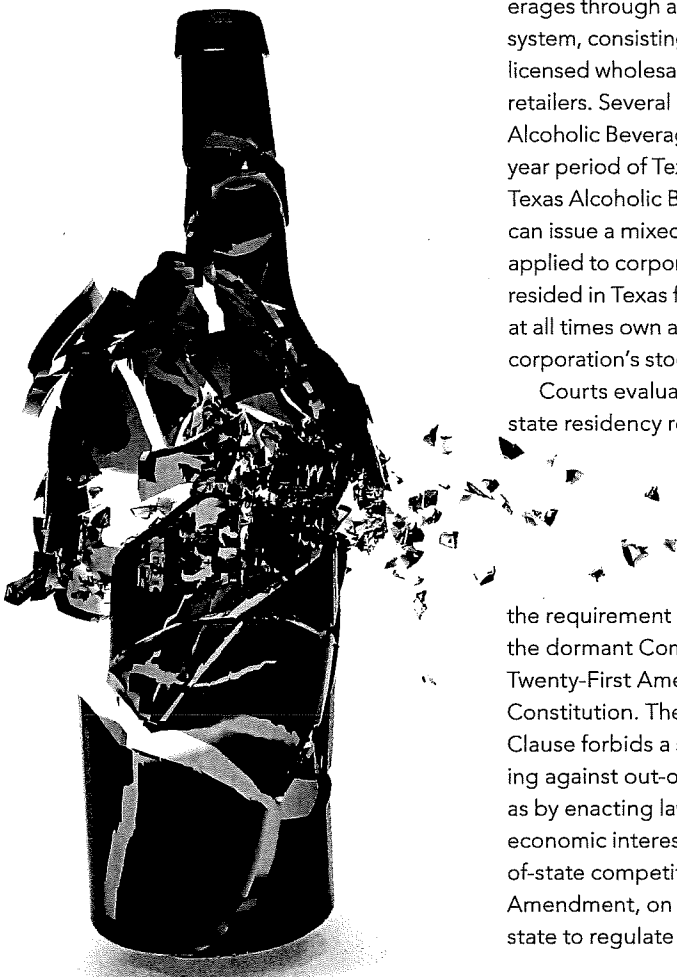


State Residency Rule for Alcohol Licenses Creates Circuit Split

By Erin Louise Palmer,
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A circuit split has emerged as to whether state durational residency requirements applied to alcohol wholesalers and retailers violate the dormant Commerce Clause. In *Cooper v. Texas Alcoholic Beverage Commission*, the U.S. Court of Appeals for the Fifth Circuit declined to invalidate an injunction barring enforcement of a one-year residency requirement for mixed beverage permit holders. The appellate court concluded that states may not impose durational residency requirements on wholesalers and retailers of alcoholic beverages, rejecting the U.S. Court of Appeals for the Eighth Circuit's reasoning in a recent decision upholding a Missouri statute imposing such requirements. ABA Section of Litigation leaders question whether the U.S. Supreme Court can create a bright-line rule to resolve the circuit split.

THREE-TIER DISTRIBUTION SYSTEM RAISES CONSTITUTIONAL QUESTION

Like much of the country, Texas regulates the sale and importation of alcoholic beverages through a three-tier distribution system, consisting of producers, state-licensed wholesalers, and state-licensed retailers. Several provisions of the Texas Alcoholic Beverage Code require a one-year period of Texas residency before the Texas Alcoholic Beverage Commission can issue a mixed beverage permit. As applied to corporations, citizens who have resided in Texas for at least one year must at all times own at least 51 percent of the corporation's stock.

Courts evaluating the validity of a state residency requirement, such as

the requirement in Texas, must consider the dormant Commerce Clause and the Twenty-First Amendment to the U.S. Constitution. The dormant Commerce Clause forbids a state from discriminating against out-of-state residents, such as by enacting laws benefiting in-state economic interests by burdening out-of-state competitors. The Twenty-First Amendment, on the other hand, allows a state to regulate "[t]he transportation or

importation into any state . . . for delivery or use therein of intoxicating liquors."

