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LEGAL ISSUES CONCERNING STATE ALCOHOL REGULATION

HEARING

BEFORE THE

SUBCOMMITTEE ON COURTS AND COMPETITION POLICY

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

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LEGAL ISSUES CONCERNING STATE ALCOHOL REGULATION

THURSDAY, MARCH 18, 2010

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COURTS AND
COMPETITION POLICY
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 1:10 p.m., in room 2141, Rayburn House Office Building, the Honorable Henry C. "Hank" Johnson, Jr. (Chairman of the Subcommittee) presiding.

Present: Representatives Johnson, Conyers, Gonzalez, Jackson Lee, Quigley, Maffei, Coble, Chaffetz, Smith, Sensenbrenner, Goodlatte, and Issa.

Staff present: (Majority) Christal Sheppard, Subcommittee Chief Counsel; Anant Raut, Counsel; Rosalind Jackson, Professional Staff Member; and (Minority) Stewart Jeffries, Counsel.

Mr. JOHNSON. This hearing of the Committee on the Judiciary, the Subcommittee on Courts and Competition Policy will now come to order. Without objection the Chair is authorized to declare a recess.

Let me start off by saying that as Chairman of the Subcommittee on Courts and Competition Policy, I strive to keep all of our hearings balanced. I like for our Members to hear a variety of views, so that they can make informed decisions. So you can imagine my disappointment when a number of groups whom we invited to testify declined the opportunity.

My staff reached out to the Wine Institute, Wine America, and the Specialty Wine Retailers Association. Collectively, they represent more that 1,000 wineries, yet they couldn't find a single person to come here today and testify.

This would have been an excellent opportunity for them to express their point of view. If I were one of their members, I would not be happy.

We also solicited the input of a number of trade associations and retailers, including Costco. I thank them for their cooperation.

Let me assure all of you that my door remains open. I invite all of the institutions whom we talked to that were unable to participate today to submit statements for the record.

The central question of this hearing is: What is the ideal balance between state regulation and Federal oversight over the alcoholic beverage industry? Now, I have heard that some people already have legislation in mind. I think that is premature.

A system that is working should continue as it is, so if there is a compelling reason to change the applicable laws in this country let us hear it. Let us bring everything out from behind closed doors.

In the early part of the last century, this country prohibited alcohol. Ultimately, we reversed course. The 21st Amendment overturned prohibition and affirmed the important role of states in the regulation of the alcoholic beverage industry.

A number of states developed a three-tier system for alcoholic beverage distribution: licensed manufacturers sell exclusively to licensed wholesalers, who in turn sell exclusively to licensed retailers. Some say that this system has been responsible for minimizing alcohol abuse and consumption by minors. There are others who say that this system favors distributors and reduces choice and increases prices for consumers.

The three-tier system has been challenged on antitrust and constitutional grounds in a number of states. In one of these decisions, *Granholm v. Heald,* the Supreme Court struck down discriminatory treatment of out-of-state wineries under the dormant Commerce Clause of the Constitution. This decision allowed for the direct shipment of wine from out-of-state vineyards, providing a huge sales boost to small wineries lacking the scale or resources to work with large national distributors.

In another case, *Costco v. Marin,* the Ninth Circuit upheld a number of Washington State alcohol regulations but struck down the post and hold pricing system. The court of appeals held that unlike the other state regulations, this one fell outside of the traditional antitrust immunity enjoyed by state regulations because it allowed private parties to fix the retail prices of certain alcoholic beverages in violation of Federal antitrust laws.

So today we ask our experts, why do we need to change anything? Aren't these decisions just clarifying the applicable law or are they creating ambiguity?

Yes, Congress had one intent in mind when it passed the 21st Amendment, but it also had a specific intent in mind with every antitrust law it passed, just as the original framers had an intent in mind when they wrote the Commerce Clause of the Constitution. I hope that today's hearing will shed some light on what the proper balance among these laws should be.

And I now recognize my colleague, Howard Coble, the distinguished Ranking Member of the Subcommittee, for his opening remarks.

Mr. Coble?

Mr. COBLE. Thank you, Mr. Chairman, for calling this hearing. We have two full panels so I will be brief, Mr. Chairman, but today's hearing, as you know, is on the legal challenges to state alcohol regulation.

I am an advocate for state regulation in this area. States are generally, without—perhaps an occasional exception—but generally the states are in the best position to determine what the appropriate level of regulation is for their citizens.

I am also an advocate of the three-tier system because I believe that it provides an efficient means to maintain quality control on alcohol and helps to ensure that alcohol is sold only to adults. These are important and laudable goals, and anything that Con-

gress does in this area should be done with an eye to ensuring that we are keeping our constituents safe.

That said, I am also an advocate in competition and giving consumers more choices. Fortunately, in the last few decades we have seen a proliferation of small wineries and breweries. These new players have helped expand Americans' palates.

I have heard from some of my constituents in the producer industry, and they support alcohol regulation, particularly those requirements—strike that—those regulations that promote quality and safety. I think this is encouraging to be aware of that.

However, they express concern that some alcohol state laws serve not to protect consumers but rather to protect the business interests of in-state producers, wholesalers, and retailers, sometimes at the expense of competition from out-of-state vendors. Others who are small producers of beer and wine depend on the ability to market their products directly to consumers throughout the country. While they may have become regional economic engines we should not overlook their interests simply because they cannot operate like other mass-produced.

December 25, 2008, Mr. Chairman, marked the 75th anniversary of the 21st Amendment, and since that time they have taken their responsibility to regulate alcohol very seriously and should be recognized for this.

I expect our distinguished panels to highlight instances within the three-tier system that warrant our attention. These are complicated matters, and as we begin to wade through these issues we should not overlook the significance of the 21st Amendment and remember there is always room for improvement, particularly in the area of safety. I am grateful that we have such an excellent panel of Members to begin with, and then expert witnesses following, here today who can shed some light on the complicated legal and factual issues that surround state alcohol regulation.

Mr. Chairman, we have all heard many stories—some humorous, some sad—involving alcohol. One of the towns I represent back home has long been a traditionally dry town. The voters, however, voted to approve the lawful sale and consumption in that town a few months ago. It is reported that one of my constituents once said, "There will be beer and wine sold in Asheboro when pigs fly." Well, there is a pub in Asheboro now entitled "The Flying Pig," so one never knows what will happen.

Thank you, Mr. Chairman. I yield back.

Mr. JOHNSON. Thank you, Mr. Coble.

I will now recognize Mr. John Conyers, a distinguished Member of this Subcommittee and also Chairman of the full Committee on the Judiciary.

Chairman?

Mr. CONYERS. Thank you very much, Chairman Johnson. I ask unanimous consent to put my remarks in the record.

Mr. JOHNSON. Without objection, so ordered.

[The prepared statement of Mr. Conyers follows:]

PREPARED STATEMENT OF THE HONORABLE JOHN CONYERS, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN, CHAIRMAN, COMMITTEE ON THE JUDICIARY, AND MEMBER, SUBCOMMITTEE ON COURTS AND COMPETITION POLICY

Statement of the Honorable John Conyers, Jr.
for the Hearing on "Legal Issues Concerning State Alcohol Regulation"

Thursday, March 18, 2010, at 1p.m.
2141 Rayburn House Office Building

We are here today to review the important area of alcohol regulation. This area of the Committee's jurisdiction springs from the 21st Amendment, which repealed the Prohibition Amendment while granting states the authority to regulate the sale and distribution of alcohol.

I'd like to briefly mention three areas that I hope we can focus on at today's hearing.

First, we need to consider the importance and value of a State-based system of regulation. Congress passed the 21st Amendment in 1933, granting States the right to regulate the importation, sale, and use of alcoholic beverages within their borders.

This approach has allowed each State to determine what is best for its citizens in protecting public health and safety. All fifty States and the District of Colombia have opted to regulate the manufacture and sale of alcohol under a long-established three-tier system of distribution, whereby manufacturers can sell only to licensed wholesalers, who are in turn allowed to sell only to licensed retailers.

The question before us today is whether the three-tier system continues to serve the public by limiting underage drinking and mitigating against excessive alcohol use, or whether it merely serves the protect the market position of wholesalers?

Second, we need to review the state of federal law in the wake of several recent Supreme Court decisions in the area.

In recent years, there has been some tension between federal and State laws in the area of alcohol regulation. In particular, questions have arisen over drawing the line between a State's right to regulate alcohol within its borders under the 21st Amendment and the Commerce Clause which

prohibits States from discriminating between in-State sellers and out-of-State sellers.

For example, five years ago, in a 5-4 decision in *Granholm v Heald*, the Supreme Court struck down Michigan laws providing special rules governing direct shipment of wine to residents from in-State and out- of-state wineries.

Courts have also been called upon to balance the States' power to regulate alcohol under the 21st Amendment against the with federal antitrust laws. In its 1980 opinion in *California Retail Liquor Dealers Association v. Midcal Aluminum*, the Supreme Court held that for State regulations to be upheld against challenge under the federal antitrust laws under the "state action" doctrine, the intent to

displace competition must be "clearly articulated," and the conduct involved must be "actively supervised" by the State.

The question before us today is whether the courts have gotten this balance right, or have the skewed the matter too far to favor either direct sellers on the one hand or states and wholesalers on the other?

Finally, today's hearing should offer us guidance into the issue as to whether further legislation is appropriate, and if so, what form it should take.

In the nearly 100 years since the adoption of the 21st Amendment, Congress has been hesitant to weigh in on alcohol regulation. However, in recent

years the courts have increasingly been called upon to referee complex legal disputes involving alcohol sales and distribution.

Our job is too consider the present legal landscape and see if this presents an instance where rebalancing and clarification would be helpful. If it is, we need to see first if Congress can protect against underage drinking while protecting fair competition; and second, protect against frivolous legal actions while preserving the right to uphold the constitution and antitrust laws.

I come into this hearing with an open mind, and look forward to today's testimony.

Mr. CONYERS. And, you know, as Chair of the Committee I am supposed to know a lot about everybody on the Committee, and it is only appropriate that I announce that today is the birthday of Howard Coble. He is now 40 years old. [Laughter.]

Mr. COBLE. Mr. Chairman, would you yield? [Applause.]

Thank you. I thank you very much.

Mr. Chairman, I thank you.

And thank you all for the generous reception, but for the gentleman from Michigan's information, I am only 39. [Laughter.]

Mr. CONYERS. This is an issue before us about the 21st Amendment and the Commerce Clause, and I have just mentioned to some friends earlier today that there is something happening in our digital age that more and more modern machines, and techniques, and Web pages, and Internets, and Web sites are creating new challenges. In intellectual property, for example, we spend a lot of time here trying to persuade not just youngsters in college but a lot of people that you may not be able to download property that is not your own without the permission of the creator.

And so here, in this area, we now find out that there are some people in the business that are saying, "The rules that you have in this state are different from the people that are outside trying to do business and the people that are inside trying to do business," and so we—I just feel I am just redescribing the nature of the challenge before us. And so I look forward to this panel.

Thank you so much.

Mr. JOHNSON. Thank you, Mr. Chairman.

And I think I should note for the record that two of our witnesses before us have green on today, so—even the Chairman does—so I believe that the activities of yesterday have continued on into today and will continue tonight as well.

Next, I would like to recognize the Ranking Member of the full Committee on Judiciary, Mr. Lamar Smith, out of Texas.

Mr. SMITH. Thank you, Mr. Chairman. Let me confess that the Chairman of the full Committee beat me to it because I was going to thank you, Chairman, for holding this hearing to help celebrate Howard Coble's birthday, but I am glad it was recognized earlier, and better to have it recognized twice than not at all. Glad to have Howard here.

Mr. Chairman, America has a long and complicated history with alcohol. In 1794 President George Washington sent troops to western Pennsylvania to quash the Whiskey Rebellion, which was fought in opposition to the Federal Government's tax on alcohol to pay for the American Revolution.

Of course, America's most famous battle with alcohol was the prohibition era, from 1920 to 1933, which began with the adoption of the 18th Amendment in 1918. While the ban on alcohol was well-intentioned, in practice it led to flaunting of the laws, with many citizens patronizing speakeasies and consuming bathtub gin. Further, while prohibition was meant to promote public safety, the proliferation of illegal alcohol distribution by organized criminal enterprises led to an increase in alcohol-related violence.

In 1933 Congress passed, and the states ratified, the 21st Amendment, which repealed prohibition. Section 2 of the 21st Amendment sets forth the power of states to regulate alcohol providing that "The transportation or importation into any state, territory, or possession of the United States for delivery or use therein of intoxicating liquors in violation of laws thereof is hereby prohibited."

The 21st Amendment, in conjunction with the Wilson Act and the Webb-Kenyon Act, supplies the basis for state regulation of alcohol. The Wilson Act provides that alcoholic beverages transported

into a state are subject to the state's laws to the same extent and in the same manner as those such liquids or liquors have been produced in such state or territory. The Webb-Kenyon Act prohibits the transportation of alcoholic beverages into a state from outside the state if received, possessed, sold, or in any manner used in violation of the receiving state's laws.

I say all this for a number of reasons: In response to the 21st Amendment most states have enacted several—some form of the three-tier system for alcohol distribution. This system separates alcohol producers from alcohol wholesalers from alcohol retailers. The inclusion of wholesalers as middlemen in the transaction makes it easier for states to regulate alcohol; it makes it possible for states to ensure that alcohol is safe; it makes it simpler to ensure that alcohol is sold only to individuals over 21 years old; and it provides a straightforward alcohol tax collection system for the states. These are all laudable goals, and for those reasons I am supportive of the three-tier system.

Naturally, some alcohol producers and retailers are concerned about state liquor regulations that they perceive hurt their ability to compete in a particular state. Such concerns have led to a number of legal challenges to various states' laws on antitrust and dormant Commerce Clause grounds.

This hearing gives us the opportunity to examine these current legal challenges to the Post-Prohibition practices of state regulation of alcohol. In doing so we are forced to reconcile the 21st Amendment, Federal statutes, state laws, and judicial doctrines.

Mr. Chairman, these are complicated legal questions and not susceptible to quick solutions. However, I hope that this hearing will start to give Congress the information necessary to ensure that state regulation of alcohol remains robust. Those regulators are best-positioned to determine that alcohol consumption in their states is both safe and lawful.

Thank you, Mr. Chairman. I will yield back.

Mr. JOHNSON. I thank the gentleman for his statement.

And now I will start with introductions, and I am pleased to introduce the first panel for today's hearing, which consists of four distinguished Members of Congress. The first is Representative Bobby Rush, representing the first district of Illinois; next is Representative George Radanovich, representing California's 19th district; and after that we have my esteemed colleague from the Judiciary Committee, the Chairman of the Subcommittee on Commercial and Administrative Law, Mr. Steve Cohen; and finally we have Representative Mike Thompson, representing California's first district.

Thank you all for your willingness to participate in today's hearing. Without objection, your written statements will be placed into the record. We ask that you limit your oral remarks to 5 minutes. You will note that we have a lighting system that starts with a green light; at 4 minutes it turns yellow; then red at 5 minutes.

Congressman Rush, will you begin your testimony, please?

TESTIMONY OF THE HONORABLE BOBBY L. RUSH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. RUSH. Thank you, Mr. Chairman, and Ranking Member Coble, and Chairman of the full Committee, Chairman Conyers, and Ranking Member of the full Committee, Ranking Member Smith. I see my colleague from Illinois——

I am delighted to see you here this afternoon.

And I want to thank you for granting me the opportunity to testify today on state alcohol regulation. I want also to acknowledge my colleagues who are participating on this first panel with me.

Mr. Chairman, as I considered coming before this Subcommittee to testify I certainly came to recognize that this is not a matter that has been at the forefront of the issues that I am normally associated with in the Congress. However, as I began to examine this matter with greater scrutiny I quickly discovered that there existed many underlying causes that are or could be greatly impacted by the undertaking of this Subcommittee as it seeks to examine state-based regulation of alcoholic beverages. This Subcommittee's decision to review this matter in light of the 2005 *Granholm* Supreme Court case is both wise and necessary.

Mr Chairman, in my state of Illinois we have a three-tier system of distribution in which, as you are aware, manufacturers or producers sell to licensed wholesalers or distributors, who in turn sell to licensed retailers such as bars, packaged-good stores, and restaurants. This system in Illinois is currently under attack in Federal court as a result of a decision last week by the Illinois Liquor Control Commission to deny a wholesaler license to an alcohol manufacturer who was seeking to acquire 100 percent of a Chicago alcohol beverage distributorship.

While alcohol laws vary by state, Illinois law is viewed as one of the strongest in the Nation as it relates to the three-tier system of alcohol distribution. Many observers believe that this case and others like it will have a profound effect on the regulation of the industry in Illinois and beyond. While regulation or deregulation may be viewed by many through the lenses of what is in the best "competitive interests" of industry, I submit that there are broader aspects of this issue to consider as well.

Prior to my election to Congress in 1992 I served for 9 years as a member of the Chicago city council. As a local alderman I cam to appreciate the value of local control of the sale and consumption of alcoholic beverages. Indeed, an effective tool of local neighborhoods in Chicago has been the ability to, through ballot referendum, to vote an area dry. Communities plagued by bad actors in the alcoholic industry at the retail level have the ability to, absent local liquor control action, to seek remedies as a result of the ability of states to regulate the industry.

My objective is not to protect wholesalers or hurt producers, but rather to protect the people of my community who are, in many cases, disproportionately overwhelmed with marketing and promotional advertising designed to get them to drink.

Additionally, I would express a concern about the direction the industry is going relative to deregulation and its impact on minority ownership at the wholesaler-distributor level.

Certainly there is strong belief in Illinois—and I suspect this would be the case elsewhere in our Nation—that regulation or the removal of state regulatory authority of the alcohol industry would have an adverse, negative impact on minority ownership, and I certainly would be in opposition to such a move.

I believe while there may be some imperfections with the levels of regulation state by state, there is significant value to having an aggressive not passive role—state role—in the regulation of the alcohol industry.

The 21st Amendment, which provides states the authority to regulate alcohol within their own boundaries, has been operating since the 1930's, and I believe should Congress decide to act it should be to more fully clarify its intent that states be allowed to regulate alcohol sales within their borders.

With that, Mr. Chairman, I thank you and I yield back the balance of my time if I have any.

[The prepared statement of Mr. Rush follows:]

PREPARED STATEMENT OF THE HONORABLE BOBBY L. RUSH,
A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Rep. Rush Testimony- Subcommittee on Courts and Competition Policy Hearing

"Legal Issues Concerning State Alcohol Regulation" March 18, 2010

Thank you, Mr. Chairman, Ranking Member Coble, my colleagues on the Subcommittee on the Courts and Competition Policy. Thank you for granting me the opportunity to testify today on state alcohol regulation. I want to also acknowledge my colleagues who are participating on this first panel with me.

Mr. Chairman, as I considered coming before this Subcommittee to testify, I certainly came to recognize that this is not a matter that has been at the forefront of issues that I am normally associated with in the Congress.

However, as I began to examine this matter with greater scrutiny, I quickly discovered that there existed many underlying causes that are or could be greatly impacted by the undertaking of this subcommittee as it seeks to examine state-based regulation of alcoholic beverages.

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Mr. Chairman, in Illinois, we have a three-tier system of distribution, in which, as you are aware, manufacturers or producers sell to licensed wholesalers or distributors, who in turn sell to licensed retailers such as bars, packaged-good stores, and restaurants.

This system in Illinois is currently under attack in federal court as a result of a decision last week by the Illinois Liquor Control Commission to deny a wholesaler license to an alcohol

manufacturer, who was seeking to acquire 100% ownership of a Chicago alcohol beverage distributorship.

While alcohol laws vary by state, Illinois' law is viewed as one of the strongest in the nation as it relates to the three-tier system of alcohol distribution. Many observers believe this case and others like it will have a profound impact on the regulation of the industry in Illinois and beyond.

While regulation and/or deregulation may be viewed by many through the lenses of what is in the best "competitive interests" of industry, I submit that there are broader aspects of this issue to consider as well.

Prior to my election to Congress in 1992, I served for ten years as a member of the Chicago City Council. As a local alderman, I came to appreciate the value of local control of the sale and consumption of alcoholic beverage. Indeed, an effective tool of local neighborhoods in Chicago has been the ability to vote, through ballot referendum, an area "dry".

Communities plagued by "bad actors" in the alcohol industry at the retail level, have the ability absent local liquor control action, to seek legal remedies as a result of the ability of states to regulate the industry.

My objective is not to protect wholesalers or hurt producers, but rather to protect the people of my community who are, in many cases, disproportionately overwhelmed with marketing and promotional advertising designed to get them to drink.

Additionally, I would express a concern about the direction the industry is going relative to deregulation and its impact on minority ownership at the wholesaler/distributor level. Certainly, there is strong belief in Illinois and I suspect this would be the case elsewhere in our nation, that deregulation or the removal of state regulatory authority of the alcohol industry would have an adverse, negative impact on minority ownership. I would clearly be in opposition to such a move.

I believe while there may be some imperfections with the levels of regulation state by state, there is significant value to having an aggressive not passive state role in the regulation of the alcohol industry.

The 21st Amendment, which provides states the authority to regulate alcohol within their own borders, has been operating since the 1930's and I believe should Congress decide to act, it should be to more fully clarify its intent that states be allowed to regulate alcohol sales within their borders.

With that, I thank you for allowing me to share my thoughts on this issue and yield my time.

Mr. JOHNSON. Thank you, sir.

We will next go with the seating order, so Representative Thompson, please proceed with your testimony, yes.

TESTIMONY OF THE HONORABLE MIKE THOMPSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. THOMPSON. Well, thank you, Mr. Chairman and Ranking Member Coble, and Members of the Committee. I appreciate the opportunity to testify today, and I appreciate, Mr. Chairman, your opening comments when you mentioned that you are going to be with open mind to see if there are any compelling reasons why we should change existing law. And I know some will try and make that compelling argument—I know some would like you to believe that this is an issue between beer wholesalers and beer producers, but by opening remarks of the different Members of the Committee, I know that you understand that the reach is far greater than that.

You will hear testimony today regarding the power of the 21st Amendment versus other constitutional rights. Wholesalers will argue for a proposal that would tip the scale completely in the favor of state control over alcohol. I have, in my prepared testimony—written testimony that I submit for the record—an address on that regard, but I would like to spend my time trying to explain how adopting this type of proposal would, in real time, disadvantage two groups that all of us in Congress are very concerned about: American businesses, particularly small businesses, and American consumers. This proposal is asking Congress to pick them, the wholesalers, as winners, and America's consumers, wineries, and breweries as losers.

My district is home to hundreds of wineries, and I have more microbreweries than any other congressional district, and I can tell you firsthand that state regulation of alcohol is alive and well. States can and states do regulate alcohol sales.

Few products, if any, come under such heavy regulation. But the Supreme Court has ruled that while states can regulate they cannot discriminate. Unfair and discriminatory regulation hurts producers and it directly hurts consumers.

We have seen this movie before, and in the sequel, a return to past practices, the ending is not going to be any better. Hawaii used to charge in-state wineries a penny per gallon tax and out-of-state wines 85 cents for tax. Arkansas would only allow Arkansas wine to be sold in grocery stores. And in Rhode Island they disallowed retailers from advertising the prices of their products.

A return to these practices means less choice for consumers and unfairly hurts producers. Take wine as an example: All 50 states make wine now. There is more than 500 percent growth in wineries over the past 30 years. They support well over 1 million jobs, and I don't believe we should be discriminating against business and reduce competition that has made our great country and American enterprise so fantastic.

Mr. Chairman and Members, the 21st Amendment does not trump the rest of the Constitution; 40 years of court decision has made that clear. The 21st Amendment must be balanced with the Commerce Clause, Due Process Clause, First Amendment, and it can't violate the Sherman Act.

Congress backed this up in 2003 when we passed legislation that said states can go to Federal court on the 21st Amendment but

must be consistent with other provisions of the Constitution. States have strong rights under the 21st Amendment, but states cannot discriminate. I urge you, don't give one side—the wholesalers—license to harm American consumers and other businesses. It is unconstitutional and it is wrong.

And I want to reference something that I understand is going to be mentioned today, and that is this U.K. study that was done. And I want to urge the Members of this Committee, please don't compare apples to lemons. Our system is very different than that of the U.K. The idea that wholesaler control reduces underage drinking is pretty farfetched.

The entire industry is interested in preventing underage drinking, but don't forget kids get alcohol from adults. They get alcohol from parents and from friends who buy it legally. And kids who are drinking aren't drinking $80 or even $20 bottles of wine that are made in my district or any other wine-producing area in the country. Any mention of kids' access to alcohol and its relationship to state control is no more than a smokescreen.

I appreciate you taking time to hear these concerns and I urge you to move with caution in trying to change a system that is working fairly well. Thank you very much.

[The prepared statement of Mr. Thompson follows:]

PREPARED STATEMENT OF THE HONORABLE MIKE THOMPSON,
A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Testimony by Rep. Mike Thompson (CA-1)

"Hearing on Legal Issues Concerning Alcohol Regulation"

March 18, 2010

Subcommittee on Courts and Competition

2138 Rayburn House Office Building

Good afternoon Chairman Johnson, Ranking Member Coble and Members of the Subcommittee. I appreciate the opportunity to testify today.

I understand that this hearing is primarily focused on issues between beer wholesalers and beer producers. I am here today to ask the committee to be very wary of taking sides and avoid legislation that ultimately picks winners and losers rather than picking the path that benefits the public.

As many of you know, my district is home to hundreds of wineries. But it is also home to many small breweries, the most of any congressional district.

Unfortunately, my wine producers heard about this hearing little more than a week ago. We've also learned that there may be a proposal by the National Beer Wholesalers Association to give states complete and total control over alcohol sales, which would have serious negative consequences for wineries, small breweries and retailers, as well as the American consumers who enjoy their products.

State regulation of alcohol is alive and well and has not been impaired since the Supreme Court's Granholm decision. In this direct to consumer shipping case, the decision was simple: states can regulate, but not discriminate. In truth, Granholm and the decisions that came before it give great deference to the 21st Amendment and state regulation of alcohol, but it affirms that these rights do not supersede other provisions of the Constitution, such as the Commerce Clause.

States have never been able to pass unconstitutional laws simply because they deal with alcohol. And we cannot write laws that grant free license to states that create an environment of discrimination and unfairness.

For decades, wholesalers have expended great resources to protect their state-mandated distributions system in ways that have harmed wineries and breweries. These efforts have stunted competition and weakened producers, which ultimately leads to fewer choices for consumers. I hope this hearing will be about stopping these unfair practices.

It's important for you to know that there has been a dramatic increase in the number of wine and beer producers, which has resulted in more jobs for American workers. Wine is produced in all 50 states, including more than 6,000 wineries – a 500% increase in the past 30 years. Yet the number of wine wholesalers has deceased by more than 50%, creating a distribution bottleneck. For example, in my home state, there are only two major wine wholesalers.

Rather than take my word for it, take a look at how the system is working now. There are really no pure three-tier systems in any state. For example, sales of wine are made in a variety of ways, with many transactions not needing a wholesaler. Self-distribution laws allow a winery to sell straight to retailers and tasting rooms sells right to consumers. And when states allow direct to consumers sales and shipping, consumers have many more product choices. All of these transactions are licensed and regulated, and the interests of the states are met with revenue collection and temperance. If any other type of business found ways to provide consumers with better choices in a more efficient manner, we'd applaud them! The wineries in my district rely on these alternative means of licensure. Without it, they'd lose jobs.

The powers vested in the states under the 21st Amendment are not absolute. Forty years of court decisions have made it clear that while state power is great, it must be balanced with other constitutional rights such as the Commerce Clause, the Due Process Clause and the First Amendment. Further, states should encourage, not stifle competition. And

they cannot make efforts to control prices or distribution that violate the Sherman Act or other antitrust principles simple because the product is alcohol.

There are no compelling reasons for Congress to intervene and tip the balance by saying that 1) the 21st Amendment trumps all other provisions of the Constitution, or 2) that these laws be exempt form antitrust principles or 3) that states should not have to bear the burden of proving that their laws do not discriminate.

We've upheld this principle before. In 2003, Congress passed the 21st Amendment Enforcement Act, which originated with the wholesalers themselves. Under this law, State Attorney Generals can access federal courts to pursue litigation for alleged violations of state regulations of alcohol shipping. However, the law says they have to demonstrate the state regulation in question is a valid exercise of power under the 21st Amendment and not inconsistent with any other provision of the Constitution. The proposal being put forth by the National Beer Wholesalers Association would turn that on its head, ceding all powers to the state and ignoring the legitimate role of the federal government and courts.

You may hear today that this legislation is needed to curb litigation by wineries and breweries. These cases are modest in number, but all point to discriminatory state laws that favor wholesalers. We don't need a new federal law – the litigation will stop when the states stop passing discriminatory laws promoted by the wholesalers.

In conclusion, today's hearing should not be about legislation to further protect a monopoly protection distribution system. That would be a power grab with dramatic unintended consequences. And it will be strongly opposed by those who value our nation's wineries and breweries and expanded choice for American consumers.

Thank you.

Mr. JOHNSON. Thank you, Representative Thompson.

Representative Cohen?

Mr. COHEN. Thank you, Chairman Johnson, Ranking Member Coble, and the full Committee Chairman and the Ranking Member,

Mr. Smith, who deserves recognition that he didn't receive yesterday properly on the floor.

Mr. JOHNSON. And I see we are still receiving the effects of St. Patrick's Day on the panel also.

TESTIMONY OF THE HONORABLE STEVE COHEN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE

Mr. COHEN. Thank you for the opportunity to testify today on this important topic. I served as a Tennessee senator for 24 years, and 22 of those years were on the State and Local Government Committee, which regulates alcohol, and for 15 of those years I chaired that committee. From that position I learned about the three-tier system and a great appreciation for the need to regulate alcohol.

America has had a relationship, I think, as Mr. Smith mentioned, since our Nation's earliest days, but that relationship has not been without significant challenge. The marketplace has changed a lot in 100 years, and 100 years ago we had temperance movements and attempts to get involved and change the way we imbibed alcohol or the opportunity.

Much of the attention in the United States was paid to the growing problems, real or perceived, that alcohol consumption might of had, and possible abuse. Significant concern about how the product was sold in retail arose around saloons and taverns, largely unregulated, and it became the focus of public ire, and I think those saloons and taverns of those years were nothing like what we know today.

On-premises establishments not known as "family friendly" venues 100 years ago were becoming what the journalists of the time referred to as dens of iniquity. Retail outlets were often owned by out-of-town people or out-of-state people who really didn't care too much about the community values, they only were concerned about selling alcohol.

Because there was no effective system of regulation in place a grassroots movement began to take hold that focused on the problems associated with alcohol and the proposals that the sale, manufacture, and transportation of intoxicating beverages should be prohibited. As a result of this, in 1920 America began a 13-year failed experiment known as prohibition.

In 1933, due to a need to collect revenue through taxation and a period of lawlessness that had given rise to organized crime—Mr. Quigley, I know in his city they had Al Capone and the Untouchables, Eliot Ness and all that—and to decriminalize the behavior many Americans had continued to participate in illegally because Americans like to drink and to end much hypocrisy and much governmental corruption that we looked the other way about prohibition was repealed through the 21st Amendment.

Prohibition was a serious mistake and an attempt at controlling adult behavior, which governments really shouldn't be doing and continue to do in Mr. Thompson's districts and throughout this country with other products. But nevertheless, that was a problem, and then the repeal took place, and we had certain problems we wanted to cure.

Prohibition had certain reasons that it arose because problems do exist with alcohol and they were ameliorated—there was a desire to ameliorate them after prohibition. Two goals that they had in repeal: one was to promote temperance, which is another way to say moderation, and the second was to maintain an orderly market.

These goals continue in the U.S. today as we work to facilitate a healthy marketplace for alcoholic beverages through effective regulation. In order to promote temperance states can use a variety of laws that work to control alcohol consumption and levy taxes to collect revenue. Giving states primary authority over alcohol ensures those attitudes about the product can be more directly reflected in community standards.

Citizens in my home state of Tennessee have different thoughts about alcohol than citizens do, say, in Nevada or Louisiana, even though sometimes that is regrettable to me. When policy problems arise around the alcohol sale or consumption states are better equipped to deal with those problems than the Federal Government is.

Additionally, having states regulate alcohol helps facilitate an orderly market. The state-based alcohol regulatory system in place, known as the three-tier system, has done a good job of achieving those 21st Amendment goals of promoting temperance and an orderly market. Alcohol suppliers, distributors, and retailers have operated successful businesses within this scheme for more than 75 years, and at the same time consumers of alcoholic beverages had an unrivaled selection of products available to them at fair prices.

Effective regulation strikes a balance between competition in the marketplace and the concerns of public health and safety. Unfortunately, over the last several years many states have begun facing deregulatory challenges that cease to strike down effective, time-tested state alcohol regulations.

If we allow the systematic deregulation of the alcohol industry to continue we already have an idea of what our regulatory system could look like a few more years down the road. I won't go into details about the dangers of alcohol deregulation the United Kingdom experienced, but Ms. Pamela Erickson, who is going to appear on the next panel, will be discussing that; I will let her fill in the details, but it doesn't seem like it has been very effective or good in the United Kingdom.

I am troubled that we are looking at stopping a system that has worked for 75 years, that has been effective, and that the public at large has not complained about. In Tennessee there is an expression, and I think it is other places as well, "If it ain't broke don't fix it." And this one is not broke, and it doesn't need fixing.

I commend the Subcommittee for holding today's hearing and look forward to the outcome of this matter in this Committee, and thank you for the opportunity to testify.

[The prepared statement of Mr. Cohen follows:]

PREPARED STATEMENT OF THE HONORABLE STEVE COHEN,
A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE

Testimony of Representative Steve Cohen

Hearing on Legal Issues Concerning State Alcohol Regulation

Subcommittee on Courts and Competition

March 18, 2010

Chairman Johnson, Ranking Member Coble, and Members of the Subcommittee. Thank you for the opportunity to testify today on this important topic.

I served in the Tennessee State Senate for 24 years. For 22 of those years, I served on the State and Local Government Committee, which has jurisdiction over alcohol regulation in the state, and I served as Chair of that committee for 15 years. From that position, I developed a great appreciation for the need to carefully regulate alcohol.

America has had a relationship with alcohol since our nation's earliest days, but that relationship has not been without significant challenge. Consider the condition of the marketplace for alcohol 100 years ago. At that time in the U.S., much attention was paid to the growing problems, real and perceived, about alcohol consumption and abuse.

Significant concern about how the product was sold at retail arose as many saloons and taverns, largely unregulated, became the focus of public ire. On-premise establishments, not known as family friendly venues one hundred years ago, were becoming what the journalists of the time referred to as "dens of iniquity" or "houses of ill repute." Retail outlets were often owned by out of town or out of state alcohol manufacturers that had no interest in promoting responsibility or reflecting community values when it came to selling alcohol.

Because there was no effective system of regulation in place, a grassroots movement began to take hold that focused on the problems associated with alcohol and the proposal that the sale, manufacture and transportation of intoxicating liquors be prohibited. As a result of this in 1920, America began a thirteen year experiment known as "Prohibition." But in 1933, due to a need to collect revenue through taxation, end a period of lawlessness that had given rise to organized

crime, and to de-criminalize a behavior many Americans had continued to participate in illegally, Prohibition was repealed through the 21st Amendment.

Prohibition was a mistake, but even lawmakers interested in repeal wanted to ensure that the problems that occurred before Prohibition did not return.

Congress had two public policy goals related to Repeal:

1. Promote temperance, which is another way to say moderation, and
2. Maintain an orderly market.

These goals continue in the U.S. today as we work to facilitate a healthy marketplace for alcoholic beverages through effective regulation. In order to promote temperance, states can use a variety of laws that work to control alcohol consumption and levy taxes to collect revenue. Giving states primary authority over alcohol also ensures that those attitudes about the product can more directly be reflected. Citizens in my home state of Tennessee feel differently about alcohol than those in New York or Michigan, and the laws reflect that diversity.

When policy problems arise around alcohol sale or consumption, states are better equipped to deal with those problems than the federal government. Additionally, having states regulate alcohol helps facilitate an orderly market.

The state-based alcohol regulatory system in place today has done a good job of achieving those 21st Amendment goals of promoting temperance and an orderly market. Alcohol suppliers, distributors and retailers have operated successful businesses within this regulatory system for

more than 75 years. At the same time, consumers of alcoholic beverages have an unrivaled selection of products available to them at prices that are fair.

Effective regulation strikes a balance between competition in the marketplace and public health and safety concerns. Unfortunately, over the last several years many states have begun facing deregulatory challenges that seek to strike down effective, time-tested state alcohol regulations. If we allow the systematic deregulation of the alcohol industry to continue we already have an idea of what our regulatory system could look like a few years down the road.

Pamela Erickson, the CEO of Public Action Management, PLC, who this subcommittee will be hearing from shortly, has recently authored a report titled, "The Dangers of Alcohol Deregulation: The United Kingdom Experience." I will let Pam fill you in on the specific details, but the key takeaway from this report is that over the course of many years alcohol regulations in the United Kingdom were removed.

Unfortunately, this deregulation has lead to an epidemic throughout the country. Reports of alcohol-related illnesses, diseases and deaths are at historic levels and youth intoxication rates are more than twice the level we have in the United States. We simply cannot allow what is happening in the United Kingdom to happen here in the United States.

I am troubled that a system that has worked so well for more than 75 years is under attack. As we say in Tennessee, "If it ain't broke, don't fix it." I commend the subcommittee for holding today's hearing and for looking into this important matter.

Thank you.

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Mr. JOHNSON. Thank you, Mr. Cohen.

Next, Mr. Radanovich? We have 5 minutes and 50 seconds of votes with 41 people having voted already.

Proceed, sir.

TESTIMONY OF THE HONORABLE GEORGE RADANOVICH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. RADANOVICH. Thank you, Chairman Johnson.

Thank you very much, Chairman Conyers, Ranking Member Coble, and Ranking Member Smith of the full Committee. Thank you for the opportunity to testify.

The business of wine is far from the bucolic splendor of the vineyards. It is difficult to sell wine—perhaps more difficult than selling most other products or services in the United States—and much of that is due to the level of diversity—and diversity of regulation and control of all aspects of the business.

The U.S. Department of Treasury's Tax and Trade Bureau's production regulations establish uniform baseline standards of identity and allow wineries from any state to know where their product is categorized on the Federal level. TTB's permitting system for wineries and distilleries, their antitrust-based trade practice laws, and their label approval processes all provide a uniform framework from which state laws build.

Despite the current diversity in state control I truly believe that the inconsistencies among state control systems would be much greater without this important Federal framework. People in the wine business here a lot about three-tier distribution, but all know that a pure three-tier distribution does not exist in the United States.

Instead, over the years since prohibition was repealed, states have chosen to exercise their powers under the 21st Amendment to create a hybrid distribution systems that use three-tier principles as a framework. In at least 39 states, for example, state laws allow in-state wineries to self distribute.

Self-distribution laws permit the in-state winery to act as its own distributor, allowing sales by the winery directly to retail on-and off-sale licenses. In California the number of wineries could not proliferate without self-distribution, but self-distribution stops at the state line and the privilege is only available for in-state wineries.

Self-distribution and winery direct sales are not three-tier concepts. They are methods of distribution that would not be categorized as three-tier. In California as well as in some other states these methods of distribution exist in addition to the three-tier distribution method, and wineries can choose to exercise any combination of methods in California to sell their wine. Even in the Granholm state of Michigan laws have been changed to allow out-of-state wineries to sell wine direct to retailers.

There is draft legislation floating around the House that is associated with this hearing today. It is being promoted by, I believe, the beer wholesalers, and it is a very long, broad, and quite frankly, outrageous wish list.

Number one, they want Congress to grant states an antitrust exemption. They also want states to allow—they want state laws to override Federal and constitutional mandates. They want Congress to overturn a long line of judicial decisions that have consistently recognized states' rights to regulate alcohol beverages as long as they don't discriminate. And they want states to be relieved from

having to prove that their own statutes and regulations are constitutional.

As a Member of the Energy and Commerce Committee, I urge this Committee to listen carefully and respectfully to today's testimony, especially to see if what is being proposed here is innovation or monopoly protection, whether the marketplace or the government is to decide winners and losers, and whether free market economy or one that is controlled by promoting discriminatory legislation to state legislatures will determine how a legal product is marketed to legal consumers.

I ask you to be on the side of states' rights, but states' rights that are measured by the principles of our country's Constitution and antitrust laws. It is right that they have access to Congress to make their request and it is right to allow them a forum to express their fears about the holdings in the current series of judicial decisions. They ask a lot, but what they ask is not justified.

What they fear is nothing less than the U.S. Constitution and antitrust laws. There must be extraordinary reasons why states should be allowed—or should get a free pass from the Constitution or antitrust laws, and I predict that you will not hear any such reasons in your hearing today.

Thank you, Mr. Chairman. I yield back.

[The prepared statement of Mr. Radanovich follows:]

PREPARED STATEMENT OF THE HONORABLE GEORGE RADANOVICH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Statement of Representative George Radanovich (CA-19):

Thank you Mr. Chairman, Ranking Member Coble and Members of the Subcommittee for allowing me to make remarks today. As you know, I am a co-founder of the Congressional Wine Caucus, and a member of the Energy and Commerce Committee, which has jurisdiction over interstate commerce. I have also been the owner of a California winery, both of which are the bases for my testimony today.

Introduction:

I know when consumers visited my winery, they thought I had the ideal job and wondered why I ever went into public service. I was outside a lot, made a good product associated with fine living and good food, and my office had a great view. But the business of wine is far from the bucolic splendor of the vineyards. It is difficult to sell wine, perhaps more difficult than selling most other products or services in the United States, and much of that is due to the level and diversity of regulation and control of all aspects of the business.

The Regulatory Reality:

Wine is a highly taxed and highly regulated business, with 50 sets of state laws as well as federal oversight from the Tax and Trade Bureau, the Federal Trade Commission, the EPA, among others. In such an environment, there are great costs involved not only in making wine, but also in getting wine to market. Tax rates differ; some states require licenses or permits; and still others will require that I pay a fee to register my labels. One state will require that I buy a license and hire a wholesaler to distribute my wine and that I designate a sales territory for that wholesaler, while a second state will prohibit me from doing that very thing and prohibit me from assigning exclusive sales territories. One state will make it impossible for me to fire my assigned wholesaler, even though the wholesaler has not performed as represented. In most of the states we tried to ship into, every bottle of our wine had to pass through a wholesaler, which adds to costs and delay.

For new wineries, as it was for me, it is always a shock to realize how difficult it is to acquire distribution in other states. Even for long-established wineries, there are a lot of human resources that are dedicated to complying with divergent state laws so that they can attempt to realize a profit. In many cases, compliance with certain state laws discouraged my winery from selling in some states. I'm sure that's common among many wineries. The cost to introduce a wine in a market can far outweigh the potential profits to be realized.

Federal Government Plays an Important Role in Alcohol Beverage Regulation:

The US Department of Treasury's Tax and Trade Bureau's production regulations establish uniform baseline standards of identity and allow wineries from any state to know how their product is categorized on the federal level. TTB's permit system for wineries and distilleries, their antitrust-based trade practice laws, and their label approval

processes, all provide a uniform framework from which state laws build. Despite the current diversity in state control, I truly believe that the inconsistencies among state control systems would be much greater without this important federal framework.

Self-Distribution:

People in the wine business hear a lot about three-tier distribution, but all know that a pure three-tier distribution system does not exist in the United States. Instead, over the years since prohibition was repealed, states have chosen to exercise their powers under the 21st Amendment to create hybrid distribution systems that use three-tier principles as a framework. In at least 39 states, for example, state laws allow in-state wineries to self-distribute. Self-distribution laws permit the in-state winery to act as its own distributor, allowing sales by the winery directly to retail on- and off-sale licensees. In California, the number of wineries could not proliferate without self-distribution. But self-distribution stops at the state line, and the privilege is only available for in-state wineries.

Direct-to-Consumer:

What is also not three-tier is a winery's ability in some states to sell wine directly to a consumer either at their tasting room or over the internet. In my home state, I'm allowed to sell wine directly to a consumer. I can operate a winetasting room at my winery and at one other retail location where I can conduct educational winetastings and sell my wine directly to consumers. Without this manner of distribution, most small wineries would find it difficult to survive. Many wineries are surviving in today's economy solely on the strength of their direct-to-consumer wine clubs. I remember when some states would punish such sales as felonies. States like Kentucky would equate wine sales with serious crimes against the person.

Self-distribution and winery direct sales are not three-tier concepts. They are methods of distribution that would not be categorized as three-tier. In California as well as in some other states, these methods of distribution exist in addition to three-tier distribution methods, and wineries can choose to exercise any combination of methods in California to sell their wine. Even in the Granholm state of Michigan, laws have been changed to allow out-of-state wineries to sell wine direct to retailers.

The Plea of the Disintermediated:

There is draft legislation floating around the House that is associated with this hearing today. It is. It is believed to be promoted by the beer wholesalers, and they present this committee today with a very long, broad and quite frankly, outrageous wish list.

- They want Congress to grant the States an antitrust exemption.
- They want state laws to override federal and Constitutional mandates.

- They want Congress to overturn a long line of judicial decisions that have consistently recognized state rights to regulate alcoholic beverages as long as they don't discriminate.
- They want states to be relieved from having to prove that their own statutes and regulations are constitutional.

As a member of the Energy and Commerce Committee, I urge this committee to listen carefully and respectfully to today's testimony, especially to see if what is being proposed here is innovation or monopoly protection; whether the marketplace or the government is to decide winners and losers; and whether a free market economy or one that is controlled by promoting discriminatory legislation to state legislatures will determine how a legal product is marketed to legal consumers.

Listen carefully to hear whether certain market segments are intent on maintaining the status quo in the face of judicial decisions that threaten that status quo. Wholesalers are the market participants that have been the most successful in a three-tier distribution system. Their loud voices, and those of their allies, are not the voice for change and innovation. They are not sitting idly, but are here because they want to exhaust all the judicial, regulatory, and legislative means at their disposal to thwart the natural evolution of distribution change in the alcohol beverage industry that is measured by the Constitutional yardstick.

I ask you to be on the side of state rights, but state rights that are measured by the principles of our country's Constitution and antitrust laws. It is right that they have access to Congress to make their request, and it is right to allow them a forum to express their fears about the holdings in the current series of judicial decisions. They ask a lot, but what they ask for is not justified. What they fear is nothing less than the US Constitution and antitrust laws. There must be extraordinary reasons why States should get a free pass from the Constitution or antitrust laws, and I predict that you will not hear such reasons today.

Mr. JOHNSON. Thank you.

With that, we will take a recess. We have got about 35 to 40 minutes worth of votes, and I appreciate you all testifying and look

forward to hearing the persons on the second panel. We shall return.

[Recess.]

Mr. JOHNSON. We now turn to our second panel and ask them to prepare to testify. I draw the gallery's attention to the first seat, which is an empty seat which is for the wine industry, and so unfortunately no one being here from the wine industry means that they will not need to prepare to testify.

Our first witness is Mr. James Ho. Mr. Ho is the solicitor general for the state of Texas, the first Asian-American to hold the office.

Welcome, Mr. Ho.

Next is Ms. Nida Samona, chairperson of the Michigan Liquor Control Commission.

Welcome, Ms. Samona.

Next, Steve Hindy, cofounder, chairman, and president of the Brooklyn Brewery.

Welcome, Mr. Hindy.

Next we have Pamela Erickson, president and CEO of Public Action Management. She was formerly the executive director of the Oregon Liquor Control Commission.

Thank you for being here, ma'am.

And finally, we have Professor Darren Bush. Professor Bush is an associate professor of law at the Houston Law Center. He as also a consulting member of the Antitrust Modernization Commission, a bipartisan taskforce established by the Judiciary Committee to critically evaluate antitrust law.

Welcome, Professor Bush. Any relation, just for the record?

All right, without—but you would still be welcome.

Without objection your written statement will be placed into the record. And as before, we ask that you limit your oral remarks to 5 minutes, and our lighting system starts with the green light, then the yellow light with 1 minute left, and then red.

