committee

January 19, 2017

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1145

Page 1, line 11, remove the overstrike over "~~manufacturer~~"

Page 1, line 11, after "~~or~~" insert "producing in excess of two hundred fifty thousand gallons [946353 liters] of wine or distilled spirits or three million gallons [11356235 liters] of beer annually or any"

Page 1, line 11, after the period insert "The production limits in this section pertain to the combined amount of production in the aggregate produced by all affiliates of the manufacturer or manufacturer ownership whether the affiliation is corporate or by management, direction, or control."

Renumber accordingly

Date: 1/10/2017

Roll Call Vote #: 1

2017 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. HB 1145

House Industry, Business and Labor **Committee**

☐ **Subcommittee**

Amendment LC# or Description:

Recommendation
☐ Adopt Amendment
☒ Do Pass ☐ Do Not Pass ☐ Without Committee Recommendation
☐ As Amended ☐ Rerefer to Appropriations
☐ Place on Consent Calendar

Other Actions ☐ Reconsider ☐

Motion Made By Rep Becker **Seconded By** Rep. Ruby

Representatives	Yes	No	Representatives	Yes	No
Chairman Keiser		X	Rep Laning		X
Vice Chairman Sukut		X	Rep Lefor		X
Rep Beadle		X	Rep Louser	X	
Rep R Becker	X		Rep O'Brien		X
Rep Bosch		X	Rep Ruby	X	
Rep C Johnson	X		Rep Boschee	X	
Rep Kasper		X	Rep Dobervich		X

Total (Yes) 5 No 9

0
Absent

Floor Assignment **FAILED**

If the vote is on an amendment, briefly indicate intent:

Date: 1/10/2017

Roll Call Vote #: 2

2017 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. HB 1145

House Industry, Business and Labor **Committee**

☐ **Subcommittee**

Amendment LC# or Description:

Recommendation
☐ Adopt Amendment
☐ Do Pass ☒ Do Not Pass ☐ Without Committee Recommendation
☐ As Amended ☐ Rerefer to Appropriations
☐ Place on Consent Calendar

Other Actions ☐ Reconsider ☐

Motion Made By Rep Sukut **Seconded By** Rep. Laning

Representatives	Yes	No	Representatives	Yes	No
Chairman Keiser	X		Rep Laning	X	
Vice Chairman Sukut	X		Rep Lefor	X	
Rep Beadle	X		Rep Louser	X	
Rep R Becker		X	Rep O'Brien	X	
Rep Bosch	X		Rep Ruby		X
Rep C Johnson		X	Rep Boschee	X	
Rep Kasper	X		Rep Dobervich	X	

Total (Yes) 11 No 3

Absent 0

Floor Assignment Rep. Sukut

If the vote is on an amendment, briefly indicate intent:

Date: Jan 11, 2017

Roll Call Vote #: 1

2017 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 1145

House Industry, Business and Labor **Committee**

☐ **Subcommittee**

Amendment LC# or Description:

Recommendation

☐ Adopt Amendment
☐ Do Pass ☐ Do Not Pass ☐ Without Committee Recommendation
☐ As Amended ☐ Rerefer to Appropriations
☐ Place on Consent Calendar

Other Actions ☒ Reconsider ☐

Motion Made By Rep Boschee **Seconded By** Rep Beadle

Representatives	Yes	No	Representatives	Yes	No
Chairman Keiser	X		Rep Laning	X	
Vice Chairman Sukut	X		Rep Lefor	X	
Rep Beadle	X		Rep Louser	X	
Rep R Becker	X		Rep O'Brien	X	
Rep Bosch	X		Rep Ruby	X	
Rep C Johnson	X		Rep Boschee	X	
Rep Kasper	X		Rep Dobervich	X	

Total (Yes) 14 No 0

Absent 0

Floor Assignment

If the vote is on an amendment, briefly indicate intent:

Reconsider bringing back HB1145

Date: 1/18/2017

Roll Call Vote #: 1

2017 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. HB 1145

House Industry, Business and Labor **Committee**

☐ **Subcommittee**

Amendment LC# or Description: 17.0285.01001

Recommendation

☒ Adopt Amendment
☐ Do Pass ☐ Do Not Pass ☐ Without Committee Recommendation
☐ As Amended ☐ Rerefer to Appropriations
☐ Place on Consent Calendar

Other Actions ☐ Reconsider ☐ _____

Motion Made By Rep. Ruby **Seconded By** Rep. Bosch

Representatives	Yes	No	Representatives	Yes	No
Chairman Keiser			Rep Laning		
Vice Chairman Sukut			Rep Lefor		
Rep Beadle			Rep Louser		
Rep R Becker			Rep O'Brien		
Rep Bosch			Rep Ruby		
Rep C Johnson			Rep Boschee		
Rep Kasper			Rep Dobervich		

Total (Yes) _____ No _____

Absent _____

Floor Assignment **Voice vote ~ Motion carried**

Amendment removes overstrike page 1, line11
& gives production limits

Date: 1/18/2017

Roll Call Vote #: 2

2017 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. HB 1145

House Industry, Business and Labor **Committee**

☐ **Subcommittee**

Amendment LC# or Description:

Recommendation
☒ Adopt Amendment & **Further amend**
☐ Do Pass ☐ Do Not Pass ☐ Without Committee Recommendation
☐ As Amended ☐ Rerefer to Appropriations
☐ Place on Consent Calendar

Other Actions ☐ Reconsider ☐

Motion Made By Rep. Becker **Seconded By** Rep. Bosch

Representatives	Yes	No	Representatives	Yes	No
Chairman Keiser			Rep Laning		
Vice Chairman Sukut			Rep Lefor		
Rep Beadle			Rep Louser		
Rep R Becker			Rep O'Brien		
Rep Bosch			Rep Ruby		
Rep C Johnson			Rep Boschee		
Rep Kasper			Rep Dobervich		

Total (Yes) No

Absent

Floor Assignment **Voice vote ~ Motion carried**

Add "aggregate"

Date: 1/18/17

Roll Call Vote #: 3

2017 HOUSE STANDING COMMITTEE
ROLL CALL VOTES 1145
BILL/RESOLUTION NO. _____

House Industry, Business and Labor **Committee**

☐ **Subcommittee**

Amendment LC# or Description: _____

Recommendation ☒ Adopt Amendment further amend
☐ Do Pass ☐ Do Not Pass ☐ Without Committee Recommendation
☐ As Amended ☐ Rerefer to Appropriations
☐ Place on Consent Calendar

Other Actions ☐ Reconsider ☐ _____

Motion Made By Rep. Becker **Seconded By** Rep. Louser

Representatives	Yes	No	Representatives	Yes	No
Chairman Keiser			Rep Laning		
Vice Chairman Sukut			Rep Lefor		
Rep Beadle			Rep Louser		
Rep R Becker			Rep O'Brien		
Rep Bosch			Rep Ruby		
Rep C Johnson			Rep Boschee		
Rep Kasper			Rep Dobervich		

Total (Yes) _____ No _____

Absent _____

Floor Assignment voice vote - Motion carried

If the vote is on an amendment, briefly indicate intent:

move from 5 to 3 million gallons

Date: 1/18/17

Roll Call Vote #: 4

2017 HOUSE STANDING COMMITTEE
ROLL CALL VOTES 1145
BILL/RESOLUTION NO. _____

House Industry, Business and Labor **Committee**

☐ **Subcommittee**

Amendment LC# or Description: 17.0285.01002

Recommendation

☐ Adopt Amendment
☒ Do Pass ☐ Do Not Pass ☐ Without Committee Recommendation
☒ As Amended ☐ Rerefer to Appropriations
☐ Place on Consent Calendar

Other Actions ☐ Reconsider ☐ _____

Motion Made By Rep. Becker **Seconded By** Rep. Johnson

Representatives	Yes	No	Representatives	Yes	No
Chairman Keiser		X	Rep Laning	X	
Vice Chairman Sukut		X	Rep Lefor		X
Rep Beadle	X		Rep Louser	X	
Rep R Becker	X		Rep O'Brien		X
Rep Bosch	X		Rep Ruby	X	
Rep C Johnson	X		Rep Boschee	X	
Rep Kasper		X	Rep Dobervich		X

Total (Yes) 8 No 6

Absent 0

Floor Assignment Rep Louser

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

HB 1145: Industry, Business and Labor Committee (Rep. Keiser, Chairman) recommends **AMENDMENTS AS FOLLOWS** and when so amended, recommends **DO PASS** (8 YEAS, 6 NAYS, 0 ABSENT AND NOT VOTING). HB 1145 was placed on the Sixth order on the calendar.

Page 1, line 11, remove the overstrike over "~~manufacturer~~"

Page 1, line 11, after "~~or~~" insert "producing in excess of two hundred fifty thousand gallons [946353 liters] of wine or distilled spirits or three million gallons [11356235 liters] of beer annually or any"

Page 1, line 11, after the period insert "The production limits in this section pertain to the combined amount of production in the aggregate produced by all affiliates of the manufacturer or manufacturer ownership whether the affiliation is corporate or by management, direction, or control."

Renumber accordingly

2017 TESTIMONY

HB 1145

HB 1145

1/10/17

#1

Rep. Becker

5-01-14. Microbrew pubs - Licensing - Taxes.
A microbrew pub shall obtain a brewer license and a retailer license as required under this title. A microbrew pub may manufacture on the licensed premises, store, transport, sell to wholesale malt beverage licensees, and export no more than ten thousand barrels of malt beverages annually; sell malt beverages manufactured on the licensed premises; and sell alcoholic beverages regardless of source to consumers for consumption on the microbrew pub's licensed premises. A microbrew pub may not engage in any wholesaling activities. All sales and delivery of malt beverages to any other retail licensed premises may be made only through a wholesale malt beverage licensee. Beer manufactured on the licensed...

5-01-16. Direct sale from out-of-state person to consumer - Penalty.
1. A person in the business of selling alcoholic beverages may not knowingly or intentionally ship, or cause to be shipped, any alcoholic beverage from an out-of-state location directly to a person in this state who is not a licensed wholesaler in this state.

5-01-17. Domestic winery license.
2. A domestic winery may sell wine produced by that winery at on sale or off sale, in retail lots, and not for resale, and may sell or direct ship its wine to persons inside or outside of the state in a manner consistent with the laws of the place of the sale or delivery in total quantities not in excess of twenty-five thousand gallons [94625 liters] in a calendar year; glassware; wine literature and accessories; and cheese, cheese spreads, and other snack food items.
3. A domestic winery may obtain a domestic winery license and a retailer license allowing the onpremises sales of alcoholic beverages at a restaurant owned by the licensee and located on property contiguous to the winery.

5-01-19. Domestic distillery.
2. A domestic distillery may sell spirits produced by that distillery at on sale or off sale, in retail lots, and not for resale, and may sell or direct ship its spirits to persons inside or....
3. A domestic distillery may obtain a domestic distillery license and a retailer license allowing the onpremises sale of alcoholic beverages at a restaurant owned by the licensee and located on property contiguous to the domestic distillery. A domestic distillery also may own or operate a winery.

5-02-09.1. Attorney general to adopt rules.
The attorney general pursuant to chapter 28-32 shall adopt rules necessary to carry out the provisions of this chapter.

HB1145 does NOT dismantle the three-tier system of alcohol sales. Each of the above provisions, as well as others, remain unchanged. If a person has a financial interest in a manufacturer as well as a retail operation, that person must direct the beer, wine, and spirits from the manufacturing entity through a wholesaler (distributor), for sale to the retailer, even if manufacturer and retailer are one in the same.

(2)

Testimony before the House Industry Business and Labor Committee
HB 1145
January 10, 2017

My name is Janet Seaworth. I am the Executive Secretary of the North Dakota Beer Distributors Association. The NDBDA is a 72 year old trade association that represents the interests of North Dakota's beer distributors. North Dakota's distributors are locally owned and operated family businesses who service 1,600 retailers in the State. In 2015, wholesalers paid $36 million in wages and salaries and $3.3 million in state excise taxes. They contributed over $189.4 million to North Dakota's economy.[1]

North Dakota, like all states, regulates the manufacture, distribution and sale of alcohol though a three-tier system that divides the industry into the manufacturer, distributor, and retailer levels. The underlying purpose of this system is to keep the levels separate and independent so that the economic forces to promote excessive consumption and control of the distribution chain are minimized. Prior to Prohibition, a brewer often owned a retailer "lock, stock, and barrel" and could exert pressure on the retailer to sell its products regardless of the social costs. At the time, the industry was vertically integrated and brewers controlled retailers and their sales and marketing practices. As a result, national brewers and their "tied-house" retailers would over-promote and over-sell their products, which lead to wide-spread abuse. These retailers were "tied-houses" because they were owned by a particular brewer and only sold that brewer's products. This lead to a proliferation of retail outlets because each supplier needed its own outlet. The result was overconsumption associated with unlimited availability and low price.

After the repeal of Prohibition, it was determined that a wholesaler should be inserted between the manufacturer and the retailer in order to avoid the problems with "tied houses" that lead to Prohibition in the first place. The most prominent feature of every state regulatory system is the tied-house prohibitions. That is, no tier may have an interest in another tier. HB 1145 seeks to remove the "tied-house" prohibition by allowing a manufacturer to have an interest in a retailer, thereby allowing the vertical integration and monopolization that lead to Prohibition in the first place.

As recently noted by the Louisiana Court of Appeals:

> "Without the three-tier system, the natural tendency historically has been for the supplier tier to integrate vertically. With vertical integration, a supplier takes control of the manufacture, distribution, and retailing of alcoholic beverages, from top to bottom. The result is that individual retail establishments become tied to a particular supplier. When so tied, the retailer takes its orders from the supplier who controls it, including naturally the supplier's mandate to maximize

[1] Center for Applied Business & Economic Research, Alfred Lerner College of Business & Economics, University of Delaware

/

sales. A further consequence is a suppression of competition as the retailer favors the particular brands of the supplier to which the retailer is tied to the exclusion of the other suppliers' brands. With vertical integration, there are also practical implications for the power of regulators. A vertically integrated enterprise -comprising manufacture, distribution, and retailing - is inevitably a powerful entity managed and controlled from afar by non-residents.

The three-tier system was implemented to counteract all these tendencies. Under the three-tier system, the industry is divided into three tiers, each with its own service focus. No one tier controls another. Further, individual firms do not grow so powerful in practice that they can out-muscle regulators. In addition, because of the very nature of their operations, firms in the wholesaling tier and the retailing tier have a local presence, which makes them more amenable to regulation and naturally keeps them accountable. Further, by separating the tiers, competition, a diversity of products, and availability of products are enhanced as the economic incentives are removed that encourage distributors and retailers to favor the products of a particular supplier (to which distributor or retailer might be tied) to the exclusion of products from other suppliers."

Manuel v. State of Louisiana, 2008 WL 1902437 (April 30, 2008 La. App. 3 Cir.). As the court noted, the purpose of the three tier system and tied-house prohibitions is to keep the levels independent. HB 1145 does just the opposite. Instead of separating the tiers, it allows the vertical integration of the tiers.

If a brewer can own a retailer, the brewer will be able to assert enormous pressure on the wholesaler to exclude competitor's products and engage in trade practices that are not in the public interest. There will be an incentive to pressure the retailer to increase sales and consumption regardless of social cost. Manufacturers are likely to only promote the sale of their own products and will inhibit the sale of competing products. There will be limited product choice. Manufacturers will likely focus on only the largest retailers in the largest cities to establish exclusive outlets. The result will be a reduction in the state's ability to effectively control alcohol, a reduction in choice and variety for consumers, the questionable viability of distributors, and the ground work will be laid for a return to the problems with vertical integration and tied houses that lead to Prohibition in the first place. We urge you to vote no on HB 1145.

Thank you.

Janet Seaworth
Executive Secretary/Legal Counsel
North Dakota Beer Distributors Association
PO Box 7401
Bismarck, ND 58507
(701) 258-8098

#3
HB 1145

Industry, Business and Labor Committee
January 10, 2017

Testimony Outline Opposing HB 1145 and HB 1146

Randy Christianson, President, Beverage Wholesalers, Inc., 701 4th Avenue North, Fargo, ND 58107
(701) 293-7404 rchristianson@beveragewholesalers.com

Impact of Tied House and Exclusive Retail Outlets Based on ND 2015 Beer Shipments

- Top two suppliers are nearly 84% of total beer shipments in volume out of the 104 brewers reporting to ND Tax Department. The top five suppliers were 90.7% of volume.
- Cumulative case equivalents of top five were 9,606,779. Two ND based brewers were .43% and .04% (less than 1%) of ND reported shipments or 50,216 case equivalents.

Code of Federal Regulations Title 27: Alcohol, Tobacco Products and Firearms

- PART 6 – TIED-HOUSE
- PART 8 – EXCLUSIVE OUTLETS

The Path of Imported Alcohol in the U.S. Flow Chart

- Foreign Alcohol Beverage Producer registers with FDA and TTB
- U.S. Domestic Importer obtains TTB Importer Permit and takes physical custody
- Importer to State based Federal and State licensed Distributor – Come to Rest Provisions
- Distributor remits excise taxes, ensures proper Federal and State registration and sells to only a licensed retailer to the address on the retailers ND and local jurisdiction licenses. State sales tax retailer permit verified for compliance.