The U.S. Supreme Court has considered the balance of these two constitutional provisions when faced with state regulations on alcohol distribution. Where alcohol is at issue, as noted by the Court in *Bacchus Imports, Ltd. v. Dias*, a court will ask "whether the interests implicated by a state regulation are so closely related to the powers reserved by the Twenty-First Amendment that the regulation may prevail, notwithstanding that its requirements directly conflict with express federal policies." Although "[i]t is well settled that the Twenty-First Amendment did not entirely remove state regulation of alcohol from the reach of the Commerce Clause," as noted by the Court in *Brown-Forman Distillers Corporation v. New York State Liquor Authority*, the precise contours of the relationship between the dormant Commerce Clause and the Twenty-First Amendment are subject to debate.

FIFTH CIRCUIT ENJOINS DURATIONAL RESIDENCY REQUIREMENT

The dispute in *Cooper* arose more than 25 years ago, when the original plaintiffs, a Florida resident and a Tennessee resident, tried to purchase a Texas nightclub. Because the original plaintiffs were not Texas citizens, they could not purchase the nightclub without endangering the nightclub's mixed beverage permit.

The original plaintiffs brought a lawsuit against the administrator of the Texas Alcoholic Beverage Commission, seeking declaratory and injunctive relief. Three trade groups, including the Texas

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Package Stores Association (TPSA), were granted permission to intervene as defendants. On cross-motions for summary judgment, the U.S. District Court for the Western District of Texas declared Texas's durational residency requirement invalid under the dormant Commerce Clause and enjoined the Texas Alcoholic Beverage Commission from enforcing the requirement. The Fifth Circuit affirmed the lower court's decision on the same grounds.

TPSA LOOKS TO REINSTITUTE ONE-YEAR RESIDENCY RULE

In 2014, TPSA moved for relief from the injunction barring enforcement of Texas's residency requirement under Federal Rule of Civil Procedure 60(b). TPSA argued that the U.S. Supreme Court's 2005 decision in *Granholm v. Heald* was a significant change in decisional law that required the Fifth Circuit to lift the injunction. In that decision, the Supreme Court struck down state statutes in Michigan and New York, prohibiting or imposing additional burdens on out-of-state wineries (i.e., producers) seeking to ship wine to that state's consumers.

TPSA argued the Court's decision in *Granholm* made clear the Commerce Clause requires only that a state treat liquor produced out of state the same

as liquor produced in state, thereby stripping away Commerce Clause protections for state regulations applied to wholesalers and retailers. In support of its argument, TPSA pointed to dicta in the Court's decision recognizing "[s]tates may . . . assume direct control of liquor distribution through state-run outlets or funnel sales through the three-tier system" and providing "[s]tate policies are protected under the

Twenty-First Amendment when they treat liquor produced out of state the same as its domestic equivalent."

The Fifth Circuit rejected TPSA's argument, upholding application of the Commerce Clause to alcohol wholesalers and retailers. It first noted the Supreme Court in *Granholm* declined to overrule—or even limit—its previous decisions considering Commerce Clause challenges to state alcohol regulations. It then noted the statute at issue in *Granholm* addressed the producer tier of the three-tier distribution system and not the wholesaler or retailer tier. Finally, in keeping with an earlier decision from the Fifth Circuit, the court interpreted *Granholm* as "reaffirming the

applicability of the Commerce Clause to state alcohol regulations but to a lesser extent when the regulations concern the retailer or wholesaler tier as distinguished from the producer tier, of the three-tier distribution system."