So with no further adieu, Mr. Ho?

TESTIMONY OF JAMES C. HO, SOLICITOR GENERAL OF TEXAS, OFFICE OF THE SOLICITOR GENERAL, AUSTIN, TX

Mr. HO. Good afternoon, Mr. Chairman and Members. Thank you very much for the invitation to appear before the Subcommittee today. My name is Jim Ho. I serve as the solicitor general of the state of Texas under the leadership of Texas Attorney General Greg Abbott, but just to be clear, I am appearing today solely in my personal capacity, not on behalf of the state.

I know the Subcommittee's time is short, so I am just going to give a shortened version of my written remarks. It is my understanding that there is some discussion of possible legislation to clarify the authority of states to regulate commercial activities involving alcoholic beverages.

Mr. Chairman, you noted at the outset your—the importance of balance in your view. In that spirit I will just make very clear, I don't have a particular dog in this fight. I have no position on the legislation; I am certainly not here to express any position on the merits of the legislation. But I can certainly testify with respect to the constitutional issues—the constitutionality of any proposed legislation based on my experiences litigating in this area.

As the Subcommittee knows, the power of states to regulate commerce in alcohol has been the subject of hotly contested litigation in numerous courts around the country in recent years. Our office has handled a number of such matters on behalf of the state of Texas. We won the most recent round in the court of appeals in Texas—Louisiana, but there are similar cases being fought in communities across the Nation.

These cases involve constitutional objections to state laws, but make no mistake, this is a unique area of constitutional litigation, and I say that because Congress has the power to step in and resolve the litigation itself at any time. In this unique area of constitutional litigation Congress can seize the reins and decide for itself whether a particular constitutional challenge should succeed or fail simply by passing a Federal statute, and that is because these cases involve a doctrine known as the dormant Commerce Clause.

Courts invoke this doctrine, the dormant Commerce Clause, as a constitutional limit on states, but courts invoke this doctrine only because they are presuming that Congress would prefer that states stay out of a particular area of regulation.

So let me say that again: It is only a presumption about what Congress wants in a particular area, and what that means is that Congress at any time has the power to make its actual views in a particular area known to the courts. And if Congress expresses those views courts will follow them.

What is more, congressional action in this area would reinforce important constitutional values. After all, alcohol is the only consumer product to receive special constitutional status, in the form of special recognition of state authority to regulate under the 21st Amendment.

Let me also add that—my conclusion here today—that Congress has full authority to regulate in this area if it chooses to. That conclusion I don't really regard as controversial, and if it is a controversial constitutional position, I look forward to hearing why. But amongst the community of constitutional lawyers this is pretty much a settled issue.

Courts across the country, including the U.S. Supreme Court, have repeatedly acknowledged that if Congress speaks clearly it can eliminate entirely constitutional challenges to state laws under the dormant Commerce Clause. After all, let us remember the whole premise, the whole point of the dormant Commerce Clause is to allow courts to step in and fill certain gaps only when Congress has failed to speak. But if courts—I am sorry, if Congress does choose to speak the courts will listen.

Thank you again for the invitation to testify. I would be delighted to answer any questions.

[The prepared statement of Mr. Ho follows:]

PREPARED STATEMENT OF JAMES C. HO

U.S. House of Representatives
Committee on the Judiciary
Subcommittee on Courts and Competition Policy

Hearing on: Legal Issues Concerning State Alcohol Regulation

Testimony of James C. Ho

Thursday, March 18, 2010, 1 p.m., 2141 Rayburn House Office Building

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Mr. Chairman and Members:

Thank you for the opportunity to appear before the subcommittee today. My name is Jim Ho. I currently serve as the Solicitor General for the State of Texas, under the leadership of Texas Attorney General Greg Abbott. But I appear today solely in my personal capacity—and not on behalf of the State of Texas or any of its officials or agencies.

It is my understanding that the subcommittee may soon consider legislation to clarify the authority of states to regulate commercial activities involving alcoholic beverages.

I am not here to express any views on the merits of any such legislation. But I have been involved in litigation in this area, and am happy to discuss my experiences accordingly.

As the subcommittee well knows, the power of states to regulate commerce in alcohol has been the subject of hotly contested litigation in numerous courts across the country in recent years. Our office has handled a number of such matters on behalf of the State of Texas, but there are similar cases being fought in communities across the nation.

The U.S. Supreme Court addressed many of these issues just a few years ago in *Granholm v. Heald*, 544 U.S. 460 (2005). And now, courts and litigants across the country—including the State of Texas—are working to determine the proper meaning and limits of the *Granholm* ruling.

This is a heavily litigated area of the law. But make no mistake: It is heavily litigated, because there is a heated debate about the meaning of previous acts of Congress—including various federal statutes, as well as the 21st Amendment to the U.S. Constitution.

These cases involve constitutional objections to state laws. But make no mistake: This is a unique area of constitutional litigation—because Congress can step in and resolve the litigation itself, at any time.

In most areas of constitutional litigation, a party objects to a federal, state, or local law—a court determines whether or not that law is constitutional—and that word is final, subject only to review by a higher court, or reversal by a constitutional amendment.

In this unique area, however, Congress can seize the reins, and decide for itself whether a constitutional challenge should succeed or fail, simply by passing a federal statute.

That is because these cases involve a doctrine known as the "dormant Commerce Clause."

Under Article I, Section 8, clause 3 of the Constitution, Congress has the "power . . . [t]o regulate commerce . . . among the several states."

Courts have consistently construed this provision to have two components. First, it contains an affirmative grant of power to Congress to regulate interstate commerce. Second, it also contains a silent but implicit, or negative, limit on the power of states to regulate commerce.

It is this second prong that is known as the "dormant Commerce Clause."

This doctrine can be used to invalidate state laws that purport to regulate commerce—an area that Congress has the constitutional power to reserve for its own regulatory authority.

But there is a catch. Courts invoke the dormant Commerce Clause as a constitutional limit on state power. But they do so only because they are *presuming* that Congress would prefer that states stay out of certain areas of regulation.

This judicial presumption has important implications for our discussion today—because it is only a *presumption* about what Congress wants. Congress can make its actual views known to the courts. And if Congress does so, courts will follow.

This principle applies with equal—if not special—force here. Litigation over state power to regulate alcohol is indeed hotly contested. But that is only because different judges have different judgments about what they *think* Congress wants in this area. If Congress were to state its views with vivid clarity, that would go a long way toward ending litigation—ending what the *New York Times* once called the "wine wars."

What's more, Congressional action in this area would only reinforce important constitutional values. After all, alcohol is the only consumer product to receive special constitutional status—in the form of special recognition of the importance of state authority to regulate alcohol under the 21st Amendment.

I want to close by making this one point: The views I express here are not remotely controversial within the community of constitutional lawyers. To the contrary, courts across the country have repeatedly acknowledged that, if Congress speaks clearly, it can eliminate constitutional challenges to state laws under the dormant Commerce Clause.[1]

After all, the entire point of dormant Commerce Clause litigation is to allow courts to step in and fill in the gaps—*only* when Congress has failed to speak.

But if Congress does choose to speak, the courts will listen.

I want to thank the subcommittee again for the opportunity to testify here today. I am happy to answer any questions the subcommittee may have.

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[1] *See, e.g.*, *Ne. Bancorp, Inc. v. Fed. Reserve Sys.*, 472 U.S. 159, 174 (1985) ("When Congress so chooses, state actions which it plainly authorizes are invulnerable to constitutional attack under the Commerce Clause."); *Liberty Mut. Ins. Co. v. La. Dep't of Ins.*, 62 F.3d 115, 118 (5th Cir. 1995) ("[B]y the McCarran-Ferguson Act, Congress removed all Commerce Clause limitations on the authority of the States to regulate and tax the business of insurance. The Court has squarely rejected the argument that discriminatory state insurance taxes may be challenged under the Commerce Clause despite the McCarran-Ferguson Act.") (citation and quotations omitted). Congress exercised this authority again just a few years ago, by enacting the Reaffirmation of State Regulation of Resident and Nonresident Hunting and Fishing Act. *See* Pub. L. No. 109-13.

Mr. JOHNSON. Thank you, sir.
Next, Ms. Samona?

TESTIMONY OF NIDA SAMONA, CHAIRPERSON, MICHIGAN LIQUOR CONTROL COMMISSION, LANSING, MI

Ms. SAMONA. Thank you. Mr. Chairman, Ranking Member Cole, Members of the—Coble, I am sorry—and Members of the Subcommittee, I want to thank you. I am the chairperson of the Michi-

gan Liquor Control Commission, and I thank you for the invitation to discuss Michigan's system for regulating alcoholic beverages and the need to preserve state control over the health, safety, and the welfare of our citizens.

Experience has taught us that government regulation can be in the best public interest. Whether it is financial markets, food safety, mortgages, government has a role in protecting the public. This is especially true when it comes to alcohol.

In 1941 Supreme Court Justice Jackson stated that liquor is "a lawlessness unto itself." That was true then, and it is certainly true today.

Because of their potential abuse and their importance as a source of tax revenue for states alcoholic beverages must be highly regulated. History has taught us that regulation is most effective and accepted when it is done at the state level.

The harmful effects on individuals, families, and societies as a whole that result for intemperate or underage consumption of alcoholic beverages are dramatically different from those related to the use of other products, whether they are measured by scale, severity, nature, or remedy. So, as a consequence states attempt to mitigate these problems through regulation.

Indeed, alcoholic beverages have always been and remain one of the most heavily regulated products in the country, and for good reason. Localities and states have enacted a variety of restrictions on the manufacture, distribution, and sale of alcoholic beverages—the three-tier system.

Alcohol is the only product that has been the subject of two constitutional amendments. The first was the 18th Amendment, which established national prohibition of alcohol; and the second was the 21st Amendment, which returned primary responsibility for alcohol regulation to the states. State of Michigan was the first one to enact the 21st Amendment, of all the states.

Community norms and standards across the country differ widely regarding alcohol. This fact underscores the soundness of the constitutional and congressional decisions to rest regulatory authority primarily at the state and local level.

Under the authority provided by the 21st Amendment the Michigan legislature created the Michigan Liquor Control Commission and granted it plenary powers to control alcoholic beverages traffic in Michigan, including the manufacture, importation, possession, transportation, and the sale of alcoholic beverages within the state. Among the goals of the commission are controlling the traffic in alcoholic beverages within the state, collecting tax revenue, and protecting both the consumer and the general public from unlawful consumption and use of alcohol.

Michigan's Liquor Control Code provides for strict regulation and control over the alcoholic beverage industry as opposed to fostering the significant degree of free enterprise that was afforded to other products. This regulation is achieved through a transparent system that requires that all alcoholic beverages need to be distributed through the commission or its licensees, who are subject to extensive oversight and regulation.

This system has worked remarkably well for over 75 years. Through the delicately balanced and historically tested regulatory

scheme Michigan has been able to address critical state interests, such as preventing illegal sales to minors, inhibiting overly aggressive marketing and consumption, collecting taxes, creating orderly distribution and importation systems, and preventing a recurrence of the problems that led to the enactment of the national prohibition. These are all recognized as core interests of the 21st Amendment.

In 2004 the *Heald v. Granholm* case struck down the Michigan—the New York and Michigan laws which banned wineries from being out—from shipping out—from allowing out-of-state wineries to ship directly to the doorsteps of customers. The *Granholm* decision did not invalidate the three-tier system. In fact, Justice Kennedy called it "unquestionably legitimate," in his opinion.

State regulatory systems are under siege, and these lawsuits are gutting out the effective state regulation that we are asking for Congress to come in and to address. Thank you.

[The prepared statement of Ms. Samona follows:]

PREPARED STATEMENT OF NIDA SAMONA

Testimony of Nida Samona,

Chairperson of the Michigan Liquor Control Commission

Before the

Subcommittee on Courts and Competition Policy

of the

Committee of the Judiciary

Hearing on Legal Issues Concerning State Alcohol Regulation

U.S. House of Representatives

March 18, 2010

Mr. Chairman, Ranking Member Coble, Members of the Subcommittee, I am the Chairperson of the Michigan Liquor Control Commission. Thank you for the invitation to discuss Michigan's system for regulating alcoholic beverages and the need to preserve state control over the health, safety, and welfare of our citizens.

Experience has taught us that government regulation can be in the public interest. Whether it is financial markets, food safety, or mortgages, government has a role in protecting the public. This is especially true with alcohol.

In 1941 Supreme Court Justice Jackson stated that liquor is "a lawlessness unto itself." That was true then and is true today. Because of their potential for abuse, and their importance as a source of tax revenue, alcoholic beverages must be highly regulated. History has taught us that regulation is most effective and accepted, when done at the state level.

The harmful effects on individuals, families, and society as a whole that result from intemperate or underage consumption of alcoholic beverages are dramatically different from those related to the use of other products, whether measured by scale, severity, nature, or remedy. As a consequence, states attempt to mitigate these problems through regulation. Indeed, alcoholic beverages have always been and remain one of the most heavily regulated products in the country. Localities and states have enacted a variety of restrictions on the manufacture, distribution, and sale of alcoholic beverages.

Alcohol is the only product that has been the subject of two Constitutional Amendments: the first was the Eighteenth Amendment, which established National Prohibition, and the second was the Twenty-first Amendment, which returned primary responsibility for alcohol regulation to the states. Community norms and standards across the country differ widely regarding alcohol. This fact underscores the soundness of the Constitutional and Congressional decisions

to rest regulatory authority primarily at the state and local level. Under the authority provided by the Twenty-first Amendment, the Michigan Legislature created the Michigan Liquor Control Commission and granted it plenary powers to control alcoholic beverage traffic in Michigan, including the manufacture, importation, possession, transportation, and sale of alcoholic beverages within the State. Among the goals of the Commission, are controlling the traffic in alcoholic beverages within the state, collecting tax revenue, and protecting both the consumer and general public from unlawful consumption and use of alcohol.

Michigan's Liquor Control Code provides for strict regulation and control over the alcoholic beverage industry as opposed to fostering the significant degree of free enterprise afforded other businesses dealing with other products. This regulation is achieved through a transparent system that requires that all alcoholic beverages be distributed through the Commission or its licensees—who are subject to extensive oversight and regulation.

That system has worked remarkably well for over seventy – five (75) years. Through this delicately balanced and historically tested regulatory scheme, Michigan has been able to address critical state interests, such as: preventing illegal sales to minors, inhibiting overly aggressive marketing and consumption, collecting taxes, creating orderly distribution and importation systems, and preventing a recurrence of the problems that led to the enactment of National Prohibition. These are all recognized as core interests of the Twenty-first Amendment.

Michigan's regulatory system is the product of its experience and history. Prior to Prohibition large suppliers controlled saloons and retailers leading to overconsumption of alcoholic beverages. These arrangements were blamed for producing monopolies and exclusive dealing arrangements, for causing a vast growth in the number of saloons and bars, for fostering commercial bribery, and for generating other serious social and political problems, including

political corruption, irresponsible ownership of retail outlets, and intemperance. Today state regulators are not only faced with large producers trying to promote their products and business, but also with large retailers who because of their market dominance can exert extreme influence over manufacturers and others in the distribution chain, if left free from state regulation.

Unfettered competition, the lowest price, and widespread availability of alcohol are not in the public interest. Therefore, in regulating the distribution system, Michigan has significantly restricted use of aggressive marketing techniques and drastic price-cutting of alcoholic beverages thereby promoting responsible usage and temperance.

In 2004 the Supreme Court's 5-4 decision in *Heald v Granholm* struck down Michigan and New York laws that banned wineries located out of state from shipping wine directly to the doorsteps of Michigan and New York customers. While the *Granholm* decision did not invalidate Michigan's three-tier distribution system for alcoholic beverages, and, indeed, referred to that three tier system as "unquestionably legitimate," state regulatory systems remain under siege. Michigan and other states continue to be challenged with lawsuits whose goal is to gut effective state regulation of alcoholic beverages by allowing entities over which state regulators have little or no control to distribute alcoholic beverages free from the oversight and rules that govern in-state licensees.

For example, Michigan was recently sued on the theory that out-of-state retailers should be able to ship wine to Michigan residents. The District Court ruled against Michigan's position and instead of facing the additional costs of litigating the Michigan Legislature restricted the ability of all retailers to ship to consumers. Michigan reached this resolution even though it believed its legal position was correct. The same arguments that were asserted by Michigan and rejected by our District Court were subsequently accepted by the 2nd and 5th Circuit Courts of

Appeal, which upheld regulatory systems similar to Michigan's against the same type of legal challenge. Because of this type of expensive and uncertain litigation-- where a state may be forced to expend great manpower and incur great defense costs and where the state is forced to litigate under the threat of severe economic sanctions if it doesn't prevail-- a federal statute is essential to confirm the primacy of State regulation over dormant commerce clause and antitrust challenges that might apply to other products.

Finally, I would like to address why as a practical matter it is important that States like Michigan have the ability to establish their own regulatory structure.

Michigan uses its limited resources, Commission staff and local law enforcement officers, to ensure that in-state retailers and wholesalers are physically inspected and checked to verify that Michigan's regulatory system is being followed, that only approved alcoholic beverages are being sold, that alcoholic beverages are not being sold to underage persons and that taxes are being paid. Michigan simply does not have the ability or financial resources to effectively regulate hundreds of thousands of out-of-state retailers to ensure they are not selling to minors and to ensure that they are paying taxes and only selling products approved by the Commission. In 2009, the Michigan Liquor Control Commission had almost a billion dollars in taxable spirit sales. But, it is unknown how much revenue loss is associated with illegal and untaxed out-of-state sales. And no state should be forced against its will to undertake what I believe is the impossible task of trying to regulate out-of-state retailers.

As an exercise of its Twenty-first Amendment authority, Michigan, like many other states, generally chooses to require an in-state presence to ensure effective regulation of its licensees. It is only through an in-state presence that states can have the confidence and assurance that licensees will be held accountable to the comprehensive regulatory system for

alcohol sales and distribution. Therefore, federal legislative action is critical in helping Michigan and other states regulate alcoholic beverages free from the dormant commerce clause and federal antitrust law restrictions that would otherwise apply. This legislation is urgently needed to help states defend against lawsuits that are motivated by economic gain or to promote a particular business model and not in the best interests of the health, safety and welfare of the public. State police power has been eroded by recent Court decisions that use the dormant commerce clause to invalidate state alcohol regulatory systems.

Dormant commerce clause litigation in the alcohol arena is typically brought by well funded corporations or individuals. This litigation has proliferated, and attorney fee awards are often enhanced at unimaginable lodestar rates that drain essential state resources. Michigan, alone, has incurred well over several million dollars in fees and costs in defending these lawsuits. States are being punished for making legislative choices that are based on sound public policy and welfare concerns.

As a state regulator concerned with public well being, I urge you to help my fellow regulators and me retain the systems that each state has chosen to regulate alcohol.

Thank you for your time and consideration of this important matter.

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Mr. JOHNSON. Thank you, Ms. Samona.
Now, Mr. Hindy?

TESTIMONY OF STEPHEN HINDY, CHAIRMAN AND PRESIDENT, BROOKLYN BREWERY, BROOKLYN, NY

Mr. HINDY. Thank you, Chairman Johnson, Representative Coble—happy birthday—Members of the Subcommittee. I am pleased to present this testimony on behalf of 1,500 small brewers in the United States.

I started my company in 1988. I employ 40 people in Brooklyn and am currently expanding my brewery and adding 20 jobs. I also brew at an upstate brewery which employs 120 people.

I am a member of the Brewers Association, the trade association of small brewers, and the Beer Institute, the trade group representing large and small brewers and importers of beer in the United States. I have had the honor of serving on the boards of both organizations.

Virtually all the beer produced, distributed, and sold in this country passes through the three-tier system. Three-tier has served our country well in both regulating the safe production and distribution of high-quality beers and in helping to foster the craft brewing renaissance that has seen the genesis of 1,500 small breweries in the past 25 years. There has been no comparable renaissance in many countries around the world where large brewing companies dominate production, distribution, and retailing.

The three-tier system is not broken, but consolidation at the distributor level has made it difficult for some small brewers to get to market. Some states make exceptions to the three-tier system to address this problem.

When I started Brooklyn Brewery none of the large New York City distributors were interested in carrying my beers. I was able to distribute my own beer and build my brand and eventually sell the rights to my brand to one of those big distributors.

There have been many similar success stories among small breweries in other states, such as Samuel Adams in Massachusetts, Sierra Nevada in California. Without the right to self-distribute it is doubtful we could have established our businesses.

We do not see any need for a drastic change in the balance between state and Federal authorities that has served the public for many years. There has been talk of ceding Federal control of alcoholic beverage regulation to the states. That would be a disaster for small brewers and consumers.

Separate state regulations on formulation, labeling, or advertising would be incredibly expensive for all brewers. Last year in my own state of New York, for example, the courts wisely struck down a law that would have required brewers to create separate, New York-specific labels for any beer sold in that state. This would have effectively closed the New York market to smaller brewers who could not afford the expense of special, New York-only labels.

The current system has also served the public interest in controlling the abuse of alcoholic beverages. My review of available national statistics shows that our Nation has made significant progress in reducing drinking by underage youth and in drunk driving. Brewers, wholesalers, and retailers alike are committed to making further progress in these areas. It is not clear—to me at least—what a radical change in the Federal-state balance would do to these very positive trends.

The number one issue facing small brewers is state franchise legislation that gives distributors virtual absolute control of our brands. In some states non-performing wholesalers sit on our brands to ensure their competitors do not get them. Talk about stifling competition. Beer distributors have significant clout in all state legislatures, and there is fear among small brewers that a switch to exclusive state regulation would only exacerbate this problem.

In spite of challenges, the three-tier system is alive and well in the United States. We want to see that system continue without radical changes that could harm the interests of American consumers who responsibly enjoy our products. Representative Cohen, I think, said it best this morning: If it ain't broke, why fix it?

Thank you.

[The prepared statement of Mr. Hindy follows:]

PREPARED STATEMENT OF STEPHEN HINDY

TESTIMONY OF STEVE HINDY
Founder, Chairman, and President of The Brooklyn Brewery

U.S. House of Representatives
Committee on the Judiciary
Subcommittee on Courts and Competition Policy
March 18, 2010

Chairman Johnson, Representative Coble, and members of the Subcommittee on Courts and Competition, I am pleased to present this testimony on behalf of the 1,500 small brewers in the United States. My name is Steve Hindy and I am founder, chairman and president of The Brooklyn Brewery, New York's leading brewery. I started my company in 1988. I employ 40 people in Brooklyn and am currently expanding my brewery and adding 20 jobs. I also brew at the Saranac brewery in Utica, NY, which employs 120 people.

I am a member of the Brewers Association, the trade association of small brewers, and the Beer Institute, the trade group representing large and small brewers and importers of beer in the United States. I have had the honor of serving on the Boards of Directors of both organizations.

The three-tier system of beer production and distribution evolved after 1933, when Prohibition ended. In general, businesses operate in three "tiers" as producers of beer, distributors of beer, or retailers of beer. States often mandate a separation between the tiers by law. Virtually all the beer produced, distributed and sold in this country passes through the three-tier system.

The three-tier system has served our country well in both regulating the safe production and distribution of high quality beers and in helping to foster the craft brewing renaissance that

has seen the genesis of 1,500 local breweries in the past 25 years. There has been no comparable renaissance in many countries around the world where large brewing companies dominate all three tiers: production, distribution and retailing.

The three-tier system is primarily governed by state laws, but with federal government oversight. Through the Commerce Clause of the Constitution, the federal government insures that no state laws unfairly favor one group of brewers over another. The federal government, through the Alcohol & Tobacco Tax & Trade Bureau, collects federal excise taxes and oversees licensing of breweries, formulation of beers, labeling, and advertising and marketing of beer brands. The federal government mandated the 21-year-old drinking age.

The three-tier system is not broken and has helped to foster the craft brewing resurgence we have since in the past several decades. But consolidation at the distributor level has made it difficult for some small brewers to get to market. Some states make exceptions to the three-tier system to address this problem. When I started Brooklyn Brewery in 1988, none of the large New York City distributors were interested in carrying my beers. I was able to distribute my own beer and build my brand and eventually sell the rights to my brand to one of those big distributors. There have been similar success stories among small brewers in other states, such as Sam Adams in Boston. Without the right to self-distribute, it is doubtful we could have established our businesses.

American consumers are demanding a wider range of products and some large retailers want to buy directly from brewers, winemakers and liquor companies. In an effort to get products not available through the three-tier system, some wineries and consumers have brought suit, challenging state alcohol laws that mandate that alcohol beverages be sold through the three-tier system. A small number of state laws have been struck down as being discriminatory,

but most have been upheld. The cost of defending these lawsuits and the threat of more litigation seeking exceptions in the three-tier system have raised concern among some members of in the beer industry.

We understand those concerns, but we do not see any need for a drastic change in the balance between state and federal authorities that has served the public for many years. There has been talk of ceding control of alcohol beverage regulation to the states. That would be a disaster for small brewers. Separate state regulations on formulation, labeling or advertising would be incredibly expensive for all brewers. Last year in my own state of New York, for example, the courts wisely struck down a law that would have required brewers to create separate, New York-specific, UPC codes for any beer sold in the state. This would have effectively closed the New York market to smaller suppliers who could not afford the expense of special New York-only labels.

Brewers like mine also benefit from other aspects of the current federal-state balance. Discriminatory tax regimes like those struck down by the courts for many years would unfairly hamper our ability to enter new markets. Laws on "post and hold" price posting, "price affirmation" and other measures long ago declared illegal by the courts could reappear to the detriment of brewers, consumers and competition. And separate state regulations on drinking age in lieu of the national 21 standard could create confusion and chaos.

The current system has also served the public's interest in controlling the abuse of alcohol. My review of available national statistics shows that our nation has made significant progress in reducing drinking by underage youth and drunk driving. Brewers, wholesalers and retailers alike are committed to making further progress in these areas. It is not clear, to me at least, what a radical change in the federal-state balance would do to these very positive trends.

The number one issue facing small brewers is state franchise laws that give distributors virtually absolute control of our brands. In some states, non-performing wholesalers sit on our brands to insure their competitors do not get them. Beer distributors have significant clout in all state legislatures, and there is fear among small brewers that a switch to exclusive state regulation would only exacerbate this problem.

In spite of challenges, the three-tier system is alive and well in the United States. We want to see that system continue without radical changes that could harm the interests of America's craft brewers and the consumers who responsibly enjoy our products.

Mr. JOHNSON. Thank you, sir.
Last but—not last, but next, Ms. Erickson, please?

TESTIMONY OF PAMELA S. ERICKSON, CHIEF EXECUTIVE OFFICER, PUBLIC ACTION MANAGEMENT, SCOTTSDALE, AZ

Ms. ERICKSON. Thank you, Mr. Chairman and Members of the Subcommittee. It is a pleasure to be here and talk about this very important issue.

I am a former alcohol regulator and current alcohol abuse prevention advocate that is deeply concerned about alcohol regulation issues. And I am the author of this some what infamous report, called "The Dangers of Alcohol Deregulation: The United Kingdom Experience."

I would like to say that the gentleman that suggested that we are comparing apples and oranges is quite correct—lemons and oranges, however you want to say it. That is correct, and the reason is that in the United States we have a comprehensive system that does control alcohol in a way that fosters moderation and consumption; the United Kingdom no longer has such a system.

Over a period of 4 decades they slowly deregulated to the point where you can sell alcohol 24 hours a day, 7 days a week in bars and all kinds of stores. Alcohol has become 70 percent more affordable in just 20 years, which means the marketplace is flooded with cheap alcohol that has encouraged people to drink.

As deregulation occurred over 4 decades consumption rates went up, and up, and up. They are now paying the price for deregulation, and let me just give you a couple of statistics.

Hospital admissions for alcohol liver disease and acute intoxication have doubled over just 10 years. Underage drinking rates are twice what ours are. Problems around bars and clubs are so severe in London that London has two buses equipped as field hospitals to take care of people who have been victims of alcohol-fueled violence or alcohol intoxication every weekend.

Could this happen to us? Again, I want to emphasize the major difference with us.

We have a comprehensive alcohol regulatory system that regulates the price, it keeps the price not too cheap to push consumption or too high that would encourage bootlegging. We have—usually have limits on outlets. We have limits on promotions that would encourage volume consumption. We have measures that address age. We have measures that address drunk driving.

We have a really good, comprehensive system. So as long as we maintain that system and keep it strong we should be okay.

Our policy is alcohol moderation—moderation in consumption. It is a very good policy. If we follow this policy, if people drink in moderation there is rarely any harm and there is some health benefit for some people. So it is a good policy.

There are threats to our system. If we had a court system that determined our regulatory measures to be unconstitutional we could be quickly deregulated. Also, if market forces became so strong that there was domination by large, big box stores that were able to offer large quantities of alcohol very cheaply that could create major problems for us.

So those are things to be concerned about. When I work with various states I see deregulation efforts in the retail sector, and it is—I worry about the slow drip-drip-drip kind of deregulation occurring here.

I believe that our current system is good for business. In my native state of Oregon there is a strong system of regulation, yet a flourishing industry of small wineries, craft brewers that produce some of the best beer in the world—and that is a fact—and a growing micro-distillery business. Big box stores, independent grocers, convenience chains are all able to operate in this flourishing business environment.

Thank you so much for your attention.

[The prepared statement of Ms. Erickson follows:]

PREPARED STATEMENT OF PAMELA S. ERICKSON

"The Danger of Alcohol Deregulation: The United Kingdom Experience"

Written Statement of Pamela S. Erickson,

Chief Executive Officer, Public Action Management

Scottsdale, Arizona

to the

Subcommittee on Courts and Competition Policy

Committee on the Judiciary

House of Representatives

US Congress

Hearing on: "Legal Issues Concerning State Alcohol Regulation"

March 18, 2010

The Danger of Alcohol Deregulation: The United Kingdom Experience

Summary of a Report by Pamela S. Erickson

In the United States, the marketing, promotion and sale of alcohol are systematically regulated. As part of a growing globalization trend across the alcohol industry some have questioned if alcohol should be deregulated in the United States. To answer this question one need only look at the recent experiences of the United Kingdom on whether liberalized alcohol laws are optimal. This paper suggests that the answer is no. Alcohol should be regulated and deregulation of alcohol has many dangerous and unintended consequently for society at large.

The British public has something America does not want: an alcohol epidemic. This epidemic is characterized by very high rates of youth intoxication, large increases in alcohol induced diseases including liver cirrhosis, and frequent public disorder and violence around pubs and clubs. An examination of how this epidemic came about is a good lesson for the United States in an effort to ensure it does not reach our shores.

Like many countries, the United Kingdom (England, Wales, Scotland and Northern Ireland) has a cyclical history with alcohol problems. Periods of heavy drinking, crime and disorder have usually been provoked by some kind of public action. Countermeasures were then needed to reduce problems. Recent history saw a comprehensive set of regulations established during the First World War and retained for several decades to good result, until the latest round of deregulation began in the 1960's.

Today's epidemic in the UK follows the path of gradual deregulation to a point where the society treats alcohol the same as any other product. All forms of alcohol—beer, wine and spirits—are sold almost everywhere and can be purchased 24 hours a day. Alcohol was allowed for sale in grocery stores in the 1960's; pubs' and clubs' hours were extended; and, enforcement of existing laws was weak. As alcohol became more available it became cheaper. From 1980 to 2007, alcohol became at least 70% more affordable. This was particularly true in grocery stores where four large supermarket chains gained 75% of the market and became locked in a price war driving alcohol prices ever lower. Alcohol is sold below cost by many of these mega-retailers. People shifted to drinking primarily at home thanks to the cheaper prices. Meanwhile, local urban communities were looking for ways to revitalize their core centers and hit upon entertainment as the key. Numerous nightlife centers sprung up—some with mega-bars able to host 1,000 patrons. These became scenes of drunken debauchery with people spilling out at closing time vomiting, urinating and passing out. An ill-advised solution was to allow 24 hour sales so drunks would exit throughout the night, not all at once. This did not seem to stop the problems. It did increase the burden on law enforcement which had to staff up for the very late hours.

Women and youth are prominent in the epidemic. Rates of female intoxication, violence, disease and death have sky-rocketed. Pictures of young intoxicated women frequent the news. Youth intoxication rates are well over twice that of the U.S. and eight year old British children are hospitalized from drinking too much.

The UK has tried education and voluntary business responsibility programs. They had little effect. With few tools left, they passed the Licensing Act of 2003. It provided new measures for enforcement of underage sales and public order offences as well as the 24-hour sales provision. While it included a new tax at 2% above inflation, it did not contain provisions for minimum prices, bans on volume discounts or other measures that might have curbed the price war. To curb public disorder offenses, a new violation regulation allowed police to arrest and charge those engaged in rowdy behavior, but there were no bans on drink specials or minimum prices that might have curbed excess drinking in pubs and

clubs. The new tax did negatively affect pubs. It exacerbated the decline in patronage associated with a smoking ban and heavy price competition from grocery supermarkets.

The primary lesson to be learned comes from public health authorities who advise the use of multiple policies that have prior scientific evidence of effectiveness implemented in a systematic way. Such policies need to address many items, not just one factor in alcohol. Price, availability, industry practices, the drinking context, drunk driving, youth consumption and enforcement are all important. The World Health Organization and a study by the UK's own Sheffield University provide excellent advice on what kinds of policies can be effective.

Controlling price is of the utmost importance as it drives consumption. Higher prices have shown to curb consumption in all classes of drinkers—moderate, heavy and hazardous drinkers. Taxes, minimum prices, bans on discount promotions, bans on price discrimination by suppliers and wholesalers all serve to increase prices. Special efforts may be needed for pubs, bars and clubs because they tend to be frequented by hazardous drinkers. The tendency is to use tax measures alone to control prices. As the science indicates, multiple measures are needed to achieve balance in the marketplace. Ironically, the United Kingdom exemplifies the problem of using taxes alone to control prices. Even before the 2008 tax increase, the UK had some of the highest taxes on alcohol among European countries.

Despite the efforts of government to control the epidemic, they are battling strong market forces that seek to use the grocery business's standard model of mass merchandising for alcohol. This model calls for high volume sales at low prices with heavy promotion. This is just what will increase consumption of alcohol. Therefore, marketplace regulation must be aimed at preventing large quantities of cheap alcohol, readily available and heavily promoted.

The U.S. has serious problems with alcohol—particularly with underage drinking, but it has not reached the point of an epidemic. This could happen as we face similar market forces that push prices lower and make alcohol ubiquitous. There are frequent calls for deregulation that would allow mass merchandising techniques for alcohol. As in the UK, alcohol is much more available than in the past—it's even at many community events including some school and church functions. We have experienced a gradual decline in alcohol prices. Our children are drinking at younger and younger ages and young women are drinking at increased rates.

Currently, the U.S. has a strong alcohol regulatory system. Most states have the regulatory elements recommended by public health authorities. Each state has a system that carefully controls alcohol through three market segments. This system prevents price wars, tainted alcohol and collects taxes. Drunk driving has declined although too many people still die on our highways from alcohol induced crashes. Enforcement has curbed illegal sales to underage buyers.

It is critical that we take the lesson from the United Kingdom with great seriousness. Unbridled and unrestrained free market forces, once unleashed, are very hard to control. Americans must be very clear about the fact that alcohol is a different product that cannot be sold just like any other commodity. It must be clear that the purpose is to prevent practices which induce increases in consumption, heavy drinking and hazardous behavior. The research and rationale for these important marketplace curbs is not sufficient. Often policy makers are at a loss to explain why we regulate in the way that we do. This is dangerous as we could lose a good regulatory system merely due to lack of understanding.

Author's Note: This report is part of an educational campaign I developed called the "Campaign for a Healthy Alcohol Marketplace." It is an effort to educate policy makers, prevention advocates, law enforcement and regulators about the efficacy of our alcohol regulatory systems as evidenced by research. I recognized the need for such a program when I joined the alcohol abuse prevention field after seven years as Director of the Oregon Liquor Control Commission. Once I became thoroughly acquainted with the research on what works to curb alcohol problems, I realized that even as a regulator, I failed to fully appreciate the value and effectiveness of our regulatory system. It is a complex subject and often hard to understand how regulations work in today's global environment. I believe it is my job to explain regulatory measures in simple terms that everyone can understand. My campaign materials can be viewed at www.healthyalcoholmarket.com.

ATTACHMENT

The Dangers of Alcohol Deregulation:

The United Kingdom Experience

By Pamela S. Erickson, M.A., CEO
Public Action Management, PLC

Executive Summary

In the United States, the marketing, promotion and sale of alcohol are systematically regulated. As part of a growing globalization trend across the alcohol industry, some have questioned if alcohol should be deregulated in the United States. To answer this question one need only look at the recent experiences of the United Kingdom on whether liberalized alcohol laws are optimal. This paper suggests that the answer is no. Alcohol should be regulated, and deregulation of alcohol has many dangerous and unintended consequences for society at large.

The British public has something America does not want: an alcohol epidemic. This epidemic is characterized by very high rates of youth intoxication; large increases in alcohol induced diseases including liver cirrhosis; and frequent public disorder and violence around pubs and nightclubs. An examination of how this epidemic came about is a good lesson for the United States in an effort to ensure it does not reach our shores.

Like many countries, the United Kingdom (England, Wales, Scotland and Northern Ireland) has a cyclical history with alcohol problems. Periods of heavy drinking, crime and disorder have usually been provoked by some kind of public action. Countermeasures were then needed to reduce problems. Recent history saw a comprehensive set of regulations established during World War I and retained for several decades to good result, until the latest round of deregulation began in the 1960s.

Today's epidemic in the U.K. follows the path of gradual deregulation to a point where society treats alcohol the same as any other product. All forms of alcohol—beer, wine and spirits—are sold almost everywhere and can be purchased 24 hours a day. Alcohol was allowed for sale in grocery stores in the 1960s; pubs' and clubs' hours were extended; and enforcement of existing laws was weak. As alcohol became more available it became cheaper. From 1980 to 2007, alcohol became at least 70% more affordable. This was particularly true in grocery stores where four large supermarket chains gained 75% of the market and became locked in a price war driving alcohol prices ever lower. Alcohol is sold below cost by many of these mega-retailers. People shifted to drinking primarily at home due to the cheaper prices. Meanwhile, local urban communities were looking for ways to revitalize their core centers and hit upon entertainment as the key. Numerous nightlife centers sprung up—some with mega-bars able to host 1,000 patrons. These became scenes of drunken debauchery with people spilling out at closing time vomiting, urinating and passing out. An ill-advised solution was to allow 24 hour sales so drunks would exit throughout the night, not all at once. This did not seem to stop the problems. It did increase the burden on law enforcement which had to staff up for the very late hours.

Women and youth are prominent in the epidemic. Rates of female intoxication, violence, disease and death have sky-rocketed. Pictures of young, intoxicated women frequent the news. Youth intoxication rates are well over twice that of the U.S., and 8-year-old British children are hospitalized from drinking too much.

The U.K. has tried education and voluntary business responsibility programs. They had little effect. With few tools left, they passed the Licensing Act of 2003. It provided new measures for enforcement of underage sales and public order offences as well as the 24-hour sales provision. While it included a new tax at 2% above inflation, it did not contain provisions for minimum prices, bans on volume discounts or other measures that might have curbed the price war. To curb public disorder offenses, a new violation allowed police to arrest and charge those engaged in rowdy behavior, but there were no bans on drink specials or minimum prices that might have curbed excess drinking in

pubs and clubs. The new tax did negatively affect pubs. It exacerbated the decline in patronage associated with a smoking ban and heavy price competition from grocery supermarkets.

The primary lesson to be learned comes from public health authorities who advise the use of multiple policies that have prior scientific evidence of effectiveness implemented in a systematic way. Such policies need to address many items, not just one factor in alcohol. Price, availability, industry practices, the drinking context, drunk driving, youth consumption and enforcement are all important. The World Health Organization and a study by the U.K.'s own Sheffield University provide excellent advice on what kinds of policies can be effective.

Controlling price is of the utmost importance as it drives consumption. Higher prices have been shown to curb consumption in all classes of drinkers—moderate, heavy and hazardous drinkers. Taxes, minimum prices, bans on discount promotions and bans on price discrimination by suppliers and wholesalers all serve to increase prices. Special efforts may be needed for pubs, bars and clubs because they tend to be frequented by hazardous drinkers. The tendency is to use tax measures alone to control prices. As the science indicates, multiple measures are needed to achieve balance in the marketplace. Ironically, the United Kingdom exemplifies the problem of using taxes alone to control prices. Even before the 2008 tax increase, the U.K. had some of the highest taxes on alcohol among European countries.

Despite the efforts of government to control the epidemic, the U.K. is battling strong market forces that seek to use the grocery business's standard model of mass merchandising for alcohol. This model calls for high volume sales at low prices with heavy promotion. This will increase consumption of alcohol. Therefore, marketplace regulation must be aimed at preventing large quantities of cheap alcohol, readily available and heavily promoted.

The U.S. has serious problems with alcohol—particularly with underage drinking, but it has not reached the point of an epidemic. This could happen as the U.S. faces similar market forces that push prices lower and make alcohol ubiquitous. There are frequent calls for deregulation that would allow mass merchandising techniques for alcohol. As in the U.K., alcohol is much more available than in the past—it's even at many community events including some school and church functions. Americans have seen a gradual decline in alcohol prices. American children are drinking at younger and younger ages, and young women are drinking at increased rates.

Currently, the U.S. has a strong alcohol regulatory system. Most states have the regulatory elements recommended by public health authorities. Each state has a system that carefully controls alcohol through three market segments. This system prevents price wars, eliminates tainted alcohol and collects taxes. Drunk driving has declined, although too many people still die on American highways from alcohol-induced crashes. Enforcement has curbed illegal sales to underage buyers.

It is critical that Americans take the lesson from the United Kingdom with great seriousness. Unbridled and unrestrained free market forces, once unleashed, are very hard to control. Americans must be very clear about the fact that alcohol is a different product that cannot be sold just like any other commodity. It must be clear that the purpose is to prevent practices which induce increases in consumption, heavy drinking and hazardous behavior. The research and rationale for these important marketplace curbs is not sufficient. Often policymakers are at a loss to explain why Americans regulate in the way that we do. This is dangerous as we could lose a good regulatory system merely due to lack of understanding.

The Dangers of Alcohol Deregulation: The United Kingdom Experience

"Quite simply, England is drinking far too much. England has an alcohol problem." - Sir Liam Donaldson, Chief Medical Advisor, U.K. [1]

The British have an epidemic on their hands, and it threatens to be exported to the United States. That epidemic is alcohol abuse. In the US, some may have a perception that Europeans are "better" at dealing with alcohol: "They have fewer regulations, the drinking age is lower and they have fewer problems." Why don't we just follow their example? Well, it turns out this presumption is not true. According to the World Health Organization (WHO), Europe is the heaviest drinking region in the world. Moreover, they reap the consequences with problems of underage drinking, violence, alcohol induced deaths and alcohol diseases. Problems do vary by country with heavier drinking concentrated in the northern regions. This paper explores the experience with alcohol in the United Kingdom because it shares many similarities with the U.S., including similar industry participants. [2] An examination of the current epidemic and how it came about can be helpful to our prevention efforts, so we don't have the same experience.

Highlights of the Current Epidemic in the United Kingdom

The U.K. has High Consumption, Disease and Death Rates from Alcohol: Today, the United Kingdom has one of the highest consumption rates in the world and faces a serious problem with youth drinking, urban violence and alcohol related disease. For example, the death rate from cirrhosis of the liver increased dramatically since 1955 in England and Wales, particularly for men. This is of great concern because the most common cause of liver cirrhosis is chronic and heavy alcohol use.

Death Rates from Liver Cirrhosis for Males and Females

Figure 1: Males

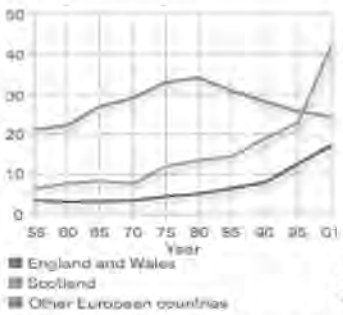
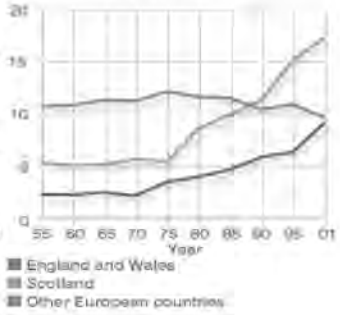


Figure 2: Females

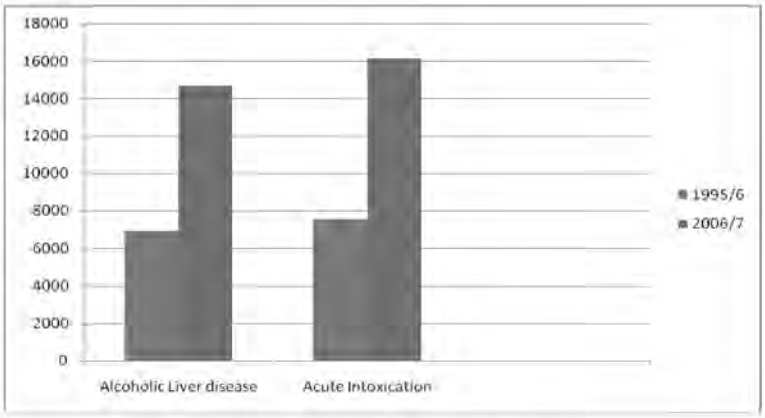


Source: World Health Organization data

According to the U.K.'s chief medical officer, cirrhosis increased for all age groups but most dramatically for the 35-44 age group which saw "an 8-fold increase in men and approaching a 7-fold increase in women." [3, p. 15] In contrast, the cirrhosis rate peaked and decreased for other European countries. As Figures 1 and 2 indicate, the rate for women is still considerably below that of men, but both are on a steady increase. In the U.S., the 2001 death rate for males was 12.3 and for females 6.4 per 100,000 population, considerably below that of Scotland and well below that of England.

Hospital admissions for alcoholic liver disease and for acute intoxication also show large increases. From 1995/6 to 2006/7, the increases for both were about double.

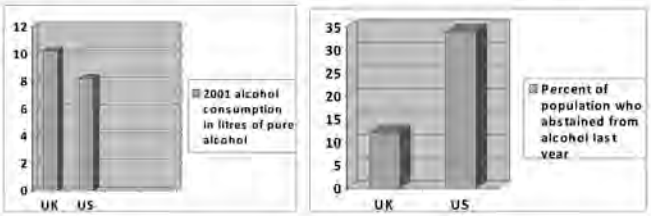
Figure 3: Hospital Admissions for Alcoholic Liver Disease and Acute Intoxication



Source: Hospital Episode Statistics, The Information Centre, 2008

For the population as a whole, the U.K. has a high consumption rate. Generally high consumption rates are associated with high levels of alcohol problems. In a comparison of per capita consumption rates with 43 selected countries, the United Kingdom had the 8th highest rate. By comparison, the U.S. ranked 27th. A large majority of the population in the U.K. drinks at some point during the year. The World Health Organization (WHO) reported that only 12% of people in the United Kingdom were "last year abstainers." [4] In the U.S., according to the WHO, 34% were abstainers. Data from other surveys in the U.S. indicate the percentage of U.S. non-drinkers may be even higher.