Required Registration of Food Facilities Under the Public Health Security and Bioterrorism Preparedness and Response Act of 2002

Video References Featuring Large Importers and Craft Brewer in Support of the Three-tier System and Distributors Abilities in Tracking Affected Product During a Recall

- https://www.youtube.com/watch?v=IsvuvAkFLzw
  - Protecting the Corona Extra Brand: The Value of Distributor Partnerships
- https://www.youtube.com/watch?v=-qPj9rDMiGk
  - Heineken USA Discusses Voluntary Recall of Specific Bottles
- https://www.youtube.com/watch?v=xbYy52mQ8rQ
  - Boston Beer's Jim Koch Discusses Beer Distributors' Role in Tracking Product

Beverage Wholesalers, Inc. Currently Represents 43 Alcohol Manufacturers or Importers

- Currently 981 Store Keeping Units on Hand and Growing
- Inventory Ranges from Seasonal Lows of $1.7 Million to Seasonal Highs of $3.1 Million

BEER SHIPMENTS INTO NORTH DAKOTA - 2015

	Bottle/Can Gallons	Bulk Gallons	TOTAL GALLONS	BBLS THE YEAR 2015	% SHARE	% Cumulative Share	Case Equivalents	Cumulative Case Equivalents
Anheuser-Busch, Inc.	10,026,725.28	1,200,493.16	11,227,218.44	362,168.36	47.12%	47.12%	4,989,875	4,989,875
MillerCoors LLC	7,716,477.23	1,022,362.30	8,738,839.53	281,898.05	36.68%	83.79%	3,883,929	8,873,804
Pabst Brewing	803,118.23	19,840.00	822,958.23	26,547.05	3.45%	87.25%	365,759	9,239,563
Crown Imports	429,244.14	5,456.00	434,700.14	14,022.58	1.82%	89.07%	193,200	9,432,763
Mark Anthoney Brands	391,535.41	-	391,535.41	12,630.18	1.64%	90.71%	174,016	9,606,779
Boston Beer	282,965.33	97,880.55	380,845.88	12,285.35	1.60%			
Heineken USA	270,288.14	34,516.76	304,804.90	9,832.41	1.28%			
August Schell Brewing	152,584.30	25,038.06	177,622.36	5,729.76	0.75%			
Diageo	141,261.72	33,726.26	174,987.98	5,644.77	0.73%			
New Belgium	112,456.33	48,348.02	160,804.35	5,187.24	0.67%			
Summit Brewing Co.	76,471.64	51,017.31	127,488.95	4,112.53	0.54%			
The Fargo Brewing Co	36,277.97	67,320.81	103,598.78	3,341.90	0.43%	0.43%	46,044	46,044
Gambrinus	50,646.75	29,465.50	80,112.25	2,584.27	0.34%			
Sierra Nevada	57,288.58	6,866.32	64,154.90	2,069.54	0.27%			
Deschutes Brewery	32,939.26	29,423.60	62,362.86	2,011.69	0.26%			
Labatt USA	45,445.74	186.00	45,631.74	1,471.97	0.19%			
Bells Brewery	14,940.00	14,853.55	29,793.55	961.09	0.13%			
Precept Brands	28,140.00	-	28,140.00	907.74	0.12%			
Utah Brewing	19,749.50	6,566.54	26,316.04	848.91	0.11%			
Big Sky	17,361.00	6,172.24	23,533.24	759.14	0.10%			
Lagunitas Brewing Co	9,607.51	13,779.50	23,387.01	754.42	0.10%			
Oregon Brewing	10,165.96	12,118.33	22,284.29	718.84	0.09%			
Associated Brewing	19,185.00	-	19,185.00	618.88	0.08%			
Fulton LLC	7,938.00	9,964.85	17,902.85	577.51	0.08%			
Founders Brewing	10,654.22	6,517.75	17,171.97	553.93	0.07%			
Empyrean Brewing Co	5,716.80	9,779.41	15,496.21	499.88	0.07%			
Duvel Moortgat USA	7,191.72	5,759.98	12,951.70	417.81	0.05%			
S&H Independent	5,958.95	6,577.88	12,536.83	404.42	0.05%			
Brown Forman	12,150.00	-	12,150.00	391.93	0.05%			
Classic Brewing Company	12,000.00	-	12,000.00	387.10	0.05%			
Blue Rock	11,253.91	-	11,253.91	363.04	0.05%			
Camo Brewing Co	10,887.00	-	10,887.00	351.20	0.05%			
United Brands Company	10,619.07	-	10,619.07	342.55	0.04%			
E & J Gallo	10,514.70	-	10,514.70	339.18	0.04%			
Red Lodge Ales	4,537.51	5,264.85	9,802.36	316.21	0.04%			
Drekker Brewing	426.25	9,059.26	9,485.51	305.98	0.04%	0.04%	4,216	4,216
Lakefront Brewery LLC	6,183.00	3,007.30	9,190.30	296.46	0.04%			
Gluek Brewing	6,522.04	2,444.26	8,966.30	289.24	0.04%			
Beaver Creek Brewery	-	8,628.09	8,628.09	278.32	0.04%			
Tall Grass Brewing	5,848.95	2,288.77	8,137.72	262.51	0.03%			
Sapporo USA	7,408.12	620.00	8,028.12	258.97	0.03%			
Phusion Projects Inc	7,717.47	-	7,717.47	248.95	0.03%			

	Bottle/Can Gallons	Bulk Gallons	TOTAL GALLONS	BBLS THE YEAR 2015	% SHARE	% Cumulative Share	Case Equivalents	Cumulative Case Equivalents
Alaskan Brewing	3,303.00	3,853.78	7,156.78	230.86	0.03%			
New Holland Brewing LLC	3,999.38	2,903.50	6,902.88	222.67	0.03%			
Five Star Brewing	6,552.00	-	6,552.00	211.35	0.03%			
Indeed	3,782.55	2,165.72	5,948.27	191.87	0.02%			
Boulder Brewing	3,522.20	2,413.23	5,935.43	191.45	0.02%			
American Vintage	5,691.90	-	5,691.90	183.62	0.02%			
Buffalo Commons	-	5,440.44	5,440.44	175.49	0.02%			
Great Northern Brewing	2,829.38	2,480.00	5,309.38	171.26	0.02%			
Merchant DeVinn	4,578.98	727.53	5,306.51	171.18	0.02%			
Southern Tier Brewing Company	2,649.30	2,407.69	5,056.99	163.11	0.02%			
North Coast Brewing	2,365.83	2,567.22	4,933.05	159.13	0.02%			
Lucky Bucket Brewing	2,416.50	2,153.90	4,570.40	147.44	0.02%			
Grand Teton Brewing	1,956.88	2,366.39	4,323.27	139.46	0.02%			
The Fresh from California Family	4,320.00	-	4,320.00	139.35	0.02%			
Carriage Hs. Imports	4,113.79	-	4,113.79	132.70	0.02%			
Green Flash Brewing	1,809.26	2,252.63	4,061.89	131.04	0.02%			
Madison River Brewing	1,400.81	2,542.00	3,942.81	127.21	0.02%			
Sprecher Brewing	2,818.00	790.50	3,608.50	116.40	0.02%			
United States Beverage	3,055.56	380.26	3,435.82	110.84	0.01%			
Paulaner-North America	1,277.54	1,980.80	3,258.34	105.10	0.01%			
Rhombus Guys Holdings	-	2,652.93	2,652.93	85.58	0.01%			
Moylan's Brewing company	561.75	1,656.95	2,218.70	71.56	0.01%			
Crow Peak Brewing	1,116.00	976.50	2,092.50	67.51	0.01%			
Ipco	1,800.00	-	1,800.00	58.08	0.01%			
D&V International Inc	1,173.57	592.76	1,766.33	56.98	0.01%			
Crazy Mountain Brewing	1,080.00	681.88	1,761.88	56.84	0.01%			
GJS Sales Inc.	1,554.75	69.75	1,624.50	52.40	0.01%			
Bard's Tale	1,620.00	-	1,620.00	52.25	0.01%			
Abita Brewing	603.09	844.75	1,447.84	46.70	0.01%			
Dalhmr Brewing	1,431.00	-	1,431.00	46.16	0.01%			
Meadowlark Brewing LLC	112.50	1,172.84	1,285.34	41.47	0.01%			
VanBerg & Dewulf	1,266.60	-	1,266.60	40.86	0.01%			
Horny Goat	813.50	372.00	1,185.50	38.25	0.00%			
MHW	573.07	554.53	1,127.60	36.38	0.00%			
Boulevard Brewing	659.64	444.33	1,103.97	35.61	0.00%			
Becks USA	-	806.00	806.00	26.00	0.00%			
Milwaukee Brewing Co	513.00	248.00	761.00	24.55	0.00%			
Sabemos Beverages LLC	718.20	-	718.20	23.17	0.00%			
Portland Brewing	115.36	470.17	585.53	18.89	0.00%			
Millstream Investments	-	559.32	559.32	18.04	0.00%			
Mark VII Distributors	556.44	-	556.44	17.95	0.00%			
Steves Point Brewery	540.00	-	540.00	17.42	0.00%			
Beverage Acquisition Group	525.60	-	525.60	16.96	0.00%			
Manneken-Brussel Imports	525.16	-	525.16	16.95	0.00%			
Old Capitol Brew Works	312.00	201.42	513.42	16.56	0.00%			

	Bottle/Can Gallons	Bulk Gallons	TOTAL GALLONS	BBLS THE YEAR 2015	% SHARE	% Cumulative Share	Case Equivalents	Cumulative Case Equivalents
Harvest Moon Brewing	-	496.00	496.00	16.00	0.00%			
Finnegans Inc.	157.50	310.00	467.50	15.09	0.00%			
BPNC Inc.	180.00	248.00	428.00	13.81	0.00%			
Shelton Brothers	266.51	131.61	398.12	12.84	0.00%			
Eurobubbles	235.88	124.00	359.88	11.61	0.00%			
Warsteiner Importers	189.00	-	189.00	6.10	0.00%			
BevLink	185.63	-	185.63	5.99	0.00%			
Lakeport	182.00	-	182.00	5.87	0.00%			
Granite City	-	139.50	139.50	4.50	0.00%			
Minhas Craft Brewery	-	-	-	-				
Founding Fathers	-	-	-	-				
Prestige	-	-	-	-				
Matt Brewing	-	-	-	-				
Twisted Pine	-	-	-	-				
Hornell Brewing	-	-	-	-				
Yellowstone Brewing	-	-	-	-				
Madhouse Brewing Co LLC	-	-	-	-				
Miscellaneous (Includes Strohs)	4,817.37	5,914.47	10,731.84	346.19	0.05%			
Total Before Transfers	20,975,230.71	2,852,436.51	23,827,667.22	768,634.51	100.00%			
Transfers Into ND	912,363.89	96,027.91	1,008,391.80	32,528.78				
Deductions/Transfers Out/Adjustments	(2,467,052.62)	(341,042.67)	(2,808,095.29)	(90,583.71)				
TOTAL	19,420,541.98	2,607,421.75	22,027,963.73	710,579.58				
	2015 Total Barrels			710,579.58				
	2014 Total Barrels			721,974.81				
	Percentage loss for 2015			-1.58%				

ELECTRONIC CODE OF FEDERAL REGULATIONS

e-CFR data is current as of January 6, 2017

Title 27 → Chapter I → Subchapter A → Part 6

Title 27: Alcohol, Tobacco Products and Firearms

PART 6—"TIED-HOUSE"

Contents

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AUTHORITY: 15 U.S.C. 49-50; 27 U.S.C. 202 and 205; 44 U.S.C. 3504(h).

SOURCE: T.D. ATF-74, 45 FR 63251, Sept. 23, 1980, unless otherwise noted.

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Subpart A—Scope of Regulations

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§6.1 General.

The regulations in this part, issued pursuant to section 105 of the Federal Alcohol Administration Act (27 U.S.C. 205), specify practices that are means to induce under section 105(b) of the Act, criteria for determining whether a practice is a violation of section 105(b) of the Act, and exceptions to section 105(b) of the Act. This part does not attempt to enumerate

ELECTRONIC CODE OF FEDERAL REGULATIONS

e-CFR data is current as of January 6, 2017

Title 27 → Chapter I → Subchapter A → Part 8

Title 27: Alcohol, Tobacco Products and Firearms

PART 8—EXCLUSIVE OUTLETS

Contents

AUTHORITY: 15 U.S.C. 49-50; 27 U.S.C. 202 and 205; 44 U.S.C. 3504(h).

SOURCE: T.D. ATF-74, 45 FR 63256, Sept. 23, 1980, unless otherwise noted.

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Subpart A—Scope of Regulations

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§8.1 General.

The regulations in this part, issued pursuant to section 105 of the Federal Alcohol Administration Act (27 U.S.C. 205), specify arrangements which are exclusive outlets under section 105(a) of the Act and criteria for determining whether a practice is a violation of section 105(a) of the Act. This part does not attempt to enumerate all of the practices prohibited by section 105(a) of the Act. Nothing in this part shall operate to exempt any person from the requirements of any State law or regulation.

[T.D. ATF-364, 60 FR 20425, Apr. 26, 1995]

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§8.2 Territorial extent.

This part applies to the several States of the United States, the District of Columbia, and Puerto Rico.

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§8.3 Application.

(a) *General.* This part applies only to transactions between industry members and retailers. It does not apply to transactions between two industry members; for example, between a producer and a wholesaler.

(b) *Transactions involving State agencies.* The regulations in this part apply only to transactions between industry members and State agencies operating as retailers as defined in this part. The regulations do not apply to State agencies with regard to their wholesale dealings with retailers.

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§8.4 Jurisdictional limits.

(a) *General.* The regulations in this part apply where:

(1) The industry member requires, by agreement or otherwise, a retailer to purchase distilled spirits, wine, or malt beverages from such industry member to the exclusion in whole or in part of products sold or offered for sale by other persons in interstate or foreign commerce; and

(2) If: (i) The requirement is made in the course of interstate or foreign commerce; or

(ii) The industry member engages in the practice of using a requirement to such an extent as substantially to restrain or prevent transactions in interstate or foreign commerce in any such products; or

(iii) The direct effect of the requirement is to prevent, deter, hinder, or restrict other persons from selling or offering for sale any such products to such retailer in interstate or foreign commerce.

(b) *Malt beverages.* In the case of malt beverages, this part applies to transactions between a retailer in any State and a brewer, importer, or wholesaler of malt beverages inside or outside such State only to the extent that the law of such State imposes requirements similar to the requirements of section 5(a) of the Federal Alcohol Administration Act (27 U.S.C. 205(a)), with respect to similar transactions between a retailer in such State and a brewer, importer, or wholesaler of malt beverages in such State.

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§8.5 Delegations of the Administrator.

Most of the regulatory authorities of the Administrator contained in this part are delegated to appropriate TTB officers. These TTB officers are specified in TTB Order 1135.8, Delegation of the Administrator's Authorities in 27 CFR Part 8, Exclusive Outlets. You may obtain a copy of this order by accessing the TTB Web site (*http://www.ttb.gov*) or by mailing a request to the Alcohol and Tobacco Tax and Trade Bureau, National Revenue Center, 550 Main Street, Room 1516, Cincinnati, OH 45202.

[T.D. TTB-44, 71 FR 16923, Apr. 4, 2006]

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§8.6 Administrative provisions.

(a) *General.* The Act makes applicable the provisions including penalties of sections 49 and 50 of Title 15, United States Code, to the jurisdiction, powers and duties of the Administrator under this Act, and to any person (whether or not a corporation) subject to the provisions of law administered by the Administrator under this Act. The Act also provides that the Administrator is authorized to require, in such manner and such form as he or she shall prescribe, such reports as are necessary to carry out the powers and duties under this chapter.

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(b) *Examination and subpoena.* Any appropriate TTB officer shall at all reasonable times have access to, for the purpose of examination, and the right to copy any documentary evidence of any person, partnership, or corporation being investigated or proceeded against. An appropriate TTB officer shall also have the power to require by subpoena the attendance and testimony of witnesses and the production of all such documentary evidence relating to any matter under [redacted]estigation, upon a satisfactory showing the requested evidence may reasonably be expected to yield information [redacted]vant to any matter being investigated under the Act.

(c) *Reports required by the appropriate TTB officer*—(1) *General.* The appropriate TTB officer may, as part of a trade practice investigation of an industry member, require such industry member to submit a written report containing information on sponsorships, advertisements, promotions, and other activities pertaining to its business subject to the Act conducted by, or on behalf of, or benefiting the industry member.

(2) *Preparation.* The report will be prepared by the industry member in letter form, executed under the penalties of perjury, and will contain the information specified by the appropriate TTB officer. The period covered by the report will not exceed three years.

(3) *Filing.* The report will be filed in accordance with the instructions of the appropriate TTB officer.

(Approved by the Office of Management and Budget under control number 1512-0392)

[T.D. ATF-364, 60 FR 20425, Apr. 26, 1995. Redesignated and amended by T.D. ATF-428, 65 FR 52020, Aug. 28, 2000]

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Subpart B—Definitions

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§8.11 Meaning of terms.

As used in this part, unless the context otherwise requires, terms have the meanings given in this section. Any other term defined in the Federal Alcohol Administration Act and used in this part shall have the meaning assigned to it by that [redacted]

Act. The Federal Alcohol Administration Act.

Administrator. The Administrator, Alcohol and Tobacco Tax and Trade Bureau, Department of the Treasury, Washington, DC.

Appropriate TTB officer. An officer or employee of the Alcohol and Tobacco Tax and Trade Bureau (TTB) authorized to perform any functions relating to the administration or enforcement of this part by TTB Order 1135.8, Delegation of the Administrator's Authorities in 27 CFR Part 8, Exclusive Outlets.

Industry member. Any person engaged in business as a distiller, brewer, rectifier, blender, or other producer, or as an importer or wholesaler, of distilled spirits, wine or malt beverages, or as a bottler, or warehouseman and bottler, of distilled spirits; industry member does not include an agency of a State or political subdivision thereof, or an officer or employee of such agency.

Product. Distilled spirits, wine or malt beverages, as defined in the Federal Alcohol Administration Act.

Retailer. Any person engaged in the sale of distilled spirits, wine or malt beverages to consumers. A wholesaler who makes incidental retail sales representing less than five percent of the wholesaler's total sales volume for the preceding two-month period shall not be considered a retailer with respect to such incidental sales.

[T.D. ATF-74, 45 FR 63256, Sept. 23, 1980, as amended by T.D. ATF-364, 60 FR 20425, Apr. 26, 1995; T.D. ATF-428, 65 FR 52020, Aug. 28, 2000; T.D. TTB-44, 71 FR 16923, Apr. 4, 2006]

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[redacted]part C—Prohibited Practices

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§8.21 General.

It is unlawful for an industry member to require, by agreement or otherwise, that any retailer purchase distilled spirits, wine, or malt beverages from the industry member to the exclusion, in whole or in part, of products sold or offered for sale by other persons in interstate or foreign commerce. This prohibition includes purchases coerced by industry members, through acts or threats of physical or economic harm, as well as voluntary industry member-retailer purchase agreements.

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§8.22 Contracts to purchase distilled spirits, wine, or malt beverages.

Any contract or agreement, written or unwritten, which has the effect of requiring the retailer to purchase distilled spirits, wine, or malt beverages from the industry member beyond a single sales transaction is prohibited. Examples of such contracts are:

(a) An advertising contract between an industry member and a retailer with the express or implied requirement of the purchase of the advertiser's products; or

(b) A sales contract awarded on a competitive bid basis which has the effect of prohibiting the retailer from purchasing from other industry members by:

(1) Requiring that for the period of the agreement, the retailer purchase a product or line of products exclusively from the industry member; or

(2) Requiring that the retailer purchase a specific or minimum quantity during the period of the agreement.

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§8.23 Third party arrangements.

Industry member requirements, by agreement or otherwise, with non-retailers which result in a retailer being required to purchase the industry member's products are within the exclusive outlet provisions. These industry member requirements are covered whether the agreement or other arrangement originates with the industry member or the third party. For example, a supplier enters into a contractual agreement or other arrangement with a third party. This agreement or arrangement contains an industry member requirement as described above. The third party, a ballclub, or municipal or private corporation, not acting as a retailer, leases the concession rights and is able to control the purchasing decisions of the retailer. The third party, as a result of the requirement, by agreement or otherwise, with the industry member, requires the retailer to purchase the industry member's products to the exclusion, in whole or in part, of products sold or offered for sale by other persons in interstate or foreign commerce. The business arrangements entered into by the industry member and the third party may consist of such things as sponsoring radio or television broadcasting, paying for advertising, or providing other services or things of value.

[T.D. ATF-364, 60 FR 20425, Apr. 26, 1995]

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Subpart D—Exclusion

SOURCE: T.D. ATF-364, 60 FR 20425, Apr. 26, 1995, unless otherwise noted.

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§8.51 Exclusion, in general.

(a) Exclusion, in whole or in part occurs:

(1) When a practice by an industry member, whether direct, indirect, or through an affiliate, places (or has the potential to place) retailer independence at risk by means of a tie or link between the industry member and retailer or by any other means of industry member control over the retailer, and

(2) Such practice results in the retailer purchasing less than it would have of a competitor's product.

(b) Section 8.52 lists practices that result in exclusion. Section 8.53 lists practices not resulting in exclusion. Section 8.54 lists the criteria used for determining whether other practices can put retailer independence at risk.

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§8.52 Practices which result in exclusion.

The practices specified in this section result in exclusion under section 105(a) of the Act. The practices specified here examples and do not constitute a complete list of such practices:

(a) Purchases of distilled spirits, wine or malt beverages by a retailer as a result, directly or indirectly, of a threat or act of physical or economic harm by the selling industry member.

(b) Contracts between an industry member and a retailer which require the retailer to purchase distilled spirits, wine, or malt beverages from that industry member and expressly restrict the retailer from purchasing, in whole or in part, such products from another industry member.

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§8.53 Practice not resulting in exclusion.

