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Liquor Law

Should States be Allowed to Discriminate Against Nonresident Liquor Business Owners?

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Alcohol is not a product that is regulated, marketed or sold like any other product. As counsel and U.S. Supreme Court justices in the *Tennessee Wine & Spirits Retailers Association v. Clayton Byrd* case point out, it is not milk, asphalt, books or paint. It is regarded as "particularly dangerous," and as a result it is closely regulated. It is the only product that is the subject of not one, but two Constitutional Amendments. The sometimes illogical and often quirky patchwork of state alcohol laws across the country derive not only from its inherently dangerous nature, but also from the compromises necessary to bring about the 21st Amendment and the repeal of Prohibition. The biggest compromise? Delegating control of alcohol regulation to the individual states.

On Jan. 16, the U.S. Supreme Court heard oral arguments in the case of *Tennessee Wine & Spirits Retailers Association v. Clayton Byrd*. Ironically, *Byrd*, a 21st Amendment alcohol regulation case, was argued on the 100th anniversary of the ratification of

the 18th Amendment—which introduced the United States to the failed experiment of Prohibition.

The parties involved in the *Byrd* case are a retail package store association, as petitioner, and two applicants for retail package store liquor licenses—Tennessee Fine Wines and Spirits (Total Wine), and Affluere Investments, Inc., d/b/a Kimbrough Fine Wine & Spirits (Kimbrough), respondents.

At the center of the *Byrd* case is a Tennessee law that imposes residency restrictions on applicants for retail package store liquor licenses. Since they had out-of-state owners (Total Wine), or owners who had not lived in Tennessee for a sufficient duration at the time of their application (Kimbrough), neither respondent qualified for licenses. Total Wine and Kimbrough applied for package store liquor licenses and informed the state that if they were denied on the basis of the state's residency requirements, they would sue the state; on the other hand, the Tennessee Association told the state that it would sue if the state issued the licenses.

Caught in the middle, the Tennessee Alcohol Beverage Commission



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(TABC) headed to federal court seeking a declaratory ruling on the residency requirement. The state sought a declaration by the federal court after the state attorney general had earlier issued two advisory opinions stating that the residency requirement was unconstitutional.

On appeal to the U.S. Supreme Court, the Tennessee Association seeks a reversal of the U.S. Court of Appeals for the Sixth Circuit ruling that struck down as unconstitutional Tennessee's residency requirement imposed on the owners of

entities applying for retail package store licenses. Under the residency law, no retail package store liquor license shall be issued to a person or entity if the person or owners of the entity have not resided in Tennessee for at least two years prior to applying for the license. It further provides that no such license will be renewed unless the person or entity resides in the state for 10 years prior to the renewal. (On appeal, it was conceded that the 10-year residency requirement for renewals was no longer “at issue.”)

In this case, the U.S. Supreme Court is being asked to find an answer to the question of how the 21st Amendment interacts with the Dormant Commerce Clause, and whether states may discriminate against nonresident-owned businesses. For some alcohol industry observers, there is a fear that the “wrong” decision in *Byrd* could bring about the end of the three-tier system of alcohol distribution that is in place in virtually every U.S. state. The concern among such observers is that if the court rules that states cannot discriminate on the basis of residency, then states also cannot require applicants to have a physical presence within their borders. Without a physical presence requirement, they believe that out-of-state liquor companies will be able to freely ship alcohol into all states, and the three-tiered system will collapse.

Arguing for the Tennessee Association, Shay Dvoretzky, said that the 21st Amendment gives states virtually unchecked discretion to regulate alcohol within their borders and to discriminate when doing so. In response to questioning by Justices

Sonia Sotomayor and Samuel Alito, he went so far as to say that state alcohol regulations are valid under the 21st Amendment “even if” they are intended to protect in-state retailers from competition posed by businesses owned by nonresidents. He argued that neither the 21st Amendment nor the Dormant Commerce Clause prohibits states from creating laws that provide in-state-owned businesses with “economic protectionism.” Citing *Granholm v. Heald*, 544 U.S. 460 (2005), his position is that the 21st Amendment was meant to allow states to have “complete control” over the regulation of alcohol within its borders, so long as alcohol products are treated the same regardless of where they are manufactured.