Figures 4 and 5: Per capita alcohol consumption comparison for adults 15 years and older

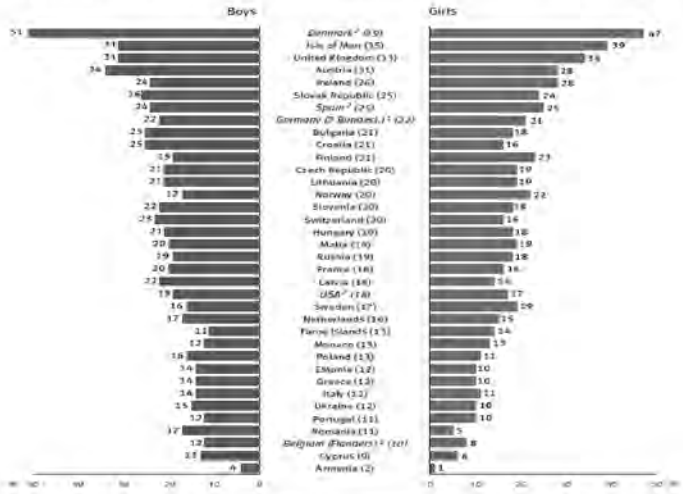


Source: WHO Global Status Report 2004

While most U.K. citizens drink moderately, a substantial portion drink more than health authorities recommend on a daily basis. In the U.K., such limits have been defined as no more than four units of alcohol for a male and three for a female. A unit is 10 milliliters of pure alcohol, about a half pint of normal strength beer, lager or cider. According to the Office for National Statistics, 41% of men and 34% of women surveyed in 2007 reported drinking above the recommended limits at least one day in the week before the survey. [5] It is difficult to compare exactly the U.S. and U.K. drinking patterns since surveys ask questions in different ways and define things differently. Nevertheless, it seems clear that the U.S. just drinks a lot less. The Centers for Disease Control does an annual telephone survey on health issues. It found that in 2008 45.5% of adults did not drink in the past 30 days, 15.6% engaged in binge drinking and 5% in heavy drinking. [6]

Youth and Childhood Drinking is over Twice the U.S. Rate: Of great concern is the exceptionally high youth drinking rate in the United Kingdom. As illustrated in Figure 2, the United Kingdom had the third highest rate among the selected counties. The U.S. ranked 22nd. [7] This is especially serious because those who start drinking before age 15 are twice as likely to become addicted and regular alcohol use can damage the developing adolescent brain. [8]

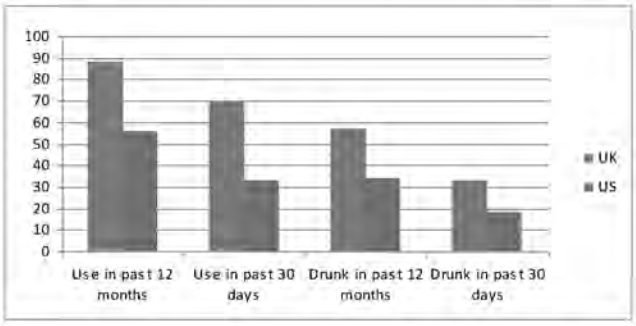
Figure 6: Percentage of 15 and 16-year-olds who have been intoxicated in the past 30 days



Source: "The 2007 European School Survey Project on Alcohol and Other Drugs (ESPA) Report, Substance Abuse Among Students in 35 Countries" (1 means "Limited geographic coverage"; 2 means "Limited comparability")

It is especially disturbing to see instances of very young children hospitalized. In 2008, a Times Online article noted, "A child under ten is admitted to hospital to be treated for alcohol-related problems once every three days in England, according to Government figures revealed today." Between 2002 and 2007, 648 youth under the age of 10 and 24,000 youth under age 16 were hospitalized due to excessive alcohol use. In the 16-17 age bracket, emergency room visits for alcohol increased 95% from 2002-2007. [9] As indicated in the Figure 7, the U.K.'s rates for 15 and 16-year-olds drinking and intoxication are almost twice the U.S. rates.

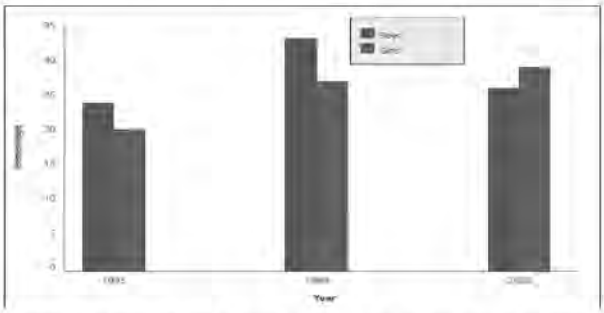
Figure 7: Drinking and Intoxication Patterns of 15 and16-Year-Olds: U.K.v.U.S.



Source: 2007 European School Survey Project on Alcohol and Other Drugs

Women in the U.K. Engage in Dangerous Drinking Practices: Along with heavy underage drinking, there is a disturbing pattern of increased drinking among women of all ages. While boys have always drunk at higher rates than girls, that pattern changed in 2003. As Figure 8 indicates, in 2003, a higher percentage of females aged 15 and 16 drank five or more drinks in a session on at least three occasions in the past month than young males. [10]

Figure 8: Percentage of U.K. boys and girls, 15 and 16, who consumed five or more drinks on at least three occasions in the previous month (1995-2003)



Source: Plant, MA & Plant, ML (2006) Binge Britain: Alcohol and the national response. Oxford: Oxford University Press

A recent article in the *Daily Telegraph* highlights the severity of the problem: "The number of young women treated for alcohol poisoning has increased by 90% in the past five years, according to the Department of Health statistics. During the past five years 4,439 girls age 14-17 were seen by doctors for alcohol poisoning compared with 1,776 boys." [11] This trend portends major future health problems as alcohol is harsher on a female body. According to the U.S. Center for Substance Abuse Prevention, "Women who drink heavily face greater health risks than men who drink heavily. They are more prone to liver disease, heart damage and brain damage. Studies show that women with alcoholism are up to twice as likely as men to die from alcohol-related causes such as suicide, accidents, and illnesses." [12]

Bars are Open 24 hours a Day and Violence, Crime and Public Disorder Are Constantly in the News: As stated in a Mail Online news article, "Public order offences have soared by 136% in the past four years as police struggle to contain a surge of alcohol-fuelled crime and disorder in town centres across the country." [13] In the same article, police officials noted that the longer hours for bars means police have to deploy larger numbers throughout the night which stresses police resources. The Licensing Act of 2003 allowed bars and stores to sell alcohol 24 hours a day. The measure was instituted to reduce the crowds of drunken celebrants flooding the streets at closing time. Some thought it would reduce problems. That doesn't seem to have happened. Things got so bad that for the 2009 New Year's celebration in London that 13 "booze buses" (actually field hospitals) were set up especially to deal with injuries suffered by revelers. It was estimated that an emergency call was received every seven seconds. [14]

While the connection between heavy drinking and crime is well established in research, Great Britain does not have good data to demonstrate how the current epidemic is impacting crime rates. Data on the number of offenders for "drunkenness" indicates a decline since 1981, but according to a British Medical Association report, "These figures should be taken with caution as they most likely reflect changes in policy and police practice rather than changes in the actual incidence of drunkenness." [15, p. 39] The difficulty with crime data is that it usually relies on arrest reports and patterns of police enforcement. The problem which seems most serious is the pattern of public order offenses around bars including vomiting, public urination, excessive noise and general rowdiness. The Licensing Act created a new violation called "Penalty Notice for Disorder."

Alcohol Epidemics are Not New to the United Kingdom

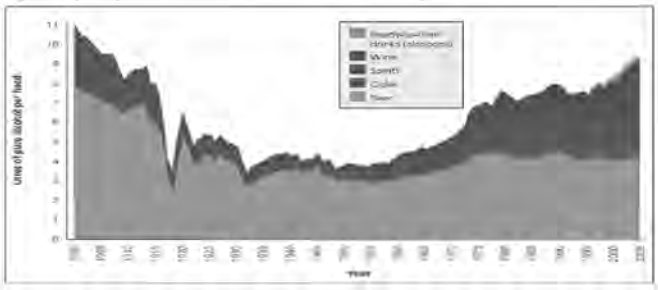
"Due to the fine tuning of taxation and success of the anti-spirits campaign after decades of experience with high consumption, the gin epidemic faded." - D. Musto, describing an alcohol epidemic in the 1700s [18]

This is not the first alcohol epidemic in the United Kingdom. The British have a long history with alcohol that includes periods of high consumption usually provoked by

reduced taxation or liberalized regulation. With the periods of high consumption came problems of mass intoxication, drunken violence and disease. Once these problems set it, the government inevitably tried to reverse the trends. Such efforts met with mixed success.

In the 1700s, a "Gin Craze" was fueled by a decrease in the tax on gin. On two occasions, a large tax increase was used to reduce problems with little success. A more moderate series of measures eventually brought the consumption level down. During the World War I, a comprehensive set of regulations went into effect that limited bar hours, heavy drinking practices and raised taxes. Because these measures appeared to be effective in curbing alcohol problems, many were retained after the war. Those measures and the Great Depression pushed a consumption decline to the point where it was half that of the beginning of the 20th century.

Figure 9: Per capita alcohol consumption in the U.K. (liters of pure alcohol)



Source: Statistical handbook 2007 (British Beer and Pub Association, 2007)

What Propels the Current Epidemic?

"Since the Second World War, there has been considerable deregulation and liberalization of alcohol control policies in the U.K. This has been accompanied by an increase in consumption levels and alcohol-related problems..." - British Medical Association Board of Science [15]

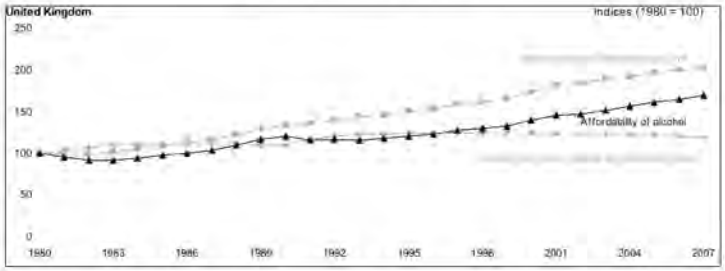
The current epidemic seems to have its origins when the U.K. started to systematically deregulate alcohol laws and when drinking patterns in the U.K. were changing. Beer consumption remained flat while wine and spirits increased significantly. In addition, alcopops were introduced. After WWII, the restrictions on availability were lessened over time, and the price generally declined. Alcohol was allowed to be sold in grocery stores beginning in the 1960s; bar and pub closing hours were extended as were

Sunday sales. After 2003, 24-hour sales were allowed in bars and stores. Today's minimum drinking age laws are very weak. In fact, "The minimum age at which alcohol consumption is permitted in the U.K. is not 18 years as widely suppose, but 5 years." [10, p. 142]. It is illegal to purchase alcohol or consume it in a bar if one is not 18. Enforcement of illegal purchases was generally not done until passage of the Licensing Act of 2003 which eliminated a 20 year moratorium on "alcohol stings."

The deregulation worked in concert with market forces to produce the current epidemic. Some of the major factors are:

Price: There is widespread belief that the price of alcohol is a major factor in the epidemic. Between 1980 and 2007, the affordability of alcohol has increased almost 70%. [17]

Figure 10: Affordability of Alcohol



Source: Focus on Consumer Price Indices, Office for National Statistics and Economic Trends

Several factors have contributed to the lower prices for alcohol. Only one of those is the tax on alcohol. [15, p. 49] The U.K. has relatively high taxes compared to other European Union countries. [15, Appendix 3] In a comparison with 25 countries in the EU, the U.K.'s tax on four forms of alcohol was the second or third highest. Price control tools such as minimum prices, price posting, non-discrimination price laws and bans on selling below cost do not exist. In addition, there is no strict regulation of industry from production through sale at the retail level. The lack of these tools has allowed retailers to gain market share through reduced prices with the result of increased consumption.

Figure 11: Excise Duty Rates in the European Union

Country	Spirits £ per 70cl bottle 40% ABV	Still wine £ per 75 cl bottle 11.5% ABV	Sparkling wine £ per 75 cl bottle	Beer £ per pint 5% ABV or 12° Plato	VAT rate %
Austria	1.9	0.00	0.00	0.10	20
Belgium	3.4	0.25	0.84	0.08	21
Cyprus	1.2	0.00	0.00	0.02	15
Czech Rep.	1.8	0.00	0.43	0.04	22
Denmark	3.9	0.43		0.13	25
Estonia	1.9	0.35	0.35	0.07	18
Finland	5.5	1.10	1.10	0.38	22
France	2.8	0.02	0.04	0.05	19.6
Germany	2.5	0.00	0.27	0.04	16
Greece	2.1	0.00	0.00	0.06	18
Hungary	1.6	0.00	0.24	0.09	25
Ireland	7.6	1.42	2.84	0.39	21
Italy	1.6	0.00	0.00	0.12	20
Latvia	1.8	0.22	0.22	0.03	18
Lithuania	1.8	0.23	0.23	0.04	18
Luxembourg	2.0	0.00	0.00	0.04	15
Malta	4.5	0.00	0.00	0.04	18
Netherlands	2.9	0.31	1.05	0.10	19
Poland	2.3	0.18	0.18	0.09	22
Portugal	1.8	0.00	0.00	0.06	21
Slovakia	1.5	0.00	0.33	0.07	19
Slovenia	1.4	0.00	0.00	0.14	20
Spain	1.6	0.00	0.00	0.04	16
Sweden	10.4	1.23	1.23	0.31	25
UK	5.5	1.25	1.65	0.38	17.5

Source: European Commission's Excise Duty Tables (Alcohol Beverages)

Domination of the Big Box Grocery Chains: The United Kingdom has a unique concentration of alcohol sellers that help drive the alcohol marketplace. This marketplace concentration has attracted not only the ire of the public health community and government leaders but also that of alcohol suppliers who are captive to these powerful interests. There is widespread belief that the selling and promotion practices of the large supermarket chains have been a major contributor to the alcohol epidemic. Cheap alcohol—wine, beer and spirits—is very available, and the best deals are in the large chain-operated grocery stores. The United Kingdom monopoly regulator, the Competition Commission, has been investigating the supermarket business for some time. It is concerned about market concentration and sales practices. The U.K. grocery market is dominated by four large chains which control approximately 75% of the market (Tesco, Asda, Sainsbury and Morrison's). One of the findings of the Competition Commission is that these chains frequently use alcohol as a "loss leader." [18, p.49] Another reason for low prices is that many supermarkets do their own wholesaling: "Grocery retailers are vertically integrated upstream to varying degrees. Most supermarket chains purchase grocery products for resale directly from food and drink manufacturers and processors..." [18, p. 18] As a result, the retailers extract significant concessions from the suppliers on pricing. This is a prohibited practice in many U.S. states.

The business model used by the big box chains makes it possible to offer large quantities of cheap alcohol. According to the Food Marketing Institute, "Low markup to stimulate high volume is the fundamental principle of mass merchandising, which the supermarket industry introduced to the marketplace in the 1930s." [19] Because the large chains have enormous purchasing power, they buy product in volume and count on high volume sales to generate profits.

With low markups and high volume comes extensive promotion. In order to profit from this formula, people have to be enticed to buy. According to the U.K.'s Institute of Alcohol Studies, "The Competition Commission have found that five leading grocery retailers sold 38.6 million pounds ($57.4 million) worth of alcohol at below-cost during the 2006 World Cup. Supermarkets know full well that drinks promotions linked to such events entice consumers to buy more alcohol and to drink more alcohol. To claim otherwise is disingenuous." [20, p.2]

These are not just big chains. They are enormous global enterprises. Tesco, which enjoyed a 32% market share in August 2008, is the world's fourth largest retailer by sales and the second largest by profit (Wal-Mart is first). It operates all over the globe with 273,000 employees. It has just opened stores in the United States in California, Nevada and Arizona. Asda is owned by Wal-Mart, the world's largest public corporation by revenue. These companies have exceptional economic power to control public purchasing habits on a massive global scale. Currently, the top four U.K. chains, locked in fierce competition, have driven the price of alcohol lower and lower purely for economic interests and not for public health gains.

Several laws and practices used in the U.K. are prohibited in the U.S. These laws include the use of quantity discounts, the use of credit, the direct sale from suppliers and central warehousing.

Decline of the Pub: The majority of drinking used to take place in pubs that sold draft beer. Pubs were typically owned or leased by large brewing companies. The pubs were "tied houses" because they were owned or controlled by a brewery. Generally, only the brewer's product was available at one of their pubs. In 1989, 75% of the beer market in the U.K. was controlled by six large brewing companies. Today things are very different.

In 1989, the Competition Commission issued the Supply of Beer Law. [21] Based on a determination that the beer industry had become monopolistic, the Commission required any brewing company with more than 2,000 pubs to divest those beyond the limit and allow at least one "guest beer" (from another brewery) to be sold in the remaining pubs. The assets of the large brewing companies were sold and some of the breweries were closed. The companies that now own the remaining assets are large, global enterprises such as Diageo, Anheuser-Busch InBev, Heineken and Carlsberg. The pubs were sold to retailers. While this seemed to eliminate the "vertical integration" by suppliers, the brewery sector is now dominated by fewer but larger globally-oriented players and the 1989 Act was repealed. Similarly, ownership of the remaining pubs is now concentrated in publically-owned and -traded retailers. This has created a tension between

independent retailers and corporate taverns. This is a much different system than the American "three-tier" system of state-based alcohol regulation which has suppliers selling to individually licensed wholesalers who can only sell to licensed retailers.

These market forces induced consumers to change their drinking habits, and pubs have suffered. As noted previously, the advent of cheap alcohol available in supermarkets fostered more drinking at home in the U.K. As the consumption data shows, people are also drinking more wine, spirits and alcopops. "Pre-drinking" became popular. This is a practice where people drink at home before going out. This reduced the amount of money spent on drinks in pubs and nightclubs. In July 2007, smoking was banned in enclosed places in England and Wales. Scotland did the same in 2006. This appears to have further reduced patronage.

Another blow to pubs came from the Licensing Act of 2003 which included a new duty to be levied over four years at 2% above inflation. The first year of levy was 2008. The British Beer and Pub Association contend the tax has caused a reduction in sales and an increase in pub closures. A report called "A Wake-up for Westminster" claims that total beer sales are down eight million pints a day since the peak in 1979 and that pub closures are occurring at a rate of five per day. Pubs have also incurred increased costs to be open longer to service people—some of whom have already been drinking at home. [22]

Night life and the Increase in Binge Drinking among Young Women: Problems with bars and rowdy behavior are not new. It has been an issue from time to time throughout history. Recent changes in urban areas, however, seem to have fostered nightlife problems. Historically, the pub was a neighborhood institution primarily populated by males. While those places still exist, entertainment districts have sprung up in urban centers as a way to lure people back to the cities and revitalize the urban core. As bars and pubs were clustered in a given area, night life in town centers became notorious for rowdy, drunken behavior. Some of the new "superpubs" are very large with capacities for up to 1,000 people. There is research to indicate that alcohol problems increase with bar density and, obviously, large premises present particular management problems. [10, p. 53] To document problems with bars, a reporter for The Observer spent three hours in a bar in Reading, a city 40 miles from London. She and a friend bought 12 rounds of drinks. Every 20 minutes they returned to the same location. "The barwoman recognized our faces and thought the drinks were for the two of us. But she never stopped serving-enough alcohol to kill each of us." As she observed, "It seemed as though everyone was drunk, but no one was turned away from the bar." [23] Another account from a bar employee confirms this pattern: "I have been a manager for 30 years in these superpubs and in town centres. How we make our money is to make people binge drink: the more people drink, the more I get as a bonus." [15, p.92]

Young women are very prominent in this nightlife scene. There was a time when women were not admitted to some pubs, so it may feel liberating to freely partake in the pub culture. A pattern of excessive drinking has emerged, known as the "Ladette" culture.

According to an article in Mail Online, "ladette" is "defined as a young woman who behaves in a boisterously assertive or crude manner and engages in heavy drinking sessions." [24] Such behavior has been publicized and encouraged by celebrities and DJs. Social networking sites such as Facebook feature young women boasting of inebriation. Even more disturbing is the pattern of violence by women. In the same article, the author cites a report by the Youth Justice Board which claims that violent offenses carried out by girls age 10-17 increased over 300% in seven years. While offenses by boys are still much higher, the percentage of incidents for boys is decreasing. [24]

Counterfeit and Tainted Alcohol: There has been publicity about tainted alcohol in Russia and countries in Asia, but there have also been incidents in the United Kingdom. In 2007, thousands of liters of fake vodka were seized at an illegal bottling plant in Wales. Initial testing indicated the product contained enough methanol to be a serious health risk. Methanol is a form of alcohol that is unfit for human consumption; too much can cause toxic hepatitis. The result can be severe health problems including death. This was a blow to the U.K. Treasury as they had just instituted a "duty stamp" program designed to prevent the sale of such products. According to the U.K. Treasury, criminal gangs in the U.K. are turning to counterfeit alcohol as it becomes harder to smuggle genuine bottles of spirits. The industry is concerned that counterfeiters will develop fake duty stamps to go with their fake products. The U.K. Revenue and Customs entity had been making steady progress to reduce the level of spirit fraud. They report that in 2000-01, it was as high as 28% of the market leading to losses of 1.2 billion pounds in revenue. By 2004-5, they estimate the market share was down to 8%, with estimated losses of 300 million pounds in revenue. [25] Moreover, there has been much concern about English citizens taking a ferry to Calais to load up with lower taxed alcohol in France and taking it back to the United Kingdom for untaxed and unregulated resale.

Government Response—What Works?

"Research on local prevention efforts suggests that local strategies have the greatest potential to be effective when prior scientific evidence is utilized and multiple policies are implemented in a systematic way. Complementary system strategies that seek to restructure the total drinking environment are more likely to be effective than single strategies." - World Health Organization [26, p.12]

Public policy can be effective in curbing alcohol problems. As England has seen, not all public policies work. The most recent example is the measure permitting alcohol to be sold 24 hours a day. That is why the World Health Organization advises that policies have some scientific evidence of efficacy and that multiple policies be adopted in a systematic formula. The effectiveness of particular types of policies is discussed in a World Health Organization publication, "What are the most effective and cost-effective interventions in alcohol control?". A very brief overview of these policies is discussed below. It is important to note that every one of these issues is complicated, and the effectiveness of any regulation in isolation is limited.

Price: The WHO concludes that "There is substantial evidence showing that an increase in alcohol prices reduces consumption and the level of alcohol-related problems." [26, p. 4] The authors go on to note that the impact of price increases differs among countries depending on the prevailing culture and public support. Alcohol prices can be affected by taxes, restrictions on price-related alcohol promotions, minimum price levels and setting limits on price discrimination at the wholesale level. Studies of price indicate that price increases impact all drinkers: "These kinds of studies strongly indicate that heavy and dependent drinkers are at least as responsive to alcohol price increases as are more moderate consumers, and furthermore, that price increases via excise duties on alcohol beverages have a particular effect in reducing youthful drinking." [26, p. 7]

Availability: As the WHO report notes, "stricter controls on the availability of alcohol, especially via a minimum legal purchasing age, government monopoly of retail sales, restrictions on sales times and regulation of the number of distribution outlets are effective interventions." [26, p. 4]

Drunk Driving Measures: Many measures to reduce drunk driving get high effectiveness ratings including: "sobriety check points, random breath testing, lowered blood alcohol concentration limits, suspension of driver's licenses, graduate licensing for novice drivers and brief interventions for hazardous drinkers." [26, p.4]

Other Measures: Other measures again demonstrate that all alcohol regulation needs to be systematic. Server liability and enforcement of on-premise regulations combined with community mobilization have some impact but can be expensive. Educational approaches, while popular, do not have much evidence of effectiveness. [26, p.4] Advertising is an area where there is uncertainty regarding the best method of curtailing ads that expose youth. According to the British Medical Association, "Research evidence suggests that repeated exposure to high-level alcohol promotion influences young people's perceptions, encourages alcohol consumption and increases the likelihood of heavy drinking." [15, p.54] The U.K. regulates advertising via compliance with advertising codes, including codes developed and enforced by an industry association of nine members representing 60% of the alcohol market. There is considerable skepticism about the efficacy of such code enforcement—particularly as it regards self-regulation. Future research is needed to guide regulatory policy on this issue.

Research on Specific Price Regulations: The U.K.'s University of Sheffield has done some unique and important research to assist in policy development. As the researchers state, "This is the first study to integrate modeling approaches intended to answer specific policy questions around pricing and promotion of alcohol and the related effects on harms in terms of health, crime and employment in England." [27, p. 11] They used several large data bases to construct a model that estimates likely changes in behavior and harms with different policies. Here are some results:

- General Price Increase: General price increases on all forms of alcohol exhibit large reductions in average consumption across the population including all classes of drinkers (they classified drinkers as moderate, hazardous and harmful based on the number of alcohol units consumed per week). Policies targeting price changes only on lower-end products had lower consumption increases although they disproportionately impacted harmful drinkers including youth

- Minimum pricing options: The researchers found that as the level of the minimum price is increased, effectiveness increases substantially. Thus, the largest minimum price produced the highest drop in consumption. Differential prices for on-premise (pubs and nightclubs) and off-premise (grocery and convenience stores) lead to larger reductions in consumption. The authors believe this occurs because younger and hazardous drinkers frequent the pubs and nightclubs. If stores also have a minimum price, switching to home drinking is inhibited.

- Restrictions on discount promotions: A ban on various kinds of discounts (such as buy three for the price of two) produces reductions in consumption. Bans on discounts only for low-priced products are not effective in reducing consumption.

- Impact on harm from price increases: Their model found that policies which result in price increases reduce alcohol-attributed hospital admissions and deaths, incidence of crime and reduced unemployment (defined as loss of job due to alcohol and absenteeism due to alcohol).

U.K. Government Actions to Combat the Epidemic: Many Problems and Few Tools

"The real reason why drinking has gone through the roof is the Government's irresponsible deregulation of alcohol, which has turned it into an everyday commodity." - Melanie Phillips, Daily Mail reporter [28]

A review of the U.K. alcohol epidemic reveals several distinct problems: generally high consumption; very high consumption in young adults and children; high consumption among women; and public disorder in bars in town centers. There is general agreement that the problem of drunk driving has improved. Drunk driving rates have declined in England and Wales since 1990 and since 1970 in Scotland. [10, p. 73]

At the present time, the government has few tools to address these problems. There has been a great deal of talk, speeches and proposals, and there does seem to be general agreement that alcohol prices are too low. However, the alcohol industry in the U.K.

generally opposes government intervention, and there is no check on the retailer-supplier power struggle. According to the authors of Binge Britain, "The formulation of recent alcohol policies within the U.K. has been predicated by a governmental wish to cooperate and agree with the beverage alcohol industry. The latter wields enormous economic and political power and appears to have dominated much of the policy making process." [10, p.83]

The 2003 Licensing Act did create some new tools: new regulations and penalties for underage sales, new laws for public order offenses and a significant tax increase. The tax increase was levied in 2008 and will be levied for four years at 2% above inflation. While the increase will likely begin to impact overall consumption, it may accelerate the pattern of drinking at home and "pre-drinking" before going out. Because grocery chains use low priced alcohol to lure shoppers to their particular stores, they may absorb all or some of the tax increase. Some of the chains are pushing the suppliers to absorb 100% of the tax increase which will allow the stores to continue their low prices. This places them at an even greater advantage vis-à-vis the pubs. Multiple methods to control prices and promotion practices are usually needed to curb the kinds of problems in existence today in the U.K.

To combat underage sales, a new offense of "persistent sales" was created. Tesco was charged with such an offense and fined for selling alcohol to a 16 year-old three times in two months. [29] As law enforcement continues to use the new tools in the 2003 Act, they may be able to curb problems. This highlights another difference between the U.K. and the U.S. as enforcement of underage drinking laws has been a priority in the United States for the last decade.

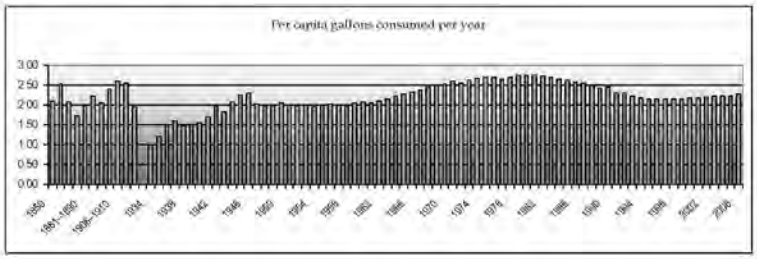
One of the most ill-advised measures is the 24-hour sales provision. This greatly increases availability and stretches law enforcement resources. According to the WHO, "Most studies have demonstrated increased drinking or rate of harmful effects with increased sales times, and decreased drinking when they are shortened." [26, p.8-9]

It seems that the U.K. has relied too heavily on a few isolated measures or ineffective measures such as education and 24-hour sales. A systematic approach with multiple measures that addresses price, industry licensing and regulation, availability, the drinking context and age limits would likely be more effective.

Could this Epidemic Infect the U.S.? Areas of Concern

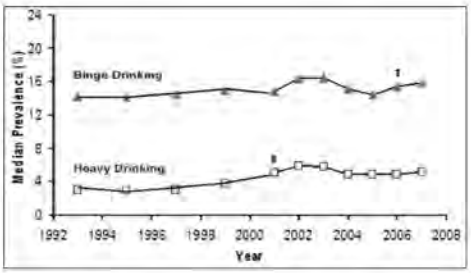
"Every country has its Achilles' heel. When a gunman goes berserk in the United States, we are quick to point out to our American friends the blindingly obvious: that if you have so many guns in circulation, such tragedies are inevitable. With alcohol, the roles are reversed. America, historically, has had more restrictions on drinking: Americans are now entitled to chide us for our complacency in allowing a happy-go-lucky culture to spiral slowly but steadily out of control." – Max Davidson, Telegraph reporter [30]

Figure 12: Apparent consumption in the U.S. 1850-2006



Source: Centers for Disease Control

Figure 13: Prevalence of binge drinking and heavy drinking among adults in the United States, 1993-2007



Source: Centers for Disease Control

In the 1990s, binge and heavy drinking also began an upward trend. Both rose during the 1993-2007 period. These patterns portend future costs for society in terms of alcohol induced disease and death.

The U.S. does have a problem with underage drinking, but the U.K.'s is much worse. As noted earlier, the drinking and intoxication rates of 15 and 16-year-olds in the U.K. are about twice as high as the U.S. In addition, data from 2002-2007 has shown some small decreases in youth drinking in several age groups. [31] Despite these decreases, there are concerns about youth drinking at very young ages. According to a report by the U.S. Department of Health, approximately 10% of 9 and 10-year-olds have started drinking, and nearly one-third of youth begin drinking before age 13. [p. 6, 32] Since we

know youth who start drinking before age 15 are four times more likely to become addicted, we risk losing the potential of a large number of our youth.

There is also a pattern of increased consumption by women, particularly young women. According to a fact sheet from the National Center on Addiction and Substance Abuse at Columbia University, "...in the 1960s, only 7% of girls reported having their first drink between the ages of 10 and 14; today, nearly one-quarter of all girls report beginning to drink alcohol before age 13." [33] For older women, problems are increasing. In a study comparing U.S. Census Bureau data from 1991-1992 and 2001-2002, Dr. Richard A. Grucza and colleagues at the Washington University School of Medicine found, "The prevalence of alcohol use and alcoholism stayed about the same in men. But except in the very youngest age group, women reported significantly more alcohol use than they did a decade ago." [34] Alcohol-induced deaths are increasing for both men and women although not at rates as high as in the U.K.

While drinking problems may not be as severe as in the United Kingdom, trends are similar. There are further similarities in the areas of deregulation, the power of the retail sector, and the increased affordability of alcohol:

Deregulation: The U.S. has experienced a gradual relaxation of alcohol laws over the past several decades. Alcohol is much more available than in the past. After Prohibition, alcohol was very limited in terms of where, when and how it could be purchased. That changed gradually over time to the point where most states allow sales in a wide variety of retail establishments. Several states that originally sold spirits and wine in state stores changed their systems to allow greater availability for these products. Some states gave up exclusive sales of wine to the retail sector. Others converted state stores to modern retailing businesses by hiring private contractors. Industry-led deregulatory interests facilitated by recent court decisions have opened-up ways around state controls of alcohol sales. Alcohol is frequently available at community events and even some church and school functions. Many states have increased the hours of sale for alcohol by extending bar closing hours, expanding hours of sale at retail stores and removing the prohibition on Sunday sales.

Retail Sector Power: The alcohol markets in the .S. and the U.K. have some similarities. In both countries, beer is the most commonly consumed beverage. But, the U.S. has not had the large chains of tied house breweries or retail bars and pubs. U.S. regulations provide major barriers to a "vertical integration" scheme which would allow ownership of retail, wholesale and manufacturing by one entity. Federal policy requires a balance to effectively regulate interstate and foreign commerce and enforce the 21st Amendment which allows for individual state alcohol regulation. As a result of this legal structure, the United States' retail market is different. Retailers have to make sure their alcohol selling practices fit both federal and state law as opposed to the U.K. situation where the retailers are able to dominate the alcohol market. Some states own the spirits business and don't allow sale of such products in grocery stores. Other states restrict what types of stores can sell what types of products. Enforcement of trade practice laws

prohibit practices such as slotting fees, credit and other measures that would break down the independence of one sector versus another. Such independence is critical to preventing "vertical integration" and further market dominance by one sector.

The market share of the grocery business is not as consolidated as the U.K. The top four in the U.K. have 75% of the market while the top four in the U.S. only have 54% based on 2007 sales data (See Figure 14).

Figure 14: Grocery chain market share in the U.S.

Wal-Mart / Sam's Club	$138.2 million	26.4%
Kroger	$ 65.6 million	12.6%
Safeway	$ 42.3 million	8.1%
Costco	$ 35.3 million	6.8%
Others	$241.2 million	46.1%

Source: Food Marketing Institute; "Top U.S. Supermarket and Grocery Chains" (by 2007 grocery sales)

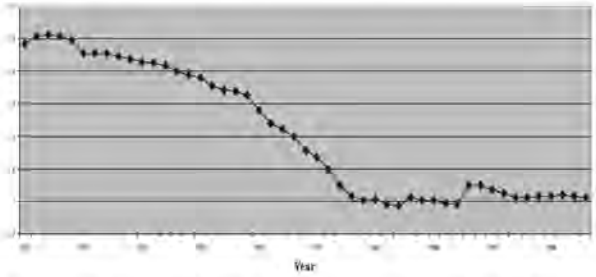
The retail grocery market has a strong incentive to sell products in high volume. According to the Food Marketing Institute, "The intense competition among food retailers for the consumer dollar is best demonstrated by profit margins that continue to be less than 2 cents on each dollar of sales." [19] They go on to explain how supermarkets survive with so little margin for error, "To earn a dollar, supermarkets would rather sell a $1 item 100 times, making a penny on each sale, than 10 times with a dime markup. Low markup to stimulate high volume is the fundamental principle of mass merchandising, which the supermarket industry introduced to the marketplace in the 1930s." [19]

With such a merchandising approach, it is easy to see why Costco—which relies on very low markups—works steadily on deregulation. Using buying power to acquire very large quantities of alcohol at deep discounts, like they do with potato chips or tires, is simply not permitted in many states. In addition, it is not possible to manage the supply of large quantities without being able to act as a wholesaler to store and distribute the large quantities. Costco has used its home state of Washington to challenge barriers to their business model. Over time they have won several. Minimum prices for retail alcohol sales were eliminated, and a bill recently passed in the state legislature eliminating a minimum 10% markup at the wholesale level. Costco challenged several major regulations in 2004. They alleged that nine different regulations "restrict many of [Costco's] efficient and competitive practices as to wine and beer suppliers..." They prevailed on most measures at the trial level but lost all but a few at the appellate level. [35] They then turned to the political arena. Continued pressure over time has been a fairly effective strategy. The wins they gain work to benefit other large chains and tend to push the model of cheap alcohol sales in high volume.

Advertising, promotion and marketing of alcohol continues to be an important subject of debate over alcohol policy and regulation. Research in this area is relatively new. According to the Center on Alcohol Marketing and Youth, youth exposure to alcohol advertising on television increased 38% from 2001 to 2007. [36] Research in the U.S. indicates that those youth with greater exposure to alcohol marketing are more likely to start drinking than their peers. [36] Both the U.S. and the U.K. have various industry self-regulation mechanisms and government advertising codes to curtail ads that appear to target youth. The U.S., however, also has state regulations, some of which restrict advertising and preclude licensees from promotions that encourage high volume drinking.

Price declines: According to economist Frank Chaloupka, "Infrequent/modest increases in taxes and repeal of some control policies have contributed to sharp reductions in inflation adjusted alcoholic beverage prices over time." [37] Despite the lack of vertical integration in the U.S. alcohol business, prices have declined and affordability has increased. As noted earlier, increased affordability is related to increased consumption, particularly among youth.

Figure 15: Inflation Adjusted Alcoholic Beverage Prices: 1953-2001



Source: "Reducing Morbidity and Mortality through Alcohol Pricing and Taxation," Frank J. Chaloupka, Director, ImpacTeen, University of Illinois at Chicago.

Protective Factors: A System, Not a Silver Bullet

There is no silver bullet to curb alcohol problems. What works for the United States may not work for the United Kingdom and vice versa. But, the U.K. situation has highlighted the need for comprehensive regulation rather than deregulation and high taxes. As the World Health Organization recommends, strategies have the greatest potential to be effective "when prior scientific evidence is utilized and multiple policies are implemented in a systematic way." [26] As we have seen, a good system to combat alcohol problems has several measures to ensure prices are not too low and availability is controlled. The

system also must have age restrictions, anti-drunk driving measures and effective enforcement.

In the U.S., each state has its own regulatory system. But, most states have a system which includes the elements recommended by the WHO. As the U.K. experience demonstrates, a good balance in pricing is critical. That means measures to keep prices high enough to avoid increased consumption but low enough to avoid the incentive for bootlegging. Most states have taxes in addition to other measures such as a ban on volume discounts, a requirement for wholesalers to sell at the same price to all, minimum prices, post and hold laws, a ban on selling below cost, uniform pricing and prohibitions on price reduction specials. These multiple measures go a long ways toward preventing the extreme price reductions and promotional practices that have occurred in the United Kingdom. These regulations are more crucial than ever as the marketplace consolidates around a few large companies in the manufacture and retail sectors. Since the U.S. system places substantial requirements on wholesalers, vertical integration that would drive prices even lower is avoided.

The fact that alcohol is regulated at the state level means each state has a different set of rules. Industry may complain that this makes life difficult for companies operating on a national or global level, but that is true for every industry. Each state has a different set of tax and consumer protection laws impacting many commodities. It is a function of our system of state government. The alcohol regulations are unique in their Constitutional origin and the American historical experience which led to a decision to regulate alcohol primarily at the state level. The alcohol regulations protect communities from experiencing the adverse impact of the global market. Moreover, regulation at the state level allows quicker response to community problems. To tear down or seriously weaken the U.S. regulatory system, each state would have to make legislative changes. Over the past decades, there has been some weakening of alcohol regulation, particularly as it relates to marketplace rules. Alcohol is much more available due to increases in the number of licensees and an expansion of hours for selling alcohol. But, it is a more gradual process when it must be done state-by-state. Incremental changes do allow for a chance to see if change brings harm. In addition, there have been some areas where regulations have been strengthened, namely drunk driving and underage drinking. The major threat to our state systems is from lawsuits that could potentially impact all states if major cases result in declaring certain types of regulation unconstitutional. If the trial court's decision in the Costco case had held on appeal, it might have drastically changed our regulatory landscape. Lawsuits will continue to be a threat. This means regulators must be ever vigilant to ensure they can clearly explain the system, its purpose and how its regulations foster public health and safety.

It is also critical that laws be adequately enforced. As noted with the United Kingdom, enforcement of what underage laws that exist has been minimal. And, they are only beginning to conduct decoy operations to reduce underage sales. In the U.S., there was a time when underage drinking laws were poorly enforced, but that changed. A federal program—called Enforcing Underage Drinking Laws—provides an annual block grant to

each state for such enforcement. Research has shown that frequent compliance checks are necessary to keep illegal sales down. [38, p.171] Greater enforcement has also occurred for laws against furnishing alcohol to minors, for serving minors in bars and for minors in-possession of alcohol. In both countries, there have been good efforts to regulate and enforce drunken driving laws to good result.

Conclusions—A Strong System is Necessary to Prevent an Epidemic

1. The U.S. could experience a similar alcohol epidemic if it does not maintain a fair, balanced and strong alcohol regulatory system. This system needs to have multiple measures to control price, availability, promotional practices, underage drinking and drunk driving. Such a system must have effective enforcement.

2. Powerful market forces will continue to chafe at the regulatory system. As the retail and manufacturing segments become more consolidated and more globally-oriented they will push to deregulate in order to use mass merchandising techniques. Therefore, it is incumbent on policymakers, regulators and prevention advocates to articulate the reasons why such techniques can create social problems. Because mass merchandising relies on high volume to profit from low prices, the business model promotes high consumption by a large number of people. Regulatory advocates must make the case that alcohol is a different commodity that requires special care in selling, marketing and industry structure.

3. The U.S. regulatory system which carefully controls alcohol through three market segments keeps the market in balance, tracks alcohol products and provides an inexpensive method of tax collection. This system helps prevent price wars and problems with tainted and counterfeit alcohol products. It also serves as a check on the most aggressive alcohol sellers and producers.

4. Price is a very critical factor in alcohol control. It is so important that states should use multiple methods to keep it balanced—not so high as to facilitate bootlegging, but not so low as to increase consumption. Because the political will is not always there to check the erosion of taxes by inflation, such methods as minimum prices, prohibition against selling below cost, post and hold legislation and volume discounts bans are ever more important. The requirement for wholesalers to have the same price for all is crucial in preventing price wars. Increases in price can have positive effects on all classes of drinkers in terms of health, crime and employment.

5. Availability is important. Alcohol products—and particularly cheap alcohol products—are much less of a problem if they are rarely available. Recent deregulation efforts have made alcohol more available. It is now sold in restaurants, bars, drugstores, grocery stores, convenience stores, gas stations, hotels, airplanes, ships, buses and even on the internet. It is also present at school, church and

community events. Sports facilities count on alcohol as a mainstay for revenue. Not only are there increased opportunities for purchase, this increase has added to the burden of local law enforcement and alcohol regulatory agencies trying to regulate these varied sources.

6. Promotion and selling practices that encourage heavy consumption especially for youth and women need to be curbed including marketing of alcohol to underage drinkers. The trends of greater drinking among youth and women are serious. While the rates are much lower in the U.S. than in the U.K., the patterns are similar. The U.K. should provide a lesson in how bad things can get. This suggests attention to the serving practice in on-premise establishments. Many states have server training and server permit systems as well as prohibitions against high volume drink practices. Retaining and enforcing these regulations are very important in curbing intoxication and public offenses in and around bars.

7. Drunk driving still kills way too many Americans. But, progress has been made through the use of several important laws and stepped-up enforcement. This is an area where both the U.S. and the U.K. have focused enforcement and regulation to reduce the problem.

NOTES

[1] Sir Liam Donaldson, Chief Medical Advisor, U.K. Department of Health as quoted in "Teenage girls and alcohol poisoning," by Urmee Khan, Telegraph, March 22, 2009.

[2] The United Kingdom is a unitary state that includes England, Scotland, Northern Ireland, and Wales. The islands of Jersey, Guernsey and the Isle of Man are Crown Dependencies. The government is a parliamentary system headquartered in London, but Scotland, Northern Ireland and Wales have "devolved national administrations" which gives them jurisdiction over things like health and education. This is why alcohol regulation may be somewhat different in England, Scotland, Northern Ireland and Wales.

[3] "On the State of the Public Health," The Annual Report of the Chief Medical Officer of the Department of Health 2001, United Kingdom Department of Health.

[4] World Health Organization Global Status Report on Alcohol, 2004.

[5] "A third 'drink over daily limit'," BBC on-line, January 22, 2009.

[6] "Behavioral Risk Factor Surveillance System, Prevalence and Trends Data, Nationwide (States and DC)-2008 Alcohol Consumption," National Center for Chronic Disease Prevention and Health Promotion, Centers for Disease Control, online document.

[7] The 2007 ESPAD Report. ESPAD is the European School Survey Project on Alcohol and Other Drugs. The project studies data on substance use among 15 and16-year-old European students and monitors trends between countries. The U.S. is included in many comparisons, but the data is from a U.S. survey, not the ESPAD survey.

[8] Harmful Consequences of Alcohol on the Brains of Children, Adolescents, and College Students, American Medical Association.

[9] "Hundreds of children under 10 hospitalised with alcohol problems," Times Online, November, 2008.

[10] Plant, M.A. and Plant, M. L., Binge Britain: Alcohol and the National Response, Oxford University Press.

[11] "Three times as many teenage girls have been admitted to hospital with alcohol poisoning as boys, official figures show," Daily Telegraph, March 22, 2009.

[12] "Effects of Alcohol on Women," U.S. Department of Health and Human Services, Substance Abuse and Mental Health Services Administration, Center for Substance Abuse Prevention brochure.

[13] "136% leap in mob crime blamed on all-day drinking, as police struggle to control city centres," by Rhodri Phillips, Mail Online, August 10, 2008.

[14] "Boozy Britain's bloody New Year: A 999 call every seven seconds in alcohol-induced mayhem," by Neil Sears, Mail Online, January 2, 2009.

[15] "Alcohol misuse: tracking the U.K. epidemic," British Medical Association Board of Science, February 2008.

[16] D. Musto, Alcohol control in historical perspective, in: Plant, M.A. and M. I. Binge Britain, p. 10.

[17] "Trends in the affordability of alcohol in the U.K.," Institute of Alcohol Studies, 1980-2007, Web site document.

[18] "Grocery Market Investigation, Emerging Thinking," U.K. Competition Commission report, January 23, 2007.

[19] "Competition and Profit," Food Marketing Institute, Web site PDF.

[20] "Supermarkets under attack," Institute of Alcohol Studies, Alcohol Alert, 2008, Issue 2.

[21] "The Supply of Beer: A report on the supply of beer for retail sale in the United Kingdom," Competition Commission, 1989.

[22] "A Wake-up for Westminster, Economic trends in the beer and pub sector," British Beer and Pub Association, September 2008.

[23] "One bar, three hours-I was sold enough drink to fill me," by Anushka Asthana, The Observer, October 23, 2005.

[24] "Ladette binge-drinking violence soars by 300% in just seven years," by Simon Alters, Mail Online, March 1, 2009.

[25] "United Kingdom: Treasury haunted by spectre of fake spirits," by Vanessa Houlder, Financial Times, December 27, 2006.

[26] "What are the most effective and cost-effective interventions in alcohol control?" World Health Organization, February 2004.

[27] "Independent Review of the Effects of Alcohol Pricing and Promotion: Part B, Modelling the Potential Impact of Pricing and Promotion Policies for Alcohol in England: Results from the Sheffield Alcohol Policy Model", University of Sheffield, U.K.

[28] "The drunken reality of deregulation," by Melanie Phillips, Daily Mail, March 16, 2009.

[29] "Tesco to challenge shoppers 'who look under the age of 25' when they are buying alcohol," by Sean Poulter, Mail Online, March 26, 2009.

[30] "Time for a little sober reflection on alcohol," by Max Davidson, Telegraph, March 17, 2009.

[31] "Exposure to Substance Use Prevention Messages and Substance Use among Adolescents: 2002 to 2007," SAMHSA's 2007 National Survey on Drug Use and Health (NSDUH), Web site document.

[32] "A Comprehensive Plan for Preventing and Reducing Underage Drinking," SAMHSA, U.S. Department of Health and Human Services, January 2006, Web site document.

[33] Fact Sheet: Girls and Alcohol, adapted from "Women under the Influence," by the National Center on Addiction and Substance Abuse at Columbia University, The Johns Hopkins University Press, 2006.

[34] "More Women Drinking More, Women's Drinking, Alcoholism Continues Post-WWII Rise," by Daniel J. DeNoon, WebMD Health News, May 6, 2008, Web site document.

[35] Costco v. Hoen, US Court of Appeals, Ninth Circuit.

[36] "Youth Exposure to Alcohol Advertising on Television, 2001 to 2007," Center on Alcohol Marketing and Youth.

[37] "Reducing Morbidity and Mortality through Alcohol Pricing and Taxation," Frank J. Chaloupka, Director, ImpacTeen, University of Illinois at Chicago.

[38] Reducing Underage Drinking: A Collective Responsibility, National Research Council, Institute of Medicine, September 2003.