The practice specified in this section is deemed not to result in exclusion under section 105(a) of the Act: a supply contract for one year or less between the industry member and retailer under which the industry member agrees to sell distilled spirits, wine, or malt beverages to the retailer on an "as needed" basis provided that the retailer is not required to purchase any minimum quantity of such product.

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§8.54 Criteria for determining retailer independence.

The criteria specified in this section are indications that a particular practice, other than those in §§8.52 and 8.53, places retailer independence at risk. A practice need not meet all of the criteria specified in this section in order to place retailer independence at risk.

(a) The practice restricts or hampers the free economic choice of a retailer to decide which products to purchase or quantity in which to purchase them for sale to consumers.

(b) The industry member obligates the retailer to participate in the promotion to obtain the industry member's product.

(c) The retailer has a continuing obligation to purchase or otherwise promote the industry member's product.

(d) The retailer has a commitment not to terminate its relationship with the industry member with respect to purchase of the industry member's products.

(e) The practice involves the industry member in the day-to-day operations of the retailer. For example, the industry member controls the retailer's decisions on which brand of products to purchase, the pricing of products, or the manner in which the products will be displayed on the retailer's premises.

(f) The practice is discriminatory in that it is not offered to all retailers in the local market on the same terms without business reasons present to justify the difference in treatment.

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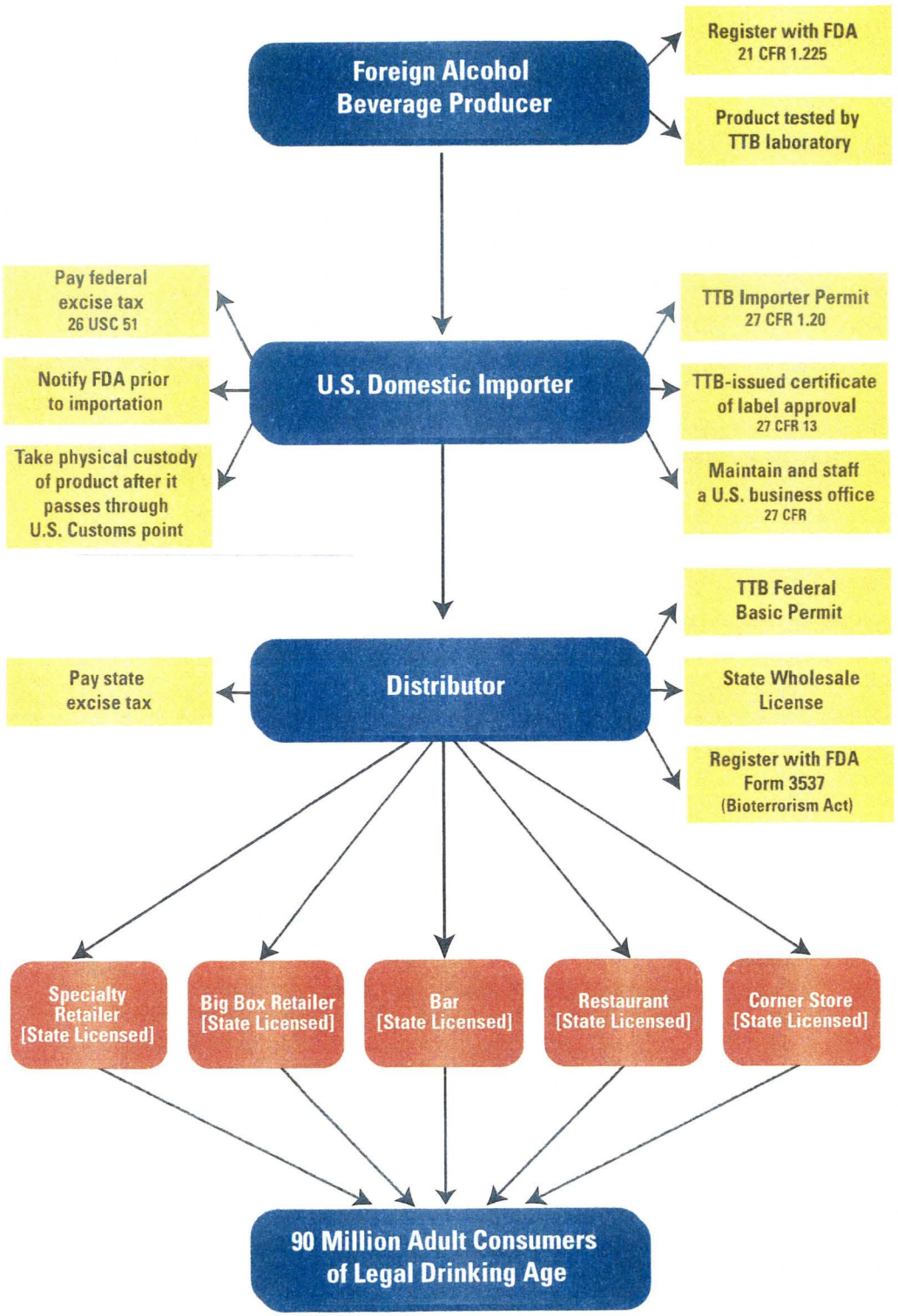
The Path of Imported Alcohol in the U.S.



Benefits of the American Alcohol Distribution System

- Unlike many consumer goods industries in the U.S., the alcohol beverage industry works within a system that ensures the transparency of the product from manufacture all the way to retail sale.
- While many countries have issues with counterfeit and poisonous alcohol entering their supply chains, the American system of alcohol distribution works to prevent tainted alcohol from infiltrating the U.S. system.
- The American three-tier system of alcohol distribution requires all parties in contact with the product to be licensed either by federal or state authorities. Alcohol beverage distributors are dually licensed by both federal and state governments.
- Should a quality concern develop over a particular product, the American system of alcohol distribution allows for that product to be quickly recalled or pulled off store shelves with minimum public exposure. The same cannot always be said of supply chains that do not operate within a strong regulatory system.
- In addition to achieving the most important goal of assuring product integrity, the American three-tier system of alcohol distribution also:
  - Ensures all proper taxes are paid on products to federal, state and local governments.
  - Provides a system of checks and balances between all the tiers of the distribution system, making it easy to identify any bad actors or companies trying to circumvent the system.
  - Allows the American consumer to enjoy unparalleled choice and variety in types and brands of alcohol. Nearly 13,000 brands of beer are available to American consumers.
  - Offers a path to market for small suppliers who otherwise would not have the manpower or infrastructure to efficiently distribute and sell their products.
  - Keeps the business of alcohol distribution local. Licensed beverage distributors are members of the community who are familiar with the local attitudes and concerns regarding their products. They sponsor a number of responsibility programs and initiatives in their communities such as speakers in schools, free cab rides or server training for local bartenders and wait staff.

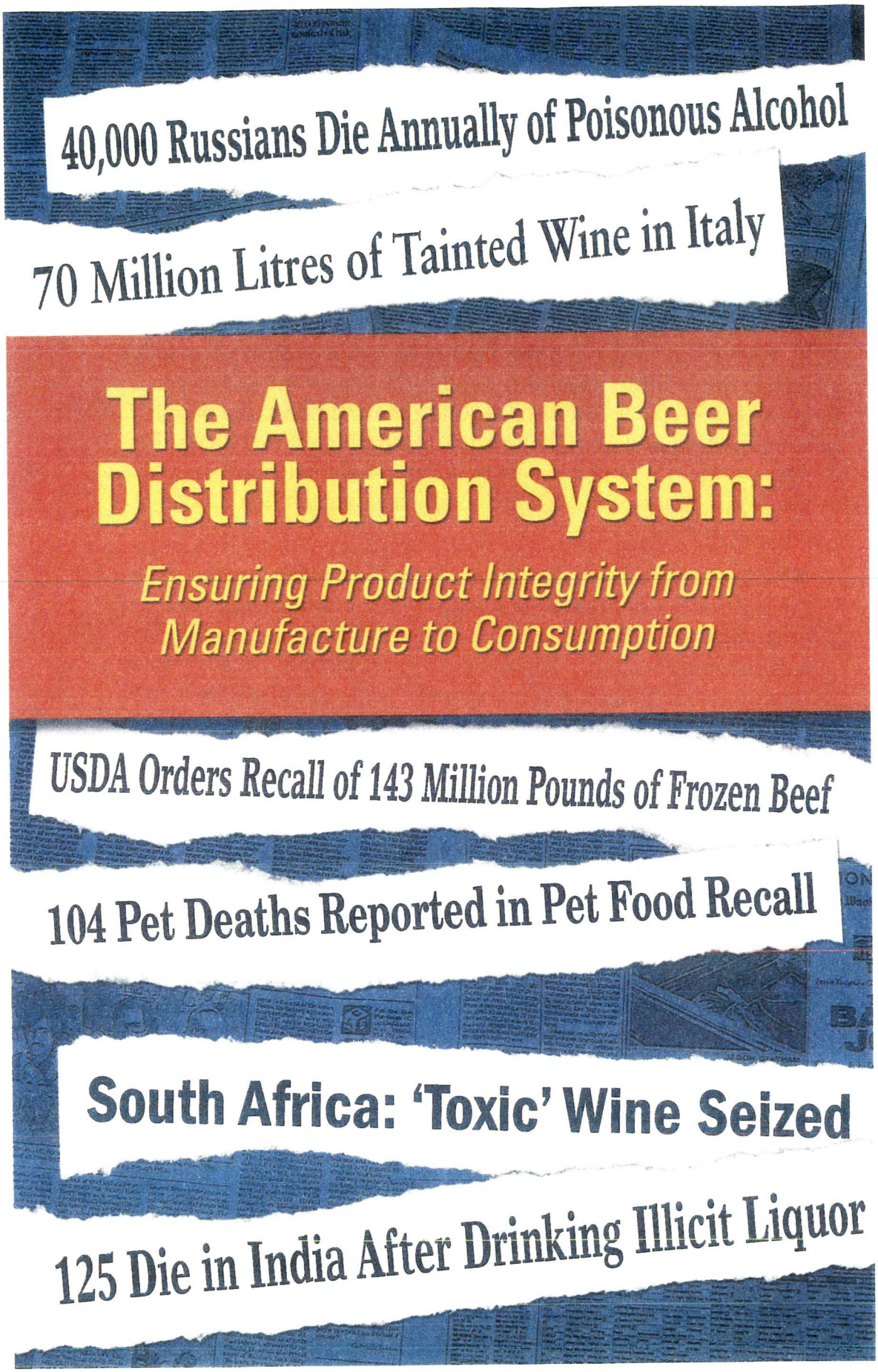
For more information:
National Beer Wholesalers Association
1101 King Street, Suite 600 • Alexandria, Virginia 22314-2965
800-300-6417 • www.nbwa.org

From toothpaste and pet food to children's toys and prescription drugs, countless consumer goods industries in the U.S. have been confronted with the problem of counterfeit or poisonous products entering their supply chains. These situations not only put consumers at risk but also result in lasting damage to innocent businesses that must work to earn back the trust of American consumers by assuring them that the products on the shelves are indeed authentic products.

In many other countries, the alcohol beverage industry has fallen victim to the infiltration of counterfeit and poisonous products. News stories from countries around the world describe people being injured and even dying after consuming tainted alcohol. This problem is not exclusive to developing countries. Counterfeit alcohol is an issue in developed countries such as England and Finland as well.

Why has this problem that spans the globe not become an issue in the U.S.? It is not because bootleggers and counterfeiters don't try to expand their black market operations. The U.S. does not have a problem with counterfeit and poisonous alcohol because it has a time-tested, regulated and transparent system in place for alcohol distribution that works to protect consumers.

The chart on the adjoining page illustrates the path all imported alcohol must take to get to a store shelf or a bar tap in the U.S. Only federally-registered manufacturers can ship alcohol into the country to a federally-licensed, U.S.-based domestic importer after the product is tested by the federal government's Tax and Trade Bureau (TTB). The importer can only sell the beer to a federal and state-licensed distributor. The distributors are then required to sell only to state-licensed retailers who in turn sell the product to adult consumers of legal drinking age. This system of alcohol distribution ensures a transparent supply chain from the point of manufacture all the way to consumption. The accountability that exists in the alcohol distribution system helps ensure the products Americans purchase and consume are safe and authentic.


40,000 Russians Die Annually of Poisonous Alcohol
70 Million Litres of Tainted Wine in Italy
The American Beer Distribution System:
Ensuring Product Integrity from Manufacture to Consumption
USDA Orders Recall of 143 Million Pounds of Frozen Beef
104 Pet Deaths Reported in Pet Food Recall
South Africa: 'Toxic' Wine Seized
125 Die in India After Drinking Illicit Liquor

Compliance Policy Guide - Registration of Food Facilities Under the Public Health Security and Bioterrorism Preparedness and Response Act of 2002

December 2003; Revised November 2004 and August 2006

Comments and suggestions regarding this Compliance Policy Guide (CPG) should be submitted to the Division of Dockets Management (HFA-305), Food and Drug Administration, 5630 Fishers Lane, rm. 1061, Rockville, MD 20852. All comments should be identified with docket number 2003D-0562.

For questions regarding this CPG, contact:

- **Re Food for Human Consumption:**

  Judith Gushee* (* Updated contact person Jennifer Thomas)
  Division of Enforcement, Office of Compliance,
  Center for Food Safety and Applied Nutrition
  301-436-2417* (* Updated contact information: 240-402-2094)

- **Re Food for Animal Consumption:**
  - **Isabel Pocurull**
    Division of Animal Feeds, Office of Surveillance and Compliance
    Center for Veterinary Medicine
    240-453-6853

U.S. Department of Health and Human Services
Food and Drug Administration
Office of Regulatory Affairs (ORA)
Center for Food Safety and Applied Nutrition (CFSAN)
Center for Veterinary Medicine (CVM)

Issued December 2003
Revised November 2004
Revised August 2006

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Compliance Policy Guide

Guidance for FDA Staff

Registration of Food Facilities Under the Public Health Security and Bioterrorism Preparedness and Response Act of 2002

Additional copies are available from:
Division of Compliance Policy HFC-230
Office of Enforcement
Office of Regulatory Affairs
Food and Drug Administration
5600 Fishers Lane
Rockville, MD 20857

Send one self-addressed adhesive label to assist that office in processing your request or fax your request to 240-632-6861
Copies available on-line at http://www.fda.gov/ora/compliance_ref/cpg/default.htm

U.S. Department of Health and Human Services
Food and Drug Administration
Office of Regulatory Affairs (ORA)
Center for Food Safety and Applied Nutrition (CFSAN)
Center for Veterinary Medicine (CVM)

Issued December 2003
Revised November 2004
Revised August 2006

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Compliance Policy Guide

Registration of Food Facilities Under the Public Health Security and Bioterrorism Preparedness and Response Act of 2002

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This guidance document represents the Food and Drug Administration's (FDA) current thinking on this topic. It does not create or confer any rights for or on any person and does not operate to bind FDA or the public. An alternative approach may be used if such approach satisfies the requirements of the applicable statute and regulations.

Sec. 110.300: Registration of Food Facilities Under the Public Health Security and Bioterrorism Preparedness and Response Act of 2002

INTRODUCTION:

The purpose of registration is to provide FDA with sufficient and reliable information about food and feed facilities. When used with the detention, record keeping, and prior notice provisions in sections 303, 306, and 307, respectively, of the Bioterrorism Act, registration will help provide FDA with information on the origin and distribution of food and feed products and thereby, aid in the detection and quick response to actual or potential threats to the U.S. food supply. Registration information also will help FDA notify firms that may be affected by the actual or potential threat. FDA estimates that the total number of food facilities that must register is approximately 420,000, approximately half of which are domestic.

This is a revision of the compliance policy guidance document issued in December, 2003. It is intended for FDA personnel and is available electronically to the public. This guidance document represents the Agency's current thinking on registration of domestic and foreign facilities manufacturing/ processing, packing, or holding food for human or animal consumption in the United States. It does not create or confer any rights for or on any person and does not operate to bind FDA or the public. An alternate approach may be used if such approach satisfies the requirements of the applicable statutes and regulations.

BACKGROUND:

Section 305 of the Public Health Security and Bioterrorism Preparedness and Response Act of 2002 (the Bioterrorism Act) (PL 177-188) requires owners, operators, or agents in charge of domestic and foreign facilities that manufacture, process, pack, or hold food for human or animal consumption in the United States to register their facilities with FDA by December 12, 2003, unless the facility is exempted. A domestic facility must be registered whether or not food from that facility enters interstate commerce. Facilities that begin, after December 12, 2003, to manufacture, process, pack, or hold food for human or animal consumption in the U.S. must be registered with FDA before beginning such activities.

The purpose of registration is to provide FDA with sufficient and reliable information about food and feed facilities. When used with the detention, record keeping, and prior notice provisions in sections 303, 306, and 307, respectively, of the Bioterrorism Act, registration will help provide FDA with information on the origin and distribution of food and feed products and thereby, aid in the detection and quick response to actual or potential threats to the U.S. food supply. Registration information also will help FDA notify firms that may be affected by the actual or potential threat. FDA estimates that the total number of food facilities that must register is approximately 420,000, approximately half of which are domestic.

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The Bioterrorism Act, as implemented by the interim final rule for registration of food facilities (68 Fed. Reg. 58894; October 10, 2003; codified at 21 CFR Part 1, Subpart H), exempts the following from registration:

1. A foreign facility, if food from such facility undergoes further manufacturing/processing (including packaging) by another facility outside the U.S. A facility is not exempt under this provision if the further manufacturing/processing (including packaging) conducted by the subsequent facility consists of adding labeling or any similar activity of a *de minimis* nature. In such circumstances, the facility conducting the *de minimis* activity also must be registered.
2. Farms, which are establishments devoted to the growing and harvesting of crops, the raising of animals (including seafood), or both. Washing, trimming of outer leaves of, and cooling produce are considered part of harvesting. The term "farm" includes:
    1. Facilities that pack or hold food, provided that all food used in such activities is grown, raised, or consumed on that farm or another farm under the same ownership; and
    2. Facilities that manufacture/process food, provided that all food used in such activities is consumed on that farm or another farm under the same ownership.
3. Retail food establishments, which are establishments that sell food directly to consumers as their primary function. If an establishment's annual sales to consumers exceed its sales to non-consumers, the establishment is an exempt retail establishment. For purposes of this exemption, businesses are not considered consumers.
4. Restaurants, which are establishments that prepare and serve food directly to consumers for immediate consumption.
5. Nonprofit food establishments, which are charitable entities that prepare or serve food directly to consumers, or otherwise provide food for consumption by humans or animals in the U.S..
6. Fishing vessels, including those that not only harvest and transport fish but also engage in practices such as heading, eviscerating, or freezing intended solely to prepare fish for holding on board a harvest vessel. Fishing vessels that otherwise engage in processing fish are required to register. "Processing" means handling, storing, preparing, shucking, changing into different market forms, manufacturing, preserving, packing, labeling, dockside unloading, holding, or heading, eviscerating, or freezing other than solely to prepare fish for holding on board a harvest vessel. Note that "dockside unloading'" is intended to cover waterfront facilities that unload vessels and pack the catch for shipment to buyers, not the vessels from which the catch is unloaded. (See 60 FR 65096, 65114 to 65115, December 18, 1995.)
7. Facilities that are regulated exclusively, throughout the entire facility, by the U.S. Department of Agriculture under the Federal Meat Inspection Act (21 U.S.C. 601 *et seq.*), the Poultry Products Inspection Act (21 U.S.C. 451 *et seq.*), or the Egg Products Inspection Act (21 U.S.C. 1031 *et seq.*)

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Federal Register

Friday,
October 10, 2003

Part VI

Department of Health and Human Services

Food and Drug Administration

21 CFR Parts 1 and 20

Registration of Food Facilities Under the Public Health Security and Bioterrorism Preparedness and Response Act of 2002; Interim Rule

Prior Notice of Imported Food Under the Public Health Security and Bioterrorism Preparedness and Response Act of 2002; Interim Rule

Risk Assessment for Food Terrorism and Other Food Safety Concerns; Availability; Notice

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DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration

21 CFR Parts 1 and 20

[Docket No. 02N–0276]

RIN 0910–AC40

Registration of Food Facilities Under the Public Health Security and Bioterrorism Preparedness and Response Act of 2002

AGENCY: Food and Drug Administration, HHS.