Justice Brett Kavanaugh, in particular, was skeptical of this argument, noting that he does not think that the 21st Amendment gives states “complete authority” over alcohol, but rather could be looked at merely as intending to allow states to decide whether to permit alcohol to be imported and distributed within their borders, not to allow commercial discrimination. While perhaps skeptical that the 21st Amendment allows unfettered discrimination, the justices were also frustrated with determining where they might draw the line between state laws that are lawfully discriminatory under the 21st Amendment vs. laws that are unlawfully discriminatory under the Dormant Commerce Clause.

Arguing for an amicus group comprised of numerous state attorneys general, Illinois Solicitor General David Franklin stated that the 21st Amendment was “designed to

supplant or displace” in its entirety any Dormant Commerce Clause analysis. The 21st Amendment, he argued, allows each state to determine who can sell alcohol and on what terms within its borders. The argument by Total Wine and Kimbrough, Franklin claimed, would strip all meaning from the 21st Amendment and would leave it with “no meaningful role to play in our modern constitutional order.”

Arguing for Total Wine, Carter Phillips was unequivocal. Total Wine is not attacking, but rather was working within the confines of, the three-tier system. He pointed out that Total Wine already has a bricks and mortar location in Tennessee (the state issued both petitioners licenses, but their status of the license is ambiguous), that it is using an entity formed in Tennessee to do business there, that it desires to open additional bricks and mortar locations in Tennessee, that its managers are residents, and that its business model for every state where it does business is to have bricks and mortar locations in each state. Phillips argued that the 21st Amendment does not give states broad authority to set up discriminatory laws.

Quoting the Supreme Court’s opinion in *Bacchus Imports v. Dias*, 468 U.S. 263 (1984) (*Bacchus*), Total Wine pointed out that the court in *Bacchus* said that “one thing is certain, the central purpose of the ... [21st Amendment] was not to empower states to favor local liquor industries by erecting barriers to competition.” According to Phillips, the Tennessee residency requirement must fall as unconstitutional under *Granholm* and *Bacchus* because it has no

purpose other than discriminatory protectionism and cannot be justified by the state on any rational, nondiscriminatory basis. (He also noted that the state of Tennessee is not even attempting to justify the residency requirement.)

Justices Stephen Breyer and Neil Gorsuch expressed their concern with how the history of alcohol regulation, court decisions and acts of Congress impact the court's analysis. Breyer pointed out that *Granholtz* and older cases seem to give states "virtually complete control" over how they structure their liquor distribution systems, telling Total Wine's counsel that "history favors the other side." And Gorsuch expressed his concern that if the court rules that residency requirements are a constitutionally invalid form of prohibited discrimination under the Dormant Commerce Clause, the "next lawsuit" will be brought by the "Amazon of liquor," who will argue that even a physical presence requirement—as opposed to a residency requirement—is an unconstitutional form of discrimination.

In *Byrd*, a private party—the Tennessee Association—took up the mantle of the state, essentially admitting that the only purpose of the residency law is to discriminate against businesses owned by non-residents, and arguing that such discrimination is permitted under the 21st Amendment and not prohibited by the Dormant Commerce Clause.

In only a second-hand manner, the Tennessee Association argued that the state needs the ability to discriminate against businesses owned by non-residents in order to protect the health, welfare and public

safety of residents, and for ease of the state conducting full background investigations of resident owners. But this argument appears disingenuous when one takes into consideration the fact that Tennessee's residency requirements apply only to applicants for off-premises retail package store liquor licenses, and not to applicants for retail on-premises licenses, such as bars, restaurants and hotels. If a state were truly concerned about protecting public safety and assuring ease in conducting full background checks, would it not impose a residency requirement on retail on-premises licensees?

Justice Elena Kagan asked, "how are we supposed to draft this opinion" when one form of discrimination may be objectionable, such as a residency requirement, and another—such as a physical presence requirement for retail package stores—may not be objectionable. She was asking, where do we draw the line and how?

No clear signal was given by the court as to its likely decision. The line might fall between physical presence requirements and residency requirements, or the court may create some sort of "rational justification" test, or it may try to avoid addressing the line-drawing-issue. With a physical presence requirement, a state is able to conduct open inspections of licensed premises for compliance with state laws, to examine the books and records of licensed businesses, to determine, in-person, who the licensed manager and other employees are, the nature of their character, and whether they are fully qualified and properly trained.

Without a physical presence in the state, an enforcement agency would be virtually foreclosed from such investigations. Suffice it to say, how the court rules could have far reaching ramifications on the alcohol industry; ramifications that could leave some parties quite happy and others quite the opposite. The opinion is expected in June.

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