About the Author

The author of this paper is a former alcohol regulator. From 1996 to 2003, she was the executive director of the Oregon Liquor Control Commission. She left that position to work for Oregon Partnership in the non-profit field of alcohol abuse prevention, specializing in the reduction of underage drinking. As a prevention advocate, she gained an increased appreciation for the value of alcohol regulation and its effectiveness as increasingly demonstrated by research. She currently operates her own company called Public Action Management, PLC, where she focuses on public education programs. Information about these programs can be found at www.pamaction.com or by e-mail at pam@pamaction.com.

This paper was developed with funding from the Center for Alcohol Policy.

Mr. JOHNSON. Thank you.

Last but not least, Professor Bush?

TESTIMONY OF DARREN BUSH, ASSOCIATE PROFESSOR OF LAW, UNIVERSITY OF HOUSTON LAW CENTER, HOUSTON, TX

Mr. BUSH. Mr. Chairman, Ranking Member Coble, and other distinguished Members of the Judiciary Committee's Subcommittee on Courts and Competition Policy, I want to thank you for giving me the opportunity today to speak about the interrelationship between antitrust laws and state regulation of alcohol consumption. My re-

marks today are my own; I speak for no one apart from myself. And I speak today based on my experience as a former antitrust division trial attorney, as an economist, and as a law professor whose research and writing has focused on antitrust issues arising in the context of regulated and deregulated industries.

Rather than repeat the highlights of my written testimony I want to walk through the methodology the Supreme Court employs in examining whether a state regulation violates the antitrust laws or is worthy of a judicially-created exemption from the antitrust laws.

The first fundamental question, as told by the Supreme Court in *Fisher v. City of Berkeley,* is whether the restraint in question is unilaterally imposed or is what the Supreme Court has described as a hybrid restraint. While state government is free to impose regulation which compels particular conduct for private actors, the regulation must not be "hybrid" in that non-market mechanisms merely enforce private marketing decisions. Where private actors are thus granted a degree of private regulatory power the regulatory scheme may be attacked under the antitrust laws.

There is a relationship between the Court's description of hybrid restraints and the notion of what it calls active supervision under the State Action Doctrine cases. The Court stated that in order for a state to create statutory restraint that is exempt from the antitrust laws, one, the challenge restraint must be one clearly articulated and affirmatively expressed as state policy; and two, the policy must be actively supervised by the state itself.

The history of antitrust enforcement in the realm of liquor is a history of state inaction in the second prong of this test, and thus a long list of hybrid restraints. In each case the conduct at the crux of the case is resale price maintenance, the foreboding of competition at wholesale level.

In the bulk of these cases the state allowed private actors to set prices which were then enforced by a state rule. The typical post and hold regulation employed by states that has been subject to antitrust challenge involved requirements designed to eliminate all price competition from the market.

With the states engaging in this "regulation"—I place the word regulation in quotes here—has elected to do is to facilitate tacit or overt collusion. These laws serve to facilitate collusion by compelling transparent prices with notification to competitors, the ability of competitors to detect and punish deviations from prior listed prices, by increasing cost to any competitor seeking to attract market share via price incentives, and by barring wholesalers from being able to employ economies of scale. Whether tacit or overt collusion, states employing such devices have given carte blanche to coordinated anticompetitive behavior without any regulatory restraint or oversight.

Antitrust challenges to such regulation do not impinge on the state's authority to regulate under the 21st Amendment. As a beginning point, I note that the cause of antitrust challenge here is an abdication of state regulatory authority in favor of the whims of a private collusive agreement, whether tacit or overt.

Secondly, while according to advocates of such schemes the goal purportedly advanced is temperance, suggesting that the cheaper

the cost of alcohol the more is consumed, the question becomes whether the goal is to eliminate alcoholism or to injure consumers who are social drinkers and already self-regulate to some degree. Regardless, the constitutional balancing to me heavily weighs in favor of competition policy, particularly when there are less restrictive alternatives more readily available to the state, namely to actively supervise the regulation in question.

In light of the foregoing, it is difficult to conceive of this pattern of conduct requiring or justifying any sort of statutory immunity. And indeed, this is the only type of regulation that has been successfully challenged in the courts.

I have written elsewhere and submitted to your Subcommittee the standards I believe applicable in establishing any statutory immunity under the antitrust laws, which I and my coauthor submitted as consultants to the Antitrust Modernization Commission. There are numerous questions that ought to be answered in granting such an immunity, and the burden should be upon those seeking to alter our magna carta of free enterprise.

In my opinion, no immunity is justified here. The states have only been successfully challenged in their regulatory authority to the extent they have advocated—abdicated such authority to private actors. Such abdication is not state regulation but the absence of regulation and the protection of private actors who may be seeking solely monopoly rents and are not vested in a public interest.

I will stop here but would like to discuss at some point sort of what the standards might be for statutory immunities. Thank you.

[The prepared statement of Mr. Bush follows:]

PREPARED STATEMENT OF DARREN BUSH

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UNIVERSITY OF HOUSTON LAW CENTER
HOUSTON, TEXAS

"Legal Issues Concerning State Alcohol Regulation"

BEFORE
THE HOUSE JUDICIARY COMMITTEE SUBCOMMITTEE ON COURTS and COMPETITION POLICY
UNITED STATES CONGRESS

ON

MARCH 18, 2010

Introduction

Mr. Chairman, Ranking Member Coble, and other distinguished members of the Judiciary Committee Subcommittee on Courts and Competition Policy, I want to thank you for giving me the opportunity today to speak about the interrelationship between antitrust laws and state regulation of alcohol consumption. More specifically, I hope today to emphasize those instances when state regulation of alcohol utterly fails to do more than present an aura of regulation to otherwise private activity, to the detriment of consumers and distributors of alcohol, and how such activity is undeserving of antitrust immunity. My remarks here today are my own. I speak today based upon my experience as an Antitrust Division trial attorney focused on deregulated industries, as an economist, and as a law professor whose research and writing has focused on antitrust issues arising in the context of regulated/deregulated industries.[1]

[1] The term "deregulation" is a bit of a misnomer. See Harry First, *Regulated Deregulation: The New York Experience in Electric Utility Deregulation*, 33 LOY. U. CHI. L. J. 911 (2002)(noting that New York's electricity market was not deregulated, but in fact replaced "one regulatory system with another.").

The Role of State Action Doctrine

The State Action Doctrine is the first line of defense against antitrust challenge to a state imposed restraint against competition. In recent times, the state action doctrine has been greatly expanded to encompass all types of regulatory activity, often even when such restraints do not seek to displace competition with regulation. While this is not the role that state action doctrine should play in modern antitrust analysis, the fact of the matter is that it is extremely difficult for a plaintiff to challenge anticompetitive restraints when the state is involved.

A successful state action defense rests upon the two prongs put forward in *California Retail Liquor Dealers Assn. v. Midcal Aluminum, Inc.*[2] In order to be exempt under the state action doctrine, (1) the challenged restraint must be "one clearly articulated and affirmatively expressed as state policy," and (2) the policy must be "actively supervised" by the state itself.[3] The Supreme Court in *Midcal* found that California's wine pricing program – a program that required wine producers to file "fair trade contracts" or post a resale price schedule– did rest upon a clearly articulated state policy. However, the Court found that the policy was not actively supervised:

> The State simply authorizes price-setting and enforces the prices established by private parties. The State neither establishes prices nor reviews the reasonableness of the price schedules; nor does it regulate the terms of fair trade contracts. The State does not monitor market conditions or engage in any "pointed reexamination" of the program. The national policy in favor of competition cannot be thwarted by casting such a gauzy cloak of state involvement over what is essentially a private price fixing arrangement. As Parker teaches, "a state does not give immunity to those who violate the Sherman Act by authorizing them to violate it, or by declaring that their action is lawful."[4]

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[2] California Retail Liquor Dealers Assn. v. Midcal Aluminum, Inc., 445 U.S. 97 (1980).
[3] *Id.* at 105.
[4] *Id.* at 106.

The metaphor of the "gauzy cloak" suggests a concern that the state in fact ought to play a role in authorizing and directing the conduct, not merely serve as pretext to the creation of an exemption for a private agreement. In the case of liquor regulation, states have traditionally placed a "gauzy cloak" of regulation without any supervision of pricing or concern about how such cartel-fostering injures consumers.

Midcal emphasizes the relationship between the state and the monitoring of the authorized conduct. However, there is a subsidiary notion that the conduct authorized and supervised must promote "state policy." The court in *Midcal* noted several times the "national policy in favor of competition,"[5] and the weighing of that policy against the state's interest in regulation. The notion is that if regulation is to displace competition policy, then the state must provide some means of assuring that its policies are carried forth. The tangential relationship between the state and the conduct at issue is insufficient. The requirement is that the conduct be authorized and supervised.

The Supreme Court's most recent pronouncement on the state action doctrine, *FTC v. Ticor Title Insurance Company*,[6] involved the setting of title search fees and administrative costs by rate bureaus licensed by the state and authorized to engage in joint price setting. The rates became effective unless rejected by the state. The Court rejected the use of these negative rate options as failing to qualify as active supervision when in fact the option had never been utilized. Here again the Court focuses on the tension between regulation and antitrust. However, the Court makes a statement that hints at the complementariness of the two regimes:

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[5] 445 U.S. at 101, 106, 110 n. 11, and 113.
[6] FTC v. Ticor Title Insurance Company, 504 U.S. 621 (1992).

> If the States must act in the shadow of state-action immunity whenever they enter the realm of economic regulation, then our doctrine will impede their freedom of action, not advance it. The fact of the matter is that the States regulate their economies in many ways not inconsistent with the antitrust laws. For example, Oregon may provide for peer review by its physicians without approving anticompetitive conduct by them. . . . Or Michigan may regulate its public utilities without authorizing monopolization in the market for electric light bulbs. . . . So we have held that state-action immunity is disfavored, much as are repeals by implication. . . . By adhering in most cases to fundamental and accepted assumptions about the benefits of competition within the framework of the antitrust laws, we increase the States' regulatory flexibility.[7]

In other words, the "default" rule of competition provides the backdrop for most state regulation. This strong presumption can be overcome, but only with clear showing that the state seeks some framework *apart from competition* to organize industrial activity within a particular industry, sector, or business.

Moreover, the cases focus on the relationship between the conduct in question and the regulation at issue. The notion of a broad exemption or exemption by proximity was anathema to the purpose behind the antitrust laws. This principle was first articulated in the "compulsion requirement,"[8] which was later relaxed with the requirement that the conduct was merely authorized by the state and perhaps that the conduct need only be "foreseeable." In other words, the state action doctrine was an exemption for purposes of engaging in particular conduct, not a blanket exemption for an industry subject to regulation.

Broad regulation does not necessarily constitute active supervision, as the court in *U.S. v. Rochester Gas & Electric*[9] noted. *RG&E* argued that its contract with the

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[7] *Id.* at 635-636.
[8] *See, e.g.,* Arbara P. Pletcher, *State Action Immunity and the Compulsion Requirement: Joint Ratemaking in Intrastate Trucking*, 71 CALIF. L. REV. 1557 (1983).
[9] 4 F.Supp.2d 172 (W.D.N.Y. 1998).

University met the active supervision prong of the *Midcal* test because the state regulatory authority had approved the contract. The Court responded:

> The Public Service Commission, however, is not charged with enforcing federal antitrust law, and did not review the contract to determine whether or not it violates that law. The fact that the New York Public Service Commission has approved the contract at issue does not mean that the State has authorized, and shielded from federal law, allegedly anticompetitive behavior.[10]

The notion that mere approval of a contract does not shield the contract with an exemption from the antitrust laws suggests that the regulatory agency would have to do more than merely rubber stamp the conduct at issue.[11]

Which Alcohol Regulations Have Undergone Antitrust Scrutiny?

With the preceding as background, it is understandable why a small class of state alcohol regulations have been scrutinized under the antitrust laws. In most instances, one particular type of state regulation, the "post-and-hold" pricing requirement, serves as a gauzy cloak that protects and fosters collusion to the detriment of consumers.

For example, in *TFSW, Inc. v. Schaefer*,[12] the court examined Maryland's "post-and-hold" pricing system, by which wholesales were required to file price schedules with the comptroller. These prices were required to be followed for at least a month following posting. Making the scheme even more disconcerting from an antitrust perspective was

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[10] 4 F.Supp. 2d. at 176.

[11] As the Supreme Court noted in Fisher v. City of Berkeley, 475 U.S. 260, 267-68 (1986), "Not all restraints imposed upon private actors by government units necessarily constitute unilateral action outside the purview of § 1. Certain restraints may be characterized as "hybrid," in that non-market mechanisms merely enforce private marketing decisions. . . . Where private actors are thus granted "a degree of private regulatory power," . . . the regulatory scheme may be attacked under § 1."(internal citations omitted). Thus, states which unilaterally imposed regulatory schemes and enforce such schemes via active state supervision are typically shielded from the antitrust laws.

[12] 242 F.3d 198 (4th Cir. 2000).

that the posted prices were made available to competitors prior to becoming final. Market participants were then given the opportunity to adjust their prices accordingly. In other words, deviations from standard prices could be detected and potentially punished, with the vehicle of punishment being a holding period. Volume discounts were also verboten under the rule.

The court rejected the restraint as lacking in active supervision by the state: "

> The post-and-hold system is a classic hybrid restraint: the State requires wholesalers to set prices and stick to them, but *it does not review those privately set prices for reasonableness*; the wholesalers are thus granted a significant degree of private regulatory power. The volume discount ban is a part of the hybrid restraint because it reinforces the post-and-hold system by making it even more inflexible. Wholesalers post their prices as required, and discounts of any nature are prohibited by regulation."[13]

The court in TSW properly noted that the history of impermissible restraints in the context of liquor regulation surrounds attempts at resale price maintenance. The *Midcal* case discussed earlier is an example of this. The Supreme Court also wrestled with such restraints in *Schwegmann Bros. v. Calvert Distillers Corp.*,[14] and *324 Liquor Corp. v. Duffy*.[15] In each instance, the role of the state regulator was as a rubber stamp of prices set by private actors.[16]

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[13] 242 F.3d at 209.

[14] 341 U.S. 384 (1951)(a state's endorsement of a resale price maintenance scheme involving whiskey and gin insufficient for purposes of state action doctrine).

[15] 479 U.S. 335 (1987)(post-and-hold pricing scheme lacks active supervision by the state).

[16] Other cases have similarly eschewed post-and-hold regulations. See Beer & Pop Warehouse v. Jones, 41 F.Supp.2d 552, 560-62 (M.D.Pa.1999) (Pennsylvania post-and-hold beer pricing statute); Canterbury Liquors & Pantry v. Sullivan, 16 F.Supp.2d 41, 47-48 (D.Mass.1998) (Massachusetts post-and-hold liquor pricing regulation). *Cf.* Battipaglia v. New York State Liquor Authority, 745 F.2d 166 (2d Cir.1984)(upholding by divided panel post-and-hold regulations for New York wholesale liquor prices). But See 1 Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 217, at 308-09 (2d ed. 2000) ("Given the great danger that agreements to post and adhere will facilitate horizontal collusion, the [Battipaglia] dissent's position is more consistent with" the Supreme Court's analysis of such restraints).

Similarly, in *Costco v. Maleng*,[17] it is the post-and-hold pricing scheme which takes the brunt of antitrust attack. Costco challenged numerous restraints established by the state, including a warehousing prohibition, a uniform pricing rule requiring each winery and brewery to sell at the same price to each distributor, a minimum markup provision, a ban on volume discounts, a ban on sales on credit, a ban on retailers selling to other retailers, and a delivered price requirement. The only restraint that failed to be protected from antitrust attack was the post-and-hold pricing mechanism, despite, in my opinion, very good reasons for some of the other restraints to not withstand antitrust scrutiny as well.

In sum, state liquor regulation as a whole is not under serious antitrust attack. Instead, in a few instances in which the states have utterly failed to regulate in any meaningful way, instead seeking to rubber stamp private activity, the courts have seen through the gauzy cloak of state regulation that merely serves as enforcing and perhaps compelling overt or tacit collusion in the market for alcoholic beverages.

Should State Alcohol Regulations Not Otherwise Immunized By Judicially Created Immunities and Exemptions Be Granted An Express Antitrust Immunity?

In light of the foregoing, the case for an express antitrust immunity for state liquor regulation is hardly compelling. The risks of granting such immunity are severe, and must be carefully considered.

[17] 522 F.3d 874 (9th Cir. 2008).

In a limited number of circumstances, Congress has expressly and unambiguously exempted certain activities from the antitrust laws.[18] Even in these circumstances, controversy over the scope of the express exemption can emerge around the periphery of the exemption. For example, the Congressional exemption from federal antitrust regulation for the insurance industry under the McCarran-Ferguson Act[19] is expressly limited to "the business of insurance" is only available to the extent the conduct in question is regulated by state law, and is further limited by a proviso excepting from the exemption conduct amounting to a "boycott", "coercion" or "intimidation." Controversy has occurred about the meaning of each of these limitations upon the scope of the express exemption.

Apart from the inherent ambiguities of language created by statutory immunities, the difficulty with statutory immunity is manifold. First, in many instances, the economic rationale for the statutory immunity is uncertain.[20] The industries or firms seeking the statutory immunity may not have laid out a compelling rationale for the elimination of the default rule of competition. Even if the proponents of the statutory immunity were to have laid out a compelling case, their analysis may not have been subject to the sunlight of an open decision-making process that has heard from all stakeholders. Such

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[18] For a list of statutory immunities, *see* DARREN BUSH, GREGORY K. LEONARD & STEPHEN ROSS, A FRAMEWORK FOR POLICYMAKERS TO ANALYZE PROPOSED AND EXISTING ANTITRUST IMMUNITIES AND EXEMPTIONS (2005)(hereafter "Immunity Framework"), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=95659739-40. The list includes statutory modifications to antitrust review of conduct as well as full immunizations from the antitrust law.

[19] 15 U.S.C. §§ 1011-15.

[20] *See* Immunity Framework at 37 (describing a sunset provision encouraging policymakers to consider whether economic "conditions have changed such that the problem would not exist even in the absence of the immunity"); *see also* Statement of James C. Miller III Before the Antitrust Modernization Commission Hearings on Statutory Immunities and Exemptions 37 (Dec. 1, 2005)("I see little reason to hold onto any of these antitrust immunities/exemptions from a strictly economic standpoint . . . eliminating these immunities/exemptions would increase economic efficiency and better serve the interest of consumers.")

stakeholders may have opposing evidence and viewpoints that could enable decision makers to weigh the costs and benefits of the immunity.[21] They could also present less restrictive alternatives to the proposed immunities. Statutory immunities often are not time limited, and thus may live well beyond their useful purposes in light of changing industry conditions. Congress does not often review statutory immunities to determine whether or not they have met their stated purpose. Finally, because of a lack of legislative history and clear record as to the underlying purpose of the immunity, courts have often expanded the scope of the immunity beyond its stated limit.[22]

Unless Congress expressly states, after careful weighing of costs and benefits, the parameters of the immunity, the default rule should always be competition. It follows from the foregoing that antitrust "savings clauses" should not be required, given that immunities ought to be express and a detailed legislative history provided. A savings clause, in contrast to establishing competition as the default rule, places the burden upon Congress to actively declare (and re-declare) that the antitrust laws apply.[23] Immunities and exemptions have created such a large umbrella for conduct that even the mantra of antitrust savings clauses has little or no effect.

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[21] Congress is partly responsible because it "grants exemptions from antitrust that legalizes otherwise unlawful exploitative and exclusionary conduct without any comparable review of the projected costs or benefits of such statutes." Statement of Peter C. Carstensen Before the Antitrust Modernization Commission Hearings on Statutory Immunities and Exemptions.

[22] Immunity Framework at 35 ("In the context of antitrust immunities, legislation ostensibly reflects a policy judgment that immunized conduct would currently confer a net benefit to society."). *See* Symposium: *Antirust Boycott Doctrine*, 69 IOWA L. REV. 1165, 1173 (1984) (discussing the Realist movement and the "assumption that Congress was not clear about its intent when it enacted the antitrust laws").

[23] "Antitrust clauses clearly preserve the applicability of the antitrust laws" by allowing "congress to consider, on a cases-by-case basis, whether to include an antitrust savings clause in particular pieces of regulatory legislation." Statement of J. Bruce McDonald Before the Antitrust Modernization Commission Hearings on Antitrust and Regulated Industries.

Granting express immunity to post-and-hold regulations seems without foundation. Benefits to such regulations fail to appear, unless the abdication of state regulators from engaging in active regulation is somehow a benefit. Moreover, such post-and-hold regulations have substantial costs in terms of facilitating collusion without proper oversight, to the detriment of consumers. A less restrictive alternative which would achieve the goals states implementing such schemes seek would be to actively supervise liquor prices, not leaving such pricing points up to private actors not vested with a public interest.

Moreover, it is increasingly difficult, given the current state of state action doctrine, for parties to challenge unlawful conduct merely wrapped in the gauzy cloak of regulation. An express immunity would create a risk of immunizing behavior not intended to be shielded by the statute, thus shielding behavior that would injure consumers. Instead, states should be encouraged to design regulations that do in fact ensure that a regulator vested with a public interest is exercising oversight authority over any price scheme.

Finally, care should be given to determine the extraterritorial effects of state regulation of liquor and any conduct immunized by federal legislation. As is mentioned in the Federal Trade Commission's State Action Report, examination of state regulation via the lens of the "state action doctrine fails to account for the efficiency losses and the breakdowns in the political process posed by interstate spillovers."[24] In examining

[24] Report of the State Action Task Force: Recommendations to Clarify and Reaffirm the Original Purposes of the State Action Doctrine To Help Ensure That Robust Competition Continues to Protect Consumers, 39-40 (September 2003),

whether post-and-hold regulatory schemes are deserving of antitrust immunity, attention should be paid whether the conduct immunized impacts upon interstate commerce and in particular consumers of other states.

ATTACHMENT

A Framework for Policymakers to Analyze Proposed and Existing Antitrust Immunities and Exemptions

October 24, 2005

Report Prepared by Consultants to the Antitrust Modernization Commission:

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Introduction

Consistent with the strong national policy favoring competition, Congress enacted the antitrust laws intending them to apply to all areas of commerce. Since William Howard Taft's landmark decision in the *Addyston Pipe* case, courts have generally followed the sound doctrine that the Sherman Act reflects a congressional policy in favor of competition, and that it is improper for courts to "set sail on a sea of doubt" and to arrogate to themselves the power to declare "how much restraint of competition is in the public interest, and how much is not."[1] A general failure by the courts to apply the antitrust laws rigorously in response to public interest arguments that might appeal personally to judges would reflect not only unsound economic policy but also a disregard for our constitutional separation of powers.

It logically follows, however, that advocates of departures from the Sherman Act as the "Magna Carta" of the free enterprise system[2] must be free to appeal to Congress, lest judges be tempted to reject Judge Taft's teachings and take things into their own hands. In response to certain political, social, or other arguments, Congress and the President (and, on rare occasion, federal courts) have established specific immunities and exemptions from the antitrust laws that permit conduct that might otherwise create liability under these laws.[3]

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[1] *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 284 (6th Cir. 1898), *modified & aff'd*, 175 U.S. 211 (1899)

[2] *United States v. Topco Assocs., Inc.*, 405 U.S. 596, 610 (1972).

[3] A list of antitrust immunities is contained in Appendix A. Note that this report defines antitrust "immunities" broadly to include any exemption from any aspect of antitrust liability or damages. This definition includes provisions that detreble damages for antitrust violations, otherwise modify antitrust liability or damages standards, or even partially immunize certain conduct from the antitrust laws in practice despite characterizations to the contrary. *See, e.g.*, H.R. Rep. No. 96-1118, *reprinted in* 1980

It is recognized that there are obvious risks to competition policy in the legislative process. Congressionally-conferred immunities usually provide the greatest benefits to a small group of private actors or interested parties.[4] Sound public policy, however, requires that the impact of these immunities on other persons also be taken into account. Because antitrust immunities typically generate concentrated benefits and diffuse costs, there is a danger that politically sophisticated special interests will seek to enact legislation enabling them to obtain monopoly profits or otherwise protect themselves from competition, without taking into account the broader effects of reduced competition. Moreover, once created, few of these immunities ever have been eliminated. Even in cases where Congress has immunized business behavior but subjected the relevant parties to regulatory supervision, there remains a significant risk that special interests will prevail in either the legislative or administrative process to enrich themselves while pursuing non-competition policies that may seem appealing, but whose full costs may not have been comprehensively analyzed.

This Report presents a general framework to assist policymakers in framing the key issues and objectively weighing the relevant evidence and policy considerations for the purpose of determining whether to create, modify, or eliminate an immunity. In attempting to ensure this Report will be a useful policy tool for future policymakers, it was developed according to three criteria:

- *Practicality*. The framework should be useful for policymakers. Inputs should be limited to readily accessible data and other information. Application of the framework should be straightforward and relatively fast without requiring extensive technical expertise. Output should provide policymakers actionable

U.S.C.C.A.N. 2373, at 2373 (stating that legislation exempting certain territorial restrictions in trademark licensing agreements from the antitrust laws "does not grant antitrust immunities").

[4] *See infra* note 9.

insight or analysis that will assist them in determining whether to create, modify, or eliminate the antitrust immunity at issue.

- *Transparency and analytical soundness.* The framework should promote transparent policymaking, in which both the arguments made by interested parties and the rationale for policymakers' decisions are open and accessible to the public. Further, the framework should be based upon generally accepted economic, legal, and/or other analytical principles.

- *General applicability.* The framework should be robust enough to allow policymakers to apply it to any specific antitrust immunity.

Following this introduction and an overview of the framework's key procedural safeguards, this Report details the five stages of the proposed framework. Stage 1 addresses the initial information gathering process. Actual analysis of antitrust immunities begins in Stage 2 with the clear identification and assessment of their justifications; conduct for which there is no reasonable justification or conduct with regard to which there is no significant risk of antitrust liability does not require immunizing legislation. After applying the Stage 2 screen, the costs and benefits of an antitrust immunity should be identified and balanced with as much qualitative and/or quantitative rigor as feasible. Stage 3 details these issues. The focus of Stage 4 is tailoring the scope of an immunity to minimize anticompetitive effect. Finally, Stage 5 addresses sunset provisions and regular review of immunities.

Key Procedural Safeguards

It is important for Congress to implement certain key procedural safeguards so that (A) the process is transparent and inclusive, (B) persons seeking the immunity have the burden of demonstrating the need for the immunity to minimize the scope and number of immunities promulgated, and (C) any promulgated immunity, although eligible for

renewal, is limited in duration to limit unintended consequences. For convenience, the brief descriptions immediately below provide an overview of these key procedural safeguards. More importantly, however, these procedural safeguards help shape and are described more thoroughly in the framework itself.[5]

A. Transparent and Inclusive Approach

i. Initial Information Gathering Process

Gathering information from a broad range of sources and means – including public hearings – is vital for sound policy and well-reasoned decision-making. Equally important is to make this information available to all interested parties for the purpose of identifying any errors or omissions in the record, facilitating even further input to Congress, and providing context regarding the purpose and scope of the immunity at issue.

ii. Codification of All Existing Immunities

All immunities should be codified in a single section of Title 15 of the United States Code.[6] The purpose would be to promote transparency and provide an easily accessible compilation of antitrust immunities at any given point in time.[7]

B. Burden of Proof on the Proponent of the Immunity

i. Justification for Immunity

The burden of establishing the case for any immunity should fall on the proponents of the immunity. At a minimum, the proponents should: (1) clearly explain

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[5] *See infra* pp. 7-39.

[6] Many immunities are scattered throughout various sections of Title 15 of the U.S. Code, while still others lurk in Titles 7, 16, 42, 46, 47 49, and 50.

[7] With regard to immunities affecting regulated industries, Congress may choose to enact identical statutory language that would be codified both in Title 15 as well as in the Code title of the relevant regulatory regime.

why conduct within the scope of a proposed immunity is both prohibited or unduly inhibited by antitrust liability and in the public interest; (2) make some estimation as to the effects the proposed immunity will have in addition to its intended effect; and (3) demonstrate that the proposed immunity is necessary to achieve the desired policy outcome.

ii. Balancing of Costs and Benefits

The ultimate purpose of the information gathering is to help policymakers determine whether, on whole, the proposed immunity's benefits exceed its costs. In part, the placement of the burden upon the immunity proponent is an acknowledgement that the proponent of the immunity is in the best position to articulate the benefits of the immunity.

iii. No Less Restrictive Alternative

Proponents also should bear the burden of convincing policymakers that the specific immunity proposal, in its breadth and scope, is necessary to achieve the claimed social benefits.

C. Sunset Provision Terminating Immunity Unless Renewed

i. Optional Consideration for Renewal

Unless renewed through an affirmative act of Congress, all statutorily created antitrust immunities would terminate after a set period of time. It would be up to Congress to determine whether or not to initiate a renewal process. Existing immunities should be amended to include sunset provisions and should be reviewed using the framework contained within this Report.

ii. Legislative History

If Congress opts to initiate a renewal process for a terminating immunity, the legislative history of its previous enactment would be particularly important. In that renewal process, the legislative history would provide the baseline analysis from which to compare the assumptions and conditions at the time of passage with the data obtained subsequent to passage.

Proposed Framework

I. Stage 1: Initial Information Gathering

The Stage 1 inquiry should focus upon the means by which information is obtained regarding the proposed immunity.

A. Input Sought From a Broad Range of Sources

To fully inform congressional decision-making, information regarding the immunity and its effects should be sought from a broad range of sources, including:

- *Proponents of the immunity*. As explained above, the proponents of the immunity should make the requisite demonstration, detailed herein, to justify passage of the immunity.

- *Relevant government entities*. Either the Department of Justice's Antitrust Division ("DOJ") or the Federal Trade Commission ("FTC") should provide an assessment of the effects of the proposed immunity.[8] Given their role as federal antitrust enforcement agencies, they have a unique perspective that would aid policymakers in their consideration of a proposed immunity. Where the proposal calls for immunizing conduct supervised by a federal regulatory agency, the relevant agency should also provide an assessment of the immunity's effects, with particular attention on the necessity of antitrust immunity for the agency to accomplish its regulatory mandate. Where appropriate, the views of other relevant

[8] In the past, there have been occasions when executive branch officials responsible for the Administration's position have been reluctant to allow the Antitrust Division to provide its professional expertise in cases where this advice may not fully support the President's policy agenda. If there are such occasions in the future, it will be imperative that the FTC provide the sort of independent analysis that Congress needs to assure that antitrust immunities are only enacted in the public interest after full deliberation.

government officials and entities – including state attorneys general – also should be solicited.

- *Opponents and other interested parties.*[9] Opponents of the proposed immunity and other interested parties – possibly including representatives from the affected industry as well as supplier and customer groups – should be solicited to provide initial input as well.

B. Written Record Should Be Made Publicly Available

Importantly, all formal submissions received from any party regarding the proposed immunity should be made publicly accessible[10] in order to facilitate scrutiny and further input from other members of the public, including independent researchers and scholars. Such a transparent and open approach maximizes both the diversity of viewpoints and the amount of relevant information available to policymakers in their decision-making process.[11]

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[9] By using the term "interested parties" this report does not mean to imply, as is the case in administrative law, that commentators be limited by notions such as standing or other measures designed to limit participation. It is recognized, however, that it is impracticable to allow all-comers to submit comments. *See Bi-Metallic Inv. Co. v. State Bd. Of Equalization*, 239 U.S. 441, 445 (1915). Rather, it is more important that all stakeholders are represented than it is that all persons are represented. Thus, consumer groups, academics (from a broad range of perspectives), supplier groups, labor representatives, community representatives, and other stakeholders should have sufficient representation in order to communicate their diverse viewpoints.

[10] Information should be made accessible in numerous ways. The method that provides the highest degree of accessibility is making all materials submitted to Congress available on the internet. Additionally, comments could be published in a fashion similar to the publication model utilized for committee hearings.

[11] Congress has routinely required transparency in the promotion of sound decision making. *See* 5 U.S.C. § 553 (notice and comment rulemaking). *See also* KENNETH CULP DAVIS, DISCRETIONARY JUSTICE: A PRELIMINARY INQUIRY 113-14 (1971) (arguing that public scrutiny protects against arbitrary decision-making by administrative agencies). In the realm of antitrust law, Congress has provided mechanisms to ensure sound decision making and openness. *See* 15 U.S.C. § 16(b)-(h) (The Tunney Act, providing for public comment and public interest review by a court regarding consent decrees).

There are multiple benefits to a transparent decision-making process. First, a transparent process aids in the ability of a decision-maker to obtain complete and accurate information by enabling observers of the process to critique, comment, and correct information submitted before the decision-making entity. Secondly, transparency helps to ensure reasoned decision-making by providing observers with means to argue persuasively before a decision-maker and to provide policy rationales in opposition to or in favor of proposed legislation. These two related benefits of transparency provide "sunlight" to the decision-making process. *See* LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY 62 (1933) ("Sunlight . . . is said to be the best of disinfectants; electric light the most efficient policeman.").

C. Public Hearing

The goal of this initial information gathering is to allow legislators to determine if the proposed immunity has sufficient merit to warrant serious consideration. To ensure that any enacted immunity is passed based upon a fully-informed legislative process, the relevant committee or subcommittee should subject proposed immunities – whether in the form of stand-alone legislation or of an amendment to another bill – to the scrutiny of a hearing to clarify the positions and arguments of interested parties.

II. Stage 2: Identification and Analysis of Justifications

The Stage 2 inquiry should focus on why the conduct covered by a proposed immunity serves the public interest and why an antitrust immunity is needed to facilitate this conduct. If no justifications can be proffered, the immunity should not be granted. Thus, Stage 2 serves as a baseline screen.

Although immunized conduct may have multiple justifications, this stage addresses three categories of justifications separately:

- *Pro-consumer justifications*. Justifications in this category are based upon a legislative determination that the immunized conduct would enhance consumer welfare. While proponents of the proposed immunity would be expected to benefit from the immunity, their welfare is not at issue under this type of justification. Instead, the question is whether the immunized conduct would lead to lower prices or improved product quality for consumers. It should be noted that the "immunity" being sought is immunity from the antitrust laws which were designed to promote consumer welfare. Thus, a valid pro-consumer justification for an immunity from these very laws would likely be limited to cases where the conduct in question may create antitrust liability under existing antitrust statutes and case law even though research and experience has demonstrated that conduct to be pro-consumer. Such situations are likely to be the exception, not the rule.

- *Justifications not related to consumer welfare*. Although the Sherman Act has been aptly called the "Magna Carta of our free enterprise system," our democratically elected representatives have a very wide berth under our Constitution to make social and political judgments about the extent to which competition is in the public interest. Moreover, if courts are to strictly adhere to the Supreme Court's admonition that the antitrust laws permit no defense that competition is unreasonable, those who feel aggrieved by the application of the antitrust laws must be able to seek recourse from their elected representatives. For justifications involving social goals that are not related to consumer welfare, it is important to be mindful of the tradeoffs between these social goals and the goal of consumer welfare. In addition, there may be tradeoffs between social goals that the immunized conduct would help achieve, on the one hand, and other social goals, on the other. How to evaluate these tradeoffs is considered in more detail in Stage 3.

- *Giving an existing regulator complete control of all competitive issues regarding the firms it regulates*. The sub-categories of justifications for immunizing from antitrust liability conduct subject to regulation include the following: (1) the regulators, rather than Congress, should balance the goal of consumer welfare against other social goals; (2) regulators, rather than the judicial process, should determine whether certain conduct within a particular industry is procompetitive or anticompetitive; or (3) the existence of antitrust laws somehow precludes the desired results of regulation. Opponents of these immunities, however, point out that regulators both are susceptible to "capture" by the industries they are supposed to be regulating[12] and do not have the expertise analyzing antitrust issues possessed by antitrust enforcers (*e.g.*, DOJ and FTC).

At least one justification should apply to a proposed immunity. If no justification applies – including situations in which the conduct at issue would be lawful under the antirust laws in any event – the immunity should not be granted.

A. Pro-Consumer Justifications

1. Immunized Conduct Leads to Lower Costs of Production, Distribution, or Marketing

[12] *See* THE POLITICS OF REGULATION, (James Q. Wilson ed., 1980); W. KIP VISCUSI, JOHN M. VERNON, & JOSEPH E. HARRINGTON, JR., ECONOMICS OF REGULATION AND ANTITRUST 44-45 (3d ed. 2000).

The immunity might be justified if the immunized conduct would lead to lower costs of production, distribution, or marketing for the immunized firms, and these lower costs would be passed through to consumers in the form of lower prices. For example, consider a group of rival firms that want to form a joint venture to manufacture an input that they all use at lower cost. The joint venture's cost of manufacturing the input would be lower than the price for the input charged by existing third-party suppliers. While the lower costs, if passed through to consumers, would appear to enhance consumer welfare, the firms may seek an antitrust immunity if the extent of their joint conduct in their particular market would expose them to antitrust liability.

This justification has been offered for several existing immunities, such as the National Cooperative Research and Production Act.[13] The argument for this act is that it limits liability for potentially illegal joint action by rival firms that produces cost reductions.

The key issue to analyze with respect to this justification is the relationship between the immunized conduct and the final price paid by consumers. What specific costs would be lowered as a result of the immunity? Would the cost savings be passed through to consumers? Is there another way to lower these costs without an antitrust immunity? Would the cost-lowering conduct create a significant risk of antitrust liability but for this immunity?

2. Immunized Conduct Leads to Greater Benefits in Terms of Product Characteristics, Distribution, or Marketing

The immunity might be justified if the immunized conduct would lead to new products, higher quality products, wider distribution, or more effective promotion. For

[13] 15 U.S.C. §§ 4301-06.

example, consider a group of rival fax machine manufacturers who want to reach agreement on a standard for interconnection of their next generation products. With interconnection possible, demand for these next generation fax machines would increase (this is an example of "network externalities"; in contrast, if the manufacturers' fax machines could not interconnect with each other, there would be significantly reduced value from owning a fax machine).[14] In other words, the value of the products to consumers might increase if interconnection were possible. While the interconnection agreement would appear to enhance consumer welfare, the firms may seek an antitrust immunity if they fear antitrust intervention by the federal agencies or third parties.

This is a justification offered for several existing immunities, such as the Standards Development Organization Advancement Act.[15] The argument for this act is that it limits liability for potentially illegal joint action by rival firms that improves product quality due to network externalities and other reasons.

The key issue to analyze with respect to this justification is the relationship between the immunized conduct and the benefit in terms of new products, higher quality products, wider distribution, or more effective promotion. What specific benefits would be produced as a result of the immunity? What is the value of these benefits to consumers? Is there another way to produce these benefits without an antitrust immunity? But for this immunity, would the immunized conduct be illegal under the antitrust laws?

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[14] A product exhibits a network externality when the value to a consumer of using the product increases with the number of other consumers also using the product. A fax machine has little value to a person unless other people also have (compatible) fax machines.

[15] 15 U.S.C. §§ 4301-05, 4301 note.

B. Justifications Not Related to Consumer Welfare

1. The Immunity Creates a Socially Desirable Redistribution of Wealth or Provides a Subsidy

The immunity might be justified as providing a subsidy to one group, or as promoting a redistribution of wealth from one group to another in a way that is viewed to be socially desirable.

One example of this type of justification involves the "correction" of asymmetric bargaining power. This is a justification offered for several existing immunities, such as the Capper-Volstead Act.[16] The argument is that this immunity enables small entities alleged to have little individual bargaining power (*e.g.*, farmers) to group together to negotiate jointly with single large entities alleged to have substantial bargaining power (*e.g.*, supermarket chains). In this situation, proponents may be able to demonstrate that a socially desirable wealth transfer from the larger to smaller entities may occur. Such a transfer may also have macroeconomic benefits (*e.g.*, one argument for the labor exemption is that conferring power on unions increases worker purchasing power). It should be noted, however, that in addition to the socially desirable wealth transfer, there may be (unintended) anti-consumer consequences of changes in bargaining power.[17]

Another example of the "redistribution of wealth" justification involves the preservation of firms that would otherwise go out of business. In the past, this has often been referred to as the "ruinous competition" justification.[18] For example, if firms in an

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[16] 7 U.S.C. §§ 291-92.

[17] This possibility is discussed in Stage 3. *See infra* Section III.

[18] The notion of ruinous competition has an extensive history. *See* Herbert Hovenkamp, *The Antitrust Movement and the Rise of Industrial Organization*, 68 Texas L. Rev. 105, 131-144 (1989). Under common law antitrust applications prior to the passage of the Sherman Act, ruinous competition was successfully used as a defense. *See, e.g.*, *Morgan v. New Orleans, M. & T.R.R.*, 17 F. Cas. 754, 758 (C.C.D. La. 1876) (No. 9804); *Nutter v. Wheeler*, 18 F. Cas. 497 (D. Mass. 1874) (No. 10,384). Merger

industry are allowed to set prices jointly, free from antitrust liability, they may be able to price at a level that allows them all to stay in business, whereas if competition were allowed to prevail the least efficient firms would be forced out of business. Immunizing joint price setting amounts to a transfer of wealth from consumers (who end up paying higher prices) to the firms. This is a justification offered for the Shipping Act,[19] which allows ocean common carriers to set prices jointly. Economists have long argued that keeping firms in business is not a valid justification as far as economic efficiency is concerned.[20] Thus, if an immunity allowing price-fixing is to be justified, it must be on the basis that the wealth transfer in question is otherwise socially desirable, either as a matter of congressional views on a just distribution, or based on non-competition policies such as the preservation of jobs in a particular region or the need to protect specified creditors or shareholders.

The key issue to analyze with respect to the redistribution-of-wealth justification is the tradeoff between the social goal achieved by the immunity and other economic or social goals. What specific social goal is being achieved as a result of the immunity? Why is the immunized conduct necessary to achieve the social goal? Is there another way to achieve the social goal without an antitrust immunity? What other social goals

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to monopoly was allowed based upon an assertion of ruinous competition. *See, e.g., Barr v. Pittsburgh Plate Glass Co.*, 51 F. 33, 40 (C.C.W.D. Pa. 1892) (No. 22); *Diamond Match Co. v. Roeber*, 13 N.E. 419, 421 (N.Y. 1887); *Lumbermen's Trust Co. v. Title Ins. & Inv. Co. of Tacoma*, 248 F. 212, 217 (9th Cir. 1918).

As a defense, the notion of "ruinous competition" has not fared as well post-Sherman Act. *See* Hovenkamp, *supra*, at 133. This is in part due to the passage of the Sherman Act itself as well as more sophisticated microeconomic theory explaining the efficiency of entry and exit from markets in most circumstances. *See United States v. Joint Traffic Ass'n*, 171 U.S. 505 (1898); *United States v. Addyston Pipe & Steel Co.*, 78 F. 712, 715 (C.C.E.D. Tenn. 1897), *rev'd*, 85 F. 271 (6th Cir. 1898), *modified & aff'd*, 175 U.S. 211 (1899); *United States v. Trenton Potteries Co.*, 273 U.S. 392 (1927).

[19] 46 U.S.C. app. §§ 1701-19.

[20] *See, e.g.*, F. SCHERER AND D. ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 296 (3d ed. 1990).

are impacted by the immunity? But for this immunity, would the immunized conduct be illegal under the antitrust laws?

2. Immunity Promotes a Socially Desirable Activity

The immunity might be justified on the basis that it promotes an activity that is deemed to be socially desirable for reasons apart from enhancing consumer welfare. This is a possible justification for the Newspapers Preservation Act, [21] which is purported to preserve diverse "points of view" for news while allowing monopoly pricing of newspapers and advertising to be shared between newspapers.

Some activities may promote total welfare (the sum of producer and consumer welfare) at the expense of consumer welfare. For example, collaboration between two competitors might allow them to avoid duplicating significant fixed costs, while at the same time leading to higher prices for consumers. It is possible that the fixed cost savings would outweigh the higher consumer prices, leading to an overall increase in total welfare. These types of activities may create antitrust liability under existing antitrust law. Producers might therefore seek antitrust immunity on the grounds that such activities are socially desirable because they improve economic efficiency and total welfare.

As with immunities providing a redistribution of wealth, the key issue to analyze with respect to this justification is the tradeoff between the social goal achieved by the immunity and other economic or social goals. What specific social goal is being achieved as a result of the immunity? Why is the immunized conduct necessary to achieve the social goal? Is there another way to achieve the social goal without an

[21] 15 U.S.C. §§ 1801-04.

antitrust immunity? What other social goals are impacted by the immunity? But for this immunity, would the immunized conduct be illegal under the antitrust laws?

C. Immunity Gives Existing Regulator Complete Control of all Competitive Issues Regarding the Firms it Regulates

An immunity may be justified when a regulatory agency has been expressly empowered by Congress to displace market outcomes in an industry. Congress may expressly confer upon the regulator the exclusive power to control competitive issues within that industry by providing the industry with antitrust immunity.[22]

The basic approach toward immunities for regulated industries should be the same as any other antitrust immunity. The burden should be on those who seek to immunize regulated conduct from the antitrust laws to demonstrate persuasively why Congress should expressly immunize conduct approved by a regulator from the antitrust laws. As with other immunities, Congress should draft the statutory provision to precisely identify its scope: that is, to precisely identify the conduct that will be exempt from antitrust scrutiny.[23] The proposed framework also seeks to minimize if not eliminate such issues as to the scope of an express immunity by requiring that a detailed legislative history accompany any statutory immunity. Finally, this approach should, to a significant degree, avoid questions regarding implied immunities for regulatory behavior.

Where Congress contemplates an antitrust immunity in a regulated industry, it is important that the FTC or DOJ be the principal agency responsible for determining the

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[22] *See, e.g.*, 49 U.S.C. § 10706 (Rail transportation exemption).

[23] Careful drafting is crucially important because even when Congress appears to be clear, controversy over the scope of an express immunity can arise around the periphery of the immunity. For example, the Congressional exemption from federal antitrust regulation for the insurance industry under the McCarran-Ferguson Act is expressly limited to "the business of insurance" is only available to the extent the conduct in question is regulated by state law, and is further limited by a proviso excepting from the exemption conduct amounting to a "boycott", "coercion" or "intimidation." Controversy has occurred about the meaning of each of these limitations upon the scope of the express exemption.

competitive effect of challenged conduct, and that determination ought to be binding upon the regulatory commission. In addition, current regulatory regimes should be reviewed by Congress to clarify any ambiguity concerning the extent to which regulated conduct should be immune, and henceforth conduct should be subject to the antitrust laws unless expressly immunized. This approach is consistent with the process utilized in consideration of renewal of any immunity.

As with all justifications unrelated to consumer welfare, the key issues are: What specific social goal is being achieved as a result of the immunity? Why is the immunized conduct necessary to achieve the social goal? Is there another way to achieve the social goal without an antitrust immunity? What other social goals are impacted by the immunity? But for this immunity, would the immunized conduct be illegal under the antitrust laws? Additional queries that might be useful in the context of regulation are: Is the immunity necessary for the administrative agency to achieve its statutorily created mandate? Is the goal of the agency the complete displacement of market outcomes or are there components of the industry at issue that would be subject to competitive conditions?

III. Stage 3: Balancing Costs and Benefits

A. Usefulness of Explicitly Considering Costs and Benefits

Sound decision-making requires that the consequences of each alternative be evaluated. This is true of decisions in areas ranging from mundane personal matters (*e.g.*, what to have for dinner) to business strategy (*e.g.*, where to invest R&D funds) and government policy (*e.g.*, what regulations to implement). In general, the decision-maker

should first identify all positive consequences ("benefits") and all negative consequences ("costs") of each potential action and then should compare the benefits to the costs. The "net benefit" from each potential action would equal the benefits less the costs.

Academicians have endorsed this approach in the literature on decision-making.[24] In addition, economists have used "cost-benefit analysis" for over 50 years to analyze government policy decisions.[25] The approach has also been adopted by the Executive Branch, which has required administrative agencies to use cost-benefit analysis in the promulgation of rulemaking.[26]

While formal cost-benefit analysis requiring quantification and extensive detailing of costs and benefits may be too time-consuming and potentially infeasible in the analysis of antitrust immunities, the general approach set forth in Stage 3 – generally identifying and assessing the costs and benefits to the extent possible – is consistent with more rigorous analysis. Although each immunity is different and thus requires a discussion of different facts and circumstances, the approach set forth in this stage is general enough to accommodate virtually any fact set that may arise in a given circumstance.