ACTION: Interim final rule.

SUMMARY: The Food and Drug Administration (FDA) is issuing an interim final regulation that requires domestic and foreign facilities that manufacture/process, pack, or hold food for human or animal consumption in the United States to register with FDA by December 12, 2003. The interim final rule implements the Public Health Security and Bioterrorism Preparedness and Response Act of 2002 (the Bioterrorism Act), which requires domestic and foreign facilities to register with FDA by December 12, 2003, even in the absence of a final regulation. Registration is one of several tools that will enable FDA to act quickly in responding to a threatened or actual terrorist attack on the U.S. food supply by giving FDA information about facilities that manufacture/process, pack, or hold food for consumption in the United States. In the event of an outbreak of foodborne illness, such information will help FDA and other authorities determine the source and cause of the event. In addition, the registration information will enable FDA to notify quickly the facilities that might be affected by the outbreak.

DATES: This interim final rule is effective December 12, 2003. Submit written or electronic comments by December 24, 2003.

FOR FURTHER INFORMATION CONTACT: Leslye M. Fraser, Center for Food Safety and Applied Nutrition (HFS–4), Food and Drug Administration, 5100 Paint Branch Pkwy., College Park, MD 20740, 301–436–2378.

ADDRESSES: Submit written comments to the Division of Dockets Management (HFA–305), Food and Drug Administration, 5630 Fishers Lane, rm. 1061, Rockville, MD 20852. Submit electronic comments to *http://www.fda.gov/dockets/ecomments.*

SUPPLEMENTARY INFORMATION:

Table of Contents

I. Background and Legal Authority

On February 3, 2003 (68 FR 5378), FDA and the Department of the Treasury jointly issued a proposed rule requiring certain food facilities to register with FDA. The events of September 11, 2001, had highlighted the need to enhance the security of the infrastructure of the United States, including the food supply. Congress had responded by enacting the Bioterrorism Act (Pub. L. 107–188), which was signed into law on June 12, 2002. The Bioterrorism Act includes a provision in title III (Protecting Safety and Security of Food and Drug Supply), Subtitle A—Protection of Food Supply, section 305, which requires the Secretary of Health and Human Services (the Secretary) to develop a regulation to require domestic and foreign facilities that manufacture, process, pack, or hold food for consumption in the United States to register with FDA by December 12, 2003. The provision creates section 415 and amends sections 301 and 801 of the Federal Food, Drug, and Cosmetic Act (the FD&C Act) (21 U.S.C. 331 and 381). The Bioterrorism Act also requires FDA to issue regulations mandating prior notice of imported food shipments (section 307), directs FDA to issue regulations regarding the maintenance of certain records (section 306), and grants FDA the authority to administratively detain food (section 303). FDA and the Department of the Treasury have jointly published proposed rules implementing section 307 (68 FR 5428, February 3, 2003), and FDA has published proposed rules implementing section 303 (68 FR 25242, May 9, 2003), and section 306 (68 FR 25188, May 9, 2003). The prior notice interim final rule appears elsewhere in this issue of the **Federal Register**.

The major components of section 305 of the Bioterrorism Act are as follows:

- The owner, operator, or agent in charge of a facility is responsible for the submission of a registration to FDA;
- Each facility must be separately registered and the registration must include the name and address of the facility, and all trade names under which the registrant conducts business from that facility. The registration for foreign facilities also must include the name of the U.S. agent for the facility;
- FDA also may require each registration to include the general food category (as identified under § 170.3 (21 CFR 170.3)) of the food manufactured, processed, packed, or held at the facility, if FDA determines through guidance that this submission is necessary. FDA issued guidance on July 17, 2003 (68 FR 42415), available at *http://www.fda.gov/oc/bioterrorism/bioact.html,* that concluded that information about food product categories is necessary for a quick, accurate, and focused response to an actual or potential bioterrorist incident or other food-related emergency;
- Foreign facilities that manufacture/process, pack, or hold food that is exported for consumption in the United States are required to register unless the food undergoes further processing or packaging at another facility outside the United States;
- Establishments excluded from the registration requirement are farms, restaurants and other retail food establishments, nonprofit food establishments, and fishing vessels (except those engaged in processing as defined in § 123.3(k) (21 CFR 123.3(k));
- FDA shall notify the registrant when it has received the registration

and assign a unique registration number to each registered facility;

- FDA may encourage electronic registration;
- Registered facilities must notify FDA in a timely manner of changes to their registration information;
- FDA is required to compile and maintain an up-to-date list of registered facilities; and
- FDA's list of facilities and registration documents are not subject to public disclosure under 5 U.S.C. 552 (the Freedom of Information Act). Information derived from this list or these documents is also not subject to such disclosure to the extent that it discloses the identity or location of a specific registered facility.

In addition to section 305 of the Bioterrorism Act, FDA is relying on section 701(a) and (b) of the FD&C Act (21 U.S.C. 371(a) and (b)) in issuing this interim final rule. Section 701(a) authorizes the agency to issue regulations for the efficient enforcement of the act, while section 701(b) of the FD&C Act authorizes FDA and the Department of Treasury jointly to prescribe regulations for the efficient enforcement of section 801 of the FD&C Act (21 U.S.C. 381).

This interim final rule implements the food facility registration requirements in section 305 of the Bioterrorism Act. Elsewhere in this issue of the **Federal Register**, FDA is issuing an interim final rule implementing section 307 (prior notice of imported food). The two interim final rules published in this issue of the **Federal Register**, as well as the regulations FDA will issue to implement section 306 (recordkeeping/records access) and section 303 (administrative detention) of the Bioterrorism Act, will help FDA act quickly in responding to a threatened or actual bioterrorist attack on the U.S. food supply or to other food-related emergencies. Registration will provide FDA with information about facilities that manufacture/process, pack, or hold food for consumption in the United States. In the event of an outbreak of foodborne illness, such information will help FDA and other authorities determine the source and cause of the event. In addition, the registration information will enable FDA to notify more quickly the facilities that might be affected by the outbreak. In developing this interim final rule, FDA has complied with its international trade obligations, including the applicable World Trade Organization (WTO) agreements and the North American Free Trade Agreement (NAFTA).

II. Highlights of the Interim Final Rule and Summary of the Significant Changes Made to the Proposed Rule

A. The Highlights of This Interim Final Rule Are Described Briefly Below and Are Discussed in More Detail Later in the Preamble

The highlights of this interim final rule are as follows:

- The owner, operator, or agent in charge of a facility engaged in manufacturing/processing, packing, or holding food for consumption in the United States by humans or animals is responsible for registering the facility with FDA;
- The owner, operator, or agent in charge of a facility that is required to register may authorize an individual to submit the facility's registration to FDA;
- Facilities covered under this rule must be registered by December 12, 2003;
- A foreign facility is exempt from registering if food from the facility undergoes further processing or packaging by another facility outside the United States. The facility is not exempt from registration if the processing or packaging activities of the subsequent facility are limited to affixing a label to a package or other de minimis activity. The facility that conducts the de minimis activity also must register;
- The following domestic and foreign facilities are also exempt from registration: Farms; restaurants and other retail food establishments; nonprofit food facilities that prepare or serve food directly to the consumer or otherwise provide food or meals for consumption by humans or animals in the United States; fishing vessels not engaged in processing as defined in § 123.3(k); and facilities regulated exclusively, throughout the entire facility, by the U.S. Department of Agriculture (USDA) under the Federal Meat Inspection Act (21 U.S.C. 601 *et seq.*), the Poultry Products Inspection Act (21 U.S.C. 451 *et seq.*), or the Egg Products Inspection Act (21 U.S.C. 1031 *et seq.*);
- Registrants must use Form 3537 to register. This form is available either on the Internet (see address below) or via mail or phone request. FDA will begin processing paper registrations on October 16, 2003. Registrants must use Form 3537a to cancel their registration;
- FDA strongly encourages electronic registration, which will be quicker and more convenient for both facilities and FDA than registration by mail or CD–ROM;
- To register electronically, beginning on October 16, 2003, a registrant may visit *http://www.fda.gov/furls,* which is available for registration 24 hours a day, 7 days a week. This Web site is available from wherever the Internet is accessible, including libraries, copy centers, schools, and Internet cafes, as well as through a foreign facility's U.S. agent or other authorized individual if the facility makes such arrangements;
- Regardless of the mode of submission (electronic, paper, or CD–ROM), each registration must include the name and contact information for the facility and its parent company (if applicable); all trade names the facility uses; applicable food product categories as identified in § 170.3 of this chapter; a statement certifying that the information submitted is true and accurate and that the person submitting the registration is authorized by the facility to register on its behalf; and if a foreign facility, the name of and contact information for the facility's U.S. agent. A domestic facility must provide emergency contact information;
- No registration fee is required;
- Updates to registration information or cancellation of registration must be submitted within 60 calendar days of any change to any of the required information previously submitted;
- Failure of a domestic or foreign facility to register, update, or cancel its registration in accordance with this regulation is a prohibited act under section 301(dd) of the FD&C Act;
- The disposition of food imported or offered for import from an unregistered foreign facility will be governed by the procedures set out in subpart I of this part 1 (21 CFR part 1) (Prior Notice of Imported Food); and
- Assignment of a registration number to a facility means that the facility is registered with FDA. Assignment of a registration number does not in any way convey FDA's approval or endorsement of a facility or its products.

B. Significant Changes Made to the Proposed Rule

The significant changes FDA made to the proposed rule are as follows:

- The interim final rule provides that private residences of individuals and nonbottled water drinking water collection and distribution establishments and structures are not facilities and, therefore, are not required to register;
- The interim final rule clarifies that transport vehicles are not facilities if they hold food only in the usual course of business as carriers;
- The definition of farm now states that washing, trimming of outer leaves, and cooling produce are part of harvesting;

- The definition of farm now includes facilities that pack or hold food, provided that all food used in such activities is grown, raised, or consumed on that farm or another farm under the same ownership;
- The definition of food for purposes of the Bioterrorism Act excludes food contact substances as defined in section 409(h)(6) of the FD&C Act (21 U.S.C. 348(h)(6)) and pesticides as defined in the Federal Insecticide, Fungicide, and Rodenticide Act (FIFRA), 7 U.S.C. 136(u);
- Packaging (when used as a verb) has been defined and means "placing food into the container that directly contacts the food and that the consumer receives;"
- The definition of "retail food establishment" has been revised to

an establishment that sells food products directly to consumers as its primary function. A retail establishment may manufacture/process, pack, or hold food if the establishment's primary function is to sell from that establishment food that it manufactures/processes, packs, or holds directly to consumers. A retail food establishment's primary function is to sell food directly to consumers if the annual monetary value of sales of food products directly to the consumers exceeds the annual monetary value of sales of food products to all other buyers. The term 'consumers' does not include businesses. A 'retail food establishment' includes grocery stores, convenience stores, and vending machine locations.

- FDA has added a definition for "trade name" as "the name or names under which the facility conducts business, or additional names by which the facility is known. A trade name is associated with a facility, and a brand name is associated with a product;"
- FDA has determined that it will contact the foreign facility's U.S. agent when an emergency occurs, unless the registration specifies another emergency contact under § 1.233(b);
- FDA is clarifying that having a single U.S. agent for FDA registration purposes does not preclude facilities from having multiple agents (such as foreign suppliers) for other business purposes. A firm's commercial business in the United States need not be conducted through the U.S. agent designated for purposes of registration;
- FDA is allowing registrants to submit their registrations by fax or CD–ROM, which FDA will enter into its registration system, along with the mailed submissions, as soon as practicable, in the order received;
- FDA has changed the timeframe in which registrants must update their registrations from 30 days to within 60 days of any change in the required information;
- FDA has deleted the requirement to update optional information previously submitted, but encourages facilities to do so voluntarily; and
- FDA has clarified that if a facility has a new owner, the former owner must submit a cancellation within 60 calendar days of the change and the new owner must re-register the facility.
- FDA now provides that the failure of an owner, operator, or agent in charge of a facility governed by this interim final rule to register such facility, update required elements of its registration, or cancel its registration, is a prohibited act under section 301(dd) of the FD&C Act (21 U.S.C. 331(dd)).

III. Comments on the Proposed Rule

FDA received approximately 350 submissions in response to the proposed rule, which raised almost 200 major issues. To make it easier to identify comments and FDA's responses to the comments, the word "Comment" will appear in parentheses before the description of the comment, and the word "Response" will appear in parentheses before FDA's response. FDA has also numbered each comment to make it easier to identify a particular comment. The number assigned to each comment is purely for organizational purposes and does not signify the comment's value or importance or the order in which it was submitted.

A. General Comments

(Comment 1) Most commenters state that they generally support protection of the U.S. food supply under the Bioterrorism Act. Although some commenters assert that the proposed rule should be amended to reflect more accurately industry practices, other commenters believe the regulation should be strengthened to ensure that FDA has all the information required to identify foods that may pose a health or security threat. Other commenters question how the interim final rule would enhance FDA's ability to improve food safety and whether the benefits outweigh the costs.

Some commenters argue that the proposed regulation should either be reproposed or not implemented at all. These commenters claim that the proposed rule is seriously flawed, unduly burdensome, and will unnecessarily interfere with trade. Some of these commenters also argue that FDA already has complete information to allow for identification of, and quick communication with, affected facilities before a shipment is introduced into U.S. commerce.

(Response) In response to the comments regarding reproposing or not implementing the rule, these options are not available to FDA under the Bioterrorism Act, because that act requires FDA to "promulgate proposed and final regulations for the requirement of registration" by December 12, 2003. The Bioterrorism Act further states that the registration requirement takes effect on December 12, 2003, even if FDA does not have a final regulation in effect by the deadline. FDA believes that both the proposed rule and this interim final rule properly implement section 305 of the Bioterrorism Act, and thus, there is no need to repropose the regulation. Further, based on the many comments supporting the proposed regulation as well as those comments suggesting limited changes to the rule as proposed, FDA disagrees that the proposed regulation is so flawed that reproposal is required.

FDA is aware that the registration regulation may alter industry practices to some extent. In enacting the Bioterrorism Act, Congress determined that registration with FDA was necessary to respond to bioterrorism and other food-related emergencies. Registration will give FDA information it does not currently have about facilities that manufacture/process, pack, or hold food for consumption in the United States, and current contact information for all of these facilities. FDA will be able to use this information to target its contacts to both domestic and foreign facilities in the event of a bioterrorist threat or other food-related emergency. Information about food product categories will permit FDA to screen food imports more carefully because the agency will be able to match a registrant's food product category with the product code and common or usual or market name submitted as part of a prior notice (21 CFR part 1, subpart I). Registration will also give FDA information that we can use to focus and better utilize the agency's limited inspection resources.

Registering with FDA creates an information trail, which would, even if the information in the registration were falsified, provide evidence that could link the registration to the registrant. By creating this paper trail, persons in the food supply chain who might intentionally contaminate food may be deterred by the creation of additional evidence that might be used against them. Persons who might intentionally contaminate the food supply but refuse to register would be subject to criminal and civil sanctions and would risk having their product, if imported, held at the port.

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Jan 10, 2017
HB 1145

PAM

Public Action Management

January 9, 2017

The Honorable George J. Keiser
Chair, and the members of the
House Industry, Business & Labor Committee
North Dakota Legislative Assembly

RE: HB 1145

Dear Representative Keiser:

I am a former alcohol regulator who has an educational campaign to foster a "Healthy Alcohol Marketplace." For seven years, I was director of the Oregon Liquor Control Commission. I left to direct Oregon's media campaign to reduce underage drinking. As a prevention advocate, my admiration of our states' regulatory systems increased as I immersed myself in the research on how to combat underage drinking and other alcohol problems. Eventually, I decided to form a small business and develop an educational campaign designed to further effective alcohol regulation. My particular mission is to explain alcohol regulations in simple terms and identify how they work to reduce problems. My program is called the "Campaign for a Healthy Alcohol Marketplace" which can be accessed at www.healthyalcoholmarket.com.

As you may know, Oregon has been a leader in developing a flourishing business for craft beer, small boutique wineries and craft distilleries. This has been accomplished without removing Tied House ownership or financial tying provisions. In fact, I don't believe that these businesses would even exist today if Tied House provisions did not exist. Large companies would likely have found ways to dominate local markets to the point where small craft products simply couldn't get to market. This is how things operate in other parts of the world. If you go to Mexico or Italy, you rarely see craft products in retail stores or restaurants. You only see products of one or two large companies.

My purpose today is to identify likely consequences of changing your alcohol control system by allowing a manufacturer to have any financial interest in a retailer and allowing a retailer to have any financial interest in a manufacturer. This would end the Tied House prohibitions in your state. Even with retention of wholesale provisions, the change would be a dramatic. Changing market regulations can unleash powerful forces that could bring you a scenario which is not the one you desired.

1. No doubt you want to give entrepreneurs in your state more opportunities for new business. However, I would ask you to think about who would take advantage of such opportunities. The large national and international corporations are in the best position to take advantage of such a change, not your local businesspeople. These companies are very interested in the retail business and its profits. Recently,

Public Action Management, PLC ▲ P.O. Box 531726 ▲ Henderson, NV 89053 ▲ P. (503) 936-0443 ▲ pam@pamaction.com

PAM

Anheuser-Busch/In Bev, now a Belgian company, started buying pubs in the United Kingdom. They have entered the retail sector in the US, where possible, sometimes by purchasing craft brewers that own brew pubs. Other large companies are doing similar things. These companies have cash, enormous purchasing power and an extensive distribution system. This legislative change would allow them to buy up as many retailers in your state as they want. They could then undercut your local operators by offering an extensive set of products at low prices. In a few years, they could come to dominate your local markets and the profits would go out of state.

2. Marketplace changes are notoriously difficult to predict and sometimes a change can result in the opposite of what was intended. Several years ago, cities in the United Kingdom sought deregulation of alcohol as a way to revitalize their inner cities. They wanted to create entertainment districts with a café-style culture similar to that in France, Spain and Italy. Small cafes, entertainment venues and pubs would bring tourists and residents to a safe, yet lively district. What happened was something different. Large moneyed interests created "mega-bars" with room for hundreds of patrons, straining the resources of law enforcement and local hospitals. Retailers were pushed by their companies to serve people to the point of extreme intoxication. These inner cities became so dangerous that police warned the public to stay away. Re-regulation has been exceptionally difficult as the large businesses object to changes and regularly file lawsuits.

3. The US alcohol regulatory system was specifically designed to prevent the problems of marketplace domination by large, out of state entities. Before Prohibition, local markets across our nation were dominated by large alcohol companies that owned retailers in a tied house system. They pushed their retailers to sell as much alcohol as possible to provide the highest profits. Our tiered system is designed to prevent a repetition of that history. Moreover, this system keeps prices balanced, inhibits aggressive sales practices and allows both small and large operators to be profitable.

Most import…our system has provided a good level of public health and safety. Our consumption levels are much less than many developed countries including those in Europe. Our regulations have prevented the kinds of problems that exist today in the United Kingdom. We have reduced underage drinking and drunk driving. But, we certainly do not want to reverse these gains. In fact, we need to re-double our efforts to prevent further deaths, injuries and health problems for our children and our citizens. I strongly urge you to consider these points.