FIFTH CIRCUIT CREATES CIRCUIT SPLIT FOR ALCOHOL RETAILERS

"While *Granholm* addressed the balance between the dormant Commerce Clause and the Twenty-First Amendment in the context of producers and direct shipping, the case did not address whether there is or should be a different balance or standard for wholesale or retail activity, as the recent circuit court cases suggest," notes Elizabeth A. DeConti, Tampa, FL, member of the Steering Committee of the ABA Section of Administrative Law and Regulatory

Practice's Beverage Alcohol Practice Subcommittee. "The Fifth Circuit in *Cooper* was putting a square peg in a round hole by trying to apply the standard in *Granholm* to a different tier of the alcohol distribution system," adds DeConti.

The Fifth Circuit attempted to define when and how states may regulate alcohol wholesalers and retailers. According to the Fifth Circuit, "[d]istinctions between in-state

and out-of-state retailers and wholesalers are permissible only if they are an inherent aspect of the three-tier system." While the Twenty-First Amendment does not authorize states to impose durational residency requirements on alcohol wholesalers and retailers, the Fifth Circuit concluded the Twenty-First Amendment does authorize physical residency requirements.

The Eighth Circuit reached a different conclusion in *Southern Wine & Spirits of America v. Division of Alcohol & Tobacco Control*, upholding the constitutionality of a residency requirement applicable to alcohol wholesalers in Missouri somewhat analogous to the Texas residency requirement. According to the Eighth Circuit,

While Section leaders recognize the tension between the Fifth Circuit's decision in *Cooper* and the Eighth Circuit's decision in *Southern Wine*, they also believe Supreme Court review may not be appropriate.

"[i]f it is beyond question that states may require wholesalers to be 'in-state' without running afoul of the Commerce Clause, then we think states have flexibility to define the requisite degree of 'instate' presence to include the in-state residence of wholesalers' directors and officers, and a super-majority of their shareholders."

While Section leaders recognize the tension between the Fifth Circuit's decision in *Cooper* and the Eighth Circuit's decision in *Southern Wine*, they also believe Supreme Court review may not be appropriate. "Even if the Supreme Court were to reach these issues, it would be difficult to come up with a bright-line rule for wholesalers and retailers . . . because there are numerous variations within states as to what the different tiers can do," observes DeConti. "Given the intricacies of the three-tier system, the Supreme Court might let the circuit courts define the contours of the relationship between the dormant Commerce Clause and the Twenty-First Amendment before taking up review," says Michael S. LeBoff, Santa Ana, CA, vice chair of the Section of Litigation's Commercial & Business Litigation Committee. **1**

RESOURCES

- 1 U.S. Const., art. I, § 8, cl. 3 (Commerce Clause), available at <http://bit.ly/commerce-clause-sec8>.
- 2 U.S. Const. Amend. XXI, § 2, available at <http://bit.ly/21-amendment>.
- 3 *Granholm v. Heald*, 544 U.S. 460 (2005), available at <http://bit.ly/granholm-heald>.
- 4 *Brown-Forman Distillers Corp. v. N.Y. State Liquor Auth.*, 476 U.S. 573 (1986), available at <http://bit.ly/brown-forman-ny>.
- 5 *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984), available at <http://bit.ly/bacchus-imports>.
- 6 *Cooper v. Tex. Alcoholic Beverage Comm'n*, No. 14-51343 (5th Cir. Apr. 22, 2016), available at <http://bit.ly/cooper-texas>.
- 7 *Southern Wine & Spirits of Am. v. Div. of Alcohol & Tobacco Control*, 731 F.3d 799 (8th Cir. 2013), available at <http://bit.ly/southern-wine>.
- 8 *Wine Country Gift Baskets.com v. Steen*, 612 F.3d 809 (5th Cir. 2010), available at <http://bit.ly/wine-country-steen>.
- 9 Tex. Alcoholic Beverage Code §§ 1.01–251.82 (2016), available at <http://bit.ly/texas-bev-code>.
- 10 Fed. R. Civ. P. 60(b), available at <http://bit.ly/rule-60>.