Besides its generality and acceptance in other areas, cost-benefit analysis offers other advantages as a methodology. Perhaps most importantly, it requires proponents, opponents, and neutral parties (including decision-makers) to completely identify and evaluate the full set of benefits and costs that the proposed immunity is expected to

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[24] *See, e.g.*, R. KEENEY AND H. RAIFFA, DECISIONS WITH MULTIPLE OBJECTIVES: PREFERENCES AND VALUE TRADEOFFS (1993).

[25] *See, e.g.*, E. MISHAN, COST BENEFIT ANALYSIS (1971).

[26] *See* Exec. Order No. 12,866, 3 C.F.R. 638 (1993-2000), *reprinted as amended in* 5 U.S.C. § 601 note. Executive Order 12,866 replaced Executive Order 12,291 which also required, to the extent permitted by law, the consideration of costs and benefits in the promulgation of regulations. *See* Exec. Order No. 12,291, 3 C.F.R. 128 (1981-93).

generate. The complete weighing of costs and benefits based upon full and complete information promotes good decision-making and increases the likelihood that only immunities Congress determines to be socially beneficial will be granted.

By using cost-benefit analysis, Congress will promote increased transparency into the rationale for conferring the immunity. Stage 3 analysis requires that the costs and benefits of a proposed immunity be explicitly identified and weighed against each other, assisting policymakers in reaching an informed conclusion regarding the proposed immunity. Outsiders to the decision-making process will be able to understand which benefits and costs were considered and how they were weighed in order to come up with the final determination.

One criticism often leveled at formal cost-benefit analysis is that it asks for too much – that it is not possible to quantify precisely all of the benefits and costs associated with a proposed action. As demonstrated in this stage, however, it is not necessary to quantify every benefit and cost to produce a useful analysis – the process of explicitly identifying all the types of costs and benefits is valuable in its own right. Moreover, a decision should be made with the list of costs and benefits in mind, even if they cannot be quantified.

B. Summary of Stage 3

This stage identifies and suggests ways to measure traditional "economic" benefits and costs as well as "societal" benefits and costs. Ultimately, however, policymakers themselves have to decide how best to balance these specific costs and benefits.

The economic benefits and costs of a proposed immunity will generally affect three groups: consumers, companies advocating for the immunity, and other companies (*e.g.*, rivals and suppliers). Generally speaking, consumers will be affected to the extent the proposed immunity changes price, quality, or the set of consumer choices. As discussed in Stage 2, business conduct may be pro-consumer, and consumers benefit to the extent that the proposed immunity promotes such conduct. On the other hand, the immunity may decrease consumer welfare if it allows conduct that is anti-consumer, such as price-fixing. Indeed, given that immunity from the antitrust laws is sought, the *prima facie* case will often be one where consumer harm is expected to result from the immunity.[27] When an immunity is proposed for conduct subject to government regulation, the analysis must consider the regulatory scheme to determine if it is likely to result in the authorization of anti-consumer conduct. Some conduct within the scope of proposed immunities may simultaneously increase the welfare of some consumers and reduce the welfare of others. This too should be considered in the cost-benefit analysis.

Companies are divided into two groups: proponents of the proposed immunity and other companies. The proponents of the proposed immunity presumably would be expected to benefit from the immunity in the form of greater profits (otherwise they would not be seeking the immunity). Other companies may benefit or may be harmed. For example, companies who are customers of the immunized companies might benefit if the immunized conduct lowered the costs and prices of the immunized companies, but

[27] For example, if the conduct proposed to be immunized from the antitrust laws involves naked price fixing or horizontal market allocations (typically *per se* illegal conduct under the antitrust laws), then consumers would likely face price increases or reductions in output due to the conduct for which immunization is sought. In contrast, vertical collaborations would be less likely to injure consumers, but also less likely to violate the antitrust laws. Thus, proponents of an antitrust immunity would have a stronger argument for their need for the immunity if the conduct is likely to violate the antitrust laws.

might be harmed if the immunized conduct allowed price-fixing by the immunized companies.

In addition to the economic benefits and costs, there may also be "societal" benefits and costs related to other social goals Congress might deem to be important, such as the redistribution of wealth.

The following sections offer an approach to identifying the potential benefits and costs and suggest methods by which these benefits and costs might be measured. The basic approach is as follows: (1) identifying of the groups potentially benefited or harmed by the proposed immunity; (2) identifying of the types of benefit or harm that each such group would receive; (3) performing a qualitative assessment of the expected magnitude of each category of benefit or harm should be made;[28] and (4) wherever possible, performing a quantitative assessment of the expected magnitude of each benefit or harm. In many cases, as described more fully below, a first order approximation may be possible using available industry information and existing economic literature.

C. Identifying and Measuring Benefits

1. Benefits to Consumers

A proposed immunity will potentially benefit consumers if it would decrease prices or improve product quality. For example, if the immunized conduct led to lower costs for producers that were then passed onto consumers, consumers would benefit from the lower prices. Similarly, if the immunized conduct led to improved product quality or the introduction of new products that would otherwise not have been introduced, consumers benefit from the increased product quality and variety.

[28] This Report suggests a "high," "medium," or "low" grade be assigned to each category of benefit or harm.

The first step in the analysis is to identify groups of consumers who might benefit from the immunity. Three potential groups are: (1) any consumers who directly purchase the products of immunized companies, who are potentially the primary beneficiaries of the pro-consumer effects of the immunity; (2) the consumers of final products for which the immunized product is an input, who could benefit to the extent that cost-savings were passed through to final consumers or the quality of the final product improved;[29] and (3) consumers of substitute products for the immunized companies' products, who might benefit if increased competition from the immunized companies forced companies selling substitute products to decrease their prices or improve their product quality.

The next step in the analysis is to make a qualitative assessment of the expected benefit associated with each potential positive effect of the immunity. This Report proposes assigning each potential positive effect a score of "high," "medium," or "low" depending on the magnitude of the potential effect and the likelihood of it occurring. A checklist of industry characteristics might be useful in making this assessment. For example, for an industry producing products for which no close substitutes exist, the benefits on consumers of substitute products would be expected to be negligible.

Ideally, it would also be valuable to make a quantitative assessment of the expected benefits. This would generally be considerably easier when re-assessing an existing immunity than when assessing a proposed immunity. For example, a comparison of prices before and after the immunity was granted (properly controlling for changes in other economic factors) would provide an estimate of the effect of the immunity on prices.

[29] This would be important in cases where the products of the immunized companies are often not directly purchased by consumers, but instead are used as inputs into the production of some final product.

However, quantitative assessments may still be possible when analyzing some proposed immunities. Some basic information may be readily available that would allow for calculations of the benefits to be performed. For example, if the proposed immunity would decrease producer costs by $1, it might be reasonable in certain circumstances to assume that this cost decrease would be passed through one-for-one to consumers. A first approximation of the benefits to consumers would equal the $1 price reduction multiplied by the number of unit sales.

Another approach to assessing the benefits to consumers of a proposed new immunity would involve referring to estimates of related consumer benefits that appear in the economic literature. For example, this Report provides several "case studies" illustrating how rough calculations of the benefits to be performed could be achieved in a situation where basic information was available.

In the first case, suppose that the proposed immunity would lead to lower producer costs. Two questions arise when analyzing the consumer benefits in this situation. First, how much of the producer cost decrease would be passed through to the prices that consumers pay? Second, how much would consumers benefit from the lower prices?

> **Case Study:** The pass-through of the cost decrease resulting from the proposed immunity to consumer prices could be approximated either by reference to the pass-through that has been observed in a comparable industry or by applying what is known in the economic literature about the relationship between pass-through and industry characteristics to the industry at issue.[30] Once the extent to which consumer prices would be

[30] *See, e.g.*, J. Hausman and G. Leonard, *Efficiencies from the Consumer Viewpoint*, 7 GEO. MASON L. REV. 707 (1999) (discussing industry characteristics that influence the extent of pass-through); T. Besley & H. Rosen, *Sales Taxes and Prices: An Empirical Analysis*, 52 NAT'L TAX J. 157 (1999) (studying the extent of pass-through of taxes in various retail industries); D. Besanko, J. Dube, & S. Gupta, *Own Brand and Cross Brand Pass-Through*, 24 MARKETING SCI. 123 (2005) (same); A. Gron and D. Swenson, *Cost*

> lower has been estimated, the value to consumers of the lower prices is a straightforward approximation based on existing unit sales, the existing price, the expected price decrease, and the expected unit sales increase.[31] The expected unit sales increase can itself be estimated based on an assessment of the price sensitivity of the demand for the product.

Turning to the case where the proposed immunity would involve the introduction of a new product, the key question is how much consumers would value the new product. This value could be estimated by calibrating the product at issue to a comparable product for which the value to consumers has been estimated in the literature on new product introductions.[32] If the proposed immunity would lead to a new product introduction, the associated value to consumers could be estimated by benchmarking off of similar products for which the value to consumers has been estimated in the literature.

> **Case Study:** Suppose that a proposed immunity would allow a group of producers to introduce a new service that would compete with direct broadcast satellite and cable TV. The gains to consumers that would result from the introduction of this new service could be estimated using an appropriate calibration to the consumer gains from direct broadcast satellite that were estimated by Goolsbee and Petrin.[33]

In the case where the proposed immunity would increase the quality of an existing product, the economic literature may contain estimates of the value to consumers of the relevant dimension of product quality. These estimates could be used to assess the value

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Pass-Through in the US Automobile Market, 82 REV. OF ECON. & STAT. 316 (2000) (discussing pass-through in the automobile industry).

[31] *See, e.g.*, J. PERLOFF AND D. CARLTON, MODERN INDUSTRIAL ORGANIZATION 70-72 (4th ed. 2005) (discussing consumer welfare calculations).

[32] *See, e.g.*, J. Hausman, *Valuation of New Goods Under Perfect and Imperfect Competition, in* THE ECONOMICS OF NEW GOODS (R. Gordon & T. Bresnahan eds., 1997); A. Petrin, *Quantifying the Benefits of New Products: The Case of the Minivan*, 110 J. POL. ECON. 705 (2002); J. Hausman and G. Leonard, *The Competitive Effects of a New Product Introduction: A Case Study*, 50 J. INDUS. ECON. 237 (2002); A. Goolsbee and A. Petrin, *The Consumer Gains From Direct Broadcast Satellites and the Competition With Cable TV*, 72 ECONOMETRICA 351 (2004).

[33] Goolsbee & Petrin, *supra* note 32.

to consumers of immunized conduct that would further improve this dimension of product quality.

> **Case Study:** Suppose a proposed immunity would allow automobile manufacturers to collaborate on the development of a new engine technology that would improve fuel efficiency. One approach to estimating the value consumers would place on vehicles with greater fuel efficiency would be to rely on existing economic studies that have studied the demand for automobiles.[34] These studies provide an estimate of the amount that consumers would be willing to pay for increased miles per gallon, from which the consumer value of improved fuel efficiency can be determined.

2. Benefits to Companies

The primary beneficiaries of antitrust immunity are likely to be the proponents. However, other companies may benefit as well. The first step in the analysis is to identify the companies that would likely benefit. In addition to the proponents, other companies that might benefit are: other companies in the same distribution chain as the immunized companies, companies that produce complementary products,[35] and companies that sell substitute products.[36]

If the immunity has pro-consumer (price-decreasing or quality-improving) effects, it would be expected to benefit other companies in the distribution chain and companies that make complementary products. To the extent that the immunity decreases the price or improves the quality of the immunized companies' products, the demand for these products should increase and thus the demand for the other companies' (complementary)

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[34] An example of such a study is S. Berry, J. Levinsohn, and A. Pakes, *Automobile Prices in Market Equilibrium*, 63 ECONOMETRICA 841 (1995).

[35] "Complementary products" are those where the demand for one product or service is positively related to the demand for another product or service. For example, shoes and shoelaces are complementary. Similarly, computer hardware and software are complementary.

[36] "Substitute products" are those where the demand for one product is negatively related to the demand for the other. For example, Coke and Pepsi are substitute products.

products should increase as well. For example, a distributor selling the products of the immunized companies would likely sell more units if those products were of higher quality.

Companies that sell substitute products, on the other hand, would generally be expected to benefit from the immunity only if the immunity had anti-consumer effects (*i.e.*, led to higher prices or lower quality). For example, if the immunity led to price-fixing among the immunized companies, companies selling substitute products might be able to raise their prices as well.

As with consumers, this Report proposes that the magnitude of each potential benefit to companies be qualitatively assessed with a high/medium/low rating. Again, a checklist of industry characteristics may help in making this assessment. For example, in an industry where promotion is an important driver of consumer demand, but free-riding by one distributor on another's promotional efforts is a serious danger, an immunized vertical restraint may provide significant benefits to the manufacturers and even to the distributors of the product.

This Report also proposes that a quantitative assessment of the benefits be made whenever possible. As with consumers, measurement of the benefits of an existing immunity may be feasible by comparing the effects of the immunity to the state of the industry prior to passage of the immunity. In cases where a new immunity is being considered, the necessary information may be available to make first approximation calculations of the benefits.

> **Case Study:** Consider an immunity that would lead to increased sales by the immunized firms. Of interest would be the benefits to the producers of complementary products. In certain situations, a complementary product may sell in roughly a fixed proportion to the product sold by the immunized

companies. For example, a company selling a cellular phone accessory such as a leather case may sell one leather case for every 10 cell phones sold. Given knowledge of the likely increased demand for the product of the immunized firms (which can be estimated using the methods described in the consumer benefit section above), one could apply the fixed proportion to determine the likely increased demand for the complementary product. The benefits to the producers of these products would equal the additional profit they would make on the additional sales.

Case Study: Suppose a proposed immunity would allow a group of producers to engage in retail price maintenance. The retail price maintenance would prevent price competition among retailers, but encourage the provision of service and promotion by retailers. Existing economic literature may provide a useful guide on the effects of retail price maintenance on the profitability of producers and retailers.[37]

3. Societal Benefits

There may be benefits of the immunized conduct that redound to parties other than consumers and companies. These benefits can be referred to as "societal" benefits. For example, an immunity that ensured that a certain resource would be available in a national defense emergency would presumably benefit all of society. As another example, an immunity that led to increased charitable activity would benefit recipients of the charitable funds. It may also be the case that the immunized conduct has redistributive or other effects that Congress views as beneficial.

All such claimed benefits should be identified and then assessed in qualitative terms using the high/medium/low rating. Industry facts may be useful in making this assessment. For example, a national defense benefit would not be expected to be very large if there were a substitute resource that would be readily available.

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[37] *See, e.g.*, S. Ornstein and D. Hanssens, *Resale Price Maintenance: Output Increasing or Restricting? The Case of Distilled Spirits in the United States*, 36 J. INDUS. ECON. 1 (1987); T. OVERSTREET, RESALE PRICE MAINTENANCE: ECONOMIC THEORIES AND EMPIRICAL EVIDENCE, FTC BUREAU OF ECONOMICS STAFF REPORT (1983); P. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J. L. & ECON. 263 (1991).

Ideally, these societal benefits should also be quantitatively assessed so that they can be compared to other benefits and costs of the proposed immunity. This is generally more difficult to do than the assessment of the benefits to consumers and companies.

> **Case Study:** Consider a small group of regulated firms seeking both regulatory approval and antitrust immunity to fix higher prices for a service they currently provide to a subset of the population. The justification is that the higher prices on customers who purchase the service would be used to cross-subsidize provision of the service to all consumers ("universal service"). Universal service might be argued to provide a desirable redistribution of wealth. The relative effectiveness of this form of redistribution might be assessed by comparing it to other redistributive programs in terms of the ratio of amount of income redistributed to the deadweight loss created; an effective program is one that has a high ratio.

D. Identifying and Measuring the Costs of an Immunity

1. Costs to Consumers

The approach to measuring the costs associated with immunity mirrors the approach used to measure benefits. The analysis of costs will, in many respects, be the opposite side of the benefits coin. For consumers, costs of the immunity might include higher prices, lower quality, or reduced consumer choice, for example.

The first step in the analysis of costs is to identify the groups of consumers that would potentially be adversely affected by the immunized conduct. The primary groups of consumers expected to be affected are: (1) direct consumers of the immunized companies' products, (2) indirect consumers of the immunized companies' product, and (3) consumers of substitute products.

If the immunized conduct would lead to price increases or quality reductions for the products of the immunized firms (due, *e.g.*, to immunized price-fixing), direct and indirect consumers of these products would likely be harmed. In addition, consumers of products that are substitutes for the products of the immunized companies would also

likely be adversely affected. The producers of these substitute products, while not immunized from price-fixing, might be able to increase their prices due to the decreased competition from the immunized companies.[38]

As with benefits, this Report proposes that a qualitative analysis first be applied in order to identify the potential costs that are of the largest magnitude and have the highest likelihood of occurring. A checklist of industry factors may again be useful in making this assessment. For example, in the case of an industry producing products that have no close substitutes, the potential for harm to consumers due to price-fixing by the immunized firm may be deemed "high."

Ideally, the likely costs to consumers would be measurable and thus quantifiable. For an existing immunity that is being reviewed, an analysis of historical data may prove to be useful for purposes of quantitative analysis. For proposed immunities, basic information may be available that would allow a first approximation to be calculated.

> **Case Study:** Suppose a proposed immunity would allow firms to engage in price-fixing. In this case, it would be useful to analyze the likely costs to consumers from higher prices. The first question that needs to be answered is how much higher prices are likely to be. For example, knowledge of the industry, elasticity of demand,[39] and company profit margins might allow one to predict the price increase that would result from price-fixing to first approximation. Alternatively, the economic literature may also be able to provide some useful guidance. For example, a recent academic study has determined that the average cartel overcharge tends to be 49% over the competitive price level.[40] This may provide a useful starting point for analyzing the negative effects on

[38] For example, if the immunized producers raised their prices, the demand faced by producers of substitute products would increase as some customers attempted to switch from the products of the immunized producers to substitute products. Faced with increased demand, the producers of substitute products would generally have the incentive to increase their prices at least somewhat. This is an indirect effect of the immunity.

[39] The industry elasticity of demand is a measure of the sensitivity of the demand of customers to an increase in the prices of all of the firms in the industry.

[40] John M. Connor & Robert H. Lande, *Optimal Cartel Fines*, TUL. L. REV. (forthcoming) (draft at Section III.B., on file with authors).

consumers of an immunity that would allow companies to jointly set their prices.

Case Study: Returning to the regulated firm case study[41], consumers of the service (who would have purchased it in the absence of universal service) would face higher prices as a result of the immunity. The resulting reduction in consumer welfare could be estimated as described in the previous case study.

2. Costs to Companies

Companies adversely affected by an immunity would include: (1) competitors of the immunized companies, (2) companies in the distribution chain, and (3) companies selling complementary products. Competitors of the immunized companies may be harmed in two ways. First, the competitor would be harmed if the immunity allows the immunized companies to exclude it from the market. For example, an immunity might allow the immunized firms to impose exclusive dealing arrangements on customers. Second, if the immunized conduct is pro-consumer, competitors of the immunized firms could be harmed simply due to the greater competition they will face from the immunized companies (through lower prices or higher quality products).

Companies in the distribution chain (*i.e.*, companies who supply the immunized companies or companies who purchase from the immunized companies) will be harmed if the immunity makes the immunized companies less competitive. For example, if the immunized companies raise their prices or reduce their product quality, companies who supply to or purchase from the immunized companies will make fewer sales themselves and thus make lower profits. Companies in the distribution chain may also be harmed if the immunized conduct causes them to be foreclosed from purchasing from or selling to the immunized companies.

[41] *See supra* Section III.C.3.

Companies who sell complementary products will be harmed if the immunity makes the immunized companies less competitive. Fewer sales of the immunized companies' products typically mean fewer sales for sellers of complementary products as well.

Having identified the groups of companies that might be harmed by the immunity, the next step is to assign a high/medium/low rating to each group. Again, a checklist of industry characteristics might be useful. For example, the harm to an excluded company would not be expected to be large if the company was in a competitive industry; in that case, its economic profits would be negligible and thus its losses if it were excluded would be relatively small.

Where possible, a quantitative analysis of the costs to companies should also be performed. For example, the profits of firms that are at risk of being excluded from the market could be calculated. As another example, a distributor's loss in profits from the loss in sales of the immunized companies' products could be calculated.

> **Case Study:** Suppose a proposed immunity would allow incumbent telecommunications firms to exclude a potential entrant to the market. The business plans of the potential entrant may provide a reasonable estimate of the entrant's likely profits if entry had not been prevented. The costs to the entrant of the immunity would be equal to the profits it would have made absent the immunity.

> **Case Study:** Suppose a proposed immunity would lead to a reduction in the immunized companies' sales. A distributor whose business included the distribution of the immunized companies' sales would likely suffer a reduction in its own sales as a result of the immunity. The distributor would lose profits based on the lost sales. The lost profits would represent a measure of the cost of the immunity to the distributor.

Economic literature on the likely costs of the conduct in question may also be useful. For example, in the case of a vertical restraint that may be immunized, economic literature exists on the effects of such restraints on distributors.

3. Societal Costs

The immunized conduct may have negative impacts on society aside from the effects on consumers and companies. For example, the immunized conduct may lead to a redistribution of wealth. To the extent Congress believes distribution impacts are important, the affected groups and the extent of the redistribution caused by the immunity should be identified and assessed qualitatively or quantitatively.

E. Balancing the Costs and Benefits of an Antitrust Immunity

The proposed analysis identifies specific costs and benefits and, where possible, quantifies them. Quantified costs can be subtracted from quantified benefits to arithmetically derive a "net quantified benefit" for the immunity. Members of Congress are then well-situated to reach an ultimate conclusion as to whether or not the proposed immunity serves the public interest. Obviously, legislators may differ as to the weight to be given to any particular cost or benefit.[42] Alternatively, legislators may prefer not to simply engage in addition, giving more weight to a cost or benefit that substantially affects some of their constituents and less weight to one that may only slightly affect many. These inherently political decisions regarding balancing costs and benefits are for elected representatives to make; the objective of this framework is simply to provide the tools for making these political decisions in an informed and transparent context.

[42] Indeed, even what should count as a cost or benefit is open to interpretation. For example, some may consider increased consumer prices affecting many of their constituents to be costs, while others may view higher prices as costly only to the extent that some consumers make less-efficient purchases (what economists refer to as "deadweight loss"), and still others may characterize what is often the larger economic effect of higher prices as welfare-neutral wealth transfers.

F. Burden on Proponents to Justify the Immunity on Cost-Benefit Grounds

The proponent of an immunity should have the burden of proof to justify the immunity on cost-benefit grounds. Of course, in the give-and-take of legislative proceedings, those who seek to persuade Congress that an immunity is not in the public interest should be required to muster factual support for any empirical claims they make as well.

IV. Stage 4: Tailoring an Immunity to Minimize Anticompetitive Effect

The Stage 4 inquiry should focus on substantive and procedural aspects of an otherwise acceptable immunity that can be tailored to minimize the anti-consumer effect.

A. Ruling Out Less Restrictive or More Beneficial Alternatives

Even if there are clear benefits to immunizing conduct that would otherwise be subject to antitrust scrutiny, it is important for Congress to determine if the benefits of the immunity could be obtained in ways less restrictive to the competitive process. In other words, could the benefits of the immunity be obtained in less costly ways than granting an antitrust immunity? Alternatively, would an alternative solution solve the problem imposing the same amount of costs as the proposed immunity, but also providing additional benefits?

B. Defining Scope and Explicit Carve-Outs

Careful drafting of legislation granting an antitrust immunity is essential if legislation is to serve the public interest without also permitting anti-consumer conduct that Congress did not intend to immunize. Two drafting techniques may appear self-evident but are worth formal incorporation in a well-designed immunity framework.

First, the scope of immunized conduct should be well-defined by clear textual language, supplemented by clear examples of legislative intent in the committee report. Textual ambiguities cause uncertainty among business planners, result in costly litigation over the scope of the immunity, and potentially result in judicial interpretations that do not reflect congressional intent, so that legitimate conduct is found illegal under the antitrust laws and harmful conduct is immunized. Second, when the foregoing analysis demonstrates that specific conduct within the general scope of a proposed immunity would not be socially beneficial, drafters should craft an explicit "carve-out" so that such conduct does not receive an unwarranted immunity.

C. Internal Structure of Joint Ventures

Historically, Congress has predominantly seen fit to immunize collaborative behavior among firms that otherwise compete in relevant markets. An important aspect of joint venture activity that has received sporadic but well-deserved attention in the case law,[43] but that Congress would be well-advised to consider as part of the immunity process, concerns limits on the internal structure of joint ventures to assure that they operate in an efficient manner to achieve the socially beneficial goals that Congress may seek to facilitate. Especially when collaborations face insufficient competition, so that (in Judge Posner's phrase), when they err, market retribution will *not* be swift,[44] it is important that the venture is structured so that efficient activity is not inhibited by the incentive of each participant to look out for its own interests rather than for the interests of the joint venture as a whole. Specifically, (i) each participant should be allowed to

[43] *See, e.g.*, Joseph F. Brodley, *Joint Ventures and Antitrust Policy*, 95 HARV. L. REV. 1521, 1528-29 (1982).

[44] *Valley Liquors, Inc. v. Renfield Importers, Ltd.*, 678 F.2d 742, 745 (7th Cir. 1982).

pursue pro-competitive actions outside of the joint venture unless such participation would clearly inhibit or free ride on collaborative activity; (ii) the management of the joint venture should have incentives to maximize the value of the joint venture's operations; and (iii) the venture should not allow a minority of participants a veto over operations that would benefit the venture as a whole.[45]

D. Transparency in Consideration of Competitive Concerns in Regulated Industries

Where Congress contemplates an antitrust immunity in a regulated industry, it will usually reflect a concern that allowing government or private antitrust litigation that challenges approved conduct would frustrate the regulator's ability to accomplish its statutory goals. In carrying out this function, regulators are often charged with considering both competitive concerns and other regulatory concerns. In these situations, is important that the FTC or DOJ be the principal agency responsible for determining the competitive effect of the challenged conduct, and their determination ought to be binding upon the regulatory commission. These antitrust enforcement agencies have the expertise and independence to assess fully the effect of regulated conduct on consumer welfare. If Congress wishes to allow non-consumer welfare concerns to prevail in specified instances, the regulator's ability to transparently determine that these concerns indeed should immunize otherwise unlawful activity will be assisted by the independent

[45] The textual discussion builds upon economic insights that suggest that often a collaboration works most efficiently when there is a "residual claimant" who keeps excess profits and therefore has an incentive to secure the approval (with side payments if necessary to those who might not initially benefit from a proposed business opportunity) of venture participants for efficient business opportunities. These insights suggest that, absent a firm or manager serving as this "residual claimant," there will be a "moral hazard" problem because participants have the incentive to free ride off of the efforts of others. *See, e.g.*, Bengt Holmstrom, *Moral Hazard in Teams*, 13 BELL J. ECON. 324 (1982); Armen Alchian and Harold Demsetz, *Production, Information Costs and Economic Organization*, 62 AM. ECON. REV. 777 (1972).

determination of the consumer welfare effects. Transparency in this context also can minimize the risks of special interest capture.

E. Potential Reporting and Approval Requirements

Finally, to ensure accurate data in the review process and to maximize the benefits perceived to arise from conferring the immunity, Congress may choose to create additional procedural safeguards. For example, Congress could create notice and reporting requirements.[46] This would promote transparency and aid in the provision of data in the review of the immunity. Congress also could require parties seeking immunity to get approval from a government official or agency to engage in the immunized conduct.[47]

V. Stage 5: Sunset Provisions and Regular Review

In the context of antitrust immunities, legislation ostensibly reflects a policy judgment that immunized conduct would currently confer a net benefit to society. In a dynamic economy, however, circumstances may change so that an immunity previously considered to be in the public interest may at some future time become socially harmful. Moreover, there is always a risk that affected parties and/or courts can misinterpret legislation granting an immunity. Policymakers can minimize these risks by means of

[46] For example, under the National Cooperative Research and Production Act, parties must submit written notification to the Department of Justice and the Federal Trade Commission identifying the parties to the joint venture, their nationality, and the nature and purpose of the venture. Parties also must submit written notification to both antitrust enforcement agencies regarding any changes in membership within 90 days of such change. 15 U.S.C. § 4305(a)(1).

[47] For example, the Small Business Act's immunities require approval of either the President in the case of national defense or approval from the Small Business Administration in the case of research and development. *See* 15 U.S.C. §§ 638(d), 640.

sunset provisions coupled with regular post-enactment review and the requirement that every immunity terminates unless renewed through an affirmative act of Congress.

Every immunity granted should include a sunset provision to ensure that the immunity is revisited periodically by policymakers and that the information, assumptions, and other factual bases for previously granting the immunity still justify its existence. Existing immunities should be amended to include sunset provisions and should be reviewed using the framework contained within this Report. If Congress opts to initiate a renewal process for a terminating immunity, the legislative history of its previous enactment will be particularly. Specifically, the legislative history of an immunity should identify the problem the immunity seeks to address, a description of how the immunity resolves the problem, the congressional calculus of benefits and costs described in Stage 3 (including specifying anticipated cost and benefits), and any limitations on the scope of the immunity. The most comprehensive legislative history would be contained in the conference committee report, and/or in a detailed report of the relevant committee or subcommittee.[48] Where this is not feasible, at a bare minimum the legislative sponsor should provide the necessary information and data in prepared floor remarks.

The regular reviews required as a result of a sunset provision enable policymakers to address any errors they perceive have arisen in interpretation of the immunity. Most importantly, the sunset provision provides policymakers with a fresh opportunity to examine the immunity with a greater level of information; they can examine its "track

[48] *See, e.g.*, George A. Costello, *Average Voting Members and Other "Benign Fictions": the Relative Reliability of Committee Reports, Floor Debates, and Other Sources of Legislative History*, 1990 DUKE L.J. 39.

record." As a rule of thumb, a reasonable length for these sunset periods is five years.[49] For certain immunities, however, it may be appropriate to have shorter or even slightly longer sunset provisions.

Prior to the expiration of a sunset period, policymakers should hold public hearings regarding possible renewal of the immunity. These reviews would be substantially similar to the process characterized in Stages 1 through 4, *supra*. However, in addition to examining the historical record of an immunity, policymakers should collect new information that was not available previously but could be relevant to their current analysis of that immunity. Key issues would include (i) whether economic or legal conditions have changed such that the problem would not exist even in the absence of the immunity; (ii) whether other potential (and less restrictive) alternative solutions could remedy the problem; and (iii) what effects the immunity has had since its passage or last renewal.

Participation of a wide range of stakeholders is critical to this review. Specifically, the enforcement agencies could provide information as to whether the immunity has deterred enforcement actions from taking place and the degree to which potential enforcement actions were subject to the immunity. Moreover, in instances where Congress required proponents of the immunity to undertake additional requirements (*e.g.*, notice and/or reporting filings), the enforcement agencies could provide data as to the number, nature, and breadth of such filings, as well as the degree to

[49] *See, e.g.*, Airline flight schedule exemption. 49 U.S.C. § 40129 (two year sunset provision for antitrust immunity); Need-Based Educational Aid Act. 15 U.S.C. § 1 note (seven year sunset provision for antitrust immunity); Television Program Improvement Act. 47 U.S.C. § 303c (three year sunset provision for antitrust immunity); Antitrust Criminal Penalty Enhancement and Reform Act of 2004, Pub. L. No. 108-237, § 211, 118 Stat. 666, 666 (2004) (five year sunset provision for limitation on recovery).

which such filings were rejected. Finally, all interested parties could provide an assessment of the effects not anticipated when the immunity initially passed (or was last renewed).

This dynamic, as opposed to merely static, analysis would provide policymakers an opportunity to check the accuracy of the assumptions and forecasts upon which they based their previous opinions about the immunity. If certain costs or benefits turned out to be substantially different than anticipated previously, it could change the way policymakers view the immunity upon renewal.

Conclusion

Ultimately, the decision whether or not to create, modify, or eliminate an antitrust immunity is a political judgment made by the legislative and executive branches. The framework presented in this Report is intended to offer a policy tool to facilitate well-informed, transparent, and analytically sound deliberations in the course of that inherently political process. Specifically, this framework is designed to help policymakers identify the key issues with regard to (i) initial information gathering, (ii) identification and analysis of justifications for an immunity, (iii) balancing the costs and benefits of an immunity, (iv) tailoring an immunity to minimize anticompetitive effect, and (v) dynamic analysis of an immunity over time through the use of sunset provisions and regular review.

Appendix A

Specific Antitrust Immunities and Exemptions
(source: AMC's May 19, 2005 Request for Public Comment)

1. Capper-Volstead Act. 7 U.S.C. §§ 291-92.
2. Non-profit agricultural cooperatives exemption. 15 U.S.C. § 17.
3. Agricultural Marketing Agreement Act. 7 U.S.C. §§ 608b, 608c.
4. Fishermen's Collective Marketing Act. 15 U.S.C. §§ 521-22.
5. Webb-Pomerene Export Act. 15 U.S.C. §§ 61-66.
6. Export Trading Company Act. 15 U.S.C. §§ 4001-21.
7. McCarran-Ferguson Act. 15 U.S.C. §§ 1011-15.
8. Shipping Act. 46 U.S.C. app. §§ 1701-19.
9. Anti-Hog-Cholera Serum and Hog-Cholera Virus Act. 7 U.S.C. § 852.
10. Air transportation exemption. 49 U.S.C. §§ 41308-09.
11. Baseball exemption. *See* Curt Flood Act, Pub. L. No. 105-297, § 2, 112 Stat. 2824 (1998); *Fed. Baseball Club of Baltimore, Inc. v. Nat'l League of Prof'l Baseball Clubs*, 259 U.S. 200 (1922); *Toolson v. New York Yankees, Inc.*, 346 U.S. 356 (1953); *Flood v. Kuhn*, 407 U.S. 258 (1972).
12. Charitable Donation Antitrust Immunity Act. 15 U.S.C. §§ 37-37a.
13. Defense Production Act. 50 U.S.C. app. § 2158.
14. Filed rate/*Keogh* doctrine. *See, e.g.*, *Keogh v. Chicago & N. W. Ry. Co.*, 260 U.S. 156 (1922).
15. Health Care Quality Improvement Act. 42 U.S.C. §§ 11101-52.
16. Labor exemptions (statutory and non-statutory). *See, e.g.*, 15 U.S.C. § 17; 29 U.S.C. §§ 52, 101-10, 113-15, 151-169; *Connell Constr. Co. v. Plumbers & Steamfitters Local Union No. 100*, 421 U.S. 616 (1975).
17. Local Government Antitrust Act. 15 U.S.C. §§ 34-36.
18. Medical resident matching program exemption. 15 U.S.C. § 37b.
19. Motor transportation exemption. 49 U.S.C. § 13703.
20. National Cooperative Research and Production Act. 15 U.S.C. §§ 4301-06.
21. Natural Gas Policy Act. 15 U.S.C. § 3364(e).
22. Need-Based Educational Aid Act. 15 U.S.C. § 1 note.
23. Newspaper Preservation Act. 15 U.S.C. §§ 1801-04.
24. Railroad transportation exemption. 49 U.S.C. § 10706.

25. Small Business Act. 15 U.S.C. §§ 638(d), 640.
26. Soft Drink Interbrand Competition Act. 15 U.S.C. §§ 3501-03.
27. Sports Broadcasting Act. 15 U.S.C. §§ 1291-95.
28. Standard Setting Development Organization Advancement Act. 15 U.S.C. §§ 4301-05, 4301 note.
29. United States Postal Service exemption. *See, e.g., United States Postal Serv. v. Flamingo Indus. Ltd.*, 540 U.S. 736 (2004).

Mr. JOHNSON. Thank you, sir.

We will now move to questioning of the witnesses. It will proceed in accordance with the 5-minute rule.

Ms. Samona, what does—what would you, based on your experience, recommend that any legislation include? We have already talked about an antitrust exemption. Is that something that you would support?

Ms. SAMONA. Mr. Chairman, thank you for the question. What I would propose is for some law or legislation to reaffirm the right of states to regulate alcohol as they deem appropriate for their state.

Mr. JOHNSON. Now, is there any particular method or language that you would find most appealing?

Ms. SAMONA. I don't have any language that is prepared. I would be happy to work with—anything to that. At this point I would be happy if Members of this Committee are open to that idea and that suggestion to do that.

Mr. JOHNSON. How would you see it—what exactly would you be seeking?

Ms. SAMONA. Well, the two major cases that exist involved the state of Michigan. The first one was the *Granholm* decision, in *Heald v. Granholm.* That case, wineries—out-state wineries—sued the state saying that in-state wineries are given this exclusion because they are able to deliver to consumers in the state of Michigan, out-state wineries are not. The argument that we made—and we think it is a valid argument and it supports the 21st Amendment—is that those wineries or those businesses that exist in the state of Michigan and licensed by the Michigan Liquor Control Commission are those that we have complete control over. We have—we can go and——

Mr. JOHNSON. Okay, well, now let me stop you. I want you to respond precisely to the—the question is, how exactly—what exactly would you be proposing with respect to state versus Federal regulation? Would it be a ban on Federal regulation? Would it be a ban on state regulation? What exactly is it that you would propose?

Ms. SAMONA. I would not, certainly, look for a ban on any kind of Federal legislation. I think that the Federal legislation that applies to all the states—I think that probably solves many of the problems that we are dealing here with.

At this point we have courts that are issuing orders that are contrary in different areas. The——

Mr. JOHNSON. Okay, so you want to try to avoid any and all litigation that may arise from the operation of the three-tier system?

Ms. SAMONA. Absolutely. I think the clearer Congress speaks the——

Mr. JOHNSON. All right.

Ms. SAMONA [continuing]. The less probability of litigation.

Mr. JOHNSON. Okay. Can I get the views of the other——

Ms. SAMONA. Absolutely.

Mr. JOHNSON [continuing]. Members on this?

Mr. Ho?

Mr. HO. Sure. We have heard a couple of times the phrase, "If it ain't broke don't fix it." I would just modify that comment slightly and say, that is wonderful. If it ain't broke, don't sue.

Congress has the complete authority to end all of this litigation and to say, "What the states are doing, that is within the states' rights to engage in that regulation and you all just keep doing that"——

Mr. JOHNSON. Do you think that——

Mr. HO [continuing]. Control.

Mr. JOHNSON [continuing]. Any circumstance where the courts can anticipate any legal arguments that could be good faith arguments supported by evidence and a lawsuit filed? Do you think there are any areas where the legislature can accomplish that feat, or are we always going to be a litigation society utilizing the third coequal branch of government?

Mr. HO. I think I would respond by saying, the clearer Congress can be in setting out what it wants states to be able to do, and not to be able to do, the less litigation we will have. The laws that the courts are struggling with right now are really just very few words. The 21st Amendment——

Mr. JOHNSON. It is pretty——

Mr. HO [continuing]. And some of these other laws.

Mr. JOHNSON [continuing]. Pretty clear stuff, but I will tell you——

Mr. HO. Sure. I mean, you can expand it and sort of explain——

Mr. JOHNSON. Right. And you can do that with anything.

The other witnesses—Mr. Hindy, Ms. Erickson, and Professor Bush?

Mr. HINDY. Well, you know, I am not an attorney, but from what I have heard there are plenty of attorneys in this town, so probably that is okay. It is interesting to hear Mr. Ho, who I believe is an attorney, calling for people not to sue.

You know, it just seems to me that the primary role of regulation of alcoholic beverages right now is with the states, and the Federal Commerce Clause just seeks to ensure that there are no discriminatory laws enacted by the states. That seems to me to be a good foundation for regulation of alcoholic beverages, served us well for 75 years, and there is bound to be litigation on any of these arenas where there are suppliers who can't get their products to market.

Mr. JOHNSON. Thank you.

Ms. Erickson and Professor Bush, you all are in favor or opposed to an antitrust exemption for the alcohol-based products?

Ms. ERICKSON. Let me give a brief response. I am not a lawyer either, so I am going to give you a layperson's response.

I think there needs to be recognition that there are legitimate reasons for not selling alcohol in a free market, that the marketplace rules need to be somewhat different for alcohol. For example, if you are a businessperson you will put in your business plan a plan to identify your best customers, those people that buy the most of your product, and you are going to aggressively promote to those people. But with alcohol a lot of those people who are your best customers are alcoholics, so your promotional activities need to be somewhat muted.

So I think some of those specific concerns where the free marketplace creates problems with the sale of alcohol there needs to be a clear recognition of that.

Mr. JOHNSON. All right, thank you.

And Professor Bush?

Mr. BUSH. I believe to a large degree they already have an immunity from the antitrust laws. It is called the State Action Doctrine. It is a judicially-created exemption that so long as the state has a clearly articulated policy and it actively supervises that policy it exempts them from the antitrust laws. Where they have run into trouble is where they have not actively supervised their alcohol regulation and have delegated that authority to private actors who are not vested in the public interest.

In creating a statutory immunity there is a great concern that I have written on extensively, and so have others, that the immunity goes beyond what might be necessary. There may not be any reasonable justification for the immunity, and there is no telling what kind of harm the immunity will do. Moreover, there doesn't seem to be any sort of legitimate justification for the immunity in that the one instance of antitrust attack is an instance where the states have actually utterly abdicated their authority to private actors.

Mr. JOHNSON. Thank you, Professor Bush.

Now I will yield the floor to the Chairman of this Committee, Chairman Conyers.

Mr. CONYERS. I thank you for your courtesy. I only have one question, and it is to Nida Samona, who has been the Michigan Liquor Control Commissioner and chairperson of that commission.

Here is what I would like to know: Since the *Granholm* decision has there been any noticeable effect, from your perspective, on Michigan's ability to regulate alcoholic beverages?

Ms. SAMONA. Thank you for that question. I appreciate that. I, too, am a lawyer that sits on this panel, though, you know, my role is a little different, but my lawyer hat is not always quite removed.

Yes, we do see a big difference in regards to what happened with the *Granholm* decision, named after our governor, my boss, and that was when the independent business owners—or the independent wineries in the state of Michigan, we had to face an issue of the legislature of, do we allow them to ship to customers in the state of Michigan, consumers or not, based on the fact that out-state wineries wanted to be able to do the same thing even though we had no control or regulatory authority over these out-state wineries as we did the in-state wineries.

We could go to the in-state wineries and check on them daily if we wanted to. We licensed them; we could take that license away from them at any time if we suspected they did anything that was against the laws and the rules of the Liquor Control Commission in the state of Michigan.

What we have had to do is we had to open up the door and allow all wineries to ship, through a permit system, to consumers. So if you are a winery that is—whether you are in California and Oregon or anywhere else, you can get a permit system—you fill out a form, you pay $100, and you ship the wine away.

Do we have control over it as far as taxes are concerned? Not necessarily, because we don't know if everything is being reported. It is an honor system.

Does it work? We think that we are losing millions of dollars of revenue as a result of that.

And then to piggyback on that, a few years later we had another lawsuit that was called the Siesta Village lawsuit against the state of Michigan, and that one wanted an out-state retailer to be able to ship directly to a consumer in the state of Michigan.

Again, that retailer is out-state, not licensed by our agency. We have not control over them. We don't know who they are shipping to. Are they checking ID? Are they selling products that would be products that we would approve in the state of Michigan? We really don't know.

And again, the rule—the district court ruled against the state of Michigan, and so in effect what we had to do was we had to shut down all delivery to all customers in the state of Michigan by any retailers, in-state or out-state. The millions of dollars that these lawsuits have cost the state of Michigan where we could have put them in enforcement and other things has been dramatic and crippling, quite honestly.

And so as a result, our in-state licensees have had to suffer as a result of these losses that have existed. We have an open market. You can bring in any product in the state of Michigan. If it is a beer or wine product bring it through a beer and wine wholesaler who is licensed by us and we have control and authority over them; if it is a spirits product bring it in through a liquor vendor that is licensed and we have authority over them. That is what we are talking about is that ability.

Mr. CONYERS. Thank you, Chairman Samona. Would you please keep us abreast of this—of what is happening in Michigan as a result of the decision and your chairing the Michigan Liquor Control Commission, because I think the Committee would be interested in that?

Ms. SAMONA. I would be happy to. Thank you.

Mr. CONYERS. And I thank you, Mr. Chairman and Ranking Member, for your courtesy.

Mr. JOHNSON. Thank you, Mr. Chairman.

Next, we will turn to Mr. Coble?

Mr. COBLE. Thank you, Mr. Chairman.

Good to have you all with us this afternoon.

Ms. Samona, the Internet has changed a great deal in this country. How has the Internet changed your ability to effectively regulate alcohol at the state level and what do you perceive to be your greatest threat to effective regulation going forward?

Ms. SAMONA. And that is our greatest threat, is the Internet, because we know that many of these companies, whether they are wine companies or spirits companies, are up 2 or 3 days a week, and by the time we are ready to track them and try to find the source of them they are down and a new company is up. And we are not, you know, blind to the fact of, we know alcohol is coming it, whether it is beer, wine, or spirits, illegally through the state of Michigan.

We know that there is millions of dollars that are lost to our state as a result of revenue and that there is no system of checking where that alcohol is being delivered to, who it is being delivered to. Is it a, you know, college town kid that is ordering it for the party that is for that weekend? We don't know. And we have really no way of effectively following that ability to do that. We need more

money, more resources. Unfortunately, much of that is used on these lawsuits.

Mr. COBLE. Thank you, Chairman Samona.

Ms. SAMONA. Thank you.

Mr. COBLE. Ms. Erickson, some states are control states, as we all know, that as the alcohol is dispensed through state-administered or state-owned stores. Other states, conversely, allow private parties to sell alcohol.

Have you ever conducted or have you ever seen a study that showed the correlation between the level of state involvement in the sale of alcohol and the level of alcoholism in a particular state?

Ms. ERICKSON. Mr. Chairman—Mr. Coble—I believe that there are studies that show that generally consumption and problems are fewer in control states, and the level of problems in any given state is a very, very complicated formula. There are so many things that impact it.

For example, the lowest drinking state in the Nation is Utah. Clearly the Mormon Church has a great influence over the drinking patterns in that state. Weather seems to have something to do with it because drinking tends to be higher in northern states.

We don't know a lot about exactly what makes one state's drinking patterns a lot different, but I have seen some studies that generally say that problems are somewhat less and that drinking patterns are somewhat less in control states.

Mr. COBLE. Mr. Hindy, did you say when you opened your brewery you had 14 employees?

Mr. HINDY. No. When I opened my brewery I had three employees——

Mr. COBLE. I thought——

Mr. HINDY [continuing]. At the end of this year I will have 60 employees.

Mr. COBLE. Okay, 60.

Mr. HINDY. Yes.

Mr. COBLE. Well, that is encouraging, given the harsh climate that plagues us today. In your view, Mr. Hindy, should states be free to discriminate in favor of their own state's breweries?

Mr. HINDY. No, I don't think so. In New York State I distributed my own product at the beginning of the company. Any brewer has that same right in New York State, so that exception to three-tier is legal and appropriate and it has not been challenged.

Mr. COBLE. I got you.

Finally, Mr. Ho, you state that—you may have already addressed this previously—but you state that Congress has the power to regulation interstate commerce and put to rest some of the legal challenges that have been directed at state alcohol regulation. As a state litigator, what tools, if any, do you need from Congress to successfully litigate the cases that come before you?

Mr. HO. Well, I am pleased to say that the main case we are litigating right now we have won, so far. But having said that, it is burdensome, obviously, to have to go through this litigation process.

Congress could pass legislation, if that is what you are asking me, kind of modeled on previous enactments. Just a few years ago my understanding is Congress passed legislation in the hunting

and fishing area where a court of appeals had struck down some state regulations in that area, Congress disagreed with that Ninth Circuit ruling and decided to essentially stop that kind of litigation from taking place.

That is the kind of legislation that, if Congress wanted to, it could easily pass in this area so that states wouldn't have to deal with the burdens of this kind of litigation.