Sincerely,

Pamela S. Erickson, President/CEO
Public Action Management

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(503) 936-0443 ▲ pam@pamaction.com

17.0285.01000

Jan 11, 2017

Attachment 1
Rep. Becker

Sixty-fifth
Legislative Assembly
of North Dakota

HOUSE BILL NO. 1145

Introduced by

Representative Rick C. Becker

A BILL for an Act to amend and reenact section 5-01-11 and subsection 6 of section 5-01-21 of the North Dakota Century Code, relating to a financial interest between alcohol retailers and manufacturers.

BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF NORTH DAKOTA:

SECTION 1. AMENDMENT. Section 5-01-11 of the North Dakota Century Code is amended and reenacted as follows:

5-01-11. Unfair competition - Penalty.

A manufacturer may not have any financial interest in any wholesale alcoholic beverage business. A ~~manufacturer or~~ wholesaler may not have any financial interest in any retail alcoholic beverage establishment and may not furnish any such retailer with anything of value. A retailer may not have any financial interest in any ~~manufacturer, supplier, or wholesaler~~ manufacturer not domiciled in this state. A wholesaler may:

1. Extend normal commercial credits to retailers for industry products sold to them. The state tax commissioner may determine by rule the definition of "normal commercial credits" for each segment of the industry.
2. Furnish retailers with beer containers and equipment for dispensing of tap beer if the expense to the wholesaler associated with the furnishing of containers, equipment, and tap or coil cleaning service does not exceed one hundred fifty dollars per tap per calendar year.
3. Furnish outside signs to retailers if the sign cost does not exceed four hundred dollars exclusive of costs of erection and repair.
4. Furnish miscellaneous materials to retailers not to exceed one hundred dollars per year. "Miscellaneous materials" not subject to this limitation include any indoor point-of-sale items for retail placement. Point-of-sale items include back bar signs,

pool table lights, neon window signs, and items of a similar nature. The point-of-sale items must be limited to five hundred dollars per retail account from the wholesaler for each of the wholesaler's brewers or suppliers.

Any wholesaler, retailer, or manufacturer violating this section, or any rule adopted to implement this section, and any retailer receiving benefits thereby, is guilty of a class A misdemeanor. ~~A microbrew pub is exempt from the provisions of this section to the extent that this section restricts the co-ownership of a manufacturer's license and a retail license for the purpose of a microbrew pub.~~ keep this

SECTION 2. AMENDMENT. Subsection 6 of section 5-01-21 of the North Dakota Century Code is amended and reenacted as follows:

6. A brewer may have multiple taproom licenses, but may not have an ownership interest in whole or in part, or be an officer, director, agent, or employee of any other manufacturer, brewer, importer, ~~or~~ wholesaler, ~~or retailer,~~ or be an affiliate thereof, whether the affiliation is corporate or by management, direction, or control.

or retailer,

7. Subsection 6. of this Section does not apply to ownership interest of a brewer and retailer when both are domiciled in this state.

Jan 11, 2017 HB 1145 1

Page 1, line 11 of the bill to read as follows:

A retailer may not have any financial interest in any manufacturer, producing in excess of two hundred fifty thousand gallons of wine or distilled spirits or five million gallons of beer annually, or any wholesaler. The production limits in this subsection refer to the combined amount of production produced by all affiliates of the manufacturer or manufacturer ownership whether the affiliation is corporate or by management, direction, or control. A wholesaler may:

Thank you.

Rick Becker
District 7
Bismarck

17.0285.01001
Title.

Prepared by the Legislative Council staff for
Representative Rick C. Becker
January 17, 2017

1
1/18/17

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1145

Page 1, line 11, remove the overstrike over "~~manufacturer~~"

Page 1, line 11, after "~~or~~" insert "producing in excess of two hundred fifty thousand gallons [946353 liters] of wine or distilled spirits or five million gallons [18927059 liters] of beer annually or any"

Page 1, line 11, after the period insert "The production limits in this section pertain to the combined amount of production produced by all affiliates of the manufacturer or manufacturer ownership whether the affiliation is corporate or by management, direction, or control."

Renumber accordingly

Rep. Becker (2)
4/18/17
HB 1145

KeyCite Yellow Flag - Negative Treatment
Distinguished by Coors Brewing Co. v. Mendez-Torres, D.Puerto Rico, March 30, 2011

592 F.3d 1
United States Court of Appeals,
First Circuit.

FAMILY WINEMAKERS OF CALIFORNIA, Stephen J. Poor, III, M.D., Gerald C. Leader, Plaintiffs, Appellees,
v.
Eddie J. JENKINS, in his official capacity as Chairman of the Massachusetts Alcoholic Beverages Control Commission; Robert H. Cronin and Susan Corcoran, in their official capacities as Associate Commissioners of the Massachusetts Alcoholic Beverages Control Commission, Defendants, Appellants.

No. 09-1169.
|
Heard Nov. 2, 2009.
|
Decided Jan. 14, 2010.

Synopsis

Background: Out-of-state wineries brought action challenging Massachusetts statute which controlled distribution of wines in Massachusetts as violative of the Commerce Clause and the Twenty-first Amendment. The United States District Court for the District of Massachusetts, Rya W. Zobel, J., issued injunction to enjoin the enforcement of the statute. State officials appealed.

Holdings: The Court of Appeals, Lynch, Chief Judge, held that:

[1] statute violated the Commerce Clause, and

[2] the Twenty-first Amendment did not protect statute from invalidation under the Commerce Clause.

Affirmed.

West Headnotes (16)

[1] **Commerce**
⇐Powers reserved to states
Intoxicating Liquors
⇐Licensing and regulation

The Twenty-first Amendment does not protect state alcohol laws that explicitly favor in-state over out-of-state interests from invalidation under the Commerce Clause. U.S.C.A. Const. Art. 1, § 8, cl. 3; U.S.C.A. Const.Amend. 21.

Cases that cite this headnote

[2] **Commerce**
⇐Regulation and conduct in general; particular businesses

The Commerce Clause prevents states from creating protectionist barriers to interstate trade. U.S.C.A. Const. Art. 1, § 8, cl. 3.

Cases that cite this headnote

[3] **Commerce**
⇐Preferences and Discriminations
Commerce
⇐Regulation and conduct in general; particular businesses

Discrimination under the Commerce Clause means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter, as opposed to state laws that regulate evenhandedly with only incidental effects on interstate commerce. U.S.C.A. Const. Art. 1, § 8, cl. 3.

6 Cases that cite this headnote

[4] **Commerce**
Powers Remaining in States, and Limitations Thereon

Plaintiffs asserting a claim for violation of the Commerce Clause bear the initial burden of showing discrimination against interstate commerce. U.S.C.A. Const. Art. 1, § 8, cl. 3.

3 Cases that cite this headnote

[5] **Commerce**
Local matters affecting commerce

Even if the challenged law regulates in-state and out-of-state interests even-handedly, it may still violate the Commerce Clause if the burden imposed on interstate commerce is clearly excessive in relation to the putative local benefits. U.S.C.A. Const. Art. 1, § 8, cl. 3.

3 Cases that cite this headnote

[6] **Commerce**
Local matters affecting commerce

If plaintiffs meet their burden of showing discrimination against interstate commerce, then a discriminatory law is virtually per se invalid under the Commerce Clause, and will survive only if it advances a legitimate local purpose that cannot be adequately served by reasonable non-discriminatory alternatives. U.S.C.A. Const. Art. 1, § 8, cl. 3.

5 Cases that cite this headnote

[7] **Commerce**
Powers Remaining in States, and Limitations Thereon
Commerce
Local matters affecting commerce

In analyzing a claim for violation of the Commerce Clause, the state bears the burden of showing legitimate local purposes and the lack of non-discriminatory alternatives, and discriminatory state laws rarely satisfy this exacting standard. U.S.C.A. Const. Art. 1, § 8, cl. 3.

2 Cases that cite this headnote

[8] **Commerce**
Subjects and regulations in general
Intoxicating Liquors
Licensing and regulation

Massachusetts statute controlling distribution of wines in Massachusetts, prohibiting large wineries from both directly shipping to in-state consumers and distributing to wholesalers at same time, and defining large wineries as those that produced more than 30,000 gallons of grape wine annually, excluding other fruit wine production, was discriminatory in effect and purpose against out-of-state wineries, and thus, violated Commerce Clause; all wineries in Massachusetts were small wineries under statute, small wineries could use multiple distribution methods at same time, giving them market advantage, so that effect of gallonage **cap** was to alter competition between in-state and out-of-state wineries to the detriment of out-of-state wineries that produced 98 percent of country's wine, advantages afforded to small wineries bore little relation to market challenges caused by relative sizes of the wineries, statutory context, legislative history, and unusual regulatory features that tracked in-state wine production demonstrated that statute was intended to benefit in-state wine industry, and viable non-discriminatory alternative existed to allow all wineries to directly ship to consumers and distribute through wholesalers. U.S.C.A. Const. Art. 1, § 8, cl. 3; M.G.L.A. c. 138, § 19F.

6 Cases that cite this headnote

[9] **Commerce**
Preferences and Discriminations

Commerce
Regulation and conduct in general; particular businesses

A state law is discriminatory in effect, as may violate the Commerce Clause, when, in practice, it affects similarly situated entities in a market by imposing disproportionate burdens on out-of-state interests and conferring advantages upon in-state interests. U.S.C.A. Const. Art. 1, § 8, cl. 3.

5 Cases that cite this headnote

[10] **Commerce**
Regulation and conduct in general; particular businesses

A law is discriminatory in effect, as may violate the Commerce Clause, when the effect of a state regulation is to cause local goods to constitute a larger share, and goods with an out-of-state source to constitute a smaller share, of the total sales in the market. U.S.C.A. Const. Art. 1, § 8, cl. 3.

2 Cases that cite this headnote

[11] **Commerce**
Powers Remaining in States, and Limitations Thereon
Commerce
Regulation and conduct in general; particular businesses

In analyzing a Commerce Clause claim, less deference to legislative judgment is due where the local regulation bears disproportionately on out-of-state residents and businesses. U.S.C.A. Const. Art. 1, § 8, cl. 3.

Cases that cite this headnote

[12] **Commerce**
Local matters affecting commerce

A state can only carry its burden of demonstrating a legitimate local purpose that could not be attained through reasonable non-discriminatory alternatives, as required to prevail in a Commerce Clause challenge when the statute discriminates against interstate commerce, by presenting concrete record evidence, and not sweeping assertions or mere speculation, to substantiate its claims that the discriminatory aspects of its challenged policy are necessary to achieve its asserted objectives. U.S.C.A. Const. Art. 1, § 8, cl. 3.

3 Cases that cite this headnote

[13] **Commerce**
Powers reserved to states
Intoxicating Liquors
Licensing and regulation

The Twenty-first Amendment, which ended Prohibition and gave states certain limited authority to regulate the transportation importation, and use of alcohol within their borders, did not protect Massachusetts statute, which controlled distribution of wines in Massachusetts, from invalidation under the Commerce Clause, although the statute was facially neutral, where the statute was discriminatory in purpose and effect against out-of-state wineries. U.S.C.A. Const. Art. 1, § 8, cl. 3; U.S.C.A. Const.Amend. 21.

1 Cases that cite this headnote

[14] **Commerce**
Delegation of power by Congress

Although Congress may authorize the States to engage in regulation that the Commerce Clause would otherwise forbid, courts can exempt state statutes from the implied limitations of the Clause only when the congressional direction to do so has been unmistakably clear. U.S.C.A.

Const. Art. 1, § 8, cl. 3.

Cases that cite this headnote

[15] **Commerce**
Powers reserved to states
Intoxicating Liquors
Licensing and regulation

The Twenty-first Amendment, which ended Prohibition and gives states certain limited authority to regulate the transportation, importation, and use of alcohol within their borders, does not exempt facially neutral state alcohol laws with discriminatory effects and purpose from the non-discrimination rule of the Commerce Clause. U.S.C.A. Const. Art. 1, § 8, cl. 3; U.S.C.A. Const.Amend. 21.

1 Cases that cite this headnote

[16] **Intoxicating Liquors**
States

Purposes of the Twenty-first Amendment, which ended Prohibition and gives states certain limited authority to regulate the transportation, importation, and use of alcohol within their borders, include promoting temperance, ensuring orderly market conditions, and raising revenue. U.S.C.A. Const.Amend. 21.

Cases that cite this headnote

West Codenotes

Held Unconstitutional
M.G.L.A. c. 138, § 19F.

Recognized as Unconstitutional
M.G.L.A. c. 138, § 19B.

Recognized as Invalid
KRS 243.155.

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4 Before LYNCH, Chief Judge, STAHL, Circuit Judge, and DiCLERICO, District Judge.

Opinion

LYNCH, Chief Judge.

Massachusetts officials appeal from an injunction against a 2006 Massachusetts statute establishing differential methods by which wineries distribute wines in Massachusetts, Mass. Gen. Laws ch. 138, § 19F. The district court enjoined enforcement of § 19F on the ground that the law discriminates against interstate commerce in violation of the Commerce Clause of the United States Constitution. *See Family Winemakers of Cal. v. Jenkins,* No. 1:06-cv-11682-RWZ at 17-28 (D.Mass. Nov. 19, 2008) (order granting summary judgment).

We briefly summarize the basis for the lawsuit, the issues

presented, and our resolution of them before turning to the supporting analysis. Section 19F only allows "small" wineries, defined by Massachusetts as those producing 30,000 gallons or less of grape wine a year, to obtain a "small winery shipping license." This license allows them to sell their wines in Massachusetts in three ways: by shipping directly to consumers, through wholesaler distribution, and through retail distribution. All of Massachusetts's wineries are "small" wineries. Some out-of-state wineries also meet this definition.

Wines from "small" Massachusetts wineries compete with wines from "large" wineries, which Massachusetts has defined as those producing more than 30,000 gallons of grape wine annually. These "large" wineries must choose between relying upon wholesalers to distribute their wines in-state or applying for a "large winery shipping license" to sell directly to Massachusetts consumers. They cannot, by law, use both methods to sell their wines in Massachusetts, and they cannot sell wines directly to retailers under either option. No "large" wineries are located inside Massachusetts.

Plaintiffs, a group of California winemakers and Massachusetts residents, assert § 19F was designed with the purpose, and has the effect, of advantaging Massachusetts wineries to the detriment of those wineries that produce 98 percent of the country's wine, in violation of the Commerce Clause. Massachusetts defends § 19F on the basis that its law has neither a discriminatory purpose nor a discriminatory effect. Massachusetts has not argued in its briefs that there are no legitimate alternative methods of regulation to serve § 19F's asserted purposes. Massachusetts also argues that under the Twenty-first Amendment, state laws are immunized from Commerce Clause scrutiny unless the laws discriminate on their face.

The primary question before us is whether § 19F unconstitutionally discriminates against interstate commerce in light of both the Commerce Clause,[1] art. I, § 8, cl. 3, and § 2 of the Twenty-first Amendment.[2]

*5 [1] It is clear that § 2 of the Twenty-first Amendment does not protect state alcohol laws that explicitly favor in-state over out-of-state interests from invalidation under the Commerce Clause. ***Granholm v. Heald*, 544 U.S. 460, 489, 125 S.Ct. 1885, 161 L.Ed.2d 796 (2005)**. But § 19F is neutral on its face; it does not, by its terms, allow only Massachusetts wineries to distribute their wines through a combination of direct shipping, wholesaler distribution, and retail sales. Section 19F instead uses a very particular gallonage **cap** to confer this benefit upon "small" as opposed to "large" wineries.

We hold that § 19F violates the Commerce Clause because the effect of its particular gallonage **cap** is to change the competitive balance between in-state and out-of-state wineries in a way that benefits Massachusetts's wineries and significantly burdens out-of-state competitors. Massachusetts has used its 30,000 gallon grape wine **cap** to expand the distribution options available to "small" wineries, including all Massachusetts wineries, but not to similarly situated "large" wineries, all of which are outside Massachusetts. The advantages afforded to "small" wineries by these expanded distribution options bear little relation to the market challenges caused by the relative sizes of the wineries. Section 19F's statutory context, legislative history, and other factors also yield the unavoidable conclusion that this discrimination was purposeful. Nor does § 19F serve any legitimate local purpose that cannot be furthered by a non-discriminatory alternative.

We further hold that the Twenty-first Amendment cannot save § 19F from invalidation under the Commerce Clause. Section 2 of the Twenty-first Amendment does not exempt or otherwise immunize facially neutral but discriminatory state alcohol laws like § 19F from scrutiny under the Commerce Clause. We affirm the grant of injunctive relief.

I. Facts

We engage in de novo review both because the district court entered summary judgment and because the issues presented are ones of law. There is no disagreement on the material facts. *See* Fed.R.Civ.P. 56(c); *see also Sullivan v. City of Springfield*, 561 F.3d 7, 14 (1st Cir.2009).

The ratification of the Twenty-first Amendment ended Prohibition and gave states substantial control over the regulation of alcoholic beverages. Most states, including Massachusetts, then imposed a three-tier system to control the sale of alcoholic beverages within their territories. The hallmark of the three-tier system is a rigid, tightly regulated separation between producers, wholesalers, and retailers of alcoholic beverages. Producers can ordinarily sell alcoholic beverages only to licensed in-state wholesalers. Mass. Gen. Laws ch. 138, §§ 2 and 19. Wholesalers then must obtain licenses to sell to retailers. *Id.* § 18. Retailers, which include stores, taverns, restaurants, and bars, must in turn obtain licenses to sell to consumers or to serve alcohol on their premises. *Id.* §§ 12, 15. Recently, as to wine, Massachusetts has adjusted the separation between these three tiers, as we describe

below.

The structure of the usual three-tier system is commonly described as an hourglass, with wholesalers at the constriction point. There are thousands of producers *6 nationwide, a handful of licensed Massachusetts wholesalers, and approximately ten thousand licensed retailers in Massachusetts. *See* Commonwealth of Massachusetts Alcoholic Beverages Control Commission, Licensing, http://www.mass.gov/abcc/licensing/licensing.htm.

The three-tier system has had a particularly pronounced effect on wineries' access to the Massachusetts market. The economic incentives created by the three-tier system, in conjunction with the structure of the wine industry, severely limited certain wineries' ability to sell their wines in Massachusetts.

In 2006, the year § 19F was enacted, 5,350 registered wineries in the United States produced a total of 646,395,818 gallons of wine, which includes both grape wine and fruit wine production. Almost all of the country's wine production and sales come from a small number of wineries. In 2006, the five largest wineries in the U.S. produced approximately 70 percent of the country's wine. The country's thirty largest wineries comprised approximately 92 percent of the market, and each produced between 680,000 and 150 million gallons per year. The rest of the commercial market-the 3,540 wineries which produce between one and 680,000 gallons per year-competed for 8 percent of the market share. Finally, 1,780 wineries produced less than one gallon of wine per year and had virtually zero percent of the market share.[3]

The concentration of wine production among the largest producers is driven by another feature of the wine industry: there are, broadly speaking, two categories of wine, high-**volume**, lower-cost wines and low-**volume**, higher-quality, higher-priced boutique wines. The largest wineries produce millions of gallons of wine per year because they have generally specialized in the former, but not to the exclusion of the latter. Wineries smaller than the largest producers have tended to specialize in low-**volume** boutique wines, which can be produced with a relatively small quantity of grapes and a much lower initial outlay of resources. At least until the current recession, consumer demand for boutique wines had grown exponentially, fueling a rise in the number of smaller U.S. wineries (which include many wineries producing more than 30,000 gallons annually). Fed. Trade Comm'n, *Possible Anticompetitive Barriers to E-Commerce: Wine* 6 (2003), *available at* http://www.ftc.gov/os/2003/07/winereport2.pdf (hereinafter FTC Report).