Mr. COBLE. Professor Bush, you want to add anything to that? Don't want to snub you; I want to examine you as well.

Mr. BUSH. It is okay if you snub me, sir. There are a couple of things that I think I want to separate out. When we are talking about regulation of alcohol there are some pretty basic principles of regulation that are typically followed and the Federal Government has followed when it has regulation industries, and one of those principles has been one of open access and nondiscrimination so that people further up the bottleneck can actually get their products to market. That a pretty standard principle in regulation.

And to the extent that states have sort of followed those principles of regulation, have actively regulated alcohol beverages and have followed those regulatory principles, I think they have been relatively safe. Where the states run into trouble, I think, is where they sort of don't follow those tenets and act more protectionist, and I am not quite sure that is a good tenet of regulation.

Mr. COBLE. Thank you.

Thank you all.

I yield back, Mr. Chairman.

Mr. JOHNSON. Thank you, Mr. Coble.

Next we will have questioning from Mr. Quigley?

Mr. QUIGLEY. Thank you, Mr. Chairman.

The earlier panel mentioned that I am from Chicago and its unique history on such things. I will tell you, though, that the only hearing previous to this one in which we have talked about regulating alcohol was in Chicago, and the question was whether or not we should have more 4 o'clock liquor licenses.

Most bars are forced to close at 2 o'clock, so the issue was, should more bars be allowed open later? It gets to many of these issues. And the first person who testified really put it in the right perspective. He said, if you don't know how to get drunk by 2 o'clock you don't know what you are doing. [Laughter.]

It gets to the same point, though, Ms. Erickson, when it came to consumption and cost, and the price that something costs.

Now, we did do smoking bans there, and we were told that numerous studies show that beyond good parenting the number one deterrent to kids smoking was cost. Can you point to anything that would help—or if not now, later, as it—how this could be—the cost issue could be more pointed as it relates to kids? Granted, obviously, they are not getting them—they are not going in, for the most part, and buying; they are getting it from other people. But does it still have that impact?

Ms. ERICKSON. Representative Quigley, the same thing is true for alcohol. Professor Alex Wagner, from the University of Florida College of Medicine complete a review of over 100 studies of the relationship of price to consumption and came out with a very strong statement that says, when the price goes up people drink less. And

it is true for all categories of drinkers: heavy drinkers, moderate drinkers, very definitely for underage drinkers.

Price is probably the most powerful driver of consumption, and there is a—research is very clear about the connection between high consumption and alcohol problems. So the same thing is true for alcohol.

Mr. QUIGLEY. Very good. Thank you.

Mr. JOHNSON. Okay. Next we will have Mr. Lamar Smith.

Mr. SMITH. Thank you, Mr. Chairman.

First of all, it is nice to have a friend from Texas here on the panel, and Mr. Ho, let me direct my first question to you. In regard to the *Granholm* decision, that created a lot more litigation than it was expected to, and what was our experience in Texas as a result of that decision? Has it increased litigation, reduced litigation, and what has been the aftermath?

Mr. HO. We are definitely seeing an increase in litigation after *Granholm*, not just in Texas but across the country, and that is for the simple reason that different litigants and different courts and different states are trying to figure out exactly how to interpret the *Granholm* decision.

We just had a case recently—so far we have won in the Fifth Circuit—where we were able to make clear to the court that *Granholm* talks about producers and restricts state authority with regard to producers, but it also holds that states have a lot more authority with respect to distribution.

Mr. SMITH. Okay. Thank you, Mr. Ho.

Ms. Samona, I know you went into it in your testimony a little bit, but tell us a little bit in greater detail some of the advantages of the three-tier system, both in regard to protecting those underage, to health, to safety, to quality of liquor itself, and so forth.

Ms. SAMONA. Thank you for the opportunity. Yes, some of the main things that we look at and that we think we believe we have to control the plenary power that was given to us by the legislature when we created our—the Michigan liquor control system is that ability to bring in the product, to make sure that that product is a safe product that can be brought in and we can track it, where it came from, who it came through, where it can go to; the ability to collect revenue on it is fundamental for our state and for all states——

Mr. SMITH. So it helps states collect revenue and increases their revenue to them, right?

Ms. SAMONA. Sure. That is one factor of it. But we never lose the health, safety, and welfare aspect of it, and that is fundamental to that, is that we make sure that the licensees that exist in the state of Michigan are responsible, they understand that overconsumption, serving to minors are things that are critical to what we do as an agency and it hurts the entire, you know, industry by having licensees like that.

We have that ability and that power to bring those licensees in, to suspend them for a few days if we need to, to take away the license, to go onsite and visit their premises to make sure, to have decoy operations that go in, either through us or that local governmental police unit, to make sure that they are not selling to minors, that they are conforming with the laws that exist in the state

of Michigan and the rules of the Michigan Liquor Control Commission. And they understand, and we have hearings on a weekly basis for those that don't comply, that they have to come in, and understand that there is consequences.

If I can just piggyback one moment on the specific case that Mr. Ho spoke of, we were sued—Michigan—for that, under the same premise, and that is the Siesta Village case in 2008, and that is what we speak about, is that we lost that case. Same argument, same principle, things Mr. Ho in Texas, the Fifth Circuit, they ruled in favor of the state. The Second Circuit, New York, ruled in favor of the state. So it is the incontinuity of this interpretation that courts have of these laws that exist that we are asking for a more fair, balanced way of approaching that and making it clearer.

Mr. SMITH. Great. Thank you.

Ms. SAMONA. Thank you.

Mr. SMITH. Ms. Erickson, I was here for the earlier panel, and if you were you heard one of our witnesses say that we really shouldn't look to the Untied Kingdom for any lessons. And I think—whether you said apples and oranges or apples and lemons, I am not sure, but the idea was that it wasn't a valid comparison.

I just wanted to know whether you agree with that or not and if you thought there were lessons that we should learn from Great Britain's deregulation of alcohol, what are they?

Ms. ERICKSON. Thank you, Representative Smith.

Actually, I think he has got a point, and that point is that it is not a fair comparison because of the fact that we currently have a comprehensive regulatory system and the United Kingdom no longer does. So it seems unlikely that we will experience the same problems that the United Kingdom has unless we deregulate in the way that they do.

So, you know, it is a way to compare lemons and oranges in a way that gives us, I think, a good lesson.

Mr. SMITH. Okay. Thank you.

Thank you, Mr. Chairman.

Mr. JOHNSON. Thank you, Mr. Chairman.

Now we will recognize Representative Sheila Jackson Lee.

Ms. JACKSON LEE. Mr. Chairman, thank you very much. I think the work of this Committee is a very important element of fixing and improving the laws of this Nation, but I also like the fact that you have presented to us a balanced perspective on some of the concerns dealing with this question and this industry.

First of all, I would like to put on the record the obvious, which is that all of us—and I guess that is what Ms. Erickson is trying to emphasize—have concern about public health and safety. I was listening to a news report this morning where they were—I think the U.S. News Report was listing the top safe cities for teenage driving. Interestingly enough, we can all be happy that D.C. was the number one. And with all this powerful drinking and competition here, I am glad that D.C. allows us to walk the streets and not be run over by teenagers, so we are grateful for that.

But we don't want to play into ignoring the power of alcohol, no matter what level it is, and I want to get that on the record, that I believe that regulation has its place. And I also believe that competition has its place.

So with that in mind, Ms. Erickson, I am not going to demonize what is happening in Britain. I feel for them and hope that they will rally around their own physical and health issues that need to be addressed.

But, Professor Bush, I am going to pose a question to you and Mr. Ho, who I understand is here on his own reconnaissance and not been released by the state to represent them. But, Professor Bush, how do I strike that balance of the question of state regulation where states would subject outside companies to their regulations, which may pose a sense of unfairness, to the question of the value of state regulation and to the—juxtaposed to the value of competition? How do we strike that balance?

Mr. BUSH. Well, that is an excellent question, and the—there are principles of regulation that the states could and should adopt that could strike that balance well. For example, when—I will confess that I get wine shipments from outside the state—I am forced to sign that I am over 21 and the UPS driver asks for my ID when I sign for these wine shipments, and there is, at least from that aspect of distribution, you know, some degree of detection of whether I am a minor or not.

The problem I have is, is the purpose of the restraint to protect in-state interests, private interests in terms of creating some monopoly power or is it, in fact, some sort of seeking of restraint so that we have temperance? When I was traveling through Utah for the first time, a state that is very clearly not liquor-oriented, I was marking on a NPR story about how teenagers were consuming Nyquil as a substitution away from liquor, which they could not get. Probably not the most exciting parties.

But the notion here is that there is substitution and you have to, when you look at these sort of temperance issues, what effects on temperance do cartel-type behaviors or collusion-type behaviors have on those? Prices go up, and that may generally decrease consumption of alcohol, but is there substitution away to other products, perhaps more dangerous products?

Those are the kinds of things I would be interested in knowing more about. But——

Ms. JACKSON LEE. So you could see us striking a balance to respecting the state's regulatory scheme and also keeping the opportunity for competition?

Mr. BUSH. Yes. From my perspective there is already a provision for doing that, called the State Action Doctrine. So long as the states actively regulate and they have a clearly articulated state policy, from an antitrust perspective there is no attack.

Now, if we go the route of advocating some sort of statutory immunity from the antitrust laws the question becomes, where does that lead us? And courts have demonstrated time and time again with respect to other express immunities that it leads us to someplace that Congress didn't intend.

Ms. JACKSON LEE. Mr. Ho, let me ask you—and I got my voice in to you before the light, if the Chairman would indulge—you were the victor of a decision out of the state of Texas, but tell us how you—and I guess it is somewhat challenging because your work role is to speak the voice of the state, so I will just hope that you can balance it, but how do you strike this Supreme Court deci-

sion of *Granholm* and its holding and what it did not hold, and how you can balance what is a reasonable request, which is that there be a free flow of commerce?

For example, we have wine country in Texas. I am excited about it. I would be happy for their wine to be sold elsewhere.

So let me yield to you, Mr. Ho, and welcome. It is a delight to see you.

Mr. HO. Thank you.

Let me first hasten to add that the litigation we are talking about we have won so far, but it remains pending in higher courts, so that is still an ongoing matter——

Ms. JACKSON LEE. And forgive me—higher Federal courts, or you are in the—where are you in the jurisdiction?

Mr. HO. We won a three to zero opinion in the Fifth Circuit——

Ms. JACKSON LEE. Fifth Circuit. Thank you.

Mr. HO [continuing]. That is now going to the en banc court.

Ms. JACKSON LEE. Right.

Mr. HO. The plaintiffs have filed with an en banc. We will see what happens there.

You have asked me how we might strike the balance between state authority and other values. If I may, I would defer to, frankly, the policymakers here and in Austin and in state capitals as to how we should strike that policy. But what I do want to say, though, is——

Ms. JACKSON LEE. I appreciate that.

Mr. HO [continuing]. It is as important to ask who should strike that balance as it is to ask how that balance should be struck. Should state legislatures and Congress strike that balance or should courts be in the business of striking that balance? Right now it is essentially a mix.

I mean, state legislatures obviously are passing laws—have laws on the books—but Federal courts are—in different settings—I think Ms. Samona very well mentioned that different courts are coming to different conclusions, and it is really confusing and costly in terms of a litigation burden on states and on industry. If somebody else were to strike the balance and to take that issue out of the courts that might provide some clarity to the entire industry.

Ms. JACKSON LEE. Well, I will just finish by saying, you just—that is the hook that I am going to hold on to: clarity. And I think we need to be deliberative in how we assess that clarity, because in addition to the Congress acting we have juxtaposed against state legislatures acting. The one thing we don't want to do is to kill what, in a reasoned manner of use, is the right of the American people to consume, and we don't want to do that, we don't want to kill business.

So I thank you and I thank the Chairman for his indulgence. And I thank you for giving us the real question, which is how do we strike a balance but how do we get clarity?

And I yield back.

Mr. JOHNSON. Thank you.

Next, we will have questions from Congressman Bob Goodlatte.

Mr. GOODLATTE. Well, thank you, Mr. Chairman. I thank you for holding this hearing.

And I would like to direct this first question to Professor Bush and Mr. Ho. If anybody else wants to join in that is fine. And it follows up on the comments of Mr. Smith.

Lawsuits have been brought challenging state alcohol beverage regulation. How successful have these suits been and how big an impact are they having on the states' ability to regulate alcohol?

Professor Bush?

Mr. BUSH. I will disclose that I am going to stay safely on the side as being an antitrust expert, so I will address the antitrust cases and let Mr. Ho discuss the rest. The antitrust cases that have been brought against the states have been quite limited in success.

And as I described in my written testimony and my oral opening statement, it is quite limited to where the states have not actively supervised state regulation. For example, the post and hold system pretty much delegates the authority over pricing to private actors in the market with a rubber stamp at the—coming at the end from the state. In those instances, in any sort of price restraint that is delegated to private actors, the states have not fared well. But that is a very small, limited number of antitrust cases, and in most instances the blanket of the State Action Doctrine protects the bulk of state regulation.

Mr. GOODLATTE. Mr. Ho?

Mr. HO. Thank you for the question. I think the record of litigation has, frankly, been mixed. Different states are fighting different issues with litigants, and so different issues result in different results, even on the same issue.

As my colleague just mentioned, on the very same issues different states are getting different results from different courts on precisely the same issue, and that is, frankly, a big part of the burden that we are seeing and the clarity that we were talking about earlier—the importance of that clarity.

There is no question, to answer your question about burden on states, we would—I am not here to testify on particular legislation, but if you are asking me the effect of this area, we would love, obviously, to free up our resources elsewhere and not have to defend these suits.

I had the honor of serving on Capitol Hill some time ago. I am familiar—just to use an example, I am familiar with the fact that each and every Member of Congress has a wide area of responsibility and jurisdiction, and you are only given certain limited resources, limited staff.

Imagine if you were told, "You have to designate one of your staff persons exclusively to doing nothing else other than to just defend your right to hold your seat." Would that be a burden on your office? I think it would be. And that is sort of analogous to the burden that we are dealing with. We are having to devote resources just to defend the right to enforce these laws.

Mr. GOODLATTE. Anyone else want to say anything?

Ms. SAMONA. If I could?

Mr. GOODLATTE. Ms. Samona?

Ms. SAMONA. Thank you very much.

As a state regulator, the chair of the Michigan Liquor Control Commission, I think that the issue that you touched upon is the critical issue that we are dealing with here, Congressman, is that,

for example, the lawsuit that Mr. Ho just spoke of, the same issue or the same lawsuit—in the state of Michigan that is the Siesta Village case that followed *Granholm*—the court ruled against us. In Texas, the court ruled in favor of Texas. In New York, the court ruled in favor of New York.

The same arguments on all three cases and you have got a difference in mix. And now the New York ruling seems like it is going to be challenged, so who knows what is going to come up with that? The fact is that, you know, there are a lot of holes that need to be filled in, and I think Congress is the right person or group set to do that.

You know, Professor Bush talks about this protectionism argument and that if you have—you know, if your protection—you know, the State Action Doctrine says if you protect or you give the ability of, you know, independent businesses to operate then that is where you lose. Well, that is clearly not the case in the *Heald*—in the Siesta Village case, where it is the same argument in three different courts—three different states, three different courts, different rules.

Mr. GOODLATTE. I have to cut you off because I have got more questions——

Ms. SAMONA. Thank you.

Mr. JOHNSON. Mr. Goodlatte, may I ask you to yield the floor on that point?

Mr. GOODLATTE. Sure.

Mr. JOHNSON. If one state regulates its alcohol distribution what does it care if it is not in a different—if it is in a different circuit from—a different circuit court ruling, what does that matter to the other state? What does that matter to you, being that the law does not apply to you as rendered by that other circuit?

Ms. SAMONA. Well, because what the state—what the court told Michigan is that, "What you are doing is inappropriate and you can't do it anymore." What the court in Texas told Texas is, "What you are doing," which was the same thing as Michigan, "you can do. Continue to do it." And so now you have got differences of how do you apply this? It is all the 21st Amendment. It is all alcohol we are regulating. How——

Mr. JOHNSON. Well, then it goes on up to the U.S. Supreme Court from there.

Ms. SAMONA. It could, yes, if it continues in that direction. The problem is, we as a state suffer millions of dollars that we have to give away for these lawsuits to continue. And as a result, you know, we are burdened with that, and at a time when economy is hurting everybody you just don't have that person power to be able to defend those lawsuits and still continue to operate business and protect the health, safety, and welfare of your citizens.

Mr. JOHNSON. Okay.

I will yield back, Mr. Goodlatte.

Mr. GOODLATTE. Thank you, Mr. Chairman.

To follow up on that—and I will ask this to Mr. Ho and Ms. Samona or Mr. Bush—Professor Bush, you want to—you indicated, Mr. Ho, in your testimony that the Congress can amend the dormant Commerce Clause. Can you give us any examples of the Congress having done this in recent times?

Mr. HO. Certainly. I think it was just a few years ago that Congress reacted to a Ninth Circuit decision—I think it was the Ninth Circuit—that dealt with striking down a state regulation of hunting and fishing. It was Congress' judgment at that time that that decision was incorrect, that states should have those regulatory powers, and I believe Congress passed legislation to authorize those state laws.

Congress has done this in any number of other industries—insurance, banking, various other industries where it wanted to preserve state authorities, state regulatory power, and the courts have consistently upheld and enforced those Federal statutes.

Mr. GOODLATTE. So if the Congress wanted to exempt the beer, wine, and spirits from the dormant Commerce Clause and Federal antitrust laws we could do that?

Mr. HO. Certainly.

Mr. GOODLATTE. What would be the disadvantages of doing that?

Mr. HO. I think there would be policy arguments back and forth that I would respectfully refer to the policymakers on, but there is no question that Congress has that power. Frankly, Congress exercised that power already when it ratified or proposed the 21st Amendment and passed other laws before and after that.

The question is, what do those laws mean in specific areas? Courts have struggled to interpret those very few words that Congress has sent so far, and so I think the question before the body is, do you want to send some more instructions so that courts know what Congress wants and will simply follow that in a very clear way?

Mr. GOODLATTE. Professor Bush, you want to comment on that?

Mr. BUSH. Yes. First of all, I just want to point out, there is a great risk when you enact any sort of statutory immunity from the antitrust laws. I mean, keep in mind that the antitrust laws are magna carta free enterprise, as the Supreme Court has said.

And the risk is, you have to weigh the benefits of the immunity with the potential costs. And in this instance an antitrust immunity carves out one particularly really small area of state regulation from what is already protected from the State Action Doctrine.

In the history of statutory immunities rarely has the immunity actually just been limited to what Congress intended; there is usually some unintended consequences. When you are dealing with the—in the realm of state regulation and protecting state regulation through the statutory immunity there may be external effects outside the state from imposition of a statutory immunity which protects state regulation that has, potentially, effect on interstate commerce.

Market conditions often change, and in the context of changing market conditions the statutory community may give way, may no longer be valid, and the statutory immunity may never actually go away because they rarely have any sort of limiting time restraint on them.

I should also point out that when we are contemplating the risks of litigation here keep in mind that when you pass Federal legislation involving state regulation of alcohol that will also open doors for potential lawsuits. We all know of examples where legislation, either contemplated or enacted, has immediately been challenged

in courts, and I would expect that the states would have to fact that kind of litigation challenge as well.

Mr. GOODLATTE. Yes, Mr. Hindy?

Mr. HINDY. Congressman, also if——

Mr. GOODLATTE. You might want to hit your microphone. I don't——

Mr. HINDY. Okay. If states were exempted from the Commerce Clause, I think it would open the door for every state having different rules for labeling, for formulation of beers, for licensing, for marketing of beer. It would be prohibitive for most brewers to ship anywhere but in their home state. It would be disastrously expensive for all brewers.

And also, imagine——

Mr. GOODLATTE. Let me—I am not sure I quite understand that. Doesn't the 21st Amendment to the Constitution give the states that authority when it comes to alcohol anyway?

Mr. HINDY. Yes, but right now they tend to observe the general guidelines of the TTB. In other words, labeling is approved by state governments, but the—most of what we have to put on a beer label is determined by the Federal Government, and it is uniform across the country: the warning—the government warning, you know, the place where the product is brewed, et cetera.

New York State recently tried to require a specific label for the state because distributors were concerned about people shipping empties into the state from other states and getting a deposit. That would have been incredibly expensive for small brewers to do, and large brewers as well.

I think the Federal oversight of our industry means there is a level of safety and a level of licensing that is uniform across the 50 states, and ceding that to every state I think would be chaotic.

Mr. GOODLATTE. I think the Chairman is indicating that my time is expired.

Mr. JOHNSON. Well, you can reserve the balance if you would like.

Next we will hear from Mr. Darrell Issa, a congressman from California.

Mr. ISSA. Thank you, Mr. Chairman. And since the wine industry isn't represented here I might mention that Temecula wine country is in my district, and so I come with 30 years of business experience and 10 years of representing wine producers who there, but for the ability to ship wine around the country, would probably—the small wineries would have no business.

So I find myself in an odd situation of caring about this issue, wanted to ensure that underage drinking is not promoted nor any of the other unintended causes of repealing prohibition, or for that matter I don't want to get back to the unintended causes of prohibition. So I am going to sort of jump around here.

But, Mr. Hindy, you are a beer equivalent of my wine constituents, and this is a Committee that looks at the Constitution in every aspect, every direction, not just the 21st Amendment. Is it your belief that you have a reasonable right to sell anywhere in the world, as a manufacturer of product, unless otherwise restrained by Federal law?

Mr. HINDY. Yes.

Mr. ISSA. And, Mr. Ho, would you say that if there was a Texas brewery that you would have an expectation that that brewery should be able to ship its products to the four corners of the earth as a promotion of commerce intended by the Constitution?

Mr. HO. I think as an employee of the Texas attorney general's office I would say that any business should have the right to engage in their business consistent with the laws of the jurisdiction they are selling to.

Mr. ISSA. That wasn't the question, Mr. Ho. Should Dell be able to sell their computers manufactured in Austin everywhere in the world and export them without any unreasonable restraint or prejudiced treatment because they simply come from Texas, and we don't like Texans in California? That is what I am asking.

Mr. HO. I understand and appreciate the spirit of the question very——

Mr. ISSA. That is why as an individual—you were here as an individual—I wanted your individual interpretation, on behalf of Dell. [Laughter.]

Mr. HO. As a constitutional matter—and I can speak personally as a constitutional lawyer—there is a huge difference between computers and, frankly, every other product—huge difference from that and alcohol, because alcohol does have this very unique——

Mr. ISSA. Yes, but that wasn't the question. The rest of the world does not regulate alcohol the way we do. The exporting of alcohol to many of the four corners of the earth is exactly the same as Dell computers. As a matter of fact, Dell computers may be more restricted in some countries, like China.

So back to the same question: Do you see, on behalf of Dell, any problem with their having a reasonable right to enjoy the same opportunities anywhere they choose to sell their product in the four corners of the earth against domestic interests of that state or that Nation?

Mr. HO. I don't mean to frustrate you, sir. I speak primarily in a legal capacity; I am a lawyer. If the people of the United States, for that matter, want to repeal the 21st Amendment that is entirely, entirely within the right of this Congress and, obviously, through the state——

Mr. ISSA. Okay. I will take that as I am not going to get a square on behalf of Dell, and when you go home to Austin, good luck.

Ms. Samona, maybe I can get a better answer from you. Automobiles are highly regulated around the world. Do you think, within reason, if I want to make a General Motors car and ship it to Great Britain, that as long as I comply equally in Great Britain with what Great Britain companies do I should have reasonable access, notwithstanding trade barriers that are artificially imposed, but generally, do you believe that Michigan companies should have that right?

Ms. SAMONA. I think within reason yes, they should.

Mr. ISSA. Okay. So can we all ask one question and get a fairly quick yes or no? Ultimately, the 21st Amendment was a bargain to repeal prohibition but to grant to the states the right to protect individuals from harm from alcohol. Is that—could I just get yeses from everyone and a no from someone that just disagrees with the intent of the 21st Amendment?

Ms. SAMONA. That was one of its intents, yes.

Mr. ISSA. Well, they allowed states to stay dry if they wanted, but nowhere in the 21st Amendment was there any language that intended individuals—or individual states to be able to truly violate the Commerce Clause other than that which was for protection—uniform protection of their people. Maybe some of the more professorial folks could help me.

Mr. BUSH. Actually, one of the shipments of wine I get is from Mount Palomar in your district. Yes, it——

Mr. ISSA. And thank you.

Mr. BUSH. There is an issue here of—there is a tension in the Constitution between the 21st—the Commerce Clause, of course, and I agree with you that the purpose is for the health, safety, and welfare of the 21st, of citizens of the state.

And I certainly do not take—ask states for regulating alcohol, per se. I have issues when they regulate alcohol in a way that is not consistent with—where they allow some degree of competition but in a discriminatory manner or where they totally delegate their authority to private actors.

Mr. ISSA. Right.

We certainly could pass a law and let the men and women across the street decide whether we are within our authority of reconciling various constitutional clauses. But wouldn't it, Mr. Bush, be—Professor Bush—be reasonable to think that we here on the dais may want to make it clear that states can protect individuals—meaning the retail, distribution, and so on—while in fact interstate clauses should be just as supported? As long as they comply with whatever in-state people do, out-of-state people should have the same opportunity, and is there any reason to believe that we shouldn't consider defining that if the courts will not?

And that means there will be no more questions, only answers to anyone that wants to answer that question.

Ms. SAMONA. I would like to answer that. I think the 21st Amendment, with all due respect, Congressman, trumps the Commerce Clause. The Commerce Clause—21st Amendment gives the rights of those states to be able to regulate alcohol in a way that those states feel is safe and appropriate so they can bring it——

Mr. ISSA. That wasn't the question for Professor Bush. The question had to do with out-of-state entities being allowed, so long as they complied as in-state entities did.

Ms. SAMONA. And that takes me to the next thing: Commerce Clause allows you to bring commerce, or goods, back from one state to the other as long as that doesn't harm that state's laws, rules, and/or existing health, safety and welfare issues. So those are two separate issues, yet they work together.

However, the Commerce Clause does not trump the 21st Amendment, and unfortunately we are getting court rulings that say exactly that——

Mr. ISSA. Okay, Professor Bush, you get the last word because I truly am out of time, about whether or not protectionism among the states was justified in the 21st Amendment.

Mr. BUSH. Protectionism—I define——

Mr. ISSA. That is what you call it when you let people in state have an advantage over people out of state. We call it protec-

tionism when it is us versus another country. It is protectionism if this 21st Amendment allows that as to a product that we are discussing here today.

Mr. BUSH. I think that that is not the purpose of the 21st Amendment. And I think the problem that the states are getting in trouble with is engaging in that kind of activity, which may or may not have a derivative benefit of temperance. But the fact of the matter is, we are an increasingly interstate economy, and these state regulations have an interstate effect. And therefore, we have to be careful about those kinds of interstate spillovers and the effect on other states' economies from those type of price restraints.

Mr. ISSA. Thank you so much, Mr. Chairman, for your indulgence. I yield back.

Mr. JOHNSON. Thank you, sir.

I appreciate the testimony from the witnesses today. Without objection Members will have 5 legislative days to submit any additional written questions, which we will forward to the witnesses and ask that you answer as promptly as you can to be made part of the record. Without objection the record will remain open for 5 legislative days for the submission of any other materials.

Today's hearing raised a number of important issues. Moving forward we must ask ourselves whether state regulation of alcohol has been clarified or undermined through recent dormant Commerce Clause and antitrust litigation. Robust state regulation of alcohol is important for the public good, but so, too, are the antitrust laws in the United States Constitution.

And with that, this hearing of the Subcommittee on Courts and Competition Policy is adjourned.

[Whereupon, at 4 p.m., the Subcommittee was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

Statement of Ranking Member Howard Coble
Subcommittee on Courts and Competition Policy
Hearing on "Legal Issues Concerning State Alcohol Regulation"
March 18, 2010

Mr. Chairman, thank you for calling this hearing of the Courts and Competition Policy Subcommittee.

We have two full panels of witnesses, so I will be brief.

Today's hearing is on legal challenges to state alcohol regulation.

Let me be clear, I am a fan of state regulation in this area. States are generally in the best position to determine the most effective regulation for their citizens.

I am also a fan of the three-tiered system because I think that it provides an efficient means to maintain

quality controls on alcohol and helps to ensure that alcohol is sold only to adults.

These are important and laudable goals and anything that Congress does in this arena should be done with an eye to ensuring that we are keeping our constituents safe.

That said, I am a strong believer in competition and giving consumers more choices. Fortunately, in the last few decades, we have seen a proliferation of small wineries and breweries. These new players have helped expand Americans palates.

I have heard from some of my friends in the producer industry that they support alcohol regulation, particularly regulations that promote quality and safety.

However, they have expressed concerns that some state alcohol laws serve not to protect consumers, but rather to protect the business interests of instate producers, wholesalers, and retailers at the expense of competition from out of state vendors.

Others, who are small producers of beer and wine depend on the ability to market their products directly to consumers throughout the country. While many have become regional economic engines, their views should not be overlooked because they impact a small percentage of the entire industry.

December 25, 2008, marked the 75th anniversary of 21st Amendment and since that time the states have taken their responsibility to regulate alcohol very seriously and should be recognized for this.

I expect our distinguished panel will highlight instances within the three-tiered system that warrant our attention – as we begin to wade through these complicated issues, we should not diminish the 21st Amendment.

I am hopeful that our expert witnesses can shed some constructive light on the complicated legal and factual issues that surround state alcohol regulation.

With that, I yield back the balance of my time.

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Statement of Judiciary Committee Ranking Member Lamar Smith
Subcommittee on Courts and Competition Policy
Hearing on Legal Issues Concerning State Alcohol Regulation
March 18, 2010
(Final)

Mr. Chairman, America has a long and complicated history with alcohol. In 1794, President George Washington sent troops to Western Pennsylvania to quash the Whiskey Rebellion, which was sparked by opposition to the federal government's tax on alcohol to pay for the American Revolution.

Of course, America's most famous battle with alcohol was the Prohibition Era from 1920 to 1933, which began with the adoption of the Eighteenth Amendment in 1918.

While the ban on alcohol was well intentioned, in practice it led to flaunting of the laws, with many citizens patronizing speakeasies and consuming bathtub gin. Further, while Prohibition was meant to promote public safety, the proliferation of illegal alcohol distribution through organized criminal enterprises led to an increase in alcohol-related violence.

In 1933, Congress passed and the States ratified the Twenty-First Amendment, which repealed Prohibition. Section 2 of the Twenty-First Amendment sets forth the power of states to regulate alcohol, providing that "the 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."

The Twenty-First Amendment, in conjunction with the Wilson Act and the Webb-Kenyon Act, supplies the basis for state regulation of alcohol. The Wilson Act provides that alcoholic beverages transported into a state are subject to that state's laws "to the same extent and in the same manner as though such liquids or liquors had been produced in such State or Territory."

The Webb-Kenyon Act prohibits the transportation of alcoholic beverages into a state from outside the state if "received, possessed, sold, or in any manner used" in violation of the receiving state's laws.

In response to the Twenty-First Amendment, most states have enacted some form of the three-tiered system for alcohol distribution. This system separates alcohol producers, from alcohol wholesalers, from alcohol retailers.

The inclusion of wholesalers as middlemen in the transaction makes it easier for states to regulate alcohol. It makes it possible for states to ensure that alcohol is safe. It makes it simpler to ensure that alcohol is sold only to individuals over 21 years old. And it provides a straightforward alcohol tax collection system for states.

These are all laudable goals and for those reasons I am supportive of the three-tiered system.

Naturally, some alcohol producers and retailers are concerned about state liquor regulations that they perceive hurt their ability to compete in a particular state. Such concerns have led to a number of legal challenges to various states' laws on antitrust and Dormant Commerce Clause grounds.

This hearing gives us the opportunity to examine these current legal challenges to the post-Prohibition practices of state regulation of alcohol. In doing so, we are forced to reconcile the Twenty-First Amendment, federal statutes, state laws, and judicial doctrines.

These are complicated legal questions and not susceptible to quick solutions. However, I hope that this hearing will start to give Congress the information necessary to ensure that State regulation of alcohol remains robust. Those regulators are best positioned to determine that alcohol consumption in their states is safe and lawful.

I yield back the balance of my time.

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PATRICK C. LYNCH
Attorney General of Rhode Island

March 29, 2010

The Honorable Hank Johnson
Chairman, Subcommittee on Courts and Competition Policy
United States House Judiciary Committee

Via Electronic Mail

Dear Mr. Chairman:

We are writing to seek your help with the growing threat facing our states from unprecedented legal challenges that seek to eliminate our ability to regulate alcohol. As you know, the ratification of the 21st Amendment rejected a "one size fits all" system for the regulation of alcohol and set forth a framework that provided states with the right to decide the appropriate regulation of alcohol within their borders.

For over a decade, major retailers and other special interests have executed a systematic legal campaign to deregulate alcohol in favor of the very "one size fits all" structure that the 21st Amendment rejected. This deregulation would effectively destroy our states' ability to control the sale and distribution of intoxicating liquor. Alarmingly, legal challenges have been filed in over half of the states challenging their alcohol laws or regulations designed to encourage temperance, collect taxes and prohibit the sale of alcoholic beverages to minors. We are extremely concerned that alcohol deregulation will make it very difficult for our states to effectively protect the public interest and ensure the safest system of alcohol distribution in the world.

Legal challenges to state alcohol laws are mostly taking two forms, positive commerce clause challenges filed primarily under the Sherman anti-trust act, and dormant commerce clause cases. All too often the judges hearing these cases have misinterpreted federal law and the intention of Congress regarding the states' right to regulate.

Perhaps most disturbingly, a recent decision by a single trial judge has created a perilous atmosphere for states. This misguided judicial ruling forced the citizens of Washington State to pay COSTCO Corporation nearly $1,500,000 in legal fees, despite prevailing on seven of the nine counts that were challenged in the case. With states around the country experiencing massive budget shortfalls, we fear this precedent will have a chilling effect on states' ability and willingness to defend their alcohol laws. Further, we hope you will read the enclosed copy of "The Dangers of Alcohol Deregulation: The United Kingdom Experience." This report calls attention to the U.K.'s alcohol-related problems associated with deregulation, including an acute public health crisis relating to cirrhosis of the liver, massive underage consumption and an alarming increase in alcohol abuse by females. The report highlights a contrast with the United States and our time-tested system of state-based alcohol regulation.

We applaud you for calling a Congressional Hearing on this matter and hope that you will strongly support legislation that will bring to a stop the erosion of state alcohol laws by re-enforcing the states' ability to regulate alcohol as it sees fit.

We respectfully request that this letter be introduced into the record of the March 18, 2010 House Judiciary Committee hearing on "Legal Issues Concerning State Alcohol Regulation."

Sincerely,

Thurbert E. Baker
Attorney General of Georgia

Jon Bruning
Attorney General of Nebraska

Patrick C. Lynch
Attorney General of Rhode Island

Rob McKenna
Attorney General of Washington

Troy King
Attorney General of Alabama

Fepulea'i Arthur Ripley, Jr.
Attorney General of American Samoa

Terry Goddard
Attorney General of Arizona

Dustin McDaniel
Attorney General of Arkansas

John Suthers
Attorney General of Colorado

Richard Blumenthal
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March 17, 2010

The Honorable John Conyers
Chairman, House Committee on the Judiciary
2138 Rayburn House Office Building
Washington, D.C. 20515

Re: Legislation to Provide Antitrust Immunity for State Alcohol Regulations

Dear Chairman Conyers:

I am writing to support an antitrust exemption for state liquor laws which seek to regulate the purchase and sale of liquor in their particular states. Unfortunately, in the past several years, state liquor laws have faced a variety of antitrust challenges alleging that those laws improperly restrain trade in violation of the Sherman Act. I believe that this litigation is misguided and ultimately, if successful, will harm the efforts of individual states to appropriately regulate the sale of alcohol within their borders. As important, even if these efforts are not successful, they will impose significant costs on the states to defend their liquor laws. The purpose of the Twenty-first Amendment of the Constitution, and other federal statutes was to enable states to regulate the importation, transportation, and distribution of alcoholic beverages. The current threat of antitrust litigation significantly impairs the ability of states to engage in this wholly appropriate regulation. Finally, this litigation usurps the ability of the legislative process to express the public will in regulating alcohol.

My observations are based on my experience of over 25 years as an antitrust attorney with over 15 years as a trial attorney in the Antitrust Division of the Department of Justice and as the Policy Director of the Federal Trade Commission. It is also based on my experience as a Senior Fellow at the Center for American Progress and as a public interest attorney representing a wide variety of consumer groups.

The Need for Antitrust Exemptions

As this Committee knows, antitrust exemptions and immunities are not favored by antitrust enforcers. Sometimes antitrust exemptions can be used to create market power or prevent the forces of competition from working. Congress has appropriately sought to eliminate some of those exemptions where they have harmed competition.

On the other hand, Congress has recognized on numerous occasions that limited antitrust immunities can serve important social, political, or competition goals. The antitrust laws are not perfect, nor are they the supreme law of the land. Congress has recognized on several occasions the need to provide exceptions to the antitrust laws for a wide variety of reasons. Sometimes Congress has enacted exemptions when antitrust liability (or the threat of antitrust liability) has prevented conduct which would ultimately benefit consumers. An antitrust exemption that shields state alcohol regulations from challenge certainly meets that qualification. For example, Congress has acted on a number of occasions to protect the interests of rivals to engage in conduct that may permit procompetitive collaboration. Such exemptions include the National Cooperative Production Research Act, the Standards Development Organization Act, the Charitable Donation Antitrust Immunity Act and the Medical Resident Matching Program Act.

Congress has also acted to protect the ability of governmental entities to regulate. For example, in 1984 Congress enacted the Local Government Antitrust Act to free towns, cities and municipalities from antitrust liability for their efforts to regulate a wide variety of services.[1] As explained below, an antitrust exemption is necessary for similar reasons to protect state alcohol regulation.

How Alcohol Markets are Different

In this debate about the proper interaction of antitrust litigation and state alcohol regulation, it is crucial to recognize how the market for alcohol is unlike any other market. In most markets, society values unfettered competition, limitless entry, and expanded output in the belief that the consumer will benefit from the greatest output at the lowest prices. But alcohol is unlike any of the normal products for which a competitive market results in the greatest benefits for consumers. Rather, unfettered competition in alcohol markets can lead to overconsumption, greater alcoholism and its social consequences, underage drinking, and greater costs to society as a whole. That is why the normal platitudes about the importance of a free market must be treated with caution when evaluating efforts to limit alcohol regulation. The same is true for other potentially dangerous products like guns or tobacco.

This is why the federal government has imposed its own regulations on the alcohol market, addressing a limited set of issues while allowing the states to enact regulations that reflect their own population's opinions and attitudes towards alcohol. The Federal Alcohol Administration Act set in place regulations to protect consumers: for example, anyone who acts as a producer, importer or wholesaler of alcoholic beverages is required to hold a permit. Labeling and advertisement of alcoholic beverages is regulated, along with a variety of trade practices like commercial bribery or tied house arrangements.[2]

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[1] Congress developed the LGAA in response to what they believed to be misguided decisions by the Supreme Court which created antitrust damage exposure for local governmental entities.

2 Moreover, the federal government has recognized the need for a balanced approach to competition and public health when it comes to alcohol markets. For example, the public health agencies of the federal government such as the Centers for Disease Control have published many findings on the elasticity of price and alcohol and its effect on public health. States should not be punished under antitrust laws for trying to regulate in this area when even the federal government recognizes the correlation between pricing and alcohol consumption.

The Statutory Structure of Alcohol Regulation

As this Committee knows, Congress has expressly enacted legislation to permit the extensive state regulation of alcohol both through the passage of the Wilson and Webb-Kenyon Acts, the Twenty-first Amendment Enforcement Act, and the Twenty-first Amendment itself. The goal of alcohol regulation is to balance product availability with appropriate control in order to limit alcohol abuse, access to minors, and other types of conduct that are ultimately harmful to consumers and society as a whole. Section 2 of the Twenty-first Amendment constitutionalized state laws regulating the importation, transportation, and distribution of alcoholic beverages. The Wilson Act, which first permitted state regulation of alcohol, and the Sherman Act were both enacted in 1890. It seems unfathomable that the Congress which passed the Wilson Act just a month after passing the Sherman Act would have wanted the federal antitrust law to stifle state efforts to regulate the alcohol market.

Mistaken Court Decisions Open the Floodgates of Antitrust Litigation

Unfortunately, since the 5-4 Supreme Court decision in *Granholm v. Heald*, 544 U.S. 460 (2005), which held that the Twenty-first Amendment did not protect state liquor laws from dormant commerce clause challenges, there has been a flood of litigation against states attacking alcohol regulation on a variety of grounds including antitrust grounds. I believe in the last five years 27 states have faced 31 lawsuits challenging their state liquor laws, including on antitrust grounds. The most significant case was *Costco v. Maleng*, 522 F.3d 874 (9th Cir. 2008), litigation in which a district court invalidated almost every aspect of the Washington State statutes regulating alcohol. Fortunately, the Ninth Circuit Court of Appeals reversed the decision and upheld the vast majority of the statutes. Unfortunately, the Ninth Circuit held that these laws were indeed subject to antitrust challenge. Based on the Ninth Circuit's decision and other similar decisions we can expect -- absent action by Congress -- a flood of antitrust lawsuits against similar regulations. Ultimately, *Granholm* threatens to invalidate the Congressional and Constitutional grants of authority to regulate the alcohol industry.

Litigation is the Wrong Way to Address These Issues

It is important to recognize what is at stake through these antitrust attacks. Alcohol regulation is a critical public policy matter: alcohol abuse costs society in thousands of lives. As a critical public policy issue, the appropriate forum for resolution is the legislature, not the courts. Alcohol regulation is enacted by state legislatures after careful study, debate and deliberation. If the public believes that that alcohol regulation is incorrect, that there is too little or too much regulation, it can always go through the legislative process to seek to have it modified or reversed. Ultimately, alcohol regulation legislation reflects the will of the public.

Unfettered antitrust litigation usurps the will of the public by transferring these disputes over alcohol regulation to the courts. Private antitrust suits ultimately will frustrate that will of the public. Through private antitrust suits attacking these state statutes, important public policy issues will be decided not by state legislatures reflecting their constituents' desires after careful study and public debate, but by generalist federal courts in expensive litigation proceedings in which the public interest will not be adequately represented. As this Committee well knows,

antitrust ligation is very time consuming and costly. These are not proceedings in which the voice of the public interest can be adequately represented. Instead, these cases tend to revolve around complex economic issues and expensive expert witnesses. The will of the public obviously will not be heard.

The Committee should also consider the cost of litigating these cases. Because of this litigation, states will have to spend millions of dollars defending their statutes instead of spending those same resources in more worthy enforcement actions. Obviously we would prefer to have a state attorney general's office bringing criminal and civil enforcement actions to improve the compliance with the law rather than defending these actions.

On the other hand, plaintiffs have tremendous incentives to bring these cases. The plaintiffs are often large big box retailers which have substantial resources and have the potential of securing damages and attorneys' fees. Because of these incentives and resources, there is no limit to the number of cases that plaintiffs will bring trying to allegedly open up markets based on these novel claims. Although states may ultimately prevail in some cases, litigation is costly and ultimately will deter states from enacting regulations of this type. When states do not prevail, the public ultimately is harmed because we have a patchwork quilt of legal decisions upholding a state law in one court and striking down an identical state law in a different court, further encouraging greater litigation.

Finally, Congress should consider the impact of this litigation on potential new areas for litigation against other important public regulations. If antitrust suits against alcohol regulation are brought, we should expect these theories to transfer to attacks on other vital forms of regulations such as state regulation of guns or tobacco. Ultimately state efforts to regulate any of a number of dangerous products may be threatened by the failure to provide a sensible antitrust exemption.

As I noted before, in the past Congress has enacted antitrust exemptions to protect private parties from antitrust litigation where the ultimate goal of those private parties was in the public interest. Obviously legislation to protect state alcohol regulation, which reflects the will of the public, is even more worthy of enactment.

I appreciate your consideration of my views and look forward to providing the committee with any other information that it seeks.

Sincerely,

David A. Balto

CC: The Honorable Lamar Smith
The Honorable Hank Johnson
The Honorable Howard Coble

STATEMENT ON BEHALF OF COSTCO WHOLESALE CORPORATION
TO THE HOUSE JUDICIARY COMMITTEE
SUBCOMMITTEE ON COURTS AND COMPETITION POLICY

Costco was unable to appear at the Subcommittee's hearing on March 18 but hopes this statement of position is helpful. In general, no persuasive case can be made that federal constitutional and statutory limitations on state alcohol regulation regimes should be relaxed. If anything, the trend has been to reduce the scope of state immunities to federal oversight, and alcohol should not be an exception to this trend.

Costco Wholesale Corporation and its subsidiaries began operations in 1983 in Seattle, Washington. We operate membership warehouses based on the concept that offering our members low prices on a limited selection of nationally branded and selected private-label products in a wide range of merchandise categories will produce high sales volumes and rapid inventory turnover. This rapid inventory turnover, when combined with the operating efficiencies achieved by volume purchasing, efficient distribution and reduced handling of merchandise in no-frills, self-service warehouse facilities, enables us to operate profitably at significantly lower gross margins than traditional retailers.

BACKGROUND CONCERNING COSTCO'S FEDERAL CHALLENGES TO CERTAIN PROVISIONS OF WASHINGTON LAW CONCERNING BEER AND WINE DISTRIBUTION

As the Subcommittee is aware, Costco challenged in federal court certain Washington state beer and wine distribution laws, arguing that they were inconsistent with the federal Sherman Antitrust Act and with the Commerce Clause. Costco believed that these laws hurt Costco members and other consumers and did not benefit the State or its citizens.

The district court found that the negative effect of the challenged restraints on competition and interstate commerce was so obvious that no trial was even necessary on that point. 407 F. Supp. 2d 1234 & 1247 (W.D. Wash. 2005). The State did not even appeal the Commerce Clause finding, and the Washington legislature amended state laws to allow retailers to buy beer and wine directly from out-of-state

as well as in-state producers. As to the restraints challenged on antitrust grounds, the Ninth Circuit affirmed the district court's finding that almost all of the restraints, even those upheld on technical grounds discussed below, were anticompetitive and violated federal antitrust law. 514 F.3d 915 (9th Cir. 2008). We understand that at least one of the legislative proposals before you would protect many such restraints on competition.

The Washington Liquor Board and the distributors argued that the State had adopted the anticompetitive restraints to overcharge law-abiding and responsible Washingtonians with the hope of deterring abuse by the few unwilling to pay the overcharges. There was no evidence that the legislature ever adopted such a strange proposition, and the district court found the restraints did not have the effect of promoting temperance. The result is restraints that cause consumers to pay more not to the State but to private distributors. The Ninth Circuit affirmed the findings that the restraints did not serve a temperance or other purpose.

Even though they harmed competition and served no valid purpose, however, the Ninth Circuit found that once it had affirmed the invalidity of the post and hold restraints it was appropriate to look at each of the other restraints in isolation. The Court held that when viewed in isolation the other restraints were "unilateral" state actions that, wise or not, Washington was allowed to pursue regardless of the effect on the competitive interests in the Sherman Act.

In the wake of the Ninth Circuit's ruling, the Washington Legislature enacted conforming changes to the "post and hold" statute and at the same time changed the law to substantially dilute so called "tied house" provisions, which previously had prevented, among other things, distributors from owning retailers and vice versa. We believe that our experience shows that legislative and judicial processes (especially those invoking federal law), performing complementary roles, are critical to achieving an alcohol distribution scheme that is fair to consumers.

VIEWS THAT MAY BE RELEVANT TO CURRENT ISSUES BEFORE THE COMMITTEE

1. *The "Three Tier System."* Those who would seek to use this as a shorthand for a regime in which distributors must touch every bottle of beer and wine before it reaches a consumer are not fairly describing the status quo. This point has been made by other witnesses. For decades many states have allowed wineries and brewers to sell directly to retailers, bypassing distributors. Other witnesses have noted the substantial benefits in competition, innovation, and consumer choice enabled by this structure, and we are aware of no evidence suggesting the structure has harmed the public in any way. Similarly, especially in the wake of *Granholm v. Heald*, 544 U.S. 460 (2005), wineries have been free to sell directly to consumers in many jurisdictions, bypassing not only distributors but retailers. The three-tier system was a unique product of its time, the post-Prohibition environment, which has little resemblance to today's commercial environment. Whether the three-tier system should continue to have any legislative sanction because of changes over the last seventy years can be debated, but clearly there is no reason to seek to pretend that the citadel has not been overrun in the last thirty years.

2. *The Role of Distributors.* Costco has been successful by maximizing efficiencies in acquiring and distributing merchandise. This has often involved dealing directly with manufacturers - "cutting out the middleman" produces significant cost savings for our members. Because of historical anomalies, only alcohol distributors enjoy positions protected by statute. Unlike the rest of us who have to earn the trust and loyalty of our customers and suppliers day in and day out, alcohol distributors have in many contexts a captive audience, both in buying and selling. We recognize that alcohol distributors perform functions that are very useful for many; we reject the notion that unsubstantiated and self-serving alarms about public health should sustain legal protections from competition. In a competitive marketplace distributors will demonstrate the value they add and will have the place they can earn. Business combinations have greatly increased concentration in the field of distribution, making it even harder for retailers and producers to find

fully competitive markets for distribution. This makes more critical the need for maintaining exceptions to the "three tier" system and the protections for commerce and competition afforded by federal law.

3. *The Role of Federal Law.* Costco believes that the correct approach under federal antitrust law is to determine whether challenged state regulations could accomplish the identified state purposes without reducing competition. There is certainly no reason to consider expanding this exemption from federal antitrust law. As the Antitrust Modernization Commission found, exemptions should be unusual and narrow. http://govinfo.library.unt.edu/amc/report recommendation/toc.htm (chapter IV). Current law gives courts more than sufficient leeway to balance state interests that conflict with robust competition.

4. *The Supposed Benefits of Restricting Competition.* The fact that anticompetitive restraints raise prices to consumers is often cited as having the benefit of reducing consumption. The effect is actually uncertain, since price-sensitive consumers can easily find a cheaper brand of wine, beer, or spirits. But even were that the objective, it is difficult to understand why private companies (rather than the states) should be the beneficiaries of those higher prices.

We appreciate the Committee's attention to these issues.

House Judiciary Subcommittee on
Courts and Competition Policy
Hearing on State Alcohol Regulation and Legal Issues
March 18, 2010
Statement of Craig A. Purser

Thank you Mr. Chairman, ladies and gentlemen. My name is Craig Purser, and I am the President of the National Beer Wholesalers Association (NBWA), the trade association representing the interests of over 2,850 licensed, independent beer distributors across the country.

Since the repeal of Prohibition, America has followed a *social* model for alcohol control. While this model allows for competition, it puts the public interest ahead of economic interests. As you have probably seen in your hometown stores back in your districts, you can't walk through a beer aisle in a licensed retail account on a holiday weekend and not see intense, inter-brand competition. That competition occurs in a *regulated* market, composed of a wide variety of regulatory tools to ensure the public's interest is paramount.

In the United States, today's alcohol market was purposely designed to be different from other markets because lawmakers recognized that alcohol is different from other products. Understanding this historical perspective helps us understand the value of the modern American system of alcohol controls gives

states primary authority. State alcohol regulation is designed to level the playing field between market participants (suppliers, distributors and retailers) and ensure that no segment of the industry has undue influence over the other. Undue influence is part of the reason for the problems that led to Prohibition. Most importantly, today's state regulatory system works to balance the public's safety with the consumer's desire for choice and variety. In short, today's system balances regulation with competition.

The license model exists for beer regulation and has allowed states to create a three-tier system for alcohol sale and distribution. The system consists of three separate tiers: the supplier tier (including producers and importers); the distributor or wholesaler tier; and the retailer tier. This three-tier system works today to facilitate the goals of the repeal of Prohibition: the promotion of temperance; the effective collection of taxes; the end of the "tied house" system (whereby suppliers owned and operated saloons and other retail outlets); and the maintenance of an orderly market. I think you'll agree that these are all still relevant public policy goals today.

These three separate tiers operate independently yet in unison to provide transparency and accountability that benefit the public. The supplier tier

manufactures or imports the product. The wholesaler or distributor tier is responsible for the sale and safe delivery of the product to licensed retailers. This tier is regulated by the state as well as the federal government; distributors have a state license as well as a federal basic permit. The retail tier sells the product to consumers of legal drinking age. The alcohol retailer is licensed by the state and buys from only regulated, licensed distributors. This independent, three-tier system allows the consumer tremendous choice and variety and protects the public's interest in effective regulation.

The independent, three-tier system also provides a very successful regulatory model as all market participants receive value. Suppliers (producers and importers) are provided access to the American market, regardless of size. Under this state regulatory system the number of brewers in the U.S. has risen from fewer than 50 in 1979 to over 1,500 today. Today, there are 13,000 labels of beer available to consumers of legal drinking age. Distributors – including 95,000 American men and women - work with suppliers and retailers to build new brands and help get them established. While overall beer volume sales were down nearly 2 percent in 2009, the craft beer category was up 7 percent. Licensed retailers large and small are able to compete and provide tremendous value and selection for consumers interested in new products, brands and styles.

This state-based regulatory system provides for transparency and accountability when it comes to chain of custody of alcohol products and assuring appropriate taxes are paid. Revenue collection and alcohol control are essential to the states. The system also makes certain that the product's integrity is protected and makes sure that it's safe for consumers. If there were to be a problem, the product could be located and removed from the marketplace efficiently. This occurred in 2008 when there was a manufacturer-led recall of specific beer products that occurred with a minimum of market disruption as the brewer, distributors and retailers were able to work together and quickly track and remove the potentially-affected product from store shelves. This success story from the alcohol distribution system stands in strong contrast to other product recalls including peanut butter, spinach, nuts and ground beef.

Additionally, the American system of alcohol regulation stands in sharp contrast to alcohol regulatory systems in other parts of the world. You have heard today about the situation in the United Kingdom, where a lack of effective regulation has given rise to numerous societal problems. Additionally, other countries have serious problems with counterfeit or adulterated alcohol products and with abuse. In the U.S., the ability of licensed partners at the supplier, distributor and retailer levels to work together with regulators helps keep

adulterated and gray market goods off the shelves unlike other areas of commerce.

Just because the U.S. has a regulatory system that works well for alcohol does not mean it can't be improved. Nor can we become complacent that a system that works well today won't be chipped away at slowly or by judicial fiat. Robust discussions occur each year in state legislatures about how the regulatory system can be improved. As marketplaces evolve, it is those state legislatures that are best able to facilitate these discussion and work to keep the playing field level between all of the competing interests with a keen eye on what is in the public's interest.

Challenges to state alcohol regulation are very real. To put this in perspective we should note, of the Fortune 50 companies in the US, 16 of them are alcohol retailers. This includes several so called "big box" stores, grocery chains and other companies. This growth is not necessarily a negative development but is worth noting as it relates to a very real issue: market power. Bigger market participants are able to apply economic pressure on producers and distributors that provide challenge to these increasingly global power retailers. This has many concerned as several large retail giants are flexing their muscle in

the marketplace and attempting to challenge existing state alcohol regulations. In the supermarket context, the Food Marketing Institute has noted "To earn a dollar, supermarkets would rather sell a $1 item 100 times, making a penny on each sale, than 10 times with a dime markup." Public policy has not thoroughly examined the concerns of this model in the sale of alcohol.

Another way these large scale retailers and some producers are seeking to drive their agenda is by deregulating alcohol through litigation. And their target with this litigation is to sue the states directly.

In recent years, over 25 states been sued by private interests challenging state liquor laws. Most of these challenges use two legal instruments in ways Congress did not intend for them to be used: the dormant Commerce Clause and the nation's antitrust laws. Both veins of litigation present challenge to the *public's* interest.

The dormant Commerce Clause was central to the claim by the plaintiffs in the 2005 *Granholm* case referenced earlier by Michigan Liquor Control Commission Chair Nida Simona. Michigan and many other states regulate different players in the alcohol industry differently. Today, existing litigation is about the *expansion* of the *Granholm* decision.

Two cases filed under the dormant Commerce Clause were in Indiana and Kentucky. Both of those states were sued over the state's basic right to require a face-to-face or in-person transaction in order to verify age and identity of the alcohol purchaser. The results of these cases are mixed putting into question whether states have the ability to effectively regulate alcohol at the point of purchase.

Another basic state regulation being challenged under the dormant Commerce Clause is the requirement that the retailer have a physical presence in the state. In Michigan, New York and Texas, out-of-state plaintiffs sued demanding that the states grant them retail licenses. State regulators have their hands full regulating the thousands of licensed retailers in their states. If the plaintiffs win in these cases, it will be virtually impossible for states to regulate and enforce the laws outside of their borders. Certainly if we look at the plain language of the 21st Amendment, a state must be able to decide who can receive a retail license and whether a retailer needs a physical presence. The result of these cases, again, was mixed with the 5th and 2nd Circuits upholding the states' position.

A recent decision by the 1st Circuit Court of Appeals challenges the idea of differential treatment for suppliers based on size in Massachusetts. The law that was struck down as a violation of the dormant Commerce Clause sought to differentiate small producers from large ones as it relates to the issue of self distribution. Numerous states have similar laws for smaller brewers or wineries which allow them to sell directly to consumers and/or self distribute based on size. This issue is central to continuing to provide a system that develops smaller brands and provides variety to consumers. Another case similar to this continues in the 9th Circuit providing a lack of certainty about a state's ability to develop smaller producers. Congress treats businesses differently on the basis of size on a whole host of laws (Small Business Act, Labor laws, etc.). Why can't the states do the same on alcohol?

When it comes to recent challenges to state alcohol laws under the Sherman Antitrust Act, the public's interest is challenged in a different way. As I mentioned, through state-based alcohol regulation, the U.S. has developed a social model for regulation. This model is built on an understanding that alcohol is different and that the lowest price and greatest availability to the consumer is not necessarily the lowest cost to society or the singular goal of regulation.

In an effort to balance the consumer's interest in competition and the public's interest in regulation, states have had a wide variety of regulatory tools at their disposal. But the state's tools are being challenged.

License restrictions, three-tier requirements and separation of the tier laws are primary state regulatory tools. Because of the universal understanding related to alcohol's unique attributes as an intoxicating beverage, price regulation is another tool that states have to balance competition with regulation. Price regulations include but are not limited to credit restrictions, minimum mark-ups, prohibitions on below cost sales and quantity discount limitations.

The 9th Circuit ruled in 2008 in the case *Costco v. Hoen* that many of these laws were legal under the Sherman Act including a prohibition on quantity discounts for alcohol. Last year, however, the 4th Circuit ruled that a prohibition on quantity discounts was prohibited under the Sherman Act. This puts circuits in conflict over whether a state can limit quantity discounts for alcohol. It is important to note that in both cases, the parties declined to appeal. In *Costco*, because the plaintiff was successful in challenging the narrow issue of "price post and hold" and unsuccessful on the seven other challenges, the retailer declared victory and asked and received attorneys fees from the state. Due to cost

concerns about the appeal of the fee issue, the state of Washington declined to appeal.

In the 4th Circuit case, the state of Maryland decided not to appeal the issue as the plaintiff offered to not collect attorney fees. Both cases are complete, but neither was appealed due to the issue of attorney fees liability by the state. Is it in the *public's interest* that alcohol policy decisions be based on whether or not a plaintiff's counsel is paid?

The spate of litigation is creating problems for the states and uncertainty for the industry. It is our recommendation that Congress review these threats to the American alcohol regulatory system and advance a legislative solution that addresses this ongoing litigation under the dormant Commerce Clause and the antitrust laws. Some may suggest that these problems can be addressed by protecting certain state core powers and limiting others. We would encourage Congress to be cautious in considering that approach as federal preemption could have unintended consequences of limiting state authority. Preserving the balanced system that exists today and ensuring that states and existing federal guidelines continue to provide an effective regulatory framework are paramount to the public's interest.

The American state-based regulatory system has worked very well for 76 years. We are very concerned about the whittling away of state authority over alcohol regulation as that is not in the public's interest. Understanding the fact that alcohol is different and that we must maintain this successful system is what we ask of the Subcommittee. Thank you for the opportunity to provide our thoughts on this issue.

Written Statement of the Beer Institute
House Judiciary Committee
Subcommittee on Courts and Competition
Hearing on State Regulation of Alcohol Beverages
March 18, 2010

Executive Summary

The Beer Institute is pleased to provide this testimony for the record being developed by the House Judiciary Committee Subcommittee on Courts and Competition on the topic of state regulation of alcohol beverages. The American beer distribution system works well. It is not broken. Every day, high quality beer is safely brewed and legally sold in every state. From the barley, hops and grain farms of several western states to modern breweries with state-of-the-art quality control, beer is produced in all fifty states. Beer is also imported from many of our valued trading partners around the world. Whether brewed in the United States or imported, beer production and distribution is highly regulated by the federal government and each of the fifty states.

Beer Institute members include companies that brew or import more than 90 percent of the beer sold in the United States. The brewer or beer importer must validate the safety of all ingredients and brewing processes. Larger brewers produce, package, and label beer and sell it to licensed wholesalers, or distributors, who generally sell it to retailers. Beer importers are affiliated with one or more brewers in other countries and they also utilize licensed distributors who sell the beer to licensed retailers. This brewer/beer importer-distributor-retailer network is known as the three-tier system.. More than 500,000 licensed retailers sell beer to consumers in the United States. The three-tier

distribution system is governed primarily by state law, with important federal oversight. Many smaller brewers utilize the three-tier system, although some exceptions exist. Where allowed by state law, some smaller brewers may chose to self-distribute their beer to retailers. Hundreds of brewpubs also exist throughout the nation. They are essentially restaurants that also brew beer and sell all or most of their production at one location. These smaller enterprises must still comply with comprehensive federal and state regulations.

This regulated system of brewers, distributors and retailers ensures that beer is delivered to responsible retailers, and that they sell it in a responsible manner to adults of legal drinking age. This system is more effective than any other alcohol regulatory system worldwide.

The three-tier system is serving society and brewers well by creating a stable and accountable distribution network in each state. This system gives brewers a predictable way to market and sell their beer. It gives each state the means to establish an orderly alcohol beverage market and to reliably collect state taxes. The Beer Institute strongly supports the states' three-tier systems, which have been adjusted in an even-handed manner over time to meet particular societal concerns or changes in the marketplace.

In recent years, the authority of the States to control alcohol beverages entering and being sold in their jurisdictions has come under scrutiny for several reasons. Small producers, particularly wineries, claim the states have not sufficiently accommodated their need to

gain access to consumers. Distributor consolidation has given some small beer and wine producers fewer choices to get their products to market. Consumers have demanded access to a wider range of products. Large retailers want to deal directly with brewers, wineries or distillers, to increase efficiency and to take advantage of their scale. . In an effort to sidestep the states' three-tier system of regulated alcohol beverage distribution, some wineries and consumers have challenged state alcohol laws in court. In a few recent court decisions, state alcohol laws have been struck down as being offensive to federal antitrust statutes or legal precedents governing interstate commerce. The cost of defending these suits, the threat of future litigation, and possible erosion of state regulatory authority have raised some policy concerns, although cycles of litigation in the alcohol beverage industry has been ongoing since repeal of Prohibition.

While states regulate the distribution and sale of beer and other alcohol beverages within their respective borders, the Beer Institute believes that there are important issues on which national uniformity is crucial to effective alcohol policy. Brewers believe these federal interests include uniformity in product composition, labeling and advertising regulation, among other areas where Congress has exercised its authority to regulate interstate commerce. These matters cannot be left to fifty states to control in conflicting and contradictory ways. Further, states should not be given free rein to discriminate against out-of-state brewers and importers nor should states be permitted to override important principles governing interstate and international commerce by enacting purely protectionist laws.

Our society is best served by maintaining the current balance of state alcohol control through their three-tier systems and federal controls that maintain national uniformity and limit discrimination against brewers and importers operating in interstate commerce. This balanced system is the basis for controlling where, how and to whom beer is sold in this country. The government regulatory structure is complemented by industry-government-health-community collaborations to prevent abusive and illegal drinking. If Congress believes more clarity is required to maintain this balanced federal/state system of alcohol regulation, a limited remedy to reinforce existing state control where it has actually been challenged is the answer, not a sweeping and unpredictable new immunity from all federal antitrust laws and the dormant Commerce Clause.

Beer Institute

The Beer Institute is a national trade association representing large and small domestic brewers, beer importers, packaging manufacturers, agricultural companies, and other suppliers of goods and services to the beer industry. Our members produce and import more than ninety percent of the beer sold in the United States. Our predecessor organization was the first trade association established in the United States in 1863. We have a longstanding and constructive relationship with the federal government and with every state government. Beer industry representatives have been working with the major organizations representing state alcohol beverage administrators since 1934, and those constructive and respectful government-industry relationships remain in place today. Testimony and model legislation developed by the United States Brewers Association

and the Beer Institute are important parts of the legislative history of numerous federal and state alcohol beverage statutes and regulations.

U.S. Beer Market

Beer is a distinct sector of the alcohol beverage market and among consumer products in general. Beer is a perishable product that is heavy and therefore costly to transport, so within the United States and throughout the world, most beer is brewed close to our consumers. About 88 percent of the beer consumed in the United States is manufactured here. Very few other products can make this claim in the 21st Century.

In 25 metropolitan areas of the United States, large breweries and related packaging manufacturing account for a major share of the overall manufacturing employment base, employing tens of thousands of men and women nationwide. The Beer Institute has prepared and regularly updates a state-by-state analysis of the economic impact of the beer industry known as "Beer Serves America."[1] U.S. and Mexican brewers are the largest purchasers of barley, rice, and hops in the United States. In addition to the largest brewers and beer importers, more than 1900 breweries are authorized to do business in the U.S. according to the federal Alcohol and Tobacco Tax and Trade Bureau (TTB). Those breweries include regional and local breweries and brewpubs, which are restaurants that brew on their premises. Today, most Americans live within 10 miles of a brewery. Within the 12 percent of the U.S. beer market that is imported, more than half is produced in Mexico and Canada. The remaining share of imports comes from successful brands built by our trading partners in the Netherlands, Germany, other

European nations, Asia, and Australia. Beer production is measured in 31 gallon barrels, and each barrel represents about 330 twelve ounce cans or bottles. In 2009, Americans consumed 209 million barrels of beer, which translates to 11.5 billion six packs.

Brewer Role in the Three-tier System of Beer Distribution

Modern breweries are among the most technologically advanced production, packaging, and transportation facilities in the world. U.S. and international brewers have pioneered many advances in the brewing process, efficient water and agricultural product usage, light-weight and recycled packaging, and other areas. Ongoing testing and quality control measures are in place from the handling of agricultural commodities to the high-speed bottling lines, packaging and pallet machinery, and other equipment operated and supervised by skilled employees.

Each beer container is produced in a sterile environment and identified with a coding system to ensure traceability from the moment the product leaves the bottling line to the point at which a consumer makes a purchase. The coding system and tracking capability provide a means for brewer and distributor personnel to remove old beer from the marketplace on a systematic basis. In the event of any indication of a problem with the beer or packaging, product can be quickly recalled and recovered from the marketplace. The coding system is also integral to a state's ability to track the volume of beer delivered to beer distributors and subsequently sold to beer retailers. This information provides a ready basis for conducting audits of state sales and excise tax payments.

Once beer is removed from a brewery or clears the import process, it is marketed and sold in the United States by more than 2,800 beer distributors, each of which holds a license issued by the alcohol beverage agency of the state where they do business and a federal basic permit issued by the United States Department of the Treasury Alcohol and Tobacco Tax and Trade Bureau (TTB). Some beer distributors are small, family-owned companies; others are large, regional or multi-state operations. Distributors help market and sell beer and make deliveries to more than 500,000 state-licensed retail outlets, including taverns, restaurants, grocery stores, warehouse stores, convenience stores, stadiums, airlines, and concessionaires. State regulation of the retail tier is extremely important given the number and diversity of retailers in each state.

The retail value of annual beer sales is approximately $100 billion, and over 40 percent of that total price paid by consumers is comprised of taxes that brewers, importers, distributors, and retailers pay to the federal government, the states, and units of local government. Beer is the only alcohol beverage that is included in the government's consumer market basket of goods that is utilized to formulate the consumer price index. More than 90 million Americans enjoy beer responsibly. Per-capita consumption of beer has declined somewhat from almost 25 gallons in 1980 to almost 21 gallons in 2009. Beer is the most popular alcohol beverage among consumers of legal drinking age, and it is a low-alcohol beverage with an average alcohol content of approximately 4.5 percent alcohol by volume. Light beer accounts for about half of all beer sales in the United States.

Statutory Framework for Alcohol Regulation

Among the first laws enacted after adoption of the United States Constitution was a series of excise taxes on imported ales and other alcohol beverages including domestically produced distilled spirits. The government regulation of alcohol has, therefore, been closely intertwined with tax policy. While the new national government relied on revenues from commerce in alcohol beverages, temperance movements organized by religious, public health, and other advocacy groups attempted to restrict alcohol beverage traffic in individual states and in territories on the American western frontier. Their determined efforts over several decades made alcohol policy a major national political issue by the late Nineteenth Century.

The temperance movement succeeded in achieving a constitutional amendment banning the manufacture and importation of alcohol beverages from 1920 until 1933, the period popularly known as Prohibition. While the public policy failures of the Prohibition era are interesting and instructive, our challenge today is to sustain what we believe to be a solid policy foundation for a heavily regulated industry. A line of current federal statutes enacted between 1890 and 2000 indicate that Congress has continuously sought to facilitate state regulation of alcohol beverages while reserving a measure of federal control over business activities that occur in interstate commerce.[2]

Intrastate distribution and retail sales are clearly within the authority vested in states by the Twenty-first Amendment. Congress has acted affirmatively in this area pursuant to its authority under the Commerce Clause of the United States Constitution to support

state regulatory authority, while retaining its own authority to regulate alcohol in interstate commerce.

The seminal federal statutes regulating interstate commerce in alcohol beverages were enacted almost contemporaneously with the major federal antitrust laws. This longstanding line of statutes demonstrates the intent of Congress to foster active state regulation of alcohol beverages within a broader federal statutory framework:

- **The Wilson Act, 26 Stat. 313, 27 U.S.C. § 121 (1890) was signed into law the same year as the Sherman Act (1890).**
- **The Webb Kenyon Act, 37 Stat. 699, 27 U.S.C. § 122 (1913) was first signed into law a year before Congress enacted the Clayton Act (1914) and the Federal Trade Commission Act (1914). The Webb-Kenyon Act language serves as the basis for the Twenty-first Amendment, and the 1913 language was reenacted in 1937 after ratification of the constitutional amendment.**
- **The Federal Alcohol Administration (FAA) Act, 49 Stat. 977, 27 U.S.C. § 201 *et seq.* (1935), which has numerous provisions respecting state regulatory authority over alcohol beverages, was enacted shortly after passage of the Securities Exchange Act, 48 Stat. 881, 15 U.S.C. § 77b *et. seq.*(1934), the same year as the Public Utility Company Act, 49 Stat. 803, 15 U.S.C. §§ 79-79z-6 (1935), and immediately before passage of the Robinson Patman Act (1936).**
- **The Twenty-First Amendment Enforcement Act, 114 Stat. 1546, 27 U.S.C. §§ 122b-124 (2000) was enacted to provide state access to the federal courts for the purpose of enforcing alcohol beverage distribution laws, and expressly supersedes the operation of the Internet Tax Freedom Act, 112 Stat. 2081-719, 47 U.S.C. § 151 note (1998).**

Several current federal criminal statutes have also been enacted to prevent illegal alcohol beverage distribution schemes and tax evasion.[3] These measures also serve to protect state distribution and tax regulations. Violations of federal law almost certainly have implications for states where the illegal activity occurs, since those who ignore their tax and other obligations under federal law are not likely to be adhering to state regulations. Where criminal or civil violations occur, federal enforcement authority is important as federal officials can bridge jurisdictional and procedural hurdles that might otherwise hinder state law enforcement personnel.

The Federal Alcohol Administration (FAA) Act of 1935 established a comprehensive national regulatory system for interstate commerce in alcohol beverages that remains in force today. The primary federal enforcement agency is the Alcohol and Tobacco Tax and Trade Bureau or TTB, and its position within the Treasury Department organization has also changed several times. The most relevant provisions of the FAA Act today include:

- **A broad grant of authority over the alcohol beverage industry vested in the Treasury Secretary (and delegated to TTB);**
- **A requirement that distillers, wineries, wholesalers, and importers obtain basic federal permits prior to conducting business (domestic brewers are not required to obtain a basic permit);**
- **Various requirements to prohibit misleading information on alcohol beverage labels and in advertising along with a specific mandate that all alcohol beverage labels be approved in advance by TTB; and**
- **A set of trade practices limiting the relationships between producers and wholesalers with retail outlets.**

Under the FAA Act and the Internal Revenue Code, which includes a lengthy alcohol tax title, the industry has evolved as Congress intended with high standards of corporate integrity and a high degree of state regulation of the distribution and retail sales. TTB is able to maintain effective oversight through scrutiny of industry reports and regular audits of company tax payments and business practices, and other forms of marketplace scrutiny. TTB has a modern laboratory that performs testing on samples of domestic and imported alcohol beverages, and the agency maintains a web-based registration system that provides public access to more than a million approved alcohol beverage labels. While few statutory changes have been made over time, TTB and its predecessor agencies have kept the regulatory structure current and responsive to protect the public interest. Title 27 of the Code of Federal Regulations has been updated frequently,

particularly in product labeling and other important functions for consumers. Numerous industry rulings, informal guidance, and other materials are available from TTB and can now be viewed by citizens.

States also effectively oversee trade practices at the wholesale and retail level, so a great deal of concurrent federal and state industry oversight exists. One provision of the FAA Act underscoring the existing degree of state regulatory authority and the distinct nature of the beer market is the so-called "penultimate clause," which applies only to interstate commerce in beer and other malt beverages. The clause limits the application of six key sections of the FAA Act. Four of the sections cover trade practices in the areas of exclusive outlets, tied house, commercial bribery, and consignment sales. Those sections of the FAA Act apply to transactions between a retailer or wholesaler in any state and a brewer, importer or wholesaler of malt beverages outside such State only "*to the extent that the law of such State imposes similar requirements with respect to similar transactions...*" (emphasis added). The clause goes on to impose an analogous requirement with respect to the federal labeling and advertising requirements as they apply to malt beverages. Therefore, several substantive provisions of the FAA Act apply to malt beverages only if similar state laws exist. The clause clearly presumes that brewers, importers, wholesalers, and retailers are engaged in transactions in interstate commerce, but requires an analogous state law to exist to give the federal law effect.

In addition to the FAA Act, Congress has enacted The Alcoholic Beverage Labeling Act of 1988 (ABLA), which imposes a requirement that a uniform government warning about

risks associated with alcohol beverage consumption appear on all alcohol beverage labels or containers. The text of the warning is specified in the law. The ABLA expressly preempts state-mandated statements "relating to alcoholic beverages and health." Consistency in this area is very important with thousands of alcohol beverage brands and packages being sold in all fifty states.

The Twenty-first Amendment Enforcement Act of 2000 was enacted to provide state officials access to federal courts in situations where out-of-state businesses are illegally shipping alcohol beverages interstate or are failing to pay state excise taxes on legal direct shipments. The law was considered necessary because officials in a state receiving an illegal shipment often lacked jurisdiction over entities in other states where the illegal shipment originated. The explosion in small wineries between 1970 and 2000 led to thousands of new brands with limited volume. Those small players began shipping directly to consumers and sometimes to retailers in other states, often without paying state taxes and in violation of requirements that shipments into a state be directed to wholesalers. This federal law provided states with an important tool in combating illegal alcohol shipments.

The Sober Truth on Preventing Underage Drinking Act, ("STOP Act") was enacted in 2006 as an effort by Congress to better coordinate federal activities and to develop federal, state, and private initiatives to further reduce underage drinking in the United States. It is the first significant federal statute that clearly combines aspects of regulatory control over industry members with social policy legislation to curb underage drinking.

Language indicated Congressional support of state regulation of industry members. The law also funds a number of grant programs to assist states in addressing underage drinking. This federal law is due to be reauthorized by Congress in 2010, and the Beer Institute and others will work toward that goal just as we supported the original legislation.

State Role in Alcohol Beverage Regulation

Since the end of Prohibition, states have primarily controlled how alcohol beverages will be distributed to consumers in their respective jurisdictions. Some established a state-run monopoly system in which states distribute alcohol beverages and in some cases operate retail outlets ("the control states"). Most control states sell distilled spirits and wine. With a few exceptions, the distribution and retail sale of beer are conducted by private businesses licensed by the state. The thirty-two states that have not adopted a state-monopoly system are known as "license states" or "open states." have established a "three-tier" system of licensure and regulation that generally funnels all alcohol beverages from licensed producers through licensed distributors to licensed retailers, which sell to individuals who are legally entitled to purchase them. Thousands of pages of state laws, regulations, and other types of guidance exist that set forth state policy. Many cities, counties, towns, and other municipalities also are authorized by state law to issue permits and to regulate retail outlets that serve alcohol beverages or sell them for home consumptions.

Policy Challenges Posed By A Changing Marketplace

The three-tier system of beer distribution operated in each state, mostly without controversy, for decades. From the 1990s through the present, however, new players and business models developed in the alcohol beverage marketplace. Resulting economic pressures created impetus for changes in state regulation. Significant consolidation has also occurred among large brewers and within the wholesale tier, increasing the size and scope of many brewer and distributor operations. An even greater degree of consolidation has occurred among wine and spirits distributors. In the same period, more than 3,000 small wineries, small breweries, and brewpubs have been established, leading to a massive increase in the number of niche brands sold in interstate and international commerce. Smaller producers have increasingly sought ways to get their products to consumers without going through the distributor tier.

Simultaneous with the consolidation of larger brewers and the rapid growth in the number of smaller brewers and vintners, the retail tier of the alcohol beverage industry has seen major consolidation. Large and economically powerful retailers such as Costco and 7-11 have multi-state or national operations with new methods of managing, purchasing, controlling inventory, and providing other services to their outlets. These entities are seeking to apply their business model and logistics systems to alcohol beverages. Retailer challenges to state laws date back to the aftermath of Prohibition, but retailer lawsuits against states and calls for regulatory reform have proliferated in the last decade with multiple commercial motivations.

Feeling increased competition, smaller alcohol beverage retailers sought to expand cross-border sales and direct shipments to consumers attacking state import controls in Michigan, New York, and Texas. Beer distributors, some of whom also distribute wine, have been impacted by the evolution of a parallel wine distribution system that increasingly has bypassed the three-tier system in favor of direct shipment to both consumers and retail licensees.

In the face of pressure from conflicting constituencies, many state legislatures modified the statutes underlying their respective three-tier distribution systems by enacting laws to allow alcohol beverage producers, retailers or consumers to bypass the distributor tier. In particular, over the last twenty years, small wineries, wine retailers, and wine consumers effectively used legislative advocacy to create a unique wine distribution system that operates to some extent outside the three-tier system. A number of state legislatures enacted laws granting self-distribution or direct shipment privileges to alcohol beverage producers resident in their own states, allowing them to ship to retailers and consumers in the state while prohibiting producers located outside the state from exercising the same privileges. These laws were often found to be protectionist in intent or on their face, but many have been modified to accommodate small producers from other states.

What began as a series of limited exceptions for a few small wineries located in particular states, evolved into an intricate system of special distribution and sales privileges for small wineries across the country. Close examination of state laws reveals that small brewers have similar privileges in some jurisdictions. Direct shipping of beer to retail or

consumers is very limited, however, because beer does not command as high a price as wine and beer is as a ratio or price to weight is more expensive to ship. Following passage of the Twenty-first Amendment Enforcement Act of 2000, the Beer Institute studied direct shipping at the request of the Justice Department and found that more than 99 percent of the beer sold in America was sold either through the licensed three-tier distribution system or at a brewery building which held the appropriate license to sell directly to consumers. We believe the situation is the same today and have no evidence that would indicate a significant expansion of direct shipping of beer to consumers.

Legal Challenges Over Direct Shipping Laws

The long history of government regulation of alcohol beverages has led to challenges that beset all regulated industries. Alcohol laws, administrative regulations, and court decisions have tended to remain static for long periods, particularly because authority is shared by the federal government and all fifty states. Fairly stable business relationships and channels of commerce in alcohol beverages have existed since the 1930s. Changes in commercial regulation are slow and erratic as members of the regulated industry have often fought lengthy political battles to maintain federal and state regulatory structures that ensured stability of their businesses.

Yet the U.S. and global economies have changed and expanded dramatically since the 1930s, rendering some of the older regulations hard to understand and enforce. As some of these economic trends continued in the early 2000's, preferential direct shipment and other state alcohol beverage laws came under attack from a number of directions. Out-

of-state wineries and in-state wine consumers sued states, arguing that laws prohibiting out-of-state producers from shipping wine to state consumers while permitting in-state producers to do the same were protectionist and discriminatory, in violation of the dormant Commerce Clause. In a small handful of states, retailers also mounted challenges to a wide range of state alcohol regulations on the grounds that they stifle competition and violate federal antitrust laws.

The direct-shipment strand of cases culminated in the United States Supreme Court decision in *Granholm v. Heald,* 544 U.S. 460 (2005). In *Granholm*, the Supreme Court held that economic protectionism was not permitted by the 21st Amendment. The *Granholm* decision also held that discriminatory direct shipping privileges favoring in-state wineries and to the detriment of out-of-state wineries violated the dormant Commerce Clause of the Constitution. In response, most states that permitted direct sales and shipping by in-state wineries to consumers or retailers amended their laws to permit out-of-state wineries to exercise the same privilege. As a result, a direct interstate market has been created in wine, in which the first tier of producers sells and ships directly to the third tier of retailers, or directly to consumers by common carrier.

The most recent antitrust strand of cases culminated in *Costco v. Hoen*, 522 F.3d 874 (9th Cir. 2008) and *TFWS v. Schaefer,* 2007 WL 2917025 (D.Md. Sept. 27, 2007), *aff'd*, 572 F.3d 186 (4th Cir. 2009). *Costco* challenged a comprehensive set of state alcohol laws, including a uniform pricing requirement, a ban on central warehousing by retailers, a ban on retailer-to-retailer sales, bans on credit and volume discounts, a state minimum mark-

up law and price posting and holding laws. The 9th Circuit Court of Appeals left Washington's laws virtually intact, upholding all but two of these laws--a law that requiring distributors to post the prices at which they would sell a beverage to retailers, and another that requiring them to hold the posted price for a set time period ("post-and-hold" law). *Costco* also challenged a law allowing Washington wineries to sell and ship wine to Washington residents but prohibited out-of-state wineries from doing the same. This law was amended by the Washington state legislature during the course of the litigation to allow producers anywhere to ship directly to consumers and retailers in Washington. In *TFWS*, the Fourth Circuit Court of Appeals affirmed a trial court's order striking Maryland's post-and-hold law, as well as a ban on volume discounts that affect the price at which alcohol beverages are sold at retail.

Since the *Granholm* decision, wineries, wine retailers and wine consumers have brought more than two dozen lawsuits in various federal courts challenging a range of state alcohol regulations. The largest number of complaints mirrored *Granholm*, alleging that a particular state alcohol law or regulation violated the dormant Commerce Clause of the United States Constitution by discriminating against out-of-state producers or retailers while favoring their in-state counterparts. In three cases, an alcohol beverage retailer challenged state alcohol laws as violations of federal antitrust laws.

In most cases where a state law was challenged as local economic protectionism discriminating against out-of-state producers, the cases were resolved by the courts or legislatures taking action to end the discriminatory policy. See Appendix A, a chart of

post-*Granholm* court cases and their outcomes, to date. Some of these cases have been decided by the courts (e.g., Massachusetts). Others have been resolved by legislative amendments (e.g., Missouri). In almost every instance where non-discriminatory state laws regulating alcohol have been challenged, courts have upheld the challenged laws. Examples include Maine, New York, Louisiana, Texas and, for the most part, Washington.

Whether a particular case is counted as a "win" for the state is, in large part, based on one's perspective. A simple tally indicates that states have gained as many "wins" as "losses," but the impact of each decision is different depending on the market within the state and many other factors. While plaintiffs have often challenged an entire string of state laws, in most cases, only one or two have been stricken. Most of the losses for states have been quite limited in practical effect, but the principles established by federal courts have sometimes upset members of the beer industry.

Of the lawsuits filed since 2005, states have successfully defended existing alcohol laws in eight jurisdictions (California, in three cases; Louisiana; Maine; Rhode Island; New York; Tennessee; Oklahoma; and Texas). In Arkansas, Illinois, Missouri, and Pennsylvania, the legislature has amended state laws during the course of litigation, leading to its dismissal. In eight states, a limited portion of the state's laws has been stricken. These states include Indiana (law stricken denying wineries outside Indiana the right to sell wine to Indiana consumers only if they were licensed as a distributor in their home state); New Jersey (law stricken prohibiting out-of-state producers from selling

and shipping directly to state residents, where in-state producers could do so); Kentucky (law stricken required in-person purchase of wine from winery that wished to ship beverages directly to out-of-state consumers); Maryland (post-and-hold and volume discount bans stricken); Massachusetts (ban on direct shipment of wine by wineries of a certain size to state residents stricken where in-state wineries were all beneath the volume cap); Michigan (ban on out-of-state retailer wine shipments to Michigan residents stricken; state legislature has since amended the law); Washington (post-and-hold law stricken; direct shipping opened to out-of-state producers by legislature).

Beer Institute's Position in Challenges to State Regulation

The Beer Institute does not wish to see erosion of existing state authority over alcohol distribution and, more specifically, erosion of the three-tier distribution system. The Beer Institute supports the three-tier system and has taken specific steps since the late 1990s to do just that. In 2000, the Beer Institute was a strong supporter of the Twenty-first Amendment Enforcement Act. In 2006, the Institute helped to draft and lobbied for passage of the STOP Act, which included a Congressional statement of support for the three-tier system. The Beer Institute has filed amicus briefs in various appellate courts supporting state alcohol laws, including in the *Granholm* case, as well as in subsequent cases in Maine, New York, Kentucky, Tennessee, and Washington State.

The Beer Institute and its members are committed to the three-tier system because they believe that it appropriately controls the distribution of alcohol beverages within each license state, while minimizing the chance that beverages will be obtained by those who

are not entitled by law or should not consume them. However, the Beer Institute and its members do not believe that sweeping new legislation immunizing state alcohol laws from all federal antitrust or dormant Commerce Clause challenges is appropriate or necessary to protect that three-tier system. If the Subcommittee determines that specific legislation is required to clarify states' authority over pricing and distribution within their respective jurisdictions, it should be limited and focused on the basic tools that states need to regulate distribution channels. To the extent possible, Congress should avoid changes that could upset the existing federal/state balance of alcohol regulation that has worked so well for so long.

The Three-Tier System Benefits Society As A Whole

Immediately after Prohibition, government officials focused on policies to establish a legal and ethical industry. They also had to eradicate massive organized criminal distribution schemes developed during Prohibition. Over time, government policy began to address alcohol abuse directly through alcoholism treatment, prevention programs, and stricter policies on underage drinking and drunk driving. As those policies evolved, government and industry members recognized that effective alcohol control required a combination of formal government regulation, self-regulation, and sustained efforts to promote consumer education and awareness of common-sense ways to reduce underage drinking, drunk driving, and other forms of alcohol abuse.

Over the course of seventy-five years, American industry, government, and public health sectors have worked together to establish a remarkable record of effective alcohol policy

while permitting the distribution and sale of alcohol to people of legal drinking age. Brewers have individually created and supported innovative and effective educational programming attacking underage drinking, drunk driving and alcohol abuse. Through the Beer Institute and individually, brewers have worked with law enforcement to reinforce proper identification checks at retail sale, to support the federal government's "We Don't Serve Teens" program, spearheaded by the Federal Trade Commission, The brewing industry, including brewers and distributors, has invested more than 750 million dollars into community, school and health initiatives that attack abusive and illegal consumption.[4] Brewers have worked with federal and state highway safety agencies, various agencies within the Department of Health and Human Services, and many other governmental and non-governmental organizations to assist in development and implementation of anti-alcohol abuse initiatives. This is one reason why America has seen unprecedented drops in underage drinking since 1982, as reflected in the Signs of Progress, a collection of government-funded survey data on key indicators of alcohol abuse and underage drinking.[5] This positive track record has been made possible, in part, by the existence of a strong, regulated three-tier system of alcohol distribution.

Conclusion

The American beer industry reliably delivers high-quality, safe beer to American consumers around the country. It does so by virtue of its own highly regulated and controlled production processes and by virtue of the regulated alcohol distribution system in each state. The current three-tier system should be defended from attack by any public or private interests that put their own profit or special interest before sound alcohol

policy. Today's competitive and orderly marketplace is beneficial to consumers. If the Subcommittee believes that federal legislation is necessary, any proposal should make it clear that states must regulate in an even-handed manner so as to avoid discrimination against out-of-state competitors/ The role of the federal government must be retained in areas of regulation where national uniformity benefits American consumers and fills gaps that would otherwise exist if alcohol beverage regulation were solely within the province of the states.

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[1] **Available at the following link:** www.beerservesamerica.com.

[2] **In addition to the Federal Alcohol Administration Act described above, the following summary of major federal laws below is intended to more fully outline the development of the U.S. regulatory system:**

The Internal Revenue Code includes the oldest laws governing the industry and many regulations still in place today originated as efforts by the Treasury Department to ensure payment of taxes. In addition to imposing alcohol beverage excise taxes and occupational taxes, the law imposes stringent recordkeeping and reporting requirements as well as specific business practices. Several newer federal laws overlap with the Internal Revenue Code.

The Wilson Act of 1890 authorized the states to regulate alcohol beverages imported from other states or from other nations. It really constitutes the first significant step by Congress to bolster state authority to regulate alcohol beverages.

Now codified at 27 U.S.C. § 121 the law was titled, "An Act to limit the effect of the regulations or commerce between the several States and with foreign countries in certain cases," and reads as follows:

> **All fermented, distilled, or other intoxicating liquors or liquids transported into any State or Territory or remaining therein for use, consumption, sale, or storage therein, shall upon arrival in such State or Territory *be subject to the operation and effect of the laws of such State or Territory 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 or Territory,* and shall not be exempt therefrom by reason of being introduced therein in original packages or otherwise. (emphasis added)**

In 1887, the U.S. Supreme Court had decided *Mugler v. Kansas*, a case upholding the right of Kansas to impose a ban on production of alcohol beverages as part of a broader statewide prohibition law. The Wilson Act was a response to pressure from state enforcement officials and activists because state prohibition laws were undermined by direct shipments to consumers that originated in other states. The Act subjected alcohol beverages "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*…"[2] From the 1890s to the present, the United State Supreme Court has recognized the grant of authority to states, but has also

interpreted the italicized language as prohibiting state laws that discriminate between alcohol beverages produced in a state and those imported from another state. That interpretation is consistent with most laws and court decisions affecting interstate commerce. The Wilson Act was construed narrowly by the U.S. Supreme Court to apply only to the resale of liquor after it had been imported into a state and not if it had been shipped in its original package directly to consumers. This interpretation protected interstate mail order shipments of alcohol and made state prohibition laws very difficult to enforce.

The Webb-Kenyon Act of 1913 was intended to close the direct shipping loophole. Now codified at 27 U.S.C. § 122, it was titled "An Act divesting intoxicating liquors of their interstate character in certain cases" and is known as the Webb Kenyon Act. The complete text of the section reads as follows:

27 U.S.C. § 122 Shipments into States for possession or sale in violation of State law

The shipment or transportation, in any manner or by any means whatsoever, of any spirituous, vinous, malted, fermented, or other intoxicating liquor of any kind from one State, Territory, or District of the United States, or place noncontiguous to but subject to the jurisdiction thereof, into any other State, Territory, or District of the United States, or place noncontiguous to but subject to the jurisdiction thereof, or from any foreign country into any State, Territory, or District of the United States, or place noncontiguous to but subject to the jurisdiction thereof, which said spirituous, vinous, malted, fermented, or other 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, Territory, or District of the United States, or place noncontiguous to but subject to the jurisdiction thereof, is prohibited.

27 U.S.C. §§ 122a and 122b were added by the Twenty-first Amendment Enforcement Act to provide the states with limited access to federal courts and injunctive relief against mail order and internet sellers of alcohol beverages who were bypassing the distribution systems established by state laws. Congress added very detailed provisions to address changes in commerce and technology, but the original grant of authority to the states in the Webb Kenyon Act remained unchanged and the newer provisions expressly protect the right of states to pursue violations separately in state court. This section was added in 2000—Pub. L. 106-386.

Once a shipment of alcohol beverages crosses the border of the state of final destination, it is immediately subject to the laws of that state regardless of who orders the alcohol beverages or how they are packaged. At least some advocates of the law believed that Webb Kenyon removed alcohol beverages from any legal principles that applied to products in interstate commerce, but the Wilson Act language highlighted above remained in place, and modern court decisions still apply the principle that states cannot discriminate against goods from other states. The process surrounding enactment of Webb Kenyon is significant. President Taft vetoed the legislation as he thought it was an unconstitutional abdication of federal authority over interstate commerce. Congress overrode the veto, and later the U.S. Supreme Court upheld Webb Kenyon.

The Eighteenth Amendment (ratified in 1919) prohibited "the manufacture, sale, or transportation of intoxicating liquors within, the importation thereof into, or the exportation thereof from the United States and all territory subject to the jurisdiction thereof for beverage purposes." The amendment also provided Congress and the states with "concurrent power" to enforce it "by appropriate legislation." Arguments over the appropriate federal and state responsibilities and funding for the massive commitment of personnel required to administer and enforce Prohibition consumed Congress and state legislatures. Over time, the policy led to creation of massive illegal enterprises to produce and distribute alcohol beverages and widespread corruption of government at all levels. Eventually, those problems led to repeal of the Eighteenth Amendment.

The Twenty-first Amendment (ratified in 1933) repealed the Eighteenth Amendment and established state authority over alcohol beverages in the U.S. Constitution using language very similar to the Webb Kenyon Act. Section 2 of the amendment states, "The 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." The basic approach of the Webb-Kenyon Act was thereby incorporated into the U.S. Constitution. Congress also reenacted the identical 1913 language of the Webb-Kenyon Act in 1937.

[3] 18 U.S.C. § 1261 authorizes the Attorney General of the United States to enforce the subsequent sections and to issue regulations to carry them out. This section was most recently amended in 2002 – Pub. L. 107-296. A prior amendment of this section contained in Pub. L. 90-518 (1968) included the following disclaimer of intent to preempt state regulation of shipments of intoxicating liquor: "Nothing contained in this Act shall be construed as indicating an intent on the part of Congress to deprive any State of the power to enact additional prohibitions with respect to the shipment of intoxicating liquors."

18 U.S.C. § 1262 is of limited application, but defines as a federal offense the transportation of alcohol beverages into a state where all sales of alcohol are prohibited, but allows shipments to proceed through such states "in the course of continuous interstate commerce." For purposes of enforcing this section, "the definition of intoxicating liquor contained in the laws of the respective states" is applied. Editorial revisions in this section were made in 1994 – Pub. L. 103-322.

18 U.S.C. § 1263 requires specific documentation to accompany shipments of alcohol beverages "into any place within the United States" to readily identify the products and the consignee. Violations are punishable by fines and imprisonment of not more than one year. This section was amended in 1994 – Pub. L. 103-322.

18 U.S.C. § 1264 ensuring that deliveries of alcohol beverages "shipped into any place in the United States" via common carriers are properly delivered to consignees and not to fictitious persons. Violators are subject to fines and imprisonment for up to one year. Most recently amended in 1994 - Pub. L. 103-322.