Under Massachusetts's former three-tier system, all wineries could only distribute their wines through licensed Massachusetts wholesalers, and 75 percent of the wine sold in Massachusetts went through five wholesalers. This gave wholesalers, not wineries, the balance of the bargaining power. Wholesalers do not necessarily distribute a winery's entire range of wines; they often distribute the wines most likely to be profitable to them, which are lower-priced, high-**volume** wines. Wholesalers make profits by selling wines to retailers at a markup. The more a wine sells out at retail, generating more requests for restocking, the more money a wholesaler *7 makes. Wholesalers also face fixed costs that do not depend on the price they pay to the winery for the wine: they bear the costs of transportation, storage, and handling. For these reasons, wineries producing higher-priced, low-**volume** wines, whatever the gallonage output of the winery, are less profitable and less likely to attract wholesaler distribution.

The largest wineries, as the major producers of lower-priced, high-**volume** wines, have been best able to attract wholesalers. Only the country's fifty to one hundred largest wineries have consistently secured wholesaler representation. For most smaller wineries of whatever gallonage, which produce mostly boutique wines, obtaining wholesaler representation has been difficult, if not impossible. And even if a smaller winery obtained wholesaler representation, wholesalers were likely to distribute only one or two of its wines, limiting Massachusetts consumers' access to particular wines.

Wineries have heralded direct shipping as a supplemental avenue of distribution because of its economic advantages, especially for wineries that do not rank among the fifty to one hundred largest producers. Direct shipping lets consumers directly order wines from the winery, with access to their full range of wines, not just those a wholesaler is willing to distribute. Direct shipping also avoids added steps in the distribution chain, eliminating wholesaler and retailer price markups. *See* FTC Report at 22-23.

Before 2005, § 19B, Massachusetts's farmer-winery licensing law, on its face allowed only in-state wineries to obtain licenses to combine distribution methods through wholesalers, retailers, and direct shipping to consumers. Mass. Gen. Laws ch. 138, § 19B (2002). Five months after ***Granholm*** invalidated similar facially discriminatory state laws, § 19B was held to be invalid under the Commerce Clause. *Stonington Vineyards v.*

Jenkins, No. 05-10982-JLT, slip op. at 1-2 (D.Mass. Oct. 5, 2005).

In 2006, the Massachusetts legislature enacted § 19F over then-Governor Romney's veto. Section 19F does not distinguish on its face between in-state and out-of-state wineries' eligibility for direct shipping licenses, but instead distinguishes between "small" or "large" wineries through the 30,000 gallon **cap**.

During floor debates, § 19F's sponsor summed up § 19F as follows: "[W]ith the limitations that we are suggesting in the legislation, we are really still giving an inherent advantage indirectly to the local wineries." Likewise, the state senator whose district included Massachusetts's then-largest winery explained his qualified support for § 19F by stating that "the agricultural industry here in Massachusetts is really strong and should be preserved. And we do this ... because we produce these specialty goods, pick-your-own orchards and wineries." The senator had another concern-that the winery in question, which primarily produced fruit wine, "comes close to the 30,000 [gallon] production limit" for "small" wineries and would likely soon exceed it because "it's a winery that is growing ... and certainly uses wholesalers in other states." The senator urged modifications to § 19F because "we should be promoting this kind of industry and not adopting regulations, however inadvertently, that might take away the advantage that the winery would have." The draft of § 19F was amended shortly thereafter to exempt non-grape fruit wine production from the 30,000 gallon **cap**, and that version was enacted.[4]

***8** To repeat, all wineries producing over 30,000 gallons of wine-all of which are located outside Massachusetts-can apply for a "large winery shipment license," which allows them to directly sell and ship wine to consumers, but only if "the winery has not contracted with or has not been represented by a wholesaler licensed under section 18 for the preceding 6 months." Mass. Gen. Laws ch. 138, § 19F(a). To the extent a choice is available at all, under § 19F(a), "large" wineries can either choose to remain completely within the three-tier system and distribute their wines solely through wholesalers, or they can completely opt out of the three-tier system and sell their wines in Massachusetts exclusively through direct shipping. They cannot do both. Wholesaler distribution is also the only way "large" wineries can distribute wines to retailers, including all Massachusetts restaurants and bars. To put it differently, "large" wineries cannot distribute directly to consumers except at the cost of giving up distribution to retailers. By contrast, "small" wineries can simultaneously use the traditional wholesaler distribution method, direct distribution to retailers, and direct shipping to reach consumers.

The practical effects of the distinctions Massachusetts has drawn are significant. In 2006, 637 U.S. wineries were "large" under § 19F(a)'s definition. They produced between 30,001 and over 100 million gallons per year and accounted for 98 percent of all wine produced in the United States. The thirty largest "large" wineries represented 92 percent of the national market, while the other 607 "large" wineries produced between 30,001 and 680,000 gallons per year, averaged slightly less than 60,000 gallons per year, and made up approximately 6 percent of the U.S. wine production market in 2006.

There were 4,713 "small" wineries in the United States in 2006, as the term "small" is defined by § 19F(b). Of these wineries, 1,780-more than a third-produced less than one gallon per year and had virtually no market share. The remaining 2,933 "small" wineries accounted for 2 percent of the total annual wine production in the United States in 2006.[5]

In 2007, there were thirty-one wineries in Massachusetts, all met § 19F(b)' s definition of "small," and approximately half of these wineries produced fruit wine in addition to or in lieu of traditional grape-based ***9** wines. Each produced between 200 and 24,000 gallons per year.[6]

II. Whether § 19F Discriminates against Interstate Commerce

[2] [3] [4] The Commerce Clause prevents states from creating protectionist barriers to interstate trade. *See, e.g., Lewis v. BT Inv. Managers, Inc.,* 447 U.S. 27, 35, 100 S.Ct. 2009, 64 L.Ed.2d 702 (1980). Discrimination under the Commerce Clause "means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter," as opposed to state laws that "regulate[ ] evenhandedly with only incidental effects on interstate commerce," *Or. Waste Sys.,* 511 U.S. at 99, 114 S.Ct. 1345 (internal quotation marks omitted). Plaintiffs bear the initial burden of showing discrimination.[7] *See Cherry Hill Vineyard LLC v. Baldacci,* 505 F.3d 28, 33 (1st Cir.2007) (citing *Hughes v. Oklahoma,* 441 U.S. 322, 336, 99 S.Ct. 1727, 60 L.Ed.2d 250 (1979)).

[5] [6] [7] If plaintiffs meet their burden, then "a discriminatory law is virtually per se invalid ... and will survive only if it advances a legitimate local purpose that cannot be adequately served by reasonable

non-discriminatory alternatives."[8] *Dep't of Revenue v. Davis,* 553 U.S. 328, 128 S.Ct. 1801, 1808, 170 L.Ed.2d 685 (2008) (citations omitted) (internal quotation marks omitted). The state bears the burden of showing legitimate local purposes and the lack of non-discriminatory alternatives, and discriminatory state laws rarely satisfy this exacting standard.[9] *See Camps Newfound/Owatonna, Inc. v. Town of Harrison,* 520 U.S. 564, 581-82, 117 S.Ct. 1590, 137 L.Ed.2d 852 (1997).

[8] We explain in more detail the arguments being made. Plaintiffs argue that Massachusetts's choice of 30,000 gallons as the demarcation point between "small" and "large" wineries, along with the production exception for fruit wine, has both a discriminatory ***10** effect and purpose. The discriminatory effect is because § 19F's definition of "large" wineries encompasses the wineries which produce 98 percent of all wine in the United States, all of which are located out-of-state and all of which are deprived of the benefits of combining distribution methods. All wines produced in Massachusetts, on the other hand, are from "small" wineries that can use multiple distribution methods. Plaintiffs also say that Section 19F is discriminatory in purpose because the gallonage **cap's** particular features, along with legislators' statements and § 19F's process of enactment, show that § 19F's true purpose was to ensure that Massachusetts's wineries obtained advantages over their out-of-state counterparts. Plaintiffs also argue that Massachusetts cannot meet its burden of justifying § 19F because the law neither advances the three-tier system nor effectively assists small wineries in ways that available non-discriminatory alternatives could not. Finally, in the alternative, plaintiffs contend that § 19F impermissibly burdens interstate commerce under *Pike* even if it is not discriminatory.

Massachusetts counters that § 19F is not discriminatory in effect because most "small" wineries are located out-of-state. It says this proves that § 19F disproportionately benefits out-of-state, not in-state, wineries, especially since there are far more "small" § 19F(b) wineries in the country than "large" § 19F(a) ones. Massachusetts argues that § 19F is not discriminatory in purpose because its aim is to level the economic playing field for all "small" wineries irrespective of where they are located, and the district court erroneously looked to comments by individual legislators, lobbyists, and intermediate steps in § 19F's process of enactment to find discriminatory purpose.[10] Finally, Massachusetts says that § 19F poses no undue burden on interstate commerce under *Pike* and any such burden is surpassed by the local benefits of greater competition and consumer choice.

We explain below our reasons for rejecting Massachusetts's arguments. Because we hold that § 19F discriminates against interstate commerce, it is unnecessary for us to decide whether § 19F would also violate the Commerce Clause under *Pike. See C & A Carbone, Inc. v. Town of Clarkstown,* 511 U.S. 383, 390, 114 S.Ct. 1677, 128 L.Ed.2d 399 (1994).

A. *Section 19F is Discriminatory in Effect*

[9] A state law is discriminatory in effect when, in practice, it affects similarly situated entities in a market by imposing disproportionate burdens on out-of-state interests and conferring advantages upon in-state interests. *Or. Waste Sys.,* 511 U.S. at 99, 114 S.Ct. 1345 (defining discrimination); *see also Gen. Motors Corp. v. Tracy,* 519 U.S. 278, 298, 117 S.Ct. 811, 136 L.Ed.2d 761 (1997) ("[A]ny notion of discrimination assumes a comparison of substantially similar entities.") (footnote omitted).

[10] One such form of discrimination is plainly when "the effect of a state regulation is to cause local goods to constitute a larger share, and goods with an out-of-state source to constitute a smaller share, of the total sales in the market." *Exxon Corp. v. Governor of Maryland,* 437 U.S. 117, 126 n. 16, 98 S.Ct. 2207, 57 L.Ed.2d 91 (1978). State laws that alter conditions of competition to favor in-state interests over ***11** out-of-state competitors in a market have long been subject to invalidation. *See, e.g., Hunt,* 432 U.S. at 350-51, 97 S.Ct. 2434; *Polar Ice Cream & Creamery Co. v. Andrews,* 375 U.S. 361, 376-77, 84 S.Ct. 378, 11 L.Ed.2d 389 (1964); *Baldwin v. G.A.F. Seelig, Inc.,* 294 U.S. 511, 519, 55 S.Ct. 497, 79 L.Ed. 1032 (1935); *see also Baldacci,* 505 F.3d at 36 (explaining the doctrine); *Houlton Citizens' Coalition v. Town of Houlton,* 175 F.3d 178, 188-89 (1st Cir.1999) (same).

Plaintiffs must present evidence as to why the law discriminates in practice. *See Baldacci,* 505 F.3d at 36-37.[11] Here, the totality of the evidence introduced by plaintiffs demonstrates that § 19F's preferential treatment of "small" wineries that produce 30,000 gallons or less of grape wine is discriminatory. Its effect is to significantly alter the terms of competition between in-state and out-of-state wineries to the detriment of the out-of-state wineries that produce 98 percent of the country's wine.

Section 19F confers a clear competitive advantage to "small" wineries, which include all Massachusetts's wineries, and creates a comparative disadvantage for "large" wineries, none of which are in Massachusetts. "Small" wineries that obtain a § 19F(b) license can use

direct shipping to consumers, retailer distribution, and wholesaler distribution simultaneously. Combining these distribution methods allows "small" wineries to sell their full range of wines at maximum efficiency because they serve complementary markets. "Small" wineries that produce higher-**volume** wines can continue distributing those wines through wholesaler relationships. They can obtain new markets for all their wines by distributing their wines directly to retailers, including individual bars, restaurants, and stores. They can also use direct shipping to offer their full range of wines directly to Massachusetts consumers, resulting in greater overall sales.

Combining these methods also lowers "small" wineries' distribution costs because they can choose which method or combination of methods will be most cost-effective for a particular wine. As the parties' briefs highlight, this produces important synergies. "Small" wineries' use of retail distribution increases brand recognition and makes wholesaler distribution more likely. Direct shipping can similarly increase consumer demand for a particular wine, increasing the prospects for further retail sales and wholesaler distribution.

Not surprisingly, Massachusetts's wineries have taken advantage of these benefits. Twenty-seven of Massachusetts's thirty-one wineries have obtained "small" winery licenses; in contrast, only twenty-six of the 2,933 out-of-state "small" wineries producing more than a gallon per year have done so.[12] Massachusetts's wineries have also benefitted from their access to multiple distribution channels in practice. In 2007, the first year § 19F was in effect, Massachusetts's wineries distributed 29 percent of their annual production through wholesalers ***12** and 71 percent through retail outlets, including direct shipping. *See* An Economic Snapshot of the Massachusetts Winery Industry.

The 637 out-of-state wineries that qualified as "large" under § 19F(a) in 2006 do not get these advantages and must instead choose between direct shipping and wholesaler distribution. Under § 19F(a), whether a "large" winery chooses wholesaler distribution or direct shipping, its choice carries a significant loss of potential profits, since using a single method results in a comparative loss of consumer sales. "Large" wineries also face comparatively greater distribution costs because they cannot always distribute a given wine through the most cost-effective method. And they cannot take advantage of the synergies that increase the net amount of demand for wines when multiple distribution methods are used together. These amount to considerable competitive disadvantages in an industry that Massachusetts's own evidence characterizes as one with indisputably slim profit margins and a highly competitive market.

Moreover, contrary to Massachusetts's assertions, § 19F does not level the playing field for all wineries unable to obtain consistent wholesaler distribution under the three-tier system. Section 19F's demarcation line between "small" and "large" wineries instead creates an especially acute competitive disadvantage for the wineries that are defined as "large" under § 19F(a) but which in practice face the same difficulties in distributing most of their wines as the "small" § 19F(b) wineries. Massachusetts's own evidence shows that only the largest 50 to 100 wineries can distribute most of their wines through wholesalers under the three-tier system. The remaining 537 or so "large" wineries each produce between 30,001 and 680,000 gallons per year of a mix of mass-market and boutique wines. In 2006, their percentage of the market share for wine production far exceeded that of § 19F(b) "small" wineries.

These smaller "large" wineries lose the most under the § 19F regime. Unlike the largest of the "large" wineries, which can distribute the vast majority of their wines through existing wholesale distribution, these smaller "large" wineries can only distribute a handful of their higher-**volume** wines through wholesalers. If they choose direct shipping, however, they are forced to terminate their existing wholesaler relationships, which also means that they lose all access to retailers in Massachusetts. Since this is a crucial way for a winery to build consumer awareness for the brand in Massachusetts, its unavailability means that these wineries are not able to compete on the same footing as § 19F(b) "small" wineries. Importantly, these are also the wineries that would otherwise be most competitive in the market for boutique wines: their size affords them otherwise considerable advantages in terms of marketing, **volume**, transportation, and brand recognition.

The ultimate effect of § 19F is to artificially limit the playing field in this market in a way that enables Massachusetts's wineries to gain market share against their out-of-state competitors. Section 19F(b)'s choice of a 30,000 gallon grape wine production **cap** helps Massachusetts wineries to improve their position in the market. At the same time, § 19F(a) burdens all the larger out-of-state competitors and impedes their ability to effectively use their natural advantages.[13]

***13** Massachusetts argues that there can be no discrimination because the favored "small" winery group created by § 19F(b) is almost entirely comprised of out-of-state wineries. Massachusetts claims this means that whatever the burden on out-of-state wineries under §

19F(a), § 19F(b) does not create an in-state benefit, since Massachusetts's "small" wineries are made no better off than their out-of-state counterparts. Without evidence of in-state benefits, Massachusetts concludes, the Supreme Court's decision in *Exxon* dictates that we find no discriminatory effect.

Massachusetts's argument ignores the effect of its statute. Section 19F(b)'s benefit to eligible "small" out-of-state wineries cannot be viewed separately from the much greater disadvantages that § 19F(a) imposes on out-of-state wineries. Massachusetts's wineries uniquely receive a net competitive gain under § 19F, while the law impairs out-of-state wineries' competitive position. It deprives "large" wineries-and especially those "large" wineries that have trouble obtaining wholesale distribution-of the competitive advantages of specialization and higher-volume production. These disadvantages exceed the benefits that out-of-state "small" wineries receive.

Exxon does not support Massachusetts's argument. *Exxon* held that a law that restricts a market consisting entirely of out-of-state interests is not discriminatory because there is no local market to benefit. 437 U.S. at 125-26, 98 S.Ct. 2207. *Exxon* is not apposite where, as here, there is an in-state market and the law operates to its competitive benefit. Massachusetts cannot apply *Exxon* only to "large" wineries as distinct from "small" wineries; the wine market is a single although differentiated market, and § 19F's two provisions operate on that market together.

Likewise, the fact that § 19F(b) benefits both in-state and some out-of-state "small" wineries does not prove that § 19F is non-discriminatory. We have previously rejected the notion that "a favored group must be *entirely* in-state for a law to have a discriminatory effect on commerce," reasoning that when a law burdened a group whose members were entirely out-of-state and benefitted a class whose members were largely but not wholly located in-state, it was still impermissibly discriminatory in effect.[14] *See Walgreen Co. v. Rullan,* 405 F.3d 50, 59 (1st Cir.2005).

B. *Section 19F is Discriminatory in Purpose*

We further hold that § 19F conferred a competitive advantage upon Massachusetts wineries by design.

In *Alliance of Auto. Mfrs. v. Gwadosky,* 430 F.3d 30 (1st Cir.2005), we discussed the methodology for determining legislative purpose when a state statute is allegedly motivated by an intent to discriminate against interstate commerce. Under that methodology, we look to "the statute as a whole," *id.* at 37, including statutory text, context, and legislative history, but we also consider whether the statute was "closely tailored to achieve the legislative purpose" the state asserted.[15] *Id.* at 38.

***14** [11] That § 19F discriminates against out-of-state wineries in its effects strengthens the inference that the statute was discriminatory by design. " '[L]ess deference to ... legislative judgment is due ... where the local regulation bears disproportionately on out-of-state residents and businesses.' " *Id.* at 39 (second and third alterations in original) (quoting *Kassel v. Consol. Freightways Corp.,* 450 U.S. 662, 675-76, 101 S.Ct. 1309, 67 L.Ed.2d 580 (1981) (plurality opinion)); *see also* D.H. Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause,* 84 Mich. L.Rev. 1091, 1144-47, 1206-45 (1986) (suggesting that the Commerce Clause is particularly concerned with deliberate discrimination, and that previous Supreme Court cases invalidating state statutes involved discriminatory effects in combination with, and as evidence of, discriminatory purpose); K.M. Sullivan & G. Gunther, *Constitutional Law* 206 (16th ed.2007).