18 U.S.C. § 3667 authorizes seizure and forfeiture of alcohol beverages or proceeds by the federal government under procedure in the Internal Revenue Code for violations of 18 U.S.C. §§ 1261-1264.. Most recently updated in 1984 – Pub. L. 98—473.

18 U.S.C. § 1716(f) includes all forms of alcohol beverages in a comprehensive provision addressing substances, weapons, and other items. Under (f), alcohol beverages are "nonmailable" and "shall not be deposited in or carried through the mails." No exceptions are included, although a number of exceptions are made for other items covered in § 1716. This section was most recently amended in 1994 - Pub. L. 103-322.

A number of analogous federal criminal statutes are also intended to control the flow of alcohol into Indian reservations where treaties or federal statutes prohibit the use or possession of alcohol beverages. (E.g. 18 U.S.C. § 3488).

[4] See, http://www.beerinstitute.org/tier.asp?sid=7 for a description of several of these programs.

[5] Available at the following link:
http://www.beerinstitute.org/BeerInstitute/files/ccLibraryFiles/Filename/000000001024/Signs%20of%20Progess%203-15-2009%20-%20FINAL.pdf.

APPENDIX A TO BEER INSTITUTE SUBMISSION TO SUBCOMMITTEE ON COURTS AND COMPETITION

	Laws At Issue	Current Status	Lower Court Outcome	Legislation Triggered		
AZ*	Statutes prohibiting out-of-state wineries producing over 20,000 gallons of wine annually from taking telephone and Internet orders for wine which prevent many out-of-state wineries from selling, delivering and shipping wine directly to consumers and Arizona retailers. Ariz. Rev. Stat. Secs. 4-202(A); 4-203.04; 4-243.01; 4-244(7).	Laws upheld, but Plaintiffs-Appellants have appealed the trial court's ruling granting Defendants' Motion for Summary Judgment. Briefing and oral argument are complete and the Court has taken the matter under advisement.	On 2/27/08, the trial court ruled that Arizona's in-person sales and gallonage cap exceptions did not discriminate against interstate commerce.	The original complaint triggered Bill 1276, modifying the challenged statutes to permit out-of-state wineries the same shipping and sale privileges as in-state wineries; plaintiffs continue to challenge the volume cap.		
AR	Statutes permitting in-state wineries to sell and ship directly to consumers and retailers while restricting out-of-state wineries from doing the same.	Concluded, laws upheld.	First case brought by AR wholesalers seeking a "level-down" remedy; the trial court dismissed claims on standing grounds and appeal was mooted by legislation. Second case brought by out-of-state wineries was dismissed. The trial court held that because all direct shipping is barred, there is no discriminatory treatment of out-of-state interests.	The original complaint triggered Act 668, which removed naive winery preferences and established a licensing procedure for small farm wineries regardless of residency. Out-of-state wineries challenged this legislation in their second complaint.		

	Laws At Issue	Current Status	Lower Court Outcome	Legislation Triggered		
CA	Statutes prohibiting consumers and retailers in non-reciprocity states from shipping wine to California; law limiting the amount of wine that consumers and retailers in reciprocity states may ship to California; laws restricting the transport of wine by airline passengers into California; laws enacting criminal penalties for violating the preceding provisions. Cal. Bus. and Prof. Code Secs. 23661.1, 23661.2 and 23670.	Laws upheld, but not enforced by California authorities	Three cases were dismissed on standing grounds as the plaintiffs were unable to show sufficient injury given California's agreement to enforce the challenged laws. The fourth case was dismissed as the plaintiffs were satisfied with the State's non-enforcement of the laws preventing out-of-state retailers from selling and shipping wine to California residents			
DE	Laws preventing out-of-state wineries from selling directly to consumers while in-state wineries may sell to consumers on their premises. Del. Code 4 Secs. 501(a), (d), (f), 526 (a-c), (e), 701, 703 and Del. Admin. Code. Title 4 Rules 8, 8.1 and 77.	Concluded, the plaintiffs voluntarily dismissed the case	The trial court dismissed plaintiffs' claims as neither in-state nor out-of-state wineries were permitted to deliver wine directly to consumers' homes. The trial court later vacated its order of dismissal to determine whether the challenged statutes were unconstitutional in practical effect, but the case was voluntarily dismissed before the question was answered.			

	Laws At Issue	Current Status	Lower Court Outcome	Legislation Triggered		
IL	Laws permitting small in-state wineries to distribute directly to retailers, while prohibiting out-of-state wineries from doing the same. 235 ILCS 5/5-1 and Public Acts 88-303 and 89-218	Concluded. The parties agreed to dismiss the lawsuit in light of legislation resolving the issues	The trial court dismissed plaintiffs' claims based on Equal Protection challenges and later dismissed plaintiffs' "special legislation" claims as moot	Public Act 095-0634 was passed, permitting both in-state and out-of state winemakers producing less than 25,000 gallons annually to self-distribute to Illinois retailers		
IN*	Laws preventing out-of state wineries from separately incorporating in order to obtain an Indiana small wine wholesaler license, as is necessary in order to sell or ship directly to licensed retail wine sellers in Indiana; law prohibiting out-of-state wineries from selling and shipping wine directly to Indiana consumers without establishing a physical presence in Indiana, while in-state wineries can do so. Law prohibiting out-of-state wineries from selling wine directly to Indiana residents unless those purchasers appear in person at the winery. Ind. Code Sec. 7.1-5-11-1.5 ——— A second case now pending challenges a law prohibiting retailers from using common carriers to make direct-to-consumer deliveries while permitting licensed wineries to do the same. Ind. Code Sec. 7.1-3-15-3.	Split appellate decision upheld face-to-face purchase requirement but overruled law preventing out-of-state winery from obtaining a direct wine seller's permit if the winery holds a wholesaler's permit in its home state, pending appeal. Plaintiffs' Petition for Writ of Certiorari to the Supreme Court was denied. ——— Cross Motions for summary judgment are currently pending in the "common carrier" direct shipping case.	On 8/29/07, the trial court ruled that two Indiana provisions violated the Commerce Clause: (1) Indiana's law prohibiting an out-of-state winery from acquiring a Direct Wine Seller's permit if it holds a wholesaler's permit in its own home state, and (2) Indiana's limitation on direct-to-consumer sales and shipment to wineries that have an initial face-to-face sales transaction with Indiana consumers. Apart from these two provisions, the Court upheld the remainder of Indiana's challenged laws as constitutional, including volume limits on producers which can ship directly and volume limits on personal importation of wine.	The original complaint triggered a new bill that allows only wineries who have not had a relationship with a distributor for the preceding 120 days to ship to consumers. Also, an initial on-site in-person purchase is required. Wineries may ship 24 cases to a consumer a year and no more than 3,000 cases to Indiana consumers each year. Plaintiffs challenge this legislation in their Amended Complaint		

	Laws At Issue	Current Status	Lower Court Outcome	Legislation Triggered		
IA*	Laws preventing out-of-state wineries located in non-reciprocity states from taking orders from Iowa residents by internet, phone or personal appearance or from shipping to Iowa consumers, statutes also favor native wineries over out-of-state wineries from reciprocity states by limiting the amount of wine that the latter may ship to Iowa consumers without imposing the same restrictions on Iowa wineries	Complaint recently filed and Defendant's response is due in May 2010		The legislature is considering proposed legislation that would permit out-of-state manufacturers to ship wine directly to Iowa residents		
KY	Quantity limitations for direct shipment of wine, designation of "small farm wineries", the "small farm winery support fund", the small farm winery wholesaler's license; "in-person" sales requirement necessary for a small farm winery to ship direct to Kentucky consumers. Ky. Rev. Stat. Secs 244.165, 243.020, 243.032, 243.100(f), 243.200 and 243.155.	Court struck down Kentucky's face-to-face sales requirement.	On 12/26/06, the district court held that the challenged provisions based on quantity limitations for direct shipment of wine, designation of "small farm wineries", the "small farm winery support fund" and the creation of the small farm winery wholesaler's license were constitutional. However, the trial court struck down Kentucky's "in-person" sales requirement (which is necessary for a small farm winery to ship direct to Kentucky consumers) as discriminating against interstate commerce in practical effect.	The original complaint triggered Kentucky Senate Bill 82 that addressed some, but not all of Plaintiffs' complaints. Plaintiffs now challenge several provisions under Senate Bill 82.		

	Laws At Issue	Current Status	Lower Court Outcome	Legislation Triggered		
LA	Ban on credit to retailers; ban on volume discounts; delivered pricing rule; ban on retailer central warehousing; ban on retailers providing distribution services; ban on wholesaler sales or deliveries outside their territory; ban on direct shipping by in-state retailers to consumers wherever they are located; and ban on direct shipment by in-state retailers to in-state consumers residing in "dry" jurisdictions.	Court upheld the laws. Plaintiffs filed a Writ of Appeal to the Louisiana Supreme Court, which was denied.	On 10/31/07, the trial court dismissed Plaintiffs claims under the Sherman Act and Commerce Clause. The trial court specifically Court ruled that the challenged bans were inherently constitutional because they are integral to the three-tier system.			
ME	Laws requiring face-to-face sales and prohibiting sales over the Internet. Maine Rev. Stat. Title 28-A §§ 1361(4), 2077 and 2077-B.	The First Circuit upheld the laws.	The trial court upheld Maine's face-to-face sales requirement as it applies equally to in-state and out-of-state vendors. The court also held that Maine should not be forced to permit mail order/Internet purchases of wine simply because it is a more practical way for out-of-state wineries to sell directly to Maine consumers.			

	Laws At Issue	Current Status	Lower Court Outcome	Legislation Triggered		
MD	Price posting and hold laws and regulations, volume discount law.	Fourth Circuit affirmed the lower court's ruling that Maryland's post-and-hold and volume discount laws were forms of horizontal price fixing that violate the Sherman Act. The Court also considered the provisions to be unenforceable hybrid restraints that were ultimately preempted by the Sherman Act. After the State unsuccessfully moved for rehearing *En Banc*, it has been reported that the parties settled in January 2010.	On 9/27/07, the trial court struck down Maryland's post-and-hold system and volume discount law, and enjoined their enforcement. Specifically, the trial court considered the impact of excise taxes on alcohol price and alcohol consumption, as part of the Defendant's 21st Amendment defense of Maryland's post-and-hold and volume discount laws. The court concluded that an analysis of the impact of price on consumption had to take alcohol excise taxes into account. This data showed that, taking excise taxes into account and comparing Delaware and Maryland prices, the challenged regulations raised alcohol prices only two cents per bottle of wine or liquor. The Court then concluded that a very small impact on alcohol consumption associated with price increases caused by the challenged provisions was outweighed by the federal interest in promoting competition under the Sherman Act.			
MA*	Statutes providing "small winery shipping licenses" to wineries based on volume caps. Wineries with a "large winery shipment license" can ship directly to Massachusetts consumers only if the winery has not contracted with or been represented by a Massachusetts wholesaler in the preceding six months. Section 19F of the Massachusetts General Laws.	On 1/14/10, the First Circuit affirmed the trial court's ruling striking down Massachusetts' volume cap laws. The Court held that the laws violated the Commerce Clause by depriving "large" wineries of routes to the market, burdening smaller "large" wineries with distribution channel struggles and failing to provide sufficient benefits to "small" wineries that outweigh these burdens. The Court held that the 21st Amendment could not save the law, given its discriminatory effect and purpose.	The trial court struck Massachusetts' volume cap laws, acknowledging that while the challenged statutes were facially neutral, the legislative history and public comments by the bill's sponsors indicate a discriminatory purpose. "[The law] was designed to allow all in-state wineries to continue direct shipping while forcing the majority of interstate wine to go through the three-tier system, thereby preserving the economic interest of both Massachusetts wholesalers and Massachusetts wineries." For a remedy, the Court "leveled up," permitting out-of-state wineries of any size to apply for a direct shipping permit that was previously restricted to small wineries.			
MI	Provisions permitting Michigan wine retailers to sell, ship and deliver wine directly to Michigan residents, while prohibiting out-of-state retailers from doing the same. Secs. 436-1203, 436.1607(1), 436.1719(c)(4) of the Michigan Alcohol Code and Michigan Liquor Control Commission Rule 436.1011(7)(b).	Court struck ban on out-of-state retailers shipping wine to Michigan residents. Rather than file appellate briefs, the parties moved jointly to remand the case to the trial court and asked that the trial court vacate its judgment and dismiss the case in light of Michigan Public Act 474 (see legislation column). The trial court did so on 7/17/09.	On 10/12/07, the trial court ruled that out-of-state retailers may sell and ship directly to Michigan residents.	Public Act 474 (HB 6644) was signed on 1/9/09, banning retailer-to-consumer direct shipping, with limited exceptions (*i.e.*, obtaining a proper license, delivering products through its own employees after complying with approved server training programs).		

	Laws At Issue	Current Status	Lower Court Outcome	Legislation Triggered		
MO	Laws permitting in-state wineries and retailers to sell, ship and deliver wine directly to consumers while prohibiting out-of-state vendors from doing the same; discrimination against wineries from non-reciprocity states.	Concluded. Agreed voluntary dismissal in light of legislation.	The court dismissed the case by agreement of the parties after legislation mooted the plaintiffs' claims.	Senate Bills 299 and 616 authorized the direct shipment of wine to Missouri consumers regardless of the winery's location or the reciprocity of any state.		
NJ*	Law that permits in-state wineries and retailers to obtain licenses permitting them to sell wine directly to consumers, restaurants and retailers while out-of-state wineries or retailers cannot; laws limiting the quantity of wine consumers may purchase from out-of-state wineries but not in-state wineries. N.J. Stat. Secs. 33:1-2(a), 33:1-10(2a-b), 33:1-28 and 33:1-13.	Split decision, striking disproportionate license fees for out-of-state wineries and laws permitting in-state wineries to operate more retail locations than out-of-state counterparts; upholding laws permitting in-state and out-of-state wineries to sell and ship directly to New Jersey consumers and retailers, laws requiring New Jersey consumers to pay a registration fee to transport excess amounts of alcohol from out-of-state, reciprocity laws and New Jersey's 2004 direct shipping law that eliminated the right of in-state wineries to ship directly to consumers. Both sides appealed and after briefing and oral argument, the Court took the matter under advisement.	On 6/30/08, the Court issued an opinion upholding most of the challenged laws. Specifically, the Court found unconstitutional: (1) the license fee charged to out-of-state wineries who wish to ship directly to New Jersey consumers (which was double the in-state wineries' fee); and (2) the law that permitted in-state wineries to open up to seven retail locations, while limiting out-of-state wineries to two such locations. The Court found constitutional laws: (1) allowing both in-state and out-of-state wineries to sell and ship directly to New Jersey consumers, restaurants and retail licensees; (2) requiring New Jersey consumers to pay a $25 registration fee to bring in excess of 12 quarts/one quarter barrel of beer, one gallon of beer or two quarts of spirits into the State, while allowing the same consumers to buy unlimited quantities in-state; (3) allowing New Jersey consumers to bring alcohol beverages into the state only if the state where those beverages were purchased allows its residents to bring New Jersey product into their territory; and (4) eliminating the right of in-state wineries to ship directly to consumers.		

	Laws At Issue	Current Status	Lower Court Outcome	Legislation Triggered		
NY	Laws prohibiting out-of-state wine retailers from selling, delivering and transporting wine to New York residents, while permitting New York wine retailers to do so. New York Alcoholic Beverage Law Secs 100(1) and 102(1)(a-b)	On 7/1/09, the Second Circuit affirmed the trial court's ruling, upholding New York's law banning out-of-state retailers from selling and delivering wine directly to New York consumers	On 9/28/07, the Court upheld New York's ban on out-of-state retailers selling directly to New York residents			
OK	Laws permitting in-state wineries to sell direct to retailers while prohibiting out-of-state wineries from doing the same	Concluded. Trial court struck the challenged laws	Wholesalers sued, seeking the elimination of direct shipping privileges for in-state wineries. The trial court struck laws permitting in-state wineries to ship direct to retailers while preventing out-of-state wineries from the same. After the Oklahoma legislature failed to act, the court eliminated the self-distribution privilege for Oklahoma wineries			

	Laws At Issue	Current Status	Lower Court Outcome	Legislation Triggered		
PA	Two cases have been filed. 1) Laws prohibiting out-of-state wineries from selling and shipping directly to Pennsylvania consumers and retailers. Penn. Stat. 47 Secs. 4-488, 4-491, 4-404, Penn. Admin. Code 40 Secs. 9.143 and 9.145; PLCB Advisory Notice 23. 2) Provisions of the Penn. Liquor Code requiring out-of-state producers to name an in-state importing distributor which cannot be terminated absent "good cause," while the "good cause" requirement does not apply to Pennsylvania producers	Both cases are concluded. In the first, the trial court struck challenged statutes. In the second, the case settled	1) Court struck statutes prohibiting out-of-state wineries from selling and shipping direct to consumers and retailers. After doing so, the Pennsylvania Liquor Control Board issued Advisory Notice 21, which stripped all wineries of direct-shipping rights. While Advisory Notice 21 was later enjoined, direct shipping in or to Pennsylvania consumers and retailers is prohibited. 2) Case settled.			
RI	Statutes establishing retail licensing requirements, barring the multiple ownership of Class A liquor stores by the same owner; barring Class A liquor licensees from participating in franchises; and requiring the owners of Class A licenses to be Rhode Island residents. Rhode Island Gen. Laws 3-5-10-, 3-5-11, and 3-5-11.1	Upholding the laws and affirming the trial court's ruling in favor of the Defendants. On 4/3/07, the Plaintiff-Appellants moved the First Circuit for a rehearing en banc, which was denied on 4/19/07.	The trial court issued a bench decision on 7/10/06, upholding the challenged laws and dismissing all of Plaintiffs' claims			

	Laws At Issue	Current Status	Lower Court Outcome	Legislation Triggered		
TN	Statute prohibiting out-of-state wineries and "other vendors" from acquiring a license in Tennessee to sell and ship wine directly to Tennessee residents, while permitting in-state wineries, retailers and other vendors to do so; Tennessee's taxation structure as applied to out-of-state wine vendors that seek to ship wine to Tennessee residents; laws subjecting Tennessee residents who possess or transport wine into the state to criminal charges, while the same is not true of consumers who purchase wine from Tennessee retailers	Split appellate decision upheld Tennessee's ban on direct shipment, overruled other Grape and Wine laws including residency requirements for winery licensees and limitations on personal import of wine from out-of-state wineries. Case was remanded; remand was stayed temporarily pending amendments of Grape and Wine Law. The plaintiff filed a Petition for Writ of Certiorari, which the Supreme Court denied on 10/5/09.	On 3/30/07, the trial court ruled that Tennessee's laws (including its ban on direct shipment) were not discriminatory on their face since all wineries, in-state and out-of-state, must sell their products through wholesalers. Despite the Plaintiffs' argument that Tennessee's limited exception permitting in-state wineries to sell their products on-site at retail was discriminatory to out-of-state interests, the Court aptly noted that it is inappropriate to compare direct shipping with on-premise sales of wine under the dormant Commerce Clause, as they are two distinct markets	The Tennessee General Assembly amended the Tennessee Grape and Wine Law (via Senate Bill 944)		
TX*	Import laws prohibiting out-of-state retailers from shipping liquor directly to Texas residents; requiring a permit to manufacture, sell, import and export alcohol; establishing permit requirements; requiring Texas residency for wholesalers; requiring package store permits to make deliveries to customers; and requiring carrier permits to transport alcohol interstate and intrastate. Texas Alcoholic Beverage Code Secs. 107.05, 107.07(f), 6.01, 11.01 (a-b), 22.03 and 41.01	Fifth Circuit vacated and remanded the trial court's ruling, effectively banning out-of-state retailers from shipping wine directly to Texas consumers. The Court also upheld Texas's personal import exception, limiting quantities that may be transported into Texas for personal consumption. Plaintiffs have moved for a rehearing *En Banc*.	On 1/14/08, the trial court held that the State's citizenship requirement for retailers, ban on out-of-state retailers' shipment of wine to Texas residents, and a series of related provisions applying to out-of-state retailers, facially discriminated against out-of-state retailers in violation of the Commerce Clause. The Court found that the ban on direct shipping by out-of-state retailers was not necessary to preserve Texas' three tier system because, at the same time as it struck down the citizenship requirement and out-of-state retailer direct shipping ban, the Court also upheld the Texas law requiring that wine sold and shipped to Texas consumers by any retailer be purchased from licensed Texas wholesalers.	No legislative activity has occurred to date, however, the Texas ABC has liberalized direct shipping regulations and tax payment schedule at request of the Wine Institute		

	Laws At Issue	Current Status	Lower Court Outcome	Legislation Triggered		
VA	Prohibiting direct shipment of wine, beer or spirits from out-of-state producers, wholesalers or retailers to Virginia residents or retailers. Va. Code Ann. §4.1-100, *et seq.*	The Fourth Circuit affirmed in part and reversed in part. It held that amendments to Virginia's statutes mooted challenges to the "distribution privilege" (allowing in-state wineries and breweries to sell direct to Virginia retailers), the "delivery privilege" (allowing in-state producers to deliver unlimited amounts direct to consumers while limiting out-of-state producers); and the "shipping privilege" (requiring out-of-state retailers to obtain written permission from manufacturers in addition to a license to sell and ship direct to Virginia consumers). The Court upheld the "personal import exception" and the "ABC store restrictions." The plaintiff filed a Petition for Writ of Certiorari, which the Supreme Court denied in May 2007.	Magistrate and trial court ruled that the challenged statutes discriminated against interstate commerce by prohibiting direct shipment of wine to Virginia residents from out-of-state entities, while permitting in-state producers to do just that. The State appealed and after the legislature amended the statutes to moot some of the plaintiff's challenges, the Fourth Circuit remanded the case to the trial court for further consideration of the new legislation. The plaintiff filed an amended complaint challenging new legislative provisions that permitted in-state wineries and breweries to sell and deliver unlimited amounts of wine and beer directly to in-state retailers ("distribution privilege"); permitted Virginia wineries to sell and deliver unlimited quantities of their products to Virginia residents by their own mode of transportation while limiting out-of-state manufacturers to two cases per month using common carriers ("delivery privilege"); required shippers licenses for some entities to ship to Virginia consumers as well as requiring out-of-state retailers or wholesalers to obtain a producer's consent before shipping each brand of its wine or beer to Virginia in order to obtain a shipper's license ("shipping privilege"); capped the quantity of wine or beer that a consumer may transport into Virginia from out-of-state ("personal import exception"); and prohibited Virginia ABC stores from selling wine produced by non-Virginia wineries ("ABC store restrictions"). The trial court found all of the challenged provisions to violate the Commerce Clause apart from the two-case-per-month limit on direct shipment of wine or beer to Virginia residents by in-state or out-of-state producers.	During the first appeal to the Fourth Circuit, Virginia's legislature enacted new statutes which modified portions of the challenged laws. Accordingly, the Fourth Circuit vacated the trial court's opinion and remanded the matter for reconsideration in light of the modified statutes.		
WA	Retailer-to-retailer sales ban; price posting and hold requirements; uniform pricing policies; ban on credit to retailers of beer and wine; prohibitions on volume discounts for beer and wine; delivered pricing; ban on central warehousing; restrictions on wine warehousing; and minimum mark-up requirements.	Split appellate decision struck Washington's post-and-hold provisions, upheld other pricing and distribution laws (*i.e.*, retailer-to-retailer sales ban; central warehousing ban; minimum mark-up requirements; prohibitions on credit to retailers of beer and wine, etc.)	On 12/21/05, the trial court ruled that the central warehousing ban was a hybrid restraint and preserved the issue of retailer-to-retailer sales bans for trial. The court further ruled that Washington's direct-to-consumer and direct-to-retailer shipping provisions discriminate against out-of-state suppliers, but stayed enforcement of the order striking these provisions until after the Washington legislature had the opportunity to address the issue. On 4/21/06, the court issued a verdict after seven days of trial, holding that the retailer-to-retailer sales ban is a unilateral restraint that does not violate the Sherman act. However, the court found that the 21st Amendment did not save the other provisions which the court had already found to be hybrid restraints including: posting requirement and 30-day hold of posted prices; uniform pricing policies; prohibitions on credit to retailers of beer and wine; prohibition on volume discounts for beer and wine; delivered pricing; ban on central warehousing; restrictions on wine warehousing; and, 10% minimum mark-up requirement.	On 3/29/06, the Governor signed a bill permitting out-of-state suppliers to ship directly to consumers and retailers. In 2009, the Legislature passed House Bill 2040 (currently awaiting the Governor's signature) which would permit wineries and breweries to engage in cross-ownership with distributors and retailers. Also, the bill would eliminate the state's post-and-hold provisions and a provision requiring wine and beer distributors to mark up the product they get from manufacturers by at least 10 percent.		

	Laws At Issue	Current Status	Lower Court Outcome	Legislation Triggered		
WV	Laws requiring suppliers that are not in-state "farm wineries" to pay a wine liter tax on sales to West Virginia distributors, while "farm wineries" can avoid the tax by shipping directly to retailers.	Concluded. Plaintiff voluntarily dismissed its complaint.	Plaintiff dismissed case and agreed to pay liter tax "under protest," permitting it to further litigate the case in a court of taxations.			

March 25, 2010

The Honorable Hank Johnson
Chairman
House Judiciary Subcommittee on
Courts and Competition Policy
2138 Rayburn House Office Building
Washington, DC 20515

The Honorable Howard Coble
Ranking Member
House Judiciary Subcommittee on
Courts and Competition Policy
2138 Rayburn House Office Building
Washington, DC 20515 VIA EMAIL

RE: Hearing on Legal Issues Concerning State Alcohol Regulation by the Subcommittee on Courts and Competition Policy – Committee on the Judiciary

Dear Chairman Johnson and Ranking Member Coble:

Marin Institute appreciates the opportunity to comment on the matter pending before the Subcommittee on Courts and Competition Policy involving the Legal Issues Concerning State Alcohol Regulation. Because Marin Institute did not testify at the hearing held by the subcommittee on March 18, 2010, we now submit these written comments.

Founded in 1987, Marin Institute is a nonprofit organization whose mission is to protect the public from alcohol-related harm. We advance policies to reduce over-consumption and monitor alcohol industry practices that undermine public health and safety. Given this background, Marin Institute is uniquely qualified to comment on the legal issues concerning state alcohol regulation and to help ensure that any changes to the federal oversight of alcohol are made in the interest of public health and safety.

GENERAL CONCERNS

The history of alcohol use and regulation in the United States is a study in contrasts that resulted in two Constitutional amendments. With the passage of the 21st Amendment, the federal government granted the states the authority to regulate alcohol. Since that

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time, states have established varying regulatory systems that allow for the orderly distribution and taxation of alcohol within their borders. While there is always room for improvement, the regulation of alcohol by the states has by most measures been a success that balances the desire of adults to consume alcohol with the state's right and duty to protect the public's health and safety.

While times have improved since the era before Prohibition, problems with alcohol still persist. Every day the lives of people in the United States are affected by problems associated with alcohol use. The U.S. Centers Disease Control and Prevention estimates nearly 80,000 Americans die each year from alcohol-attributable deaths. Other problems include underage drinking, drunk driving, violence, and addiction, as well as broader societal costs including lost work productivity, healthcare costs, and criminal justice costs. State laws and regulations controlling alcohol sales were passed to help protect the health and safety of the public. It is this public imperative that must be protected and strengthened.

Over the past few years, market forces have been challenging state regulatory authority and threaten to undermine the protections every state has established. Court cases such as those in *Granholm v. Heald*[1] and *Costco v. Hoen*[2] are chipping away at the authority of states to regulate the sale of alcohol within their borders by allowing the direct shipment of alcohol by out-of-state retailers into states and by undermining in-state distribution systems. Similarly, efforts for federal action to preempt states' ability to control alcohol sales and other business practices such as labeling and advertising will further undermine the public health and safety that state-based regulation protects.

AREAS OF SPECIFIC CONCERN

I. ACCESS TO ALCOHOL

The scientific literature is abundantly clear that the more access people (especially youth) have to alcohol, the greater the number of problems communities will suffer. In addition to the individual struggles of dependence and addiction, societal challenges include drunk driving, increased health care costs, violent crime, child abuse and neglect, just to name a few. In addition to the specific comments below, Marin Institute stresses that in all considerations, the subcommittee should bear this reality in mind.

Currently states have the authority to directly sell alcohol or license private retailers to do so. By controlling where and when alcohol is sold, states can seek to prevent those issues associated with increased availability. For example studies have demonstrated that the higher the alcohol outlet density in a given area, the greater the incidence of community violence, drinking-driving incidents, injuries, underage drinking, public nuisance activities, among other societal problems. Because states are in the best position to evaluate and address problems facing its communities, Marin Institute supports actions that reinforce the authority of states to regulate all aspects of the sale of alcohol within its borders.

[1] 544 U.S. 460 (2005).
[2] 538 F.3d 1128 (2008).

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Similarly, Marin Institute supports actions that limit the direct shipment of alcohol. The ease of Internet sales has the potential of undermining the ability of states to fully account for the sale of alcohol within its borders. Marin Institute supports actions that allow for states to strictly limit or ban Internet sales of all alcoholic beverages. Such strict measures are necessary because in addition to the aforementioned problems associated with increased access to alcoholic beverages, Internet sales present increased opportunities for underage youth to purchase alcohol, which is nearly impossible to police. In addition, Internet sales represent an end-run around the three-tier system that potentially deprives the government of taxes paid by wholesalers.

II. PRICING

Marin Institute strongly supports measures that reinforce the authority of states to set the prices for alcohol. Substantial research shows that higher prices of alcohol are associated with reduced alcohol consumption and alcohol-related problems, especially in youth. As a result, the subcommittee ought to seek to reinforce the rights of states to set the price of alcohol both through control measures and taxation.

III. LABELS & ADVERTISING

Marin Institute supports the ability of states to regulate labeling and the advertising of alcoholic beverages within its borders. Alcohol advertising and packaging have been shown to influence both adult and underage drinking. As a result, active regulation of labels and advertising can have a positive impact on reducing alcohol consumption.

Some have argued that combined with federal labeling laws, state labeling laws are unnecessary, duplicative, and result in a lack of uniformity. However, this argument presupposes that one, the federal government is better suited to establish labeling rules for than state authorities; and two, the need for alcohol companies to enjoy uniform labeling outweighs a state's citizens to have the most effective labeling laws possible, neither of which is necessarily true. Moreover, the 21st Amendment grants states with the power to regulate alcohol within their border. As for concerns with regard to advertising, states are already held accountable by the 1st Amendment.

IV. THREE-TIER SYSTEM

Maintaining the integrity of the three-tier system is necessary for ensuring the health and safety of the public. The three-tier system ensures that alcoholic beverages are distributed and sold in a responsible manner. By requiring all alcoholic beverages sold in states to go through the channels established in a three-tier system, states are able to more easily hold parties responsible for violations of the law, as well as more easily collect taxes. Prior to the establishment of the three-tier system, manufacturers could sell directly to drinkers through tied houses. These vertically integrated systems often resulted in overly aggressive marketing and excessive sales, which in turn led to problems with over-consumption. Because larger manufacturers were not located in

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many of the communities in which their beverages were sold, it was difficult for communities to hold manufacturers responsible for their irresponsible sales practices.

The system now requires manufacturers to sell their products to local or regional distributors, who in turn sell the products to local retailers. The three-tier system creates a structure that ensures that the state has adequate oversight of alcohol sales. It is in this way that the three-tier system helps prevent aggressive and abusive marketing and sales techniques, as well as encourage moderation. For these reasons, Marin Institute strongly supports maintaining the integrity of the three-tier system.

V. ANTITRUST AND INDUSTY CONSOLIDATION

Finally, we want to point out two reports Marin Institute released last year that illustrate concerns we have regarding the increasing consolidation of the alcohol industry, the potential impacts on the state-based three-tier distribution system, along with other public health concerns: "Big Beer Duopoly: A Primer for Policymakers and Regulators"[3] and "The Myth of the Family Winery: Global Corporations Behind California Wine."[4]

CONCLUSION

Alcohol use remains a major problem in America today. Increasingly powerful forces are challenging state regulatory authority that threatens to undermine the protections each state has established. Thus, the subcommittee must be careful to consider any proposed change within the greater context of public policy and public interest.

While chipping away at the current regulatory system may provide some economic benefit to a few businesses in the short run, the long-term toll on public health and safety will ultimately be felt (and paid for) by everyone, personally and collectively. Instead, the subcommittee can seize this opportunity to recommend strengthening the regulatory authority of states, and more broadly reduce alcohol-related harm and ensure that the public health and safety of the American people remain the top priority.

Thank you for the opportunity to comment on this important matter.

Sincerely,

Michele Simon, JD, MPH
Research and Policy Director
Marin Institute

[3] Available here: http://www.marininstitute.org/site/images/stories/pdfs/big_beer_duopoly.pdf.
[4] Available here: http://www.marininstitute.org/site/images/stories/pdfs/winemythreport.pdf.

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Statement of Robert S. Pezzolesi, MPH
Founder and President
New York Center for Alcohol Policy Solutions
677 S. Salina St.
Syracuse, NY 13202

RE: Legal Issues Concerning State Alcohol Regulation

March 18, 2010

To: Honorable Members of the House Subcommittee on Courts and Competition Policy

As a public health practitioner and a community advocate working to limit the harms engendered by alcohol consumption, I urge you to reaffirm the state regulation of alcohol, as established by the Twenty-first Amendment of the U.S. Constitution.

Alcohol is not a typical consumer product. It is the 3rd leading root cause of death in the U.S. and is responsible for over 4,500 underage deaths per year (according to the Centers for Disease Control and Prevention). The economic costs of alcohol-related harms to our nation amount to over $180 billion per year, with many of those costs borne by our already overburdened healthcare system.

Because alcohol is not just another consumer product, great care needs to be taken to protect (and enhance) our state systems of regulation in order to preserve public health and public safety.

Strong regulatory policies have been shown to reduce alcohol misuse and its consequences, and state policies have shown to be important factors in reducing binge drinking, even among college students. State-level and local control of alcohol regulation are preferable to federal control because of differences in drinking cultures, among many other reasons.

Additionally, any policies that work to reduce the price of alcohol are misguided. A vast body of research has confirmed that cheap alcohol leads to higher levels of consumption and more alcohol-related problems, including underage drinking. I would refer the subcommittee members to the federal agencies with expertise in this matter: the Alcohol Team at the CDC, and the NIAAA.

In closing, I would again ask you to protect the health and safety of the American people and do not be party to what Brannon Denning has called "the functional repeal of the Twenty-first Amendment."

Respectfully submitted,

Robert S. Pezzolesi, MPH

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Statement Submitted for the Record by
The Specialty Wine Retailers Association

Hearings on Legal Issues Concerning State Alcohol Regulations

March 18, 2008
Subcommittee on Courts & Competition

Specialty Wine Retailers Association was invited to testify at the March 18 hearings on Legal Issues Concerning State Alcohol Regulations. However, the extraordinarily short notice of these hearings and being invited only three days in advance made it impossible for a representative of SWRA to appear. In lieu of appearing in person, we submit the following statement to be included in the record of the hearings.

The Specialty Wine Retailers Association is an organization of brick and mortar retailers, wine auction houses, Internet wine retailers and wine clubs located across the country. All members are licensed in their home state and many hold licenses in other states that grant them the right to ship wine directly to consumers there. This organization formed for the simple reason of overcoming state based discrimination against out-of-state retailers who have, for the purposes of protecting the profits of huge distributor conglomerates, been prohibited from supplying consumers with the wines they want via direct shipment of wine.

For the record, SWRA would urge this committee to ignore calls for exempting states from Commerce Clause court challenges for the simple reason that to do so would irrevocably harm consumers, competition and commerce across the country.

The current claim that states ought to be protected via federal legislation from court challenges of discriminatory laws aimed at out of state commercial interests is one more attempt by alcohol wholesalers to see their interests protected over the interests of consumers, retailers, and producers of wine. It is an attempt by multi-state, huge alcohol wholesalers to gain exemption from playing by the rules outlined in the United States Constitution. To grant them this kind of protection would not merely be slap in the face to fairness and American entrepreneurs and to law abiding consumers, but would inevitably lead to an upwelling of outrage by consumers who feel it is unfair to punish them and preclude them from accessing the products they want simply to protect the profits of well-heeled wholesalers.

The American courts, including the Supreme Court, have been clear in their interpretation of the Commerce Clause and the 21st Amendment: States have broad rights to regulate the sale and distribution of alcohol. However, they may not do so by burdening out of state commercial interests with protectionist laws. Rightly, numerous courts have struck down those protectionist laws. Legislation currently being pushed by alcohol wholesalers that would make challenges of protectionist laws more difficult is nothing more than sour grapes and, if enacted, would prove disastrous to consumer interests and entrepreneurship.

It is important to note that testimony given Michigan Liquor Control Commission Chairwoman Nida Samona was delivered without substantiation. There is no evidence to suggest that out of state shipments of wine result in either increased consumption by

minor or tax revenue. In fact, Michigan currently collects taxes on shipments from out-of-state wineries that were not collected prior to their enactment of a permit system for out-of-state winery shipments. The same permit granted to out of state wine retailers would also result in increased tax revenue. However, that avenue for regulating and collecting taxes on wine shipments from out-of-state retailers was closed. The result is that Michigan consumers cannot have access to the vast majority of wines available in the United States, Michigan retailers, who now may no longer ship to Michigan residents, have been hurt and the state of Michigan has lost substantial tax revenue.

Despite statements and positions by wholesalers who would seek to completely control the distribution and sale of alcohol and thereby exert near total control over producers and retailers, there remains no evidence that reform to state alcohol laws would lead to anything of the conditions said to exist in the UK.

In fact, where direct shipping of wine to consumers from out of state wineries and retailers is concerned, we hope the committee will take note that no state alcohol regulator and no member of law enforcement anywhere in the country has at anytime claimed or testified that problems with minors obtaining alcohol via direct shipping have occurred.

The members of the Specialty Wine Retailers Association urge the Committee to not bow to unsubstantiated claims that disaster will befall the states if alcohol wholesalers are not granted protection from competition through legitimate commerce clause challenges as well as exemption from anti-trust laws. Wine retailers across the country urge the

committee to not move toward removing recourse to the American Courts when states enact legislation that discriminates against out of state interests. To do so would forever harm wine producers, beer producers, America's small retailers and, most of all, consumers.

States have numerous tools at their disposal for assuring that alcohol sales are well regulated, minors protected, tax revenue collected and societal concerns considered, while at the same time assuring that consumers have access to the products they want and entrepreneurs able to supply a growing demand for artisan and craft products.

Contact Information:
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March 24, 2010

Joint Statement by Wine Institute and WineAmerica

"Legal Issues Concerning State Alcohol Regulation"

For the March 18, 2010 hearing before the Subcommittee on Courts and Competition Policy Committee on the Judiciary U. S. House of Representatives

Introduction

Wine Institute and WineAmerica jointly and respectfully submit these comments in response to the Subcommittee on Courts and Competition Policy of the House Committee on the Judiciary's hearing of March 18, 2010, entitled "Legal Issues Concerning State Alcohol Regulation". Together, our membership represents virtually all wine produced in the United States. We appreciate the opportunity to submit these comments.

I. Granholm Decision Clarifies State Power and Does Not Create Exigent Circumstances that Require Congressional Intervention

Both Wine Institute and WineAmerica have consistently supported a state's right to require a three-tier distribution system, and the Supreme Court in Granholm was very clear that three-tier distribution is "unquestionably legitimate." That being said, the current line of litigation that has come after the *Granholm v Heald* decision does not create circumstances that call for Congressional intervention. Granholm stands for one thing: that states may regulate, but cannot discriminate. Many of the state laws being challenged in the post-Granholm litigation present issues similar to what were presented in the Granholm case. Not all cases have resulted in the challenged provisions being struck down, and in several cases, courts have refused to strike down some challenged provisions and have found them to be proper exercise of state power under the 21st Amendment. We view the litigation, which has been utilized by all three tiers, producers, retailers, and wholesalers, as an effort to balance state laws and regulations to the findings in the Supreme Court decision and are an important part of this country's much larger legal history of alcohol beverage control. These cases, and the many cases that have come before it, are not an assault on a state's 21st Amendment rights, but a constant evolution to clarify and more clearly define the boundaries and limits of the 21st Amendment. The balance struck by the

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body of law regulating alcohol over the last 4 decades provides flexibility in the system and permits states to use a wide selection of alternate regulatory tools to meet 21st Amendment goals.

We note that while three-tier distribution is legitimate, it is by no means exclusive. In fact, we would argue no true three-tier system exists as alcohol regulation has evolved. There are several other distribution methods that are likewise legitimate and crucial to the survival of many of our members. For example, state provisions that permit self-distribution of wine are important to many of our members, as are laws that allow wine producers to sell wine directly to consumers. Not only are important state interests met through the adoption of these methods, but they are also vital to consumer choice and the continued growth of our industry. These methods are what many of our members have turned to in response to the economic downturn that has faced many businesses, large and small, in the United States and to the lack of wholesaler interest in distributing many of our members' wines.

Rather than diluting state power to regulate alcohol, Granholm clearly acknowledges state rights, but tempers those rights by raising Constitutional borders to define the outer limits of a state's exercise of power. Granholm does not prophesize the swift erosion of state rights, but rather telegraphs to states that their exercise of power under the 21st Amendment must be tempered with Constitutional principles of fairness as found in the Commerce Clause and due process provisions. These constitutional limitations are important and act as curbs against abusive and protectionist laws that solely benefit local economic interests. No state should be able to claim constitutional immunity for its exercise of 21st Amendment power, and a Congressional act that would grant such constitutional immunity would simply give license to those with a vested economic interest to pass discriminatory laws in state legislatures absent any of the safeguards now provided by the Constitution.

The dynamics of litigation and state legislation will no doubt draw more distinct legal tests to measure the appropriateness of a state's exercise of power. The legacy of Granholm is a business environment that is less protectionist and free from collusion, discrimination and preferences. We look forward to the ongoing development of this environment so that our members can more effectively work with all distribution levels and fairly and actively compete. We do not believe that states need to seek authorization from Congress to exceed the protections of the Constitution or the antitrust laws. The circumstances hardly warrant such an extraordinary remedy, or indeed any effort to roll back alcohol regulation to days of outright preferences and discrimination. As several witnesses noted at the hearing, "If it ain't broke, don't fix it."

II. State Rights Under 21st Amendment Provide Ample Power; No Risk of Deregulation

States have very broad rights under the 21st Amendment when it comes to alcohol beverages. Three-tier distribution is just one of several industry areas in the much larger universe of alcohol beverage control. Licenses, permits, accessibility, age of purchase and possession, excise taxes, transportation, direct sales, are all areas that have been the subject of state power under the 21st Amendment.

Congress granted states an important tool by giving states access to federal courts to enjoin actions of out-of-state businesses that ship alcohol into their states in violation of state law. The 21st Amendment Enforcement Act extends the jurisdiction of Federal courts for violations of state shipping laws that are a valid exercise of the 21st Amendment and other provisions of the Constitution. Wine Institute and WineAmerica supported this legislation.

This Act of Congress, along with the continuous exercise of state power in the day-to-day regulation of alcohol beverages, even in light of Granholm, are not indications of deregulation, but of freedom from discrimination. Even after the decision in Granholm, Michigan could choose to prohibit all winery-to-consumer sales, or allow such sales without regard to whether a winery was in-state or out-of-state. Far from the fragile situation and dark demise postured by proponents for Constitutional and antitrust immunity, states are constantly and continuously regulating alcohol beverages in ways that are consistent not only with the Constitution, but also with clear state interests such as the need for temperance, curbing excessive consumption or abuse of alcohol beverages, addressing underage drinking, and punishing conduct such as driving while under the influence. The exercise of state power is well, healthy, and in these areas continues unchallenged.

III. Role of Federal Regulation in Alcohol Market Would Be Gutted By Drastic Remedy

Federal laws, regulations, and activities supply an important baseline framework for states when exercising their 21st Amendment powers. Federal laws and regulations such as the Federal Alcohol Administration Act, the regulations enforced by the federal Alcohol & Tobacco Tax & Trade Bureau that establish product standards of identity and require permits and label approvals, the oversight of advertising and competition by the Federal Trade Commission, are just a few examples of the importance of federal presence. Many states rely on federal label approvals and require wineries to submit approved federal Certificates of Label Approval when registering their brands in the state. Uniform standards of identity on the federal level lead to consistent product integrity nationwide.

Extraordinary proposals such as Constitutional or antitrust immunity or the elimination of federal preemption would have equally extraordinary consequences, removing any limits on abusive control. States would, for example, be entitled to impose burdensome labeling requirements on out-of-state wineries, require costly and senseless product reformulations for in-state sales, design a protectionist distribution system that favors in-state interests or provides commercial advantages to in-state businesses, fix prices or impose consumer-unfriendly resale price maintenance schemes, or create tax preferences or exemptions for in-state products. If state law is allowed to reign supreme when it comes to the sale or distribution of alcohol beverages, the impact on federal regulatory schemes would be profound. Four decades of judicial decisions have already addressed many of these issues and laid many of them to rest. Removing Constitutional, antitrust, or preemption limitations would only serve to resurrect these protectionist measures.

IV. Congress Should Be In Favor of Open Competition and Free Markets

Pricing controls have been the subject of previous litigation, and in several of these cases, state laws were viewed through the lens of state and federal antitrust laws. Provisions such as resale price maintenance and pricing controls that affect interstate commerce have been consistently struck down either as being offensive to federal commerce power or as antitrust violations.

Many states have enacted laws that provide by statute what a face-to-face contract might not require. Monopoly protection laws, sometimes more benignly called "franchise security" laws, are enforced in many states. These laws provide contractual and commercial advantages to in-state wholesalers who benefit immensely from these provisions. Under such laws, producers are not as free to move from poor performing wholesalers to wholesalers that will more adequately service their brands. The Federal Trade Commission has viewed some of these laws to be questionable under the antitrust laws and has taken an interest in this area.

Congress is historically in favor of consumer choice and market development. There is no merit to a request for an antitrust exemption or constitutional immunity unless the true intent is to enact laws that violate them. Our members can only ask what public good is served by such drastic relief. We cannot believe that states must act without constitutional limitations and with total disregard of the Sherman Act in order to regulate alcohol effectively.

V. Baseless Comparison Between UK and US With Regard to Regulation of Alcohol

As both Pam Erickson and Representative Mike Thompson pointed out in the hearing, comparing US and UK alcohol regulation regimes is "comparing apples to lemons." The problems that the UK is currently experiencing are of their own kind, and unique in their characteristics. It is caused in large part by a nationwide regulatory vacuum that resulted in expanded retail serving hours of sale and uncontrolled consumer accessibility. While we acknowledge the issues with alcohol in the UK, it is a country confined to its own facts. The UK conditions would be impossible to reproduce in the United States because of the powers granted to the states by the 21st Amendment.

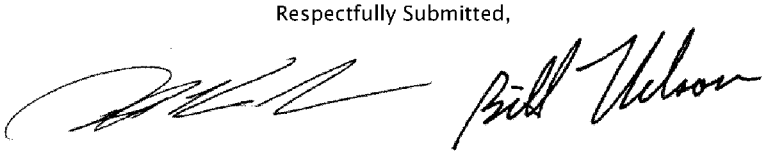
Our members appreciate the benefits of an orderly yet sensible, non-discriminatory and fair distribution market for wine. The 21st Amendment, properly exercised by the states to address retail sales hours and consumer accessibility, make any comparisons between the UK and the US purely academic.

VI. Conclusion

Circumstances do not warrant the position advocated by the wholesalers that states need powers beyond the broad powers granted by the 21st Amendment. Neither do we believe that an antitrust exemption is necessary to regulate markets to address legitimate state interests. Although broad, we believe that the powers granted to the states by the 21st Amendment do not and should not in the future supercede or take precedence over other provisions of the Constitution. This is what the wholesalers desire to protect their monopoly distribution system,

and it is wrong-headed. As wine producers navigate the state labyrinth of regulations and controls, we believe that in a free market, consumer choice and fair and non-discriminatory control should determine how commerce is structured.

Respectfully Submitted,



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