As to statutory context, § 19F is a new addition to a provision that covers an array of alcohol licensing rules.[16] While § 19 generally includes licensing rules for producers that are typical of the three-tier system, § 19F is one of a number of recently appended subsections that sets out special exceptions to that system for particular entities. *See, e.g.,* Mass. Gen. Laws. ch. 138, § 19C (farmer-brewery licenses); *id.* § 19D (pub-brewery licenses); § 19E (farmer-distillery licenses). Many of these subsections were enacted for the express purpose of assisting Massachusetts's domestic industries, including but not limited to § 19B, § 19F's facially discriminatory and unconstitutional predecessor.[17] Though § 19F contains no stated statutory purpose, its placement in a licensing law that grants exceptions to the three-tier system for the predominant purpose of benefitting local industry is pertinent evidence of discriminatory intent. Based on statements made by various Massachusetts legislators, it is also clear that Massachusetts intended to benefit its local wine industry, and that it did so in particular ways whose effects on out-of-state wineries could easily be foreseen.

The gap between Massachusetts's professed neutrality and § 19F's practical effects also underscores the conclusion of discriminatory purpose. *See* ***15** *Hunt,* 432 U.S. at 352, 97 S.Ct. 2434 (observing that the disparity between a law's asserted ends and its means was "somewhat suspect" and evidenced a likely discriminatory purpose).

Massachusetts has asserted various purposes behind § 19F: to facilitate direct shipment, to further the three-tier system, to make all small wineries, irrespective of their location, better able to compete, and to thereby provide Massachusetts consumers with greater choice. The 30,000 gallon **cap** and the fruit wine exception, Massachusetts claimed at oral argument, reflected the legislature's rational assessment of the kind of wineries that needed special assistance because they were suffering from the limitations of the three-tier system. But these general aims stand in stark contrast to § 19F's specific and highly irregular features.

The wine industry and federal law have developed definitions of "small," "medium," and "large" wineries in order to describe the way the industry produces and distributes wines and, in the case of federal law, to offer "small" wineries regulatory benefits. These definitions do not, of course, bind states to particular regulatory choices. But their lack of correlation to § 19F belies Massachusetts's claim that § 19F's features reflected an objective choice to remedy the purported competitive disadvantage faced uniquely by wineries producing 30,000 gallons or less of grape wine. That is particularly true given that this gallonage **cap** counts wineries as "small" even if they produce more than 30,000 gallons of wine when fruit wine production is counted. *See Kassel,* 450 U.S. at 675-78, 101 S.Ct. 1309 (questioning the legitimacy of the Iowa legislature's motives in enacting a statute that banned vehicles longer than 55 feet from using Iowa roads, when all other states in the West and Midwest had a 65-foot limit and the Iowa statute had a number of significant and irregular exceptions); *Hunt,* 432 U.S. at 350-52, 97 S.Ct. 2434 (finding a North Carolina apple-labeling law discriminatory in effect and, impliedly, in purpose when its requirements prevented Washington from using its apple-grading and labeling system, which had become the industry standard).

According to uncontested evidence in the record, the wine industry considers wineries that produce 120,000 gallons per year or less "small." "Medium" wineries produce between 120,000 and 600,000 gallons annually, and "large" wineries produce more than 600,000 gallons per year. The industry apparently does not differentiate between wineries that produce fruit as opposed to grape wine; relative size is the critical factor. The Federal Trade Commission largely adopted these definitions when it surveyed conditions of competition in the wine industry. *See* FTC Report at 6.

Nor, according to testimony from industry figures, does Massachusetts's 30,000 gallon demarcation point between "small" and "large" wineries correspond to the ability of the winery to obtain wholesaler representation. To the contrary, this choice prevents out-of-state, smaller "large" wineries from competing on equal terms with Massachusetts's "small" wineries even though these wineries faced similar difficulties in obtaining wholesaler distribution under the three-tier system.

Massachusetts's claim at oral argument that its definition of "small" wineries targets those wineries in need of competitive assistance also diverges considerably from the definitions the federal government and other states have developed for this same broad purpose. As we have said, there is no relationship to those wineries who are able or unable to obtain wholesalers. Beyond that, as a matter of federal tax policy, ***16** wineries producing 250,000 gallons or less of any type of wine, and not merely wineries that produce less than 30,000 gallons of grape wine per year, are deemed "small wineries" in need of competitive assistance in the form of a substantial tax break. *See* Alcohol & Tobacco Tax & Trade Bureau, Dep't of the Treasury, *TTB Compliance Seminar for Bonded Wine Premises* 73-74 (2008), *available at* http://www.ttb.gov/pdf/compliance-seminar.pdf (hereinafter TTB Compliance Seminar).[18] No other state has defined a "small" wine producer and attached the same consequences to this definition as Massachusetts has.[19] And no other state counts gallonage by excluding all fruit wine production; "wine" in these other states means wines made from any fruit or other agricultural product. *See* Ariz.Rev.Stat. Ann. § 4-101(36); Ark.Code Ann. § 3-5-202(4); Fla. Stat. § 564.01; Ky.Rev.Stat. Ann. § 241.010(55); Ind.Code 7.1-1-3-49; Ohio Rev.Code Ann. § 4301.01(3). Section 19F's definition of a "small" winery does not even correspond to the way Massachusetts previously classified wineries by size for the purpose of calculating a licensing fee.[20]

Section 19F's unusual regulatory features do track one thing precisely: the unique attributes of Massachusetts's own wine industry.[21] All of Massachusetts's thirty-one wineries are eligible for "small" winery licenses. All fall neatly within the 30,000 gallon **cap**, producing between 200 gallons and 24,000 gallons annually. And the record demonstrates-and Massachusetts does not contest-that legislators were well aware of these figures.

The fact that this gallonage **cap** excludes wines made from fruits other than grapes, no matter how many gallons a winery produces per year, is particularly probative. ***17** In past years, Massachusetts's largest winery produced more than 30,000 gallons of wine annually because between half and three-quarters of its production came from apple wines. The main effect of the fruit wine

exception was to guarantee that this winery, like all other Massachusetts wineries, could take advantage of § 19F(b)'s beneficial distribution rules for "small" wineries. Massachusetts has offered no other explanation for the fruit wine exception, and there is no obvious reason why it would serve § 19F's ostensible purposes. This exception, like similar, facially neutral statutory exemptions apparently motivated by a desire to shield in-state interests, "weaken[s] the presumption in favor of the validity of the [general provision], because [it] undermine[s] the assumption that the State's own political processes will act as a check on local regulations that unduly burden interstate commerce." *Raymond Motor Transp., Inc. v. Rice,* 434 U.S. 429, 447, 98 S.Ct. 787, 54 L.Ed.2d 664 (1978).

We conclude that § 19F altered the competitive balance to favor Massachusetts's wineries and disfavor out-of-state competition by design.[22]

C. Lack of Legitimate Local Purpose and Availability of Reasonable Non-Discriminatory Alternatives

[12] Because plaintiffs have shown that § 19F discriminates against interstate commerce, Massachusetts bears the heavy burden of showing that the statute is nonetheless constitutional because it serves a legitimate local purpose that cannot be attained through reasonable non-discriminatory alternatives. *Dep't of Revenue,* 128 S.Ct. at 1808. The state can only carry this burden by presenting "concrete record evidence," and not "sweeping assertion[s]" or "mere speculation," to substantiate its claims that the discriminatory aspects of its challenged policy are necessary to achieve its asserted objectives. ***Granholm,* 544 U.S. at 492-93, 125 S.Ct. 1885**; *see also Chem. Waste Mgmt.,* 504 U.S. at 342, 112 S.Ct. 2009. Massachusetts has not even attempted to do so here.[23] Because the constitutionality of a state statute is involved, we nonetheless consider the issue.

The record shows that at least one viable non-discriminatory alternative existed when § 19F was under consideration: the Model Direct Shipment Bill, which the National Conference of State Legislatures adopted in 1997. The Model Bill does not define "small" or "large" wineries or regulate access to licenses depending on winery size. As an alternative to § 19F, then-Governor Romney proposed a version of the Model Bill which would have allowed all wineries to ship directly to consumers, sell to retailers, and distribute through wholesalers. But the state legislature rejected this proposal and overrode his veto.

Plaintiffs argue that this alternative would have helped small wineries without undercutting the three-tier system because it included limitations on the total **volume** wineries could ship to consumers. Whatever ***18** the merits of this proposal, Massachusetts has never claimed it would be unworkable. Under similar circumstances, the Supreme Court has, as a rule, struck down the discriminatory state law in question. *See* ***Granholm,* 544 U.S. at 491-92, 125 S.Ct. 1885**; *Camps Newfound/Owatonna,* 520 U.S. at 582 n. 16, 117 S.Ct. 1590.

III. Whether the Twenty-first Amendment Immunizes Facially Neutral Alcohol Statutes from Commerce Clause Scrutiny

[13] We now consider whether, as Massachusetts asserts, the Twenty-first Amendment protects § 19F from invalidation, notwithstanding the fact that it discriminates against interstate commerce in purpose and effect.

Whether the Twenty-first Amendment granted states the authority to enact even facially neutral but discriminatory alcohol laws that would otherwise violate the Commerce Clause was not decided by ***Granholm*** and the answer is not readily apparent from the text of the Amendment. ***Granholm*** holds the interpretation of this amendment instead turns on historical context. Section 2 of the Twenty-first Amendment granted the states the authority to regulate liquor only to the extent that they had done so before Prohibition under two federal laws: the Wilson Act of 1890[24] and the Webb-Kenyon Act of 1913.[25] *See* ***Granholm,* 544 U.S. at 484, 125 S.Ct. 1885**.

The Supreme Court held in ***Granholm*** that through these Acts, Congress gave the states newfound powers to regulate alcohol that came within their borders, even if it had traveled in interstate commerce. The Wilson Act did this by allowing states to restrict or prohibit the sale of out-of-state alcohol "to the same extent and in the same manner" as alcohol that was produced in-state. **544 U.S. at 478, 125 S.Ct. 1885** (quoting 27 U.S.C. § 121) (internal quotation marks omitted). The Webb-Kenyon Act expanded states' regulatory authority by expressly authorizing states to regulate alcohol that traveled in interstate commerce even if it was being shipped solely for consumers' personal use. ***Id.* at 481-84, 125 S.Ct. 1885**. These Acts did not, however, exempt states from the Commerce Clause's existing prohibitions on state laws that discriminated against out-of-state goods and favored local interests. ***Id.* at 484-85, 125 S.Ct. 1885**.

The precise question in ***Granholm*** was what effect, if

any, the Twenty-first Amendment has upon facially discriminatory state alcohol laws that would otherwise be subject to invalidation under the Commerce Clause. **544 U.S. at 471, 125 S.Ct. 1885.** The question of whether the Twenty-first Amendment protects facially neutral laws like § 19F was not before the Court.

Massachusetts now contends that the Twenty-first Amendment protects facially ***19** neutral laws from invalidation under the Commerce Clause, even if they discriminate in purpose or effect, because it says such laws are distinguishable from facially discriminatory laws for the purposes of the Twenty-first Amendment. In the alternative, Massachusetts asserted at oral argument that the Twenty-first Amendment should lessen Commerce Clause scrutiny of such laws to mere rational basis review.[26]

We reject these arguments. Based on our analysis of historical sources, we conclude that the Wilson and Webb-Kenyon Acts did not protect facially neutral state liquor laws from invalidation under the Commerce Clause if they were discriminatory.[27] To hold otherwise, we would have to find that these Acts not only recognized the difference between facially discriminatory and facially neutral but discriminatory state laws, but also affirmatively intended to protect the latter and not the former. All evidence points to the contrary.

By the time the Wilson Act became law in 1890, it was well established that under the Commerce Clause, facially neutral state statutes that had a discriminatory effect on out-of-state interests constituted impermissible discrimination, just as facially discriminatory state laws did.

The Supreme Court had decided two major discriminatory effects Commerce Clause cases just before the Wilson Act passed. In *Robbins v. Taxing Dist. of Shelby County,* 120 U.S. 489, 7 S.Ct. 592, 30 L.Ed. 694 (1887), the Court had invalidated a facially neutral state tax on "drummers," individuals who "drummed up" sales by displaying samples, because, inter alia, the tax disproportionately disadvantaged out-of-state merchants and manufacturers. *Id.* at 490-91, 497-98, 7 S.Ct. 592. And in *Minnesota v. Barber,* 136 U.S. 313, 10 S.Ct. 862, 34 L.Ed. 455 (1890), the Supreme Court had invalidated a Minnesota statute that required in-state inspection of all meat before it could be sold within the state. *Id.* at 326, 10 S.Ct. 862. Its reasoning cut broadly: "Although this statute is not avowedly or in its terms directed against the bringing into Minnesota of the products of other states," this was the statute's "necessary effect." *Id.*

In a separate line of cases, the Supreme Court had also indicated that a state's asserted rationale for a statute would be viewed with skepticism if other evidence, including the statute's effects, pointed strongly to a discriminatory purpose. "[I]f the State, under the guise of exerting its police powers, should make such exclusion or prohibition applicable solely to articles, of that kind, that may be produced or manufactured in other States," the Court stated as early as 1879, "the courts would find no difficulty in holding such legislation ***20** to be in conflict with the Constitution of the United States." *Guy v. City of Baltimore,* 100 U.S. 434, 443, 25 L.Ed. 743 (1879); *see also Austin v. Tennessee,* 179 U.S. 343, 349-50, 21 S.Ct. 132, 45 L.Ed. 224 (1900) (suggesting that ostensibly neutral laws that were intentionally applied in a discriminatory manner were invalid in the Commerce Clause context).

[14] When drafting the Wilson and Webb-Kenyon Acts, Congress was presumably aware that these types of facially neutral but discriminatory state laws were subject to invalidation under the Commerce Clause. *See Edelman v. Lynchburg Coll.,* 535 U.S. 106, 117 n. 13, 122 S.Ct. 1145, 152 L.Ed.2d 188 (2002); *see also N. Star Steel Co. v. Thomas,* 515 U.S. 29, 34, 115 S.Ct. 1927, 132 L.Ed.2d 27 (1995). Yet Congress made no reference to the notion that the Wilson and Webb-Kenyon Acts would permit states to enact liquor laws with a discriminatory effect or motive. Although "Congress may authorize the States to engage in regulation that the Commerce Clause would otherwise forbid," courts can "exempt[ ] state statutes from the implied limitations of the Clause only when the congressional direction to do so has been unmistakably clear." *Maine v. Taylor,* 477 U.S. 131, 138-39, 106 S.Ct. 2440, 91 L.Ed.2d 110 (1986) (internal quotation marks omitted). The Wilson and Webb-Kenyon Acts do evince an unmistakably clear intention to permit states to regulate alcohol which traveled in interstate commerce the same way as they regulated in-state alcohol.[28] But the two Acts cannot be construed to authorize anything more.

Supreme Court decisions and legal scholarship of the era confirm this interpretation. *Scott v. Donald,* 165 U.S. 58, 17 S.Ct. 265, 41 L.Ed. 632 (1897), involved a challenge to a state law that gave the state liquor commissioner control over all state sales of alcohol and included two other provisions that explicitly disfavored out-of-state manufacturers. *Id.* at 92, 17 S.Ct. 265. The Court compared the facts to other Commerce Clause cases, including various discriminatory effects cases involving goods other than alcohol, implying that alcohol regulation was not a unique category for the purposes of the non-discrimination rule. *Id.* at 93-99, 17 S.Ct. 265. The Court's ultimate holding was that "[the Wilson Act] was

not intended to confer upon any state the power to discriminate injuriously against the products of other states." While states, under the Wilson Act, could enact laws to "forbid entirely the manufacture and sale of intoxicating liquors," they "cannot ... establish a system which, in effect, discriminates between interstate and domestic commerce." *Id.* at 100, 17 S.Ct. 265.

Contemporaneous treatises on liquor law likewise concluded that the Wilson Act did not immunize any kind of discriminatory state law from scrutiny under the non-discrimination rule.[29]

[15] Against this background, we hold that the Twenty-first Amendment does not *21 exempt facially neutral state alcohol laws with discriminatory effects from the non-discrimination rule of the Commerce Clause. Nor, of course, are such laws exempt when they also discriminate by design.

We also reject Massachusetts's alternate contention that the Twenty-first Amendment lessens the degree of Commerce Clause scrutiny for facially neutral but discriminatory state alcohol laws to mere rational basis review. The Supreme Court implicitly rejected this argument in ***Granholm*** when it applied the usual, searching degree of scrutiny to invalidate the facially discriminatory laws at issue. **544 U.S. at 489-90, 125 S.Ct. 1885**. And there is nothing in the text, legislative history, or contemporaneous understandings of the Wilson or Webb-Kenyon Acts that supports Massachusetts's argument, let alone yields an unambiguous indication of congressional intent to reduce Commerce Clause scrutiny. In the absence of such evidence, Massachusetts's interpretation of the Twenty-first Amendment fails.

[16] Finally, we need not address whether § 19F could escape invalidation on the ground that, despite its discriminatory effect and design, the "core purposes" of the Twenty-first Amendment "are sufficiently implicated ... to outweigh the Commerce Clause principles that would otherwise be offended." *Bacchus,* 468 U.S. at 275, 104 S.Ct. 3049. Those purposes include "promoting temperance, ensuring orderly market conditions, and raising revenue." *North Dakota,* 495 U.S. at 432, 110 S.Ct. 1986. Massachusetts does not present any argument as to why § 19F serves any of these purposes.[30] In any event, it is unclear that this balancing test survives ***Granholm***.[31]

IV.

We *affirm* the judgment of the district court.

So ordered.

All Citations

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Footnotes

* Of the District of New Hampshire, sitting by designation.

1 The Commerce Clause vests Congress with the authority to "regulate Commerce ... among the several States." U.S. Const. art. I, § 8, cl. 3. This grant of exclusive federal power carries an implicit consequence for states' powers. When states regulate commerce within their own borders, they cannot enact laws that discriminate against out-of-state economic interests in favor of in-state competitors absent congressional authorization or some other source of constitutional authority. *Or. Waste Sys., Inc. v. Dep't of Envtl. Quality,* 511 U.S. 93, 98, 114 S.Ct. 1345, 128 L.Ed.2d 13 (1994). This aspect of the Commerce Clause is commonly referred to as the "dormant commerce clause" because its limitations upon states are not stated in the text.

2 Section 2 of the Twenty-first Amendment states 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." It thereby gives states certain limited authority to regulate the transportation, importation, and use of alcohol within their borders notwithstanding the effects on interstate commerce.

3 These figures were derived from industry statistics tracked by Wine Business Monthly and from data provided by the federal Alcohol and Tobacco Tax and Trade Bureau (TTB) for 2006, both of which are publicly available and were introduced either in the record or by various amici. *See* The Top 30 Wine Companies of 2006, *available at* http://www.winebusiness.com/wbm/?gogetArticle & dataID=46697; *see also* Gina Riekhof and Michael Sykuta, Politics, Economics, and the Regulation of Direct Interstate Shipping in the Wine Industry, April 2004, Working Paper No.2003-04 at 7, *available at*

http://cori.missouri.edu/wps.

4 Massachusetts tries to dismiss these statements as the isolated and unrepresentative comments of a few legislators. But such statements are precisely the kind of evidence the Supreme Court has looked to in previous Commerce Clause cases challenging a statute as discriminatory in purpose. *See Minnesota v. Clover Leaf Creamery Co.,* 449 U.S. 456, 465-68, 101 S.Ct. 715, 66 L.Ed.2d 659 (1981) (looking to a senator's and representatives' statements during floor debates as probative evidence of purpose); *Hunt v. Wash. State Apple Adver. Comm'n,* 432 U.S. 333, 352, 97 S.Ct. 2434, 53 L.Ed.2d 383 (1977) (pointing to a statement by a single state commissioner as strong evidence of discriminatory purpose).

Clearly the remarks of a single legislator are not controlling and do not compel any conclusion that the remarks reflect legislative intent. *See Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.,* 447 U.S. 102, 118, 100 S.Ct. 2051, 64 L.Ed.2d 766 (1980). But they are evidence.

5 We accept these facts as true, as both parties have agreed upon them, although important gaps appear in these statistics. TTB counted the number of wineries in the U.S. and their total gallonage based on the records it keeps for the purpose of levying a federal excise tax on "wine premises." *See* 27 C.F.R. § 24.100 (2009). These statistics do not precisely line up to the "large" and "small" categories in § 19F, because TTB's statistics do not distinguish between wines produced from grapes versus from other fruits. *Id.* at § 24.10 (defining "wine premises" as places where wine operations occur and "wine" to include both grape wine and other fruit wines).

6 They collectively produced 235,690 gallons of wine in 2007, though Massachusetts's statistics do not say whether this is all wine or just grape wine. While this was well under one tenth of one percent of U.S. annual wine production, Massachusetts's wine industry is in its early stages and is growing rapidly. *See* An Economic Snapshot of the Mass. Winery Industry, Mass. Dep't of Agriculture, Sept. 2008, *available at* http://www.mass.gov/agr/facts/wine.htm.

7 While the Supreme Court has said "[a] finding that state legislation constitutes economic protectionism may be made on the basis of either discriminatory purpose or discriminatory effect," *Chem. Waste Mgmt., Inc. v. Hunt,* 504 U.S. 334, 344 n. 6, 112 S.Ct. 2009, 119 L.Ed.2d 121 (1992) (quoting *Bacchus Imps., Ltd. v. Dias,* 468 U.S. 263, 270, 104 S.Ct. 3049, 82 L.Ed.2d 200 (1984)) (alteration in original) (citation omitted) (internal quotation marks omitted), plaintiffs argue both are present, and we agree.

8 Though this standard is stringent, it is also quite different from a standard requiring the state to demonstrate a "compelling state interest" that cannot be served through a non-discriminatory alternative. We reject plaintiffs' contention that the "compelling interest" standard applies here and is required by *Maine v. Taylor,* 477 U.S. 131, 106 S.Ct. 2440, 91 L.Ed.2d 110 (1986). *Maine v. Taylor,* like subsequent Supreme Court precedents, required states to demonstrate only that the statute "serves a legitimate local purpose" that "could not be served as well by available non-discriminatory means." *Id.* at 138, 106 S.Ct. 2440.

9 Of course, even if the challenged law regulates in-state and out-of-state interests even-handedly, it may still violate the Commerce Clause if "the burden imposed on [interstate] commerce is clearly excessive in relation to the putative local benefits" under the test first set forth in *Pike. Dep't of Revenue,* 128 S.Ct. at 1808 (quoting *Pike v. Bruce Church Inc.,* 397 U.S. 137, 142, 90 S.Ct. 844, 25 L.Ed.2d 174 (1970)) (alteration in original) (internal quotation marks omitted).

10 Massachusetts further asserted, but only at oral argument, that there are no other feasible means of giving small wineries a limited exemption from the three-tier system than through § 19F.

11 *Baldacci* only addressed the kind of showing required when a statute is challenged as discriminatory in effect but is concededly non-discriminatory in purpose. 505 F.3d at 36. We did not address whether a lesser showing might suffice when a law is allegedly discriminatory in both effect and purpose. We do not reach this question because even under the standard in *Baldacci,* plaintiffs have shown § 19F is discriminatory in effect.

12 It is true, as Massachusetts argues, that in 2006, 4,713 wineries qualified as "small" under § 19F(b). But more than a third of these wineries produced less than a gallon of wine a year and cannot really be considered part of the interstate wine market. Moreover, many "small" out-of-state wineries likely distribute virtually all of their wine through in-person sales or to their home-state markets.

13 Our decision in *Baldacci* is consistent with this conclusion. That case involved a challenge to a Maine law that allowed wineries to sell to consumers only in face-to-face transactions. 505 F.3d at 30-31. That challenge failed because plaintiffs did not introduce any evidence that the law benefitted Maine vineyards or harmed out-of-state wineries. *Id.* at 38.

14 Nor do we find the reasoning of the two district court cases that have upheld other states' gallonage caps to be persuasive. *See Black Star Farms, LLC v. Oliver,* 544 F.Supp.2d 913 (D.Ariz.2008); *Cherry Hill Vineyards, LLC v. Hudgins,* 488 F.Supp.2d 601 (W.D.Ky.2006).

15 Other courts have invalidated state statutes as motivated by a discriminatory intent after examining an even wider range of sources. Some have done so based on the test for discriminatory purpose used in the Equal Protection context, which looks for a history or pattern of discrimination. *See, e.g., S.D. Farm Bureau, Inc. v. Hazeltine,* 340 F.3d 583, 593-96 (8th Cir.2003); *Waste Mgmt. Holdings, Inc. v. Gilmore,* 252 F.3d 316, 336 (4th Cir.2001); *see also McNeilus Truck and Mfg., Inc. v. Ohio ex rel. Montgomery,* 226 F.3d 429, 443 (6th Cir.2000) (invalidating a statute as discriminatory in both purpose and effect). We need not adopt a broader view of the sources probative of legislative intent to find that § 19F is discriminatory in purpose. Nor need we consider whether an Equal Protection analysis is apposite in the Commerce Clause context. Even under our narrower methodology in *Alliance of Auto. Mfrs.,* § 19F is discriminatory in purpose.

16 Section 19F is unlike the law at issue in *Alliance of Auto. Mfrs.,* which we described as a fully integrated part of an "intricately constructed law" that had been on the books for three decades. 430 F.3d at 37-38.

Moreover, when, as here, a state statute is both discriminatory in effect and in purpose, it is clearly discriminatory within the meaning of the Commerce Clause, and we need not address whether evidence of a legislative intent to discriminate would suffice on its own. *Cf. Alliance of Auto. Mfrs.,* 430 F.3d at 36 n. 3.

17 *See id.* § 19B(a) (farmer-winery licenses were created "[f]or the purpose of encouraging the development of domestic vineyards"); *id.* § 19C(a) (farmer-brewery licenses exist "[f]or the purpose of encouraging the development of domestic farms"); *id.* § 19E(a) (farmer-distillery licenses are issued "[f]or the purpose of encouraging the development of domestic farms").

18 The tax code provision defines "small" wineries as those under 250,000 gallons annually and provides the greatest incentives for wineries that produce under 150,000 gallons annually. *See* 26 U.S.C. § 5041(c)(1)-(2); 27 C.F.R. § 24.278(a) (2008); TTB Compliance Seminar at 70-71. The federal tax code also measures "wine" production by counting wines produced from various fruits, not just grape wine. *See* 27 C.F.R. § 24.10.

19 Arizona, Kentucky, Ohio, and Indiana have limited access to direct shipping to "small" or "farm" wineries. *See* Ariz.Rev.Stat. Ann. § 4-205.04(C); Ky.Rev.Stat. Ann. § 243.155, *invalidated in part by Cherry Hill Vineyards, LLC v. Lilly,* 553 F.3d 423 (6th Cir.2008); Ohio Rev.Code Ann. § 4303.232(A)(1); Ind.Code 7.1-3-12-4, 7.1-3-12-5(a). Other states provide other regulatory benefits to such wineries. *See, e.g.,* Ark.Code Ann. § 3-5-1602(c)(1)(E); Fla. Stat. § 599.004. Though most of these states define "small" wineries with reference to the number of gallons they produce annually, no other state considers 30,000 gallons a significant figure. *See* Ariz.Rev.Stat. Ann. § 4-205.04(C); Ark.Code Ann. §§ 3-5-1601, 3-5-1602(c)(1)(E); Fla. Stat. § 599.004; Ky.Rev.Stat. Ann. § 241.010(46); Ohio Rev.Code Ann. § 4303.232(A)(1).

20 Section 19B, § 19F's unconstitutional predecessor, included a subsection that calculated license fees based on a winery's annual gallonage. Wineries in lower-gallonage categories paid lower fees. Mass. Gen. Laws ch. 138, § 19B(*l*). Wineries were divided into categories of 5,000 gallons or less per year; 5,000 to 20,000 gallons; 20,000 to 100,000 gallons; 100,000 to 200,000 gallons; 200,000 to 1,000,000 gallons; and more than 1,000,000 gallons per year. *Id.* These categories were based on total annual gallonage and did not consider whether the wine came from grapes or other fruits. *Id.; id.* § 19B(m).

21 To be clear, we do not hold that when an industry and the federal government have developed a standard definition in the field of alcohol regulation, a state must follow that definition or have its law deemed suspect. *Cf. North Dakota v. United States,* 495 U.S. 423, 430-33, 110 S.Ct. 1986, 109 L.Ed.2d 420 (1990). It is the totality of the evidence of discriminatory purpose and discriminatory effect that leads us to conclude that § 19F discriminates against interstate commerce.

22 This conclusion is not dependent on the many statements of discriminatory purpose by lobbyists and the intermediate steps in the legislative process the district court relied upon in its opinion.

23 The state did not brief this point. It was only in response to questioning at oral argument that Massachusetts characterized § 19F as the only feasible means the state has to serve the local purposes of benefitting small wineries, supporting the three-tier system, and increasing consumer choice. This argument is untimely and likely waived. It is also not supported by anything in the record. Several amici try to fill the gap, but amici may not make up for waiver by a party. *See United States v. Sturm, Ruger & Co., Inc.,* 84 F.3d 1, 6 (1st Cir.1996).

24 The Wilson Act stated "[t]hat all ... intoxicating liquors ... transported into any State ... for use, consumption, sale or storage

therein, shall upon arrival in such State ... be subject to the operation and effect of the laws of such State ... enacted in the exercise of its police powers, to the same extent and in the same manner as though such liquids or liquors had been produced in such State ... and shall not be exempt therefrom by reason of being introduced therein in original packages or otherwise." 27 U.S.C. § 121.

25 The Webb-Kenyon Act provided that "[t]he shipment or transportation ... of any ... intoxicating liquor of any kind from one State ... into any other State ... which said ... intoxicating liquor is intended, by any person interested therein, to be received, possessed, sold, or in any manner used, either in the original package or otherwise, in violation of any law of such State ... is prohibited." 27 U.S.C. § 122.

26 The states of New Jersey, Ohio, Rhode Island, and Wyoming, as amici, do not join Massachusetts's argument that there is no Commerce Clause scrutiny if the statute is facially neutral. They do support the contention that § 19F is not discriminatory in effect or purpose. They argue in general terms that it cannot be irrational for a legislature to make distinctions based on winery size. It does not, of course, follow that the precise distinction drawn cannot have a discriminatory effect. These states also make the parade of horribles-style argument that a state's loss of control over the alcoholic beverage market "can lead to illegal activity, including shipment to underage individuals, the sale of adulterated products, and the possibility of organized crime involvement in disguised internet schemes." Massachusetts has not advanced any of these theories, and it is difficult to see the claimed causal relationship.

27 Because we hold that § 19F discriminates in effect and in purpose in violation of the Commerce Clause, *see supra* Part II, we do not decide whether, as Massachusetts argues, the Twenty-first Amendment nonetheless immunizes non-discriminatory laws that impose an undue burden on interstate commerce under *Pike*.

28 It is clear that the Wilson and Webb-Kenyon Acts were designed to advance the temperance movement's objectives by letting states restrict or even prohibit the sale of alcohol within their borders. *See* A.A. Bruce, *The Wilson Act and the Constitution,* 21 Green Bag 211, 215-16 (1909); L. Rogers, *Interstate Commerce in Intoxicating Liquors Before the Webb-Kenyon Act,* 4 Va. L.Rev. 288, 293-300 (1917). The rule that state laws had to regulate in-state and out-of-state interests even-handedly was no impediment to the kind of laws the temperance movement pushed states to enact. *See* R.F. Hamm, *Shaping the Eighteenth Amendment: Temperance Reform, Legal Culture, & the Polity, 1880-1920* 188-89, 197-202 (1995).

29 *See* H.C. Black, *A Treatise on the Laws Regulating the Manufacture and Sale of Intoxicating Liquors* § 44, at 55-56 (1892) (noting the invalidity of state laws that involve "a tax imposed upon an occupation, which necessarily discriminates against the introduction and sale of products from another state" in its effect); H. Joyce, *The Law Relating to Intoxicating Liquors* § 54, at 67-69 (1910) (suggesting that the "special rule" embodied in the Wilson Act was only to enable states to regulate alcohol in interstate commerce). The Webb-Kenyon Act did not alter this outcome, nor was it meant to do so. All it did was to enable states to regulate alcohol shipped into a state for consumers' personal use. *See* ***Granholm,*** **544 U.S. at 482-83, 125 S.Ct. 1885.**

30 In its argument that § 19F would pass muster under *Pike,* Massachusetts identifies two interests § 19F serves: "the promotion of competition and consumer choice." The state also mentions its three-tier system as a local benefit, without analyzing whether § 19F, which relaxes the system, can be justified on this ground. Massachusetts does not make the argument, made by the amici Wine and Spirits Wholesalers, that the state's three-tier system "prevent[s] a deluge of alcoholic beverages [from] descending chaotically on consumers from many different sources" and that the scheme is necessary to prevent the evils of the tied house. Amici admit that the limits embodied in § 19F have the effect of protecting in-state wholesalers from competition.

31 *See Brooks v. Vassar,* 462 F.3d 341, 351 (4th Cir.2006) (suggesting, over a dissent, that ***Granholm*** narrowed this inquiry but did not eliminate it); *see also* M.K. Ohlhausen and G.L. Luib, *Moving Sideways: Post-*Granholm *Developments in Wine Direct Shipping and Their Implications for Competition,* 75 Antitrust L.J. 505, 528-29 (2008) (noting that ***Granholm*** left it "unclear whether there are any circumstances under which the Twenty-first Amendment can 'save' such regulation from judicial condemnation" under the Commerce Clause).

End of Document

1/18/17 HB 1145 (3)
Rep. Becker

Research regarding HB 1145

- **Opponents of HB 1145 argue:**
  - HB 1145 could result in large national and international corporations buying up retailers in ND and then undercutting local operators. Consequently, the large companies could come to dominate ND's local markets and profits would go out of state.
  - This argument is the sole concern arising *directly* out of this bill, rather than other bills or laws that might or might not potentially be submitted at some time in the future. This concern is fully addressed with the proposed amendment.
  - HB 1145 discriminates against out-of-state manufacturers and in favor of in-state manufacturers in violation of the Commerce Clause of the U.S. Constitution.
  - While this seems to be true with an amendment which would have addressed the state of domicile, the current proposed amendment instead uses production volume.
    - Opponents cite *Family Winemakers of CA v. Jenkins*, 592 F.3d 1 (1st Cir. 2010). In *Family Winemakers*, the First Circuit struck down a Massachusetts statute establishing differential methods by which wineries distribute wine. The statute differentiated between small wineries producing 30,000 gallons or less of wine per year on one hand, and large wineries producing more than 30,000 gallons of wine on the other hand.
      - The problem identified by the First Circuit was that "small" wineries could sell their wines in Massachusetts in 3 ways: (1) shipping directly to consumers, (2) through wholesaler distribution, and (3) through retail distribution. All of Massachusetts wineries were "small" (produced less than 30,0000 gallons per year), so they could use all 3 methods. By contrast, "large" wineries, all of which were in other states, were required to choose between relying upon wholesalers to distribute their wine or apply for a "large winery shipping license." Further, they cannot sell wines directly to retailers under either option.
      - The above problem would actually be a better argument against the various statutes we already have dealing with breweries, wineries, distilleries, and tap rooms, which are specific, limited carve-outs to the three-tier system. This bill does not give any carve out to the three tier system, because NO product may go from the manufacturer to the retailer without going through the distributor.
      - The court concluded the statute violated the Commerce Clause because the effect of the particular gallonage cap changed the competitive balance between in state and out of state wineries in a way that benefits Massachusetts wineries and burdens its out of state competitors.

- **Proponents of HB 1145 argue:**

    - HB 1145 does NOT dismantle the three-tier system of alcohol sales. If a person has a financial interest in a manufacturer as well as a retail operation, that person must direct the beer, wine, and spirits from the manufacturing entity through a wholesaler (distributer), for sale to the retailer, even if manufacturer and retailer are one in the same.

    - In response to opponents' concern that HB 1145 would result in large corporations dominating ND's local markets, proponents of HB 1145 proposed the following amendment on Page 1 line 11:
        - "A retailer may not have any financial interest in any manufacturer, producing in excess of two hundred fifty thousand gallons of wine or distilled spirits or five million gallons of beer annually, or any wholesaler. The production limits in this subsection refer to the combined amount of production produced by all affiliates of the manufacturer or manufacturer ownership whether the affiliation is corporate or by management, direction, or control."

        - Opponents of HB 1145 argue that the proposed amendment's volume production cap limits discriminate against interstate commerce, however, the following two cases illustrate that courts have upheld production limitations under the Commerce Clause.
            - In *Black Star Farms LLC v. Oliver*, 600 F.3d 1225 (9th Cir. 2010), the Court of Appeals held a small winery exception to AZ's three-tiered alcoholic beverage distribution system did not violate the dormant Commerce Clause. The small winery exception to AZ's three-tier alcoholic beverage distribution system allowed in state and out of state wineries that produced less that 20,000 gallons of wine per year to directly ship wine to AZ residents
                - The Court explained two levels of scrutiny exist for analyzing state statutes challenged under the dormant Commerce Clause. The higher level of scrutiny applies to state statute that "discriminates against interstate commerce 'either on its face or in practical effect.'" Black Star Farms conceded that the statutory scheme was not discriminatory at its face. Thus, the court of appeals had to decide only one question: Did AZ's statutory scheme for regulating the shipment of wine to consumers have the *practical effect* of favoring in state economic interests over out of state interests?
                    - The court concluded (1) the production limit exception did NOT have the practical effect of

favoring in state economic interests and thus did not violate the dormant Commerce Clause (2) the exception was facially neutral and did not restrict the flow of interstate commerce in favor of in state wineries (3) the number of out of state wineries that could take advantage of the exception dwarfed the number of in state wineries that could do so.

- In pertinent part the court noted, "Black Star Farm **asks us without substantial evidentiary support to speculate and to infer that this scheme necessarily has the effect it fears. This leap of faith we will not take. Courts examining a "practical effect" challenge must be reluctant to invalidate a state statutory scheme regulating alcoholic beverages simply because it *might* turn out down the road to be at odds with our constitutional prohibition against state laws that discriminate against Interstate Commerce"**

- In *Cherry Hill Vineyards, LLC v. Hudgins,* 488 F.Supp. 2d 601 (W.D. Ky. 2006), plaintiffs challenged Kentucky's "small farm winery" licensing provision. The licensing provision permits both in state and out of state wineries to apply for a small farm winery license, if the winery produces wine in an amount that does not exceed 50,000 gallons per year. The court found that the 50,000 gallon limitation for a "small farm winery" license did not violate the Commerce Clause.
  - The plaintiffs argued that the provision affords licensing rights to all Kentucky wineries, as no Kentucky winery produces in excess of 50,000 gallons per year. Further, plaintiffs argued the provision was a protectionist measure as many out of state wineries are excluded by this requirement and the 50,000 gallon cutoff served no apparent purpose.
  - The court explained there was no facial discrimination against out of state wineries as the 50,000 gallon limit applied equally to both in state and out of state wineries. Further, the limit did not violate *Granholm* inasmuch as there was no showing that the provision burdened out of state producers or shippers simply to give a competitive advantage to in state businesses. Moreover, the court explained no justification needs to be shown for the 50,000 gallon limit, as it simply does not give Kentucky wineries a competitive advantage over similarly situated out of state producers