

OUTLINE OF TESTIMONY
BEFORE THE SENATE OF PENNSYLVANIA
LAW AND JUSTICE COMMITTEE

BY

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I. Introduction

- A. Thank you for the opportunity to address the committee this morning and offer my perspective with regard to HB 291.
- B. Practiced law for 29 years
- C. Managing partner of the Minneapolis law firm of MDH
- D. I have been an AV rated lawyer by Martindale Hubbell (the highest possible peer review rating in legal ability and ethical standards) for over 20 years and have been recognized as a "super lawyer" (a peer review rating given to only 4% of the lawyers in Minnesota) for the last ten years.
- E. I am licensed to practice in the states of Minnesota and Wisconsin. I am also licensed to practice before the United States Supreme Court and the 1st, 4th, 7th, 8th, and 9th Circuit Courts of Appeal.
- F. During my career, I have represented numerous beer wholesalers and beer wholesaler associations across the country. In pertinent part, I serve as Counsel to the National Beer Wholesalers Association, the Minnesota Beer Wholesalers Association, and the Beverage Distributors of New Hampshire. I have been retained by numerous other beer wholesaler associations to analyze liquor laws and recommend statutory changes. I have presented numerous seminars and been a featured speaker at annual meetings and conferences of the NBWA, the Center for Alcohol Policy, as well as many state beer wholesalers associations. I was counsel of record on behalf of the NBWA regarding amicus briefs submitted to the United States Supreme Court and the 1st, 4th, 7th, and 9th Circuit Courts of Appeals in cases that I will be referencing in my remarks this morning.

II. Alcohol is unique

- A. As the committee knows, intoxicating liquor is a unique product in American law. The detrimental impacts on individuals, families, and society as a whole that result from intemperate or underage consumption of intoxicating liquors are dramatically different from those related to the use of other products, whether measured by scale, severity, nature or remediability. As a consequence, government attempts to mitigate these impacts through regulation. Indeed, intoxicating liquor has always been, and remains, 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 intoxicating liquor. No other product has been the subject of one, let alone 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 intoxicating liquors.

This fact underscores the soundness of the Constitutional decision to rest regulatory authority primarily at the state and local level.

- B. We all recognize the attributes of alcohol when responsibly used and the dangers when abused. The goal of alcohol regulation is to balance product availability with appropriate control in order to prevent or at least limit alcohol abuse and underage sales. Regulation is designed to protect consumers against unlawful sales practices, excessive sales promotion, alcohol abuse, and access to minors.
- C. As we have recently and painfully learned in the banking, securities, and mortgage finance industries, we deregulate at our peril. This is particularly true in the socially sensitive alcoholic beverage industry. This lesson was unfortunately learned in the United Kingdom where deregulation in the alcohol industry has resulted in a crisis in national alcohol abuse and underage consumption. In order to attempt to “stuff the genie back in the bottle”, the United Kingdom is currently debating reinstating draconian measures like minimum pricing, far more strict limits on hours and outlets, and the like. These issues dominant political discourse in the United Kingdom and one cannot pick up a newspaper without reading about it.
- D. The most prominent feature of our state liquor regulatory structures is the three-tier system. It was created to avoid the harmful effects of vertical integration in the industry by restricting suppliers, distributors and retailers to one level of activity. Prior to the enactment of three-tier and tied-house laws, suppliers owned retailers “lock, stock and barrel”, the origin of that phrase. The resulting “tied-houses” led to excessive retail capacity and cutthroat competition for market share, which, in turn, led to intemperate consumption as a consequence of excessive sales stimulation. It also had all of the vices of absentee ownership. Suppliers were not typically based in the local community where they sold product and, accordingly, were not particularly sensitive to local concern and social influence. The three-tier system creates a transparent and accountable distribution system which facilitates effective regulation by the state. Also, because of the very nature of their operations, firms in the distribution and retailing tier have a local presence which makes them more amenable to regulation and naturally keeps them accountable. Also, by prohibiting tied-houses, competition, a diversity of products, and availability of products are enhanced as the economic incentives are removed that encourage wholesalers and retailers to favor the products of a particular supplier.
- E. Ordinarily, in our constitutional scheme, if a federal law conflicts with a state law, the federal law trumps and the state law is preempted. State laws regulating intoxicating liquor are treated differently, however, by virtue of the 21st Amendment. Until recently, courts interpreted the 21st Amendment to mean that state liquor laws were exempt from challenge under the Commerce Clause of the Constitution (which is the source of Congress’ power to regulate interstate commerce). Accordingly, if a state liquor law conflicted with a federal law, the state liquor law controlled and the federal law was preempted. Furthermore, states were exempt from challenge under what is referred to as the “dormant” Commerce Clause which ordinarily prohibits a state from passing a law which discriminates against out of state businesses in favor of in-state businesses (and thereby “burdens” interstate commerce).
- F. That long line of cases, however, was recently overruled by a 5-4 majority in the United States Supreme Court case of *Granholm vs. Heald*. At issue in that case were laws in Michigan and New York which permitted in-state wineries to ship direct to consumers but prohibited out-of-state wineries from doing so. The Court held that:

"States have broad power to regulate liquor under § 2 of the Twenty-first Amendment. This power, however, does not allow States to ban, or severely limit, the direct shipment of out-of-state wine while simultaneously authorizing direct shipment by in-state producers. If a state chooses to allow direct shipment of wine, it must do so on evenhanded terms. Without demonstrating the need for discrimination, New York and Michigan have enacted regulations that disadvantage out-of-state wine producers. Under our Commerce Clause jurisprudence, these regulations cannot stand." Importantly, however, the Court also noted the following: "State may also assume direct control of liquor distribution through state-run outlets or funnel sales through the three-tier system. We have previously recognized that the three-tier system itself is 'unquestionably legitimate.'"

- G. Accordingly, Granholm changed the rules of the game. Although the three-tier system itself is "unquestionably legitimate", states could no longer pass liquor laws that expressly discriminate against out-of-state businesses.
- H. As a result of this ruling, many states, like Pennsylvania, have reviewed their liquor laws to determine whether such express discrimination exists. In determining how to address discriminatory statutes, states have balanced a desire to preserve the "unquestionably legitimate" three-tier system (with strict control, transparency and accountability over the distribution and sale of alcoholic beverages) with a desire to nurture small craft wineries, breweries and distilleries, guaranty access to market for those small suppliers and thereby create jobs, expand their tax base and provide a greater diversity of products. Many states have achieved this balance by mandating that all alcohol sales must be effectuated through the three-tier system except those of suppliers (wherever located) which produce less than a certain quantity per year. Under current law, such an exception will pass constitutional muster if it does not have a discriminatory purpose or a discriminatory effect.
- I. A state law is discriminatory in effect when, in practice, it affects similarly situated entities in a market by imposing disproportionate burdens on out-of-state interests and conferring advantages upon in-state interests. A state law has a discriminatory purpose when it is designed to discriminate against out-of-state interests in favor of in-state interests through a facially neutral statute. For instance, just two weeks ago, the 1st Circuit Court of Appeals in the Family Winemakers of California vs. Jenkins case struck down a Massachusetts law which permitted any winery (wherever located) which produced 30,000 gallons of wine per year or less to ship direct to retailers or to consumers. Even though the case was facially neutral, the court found that the law violated the Commerce Clause because every winery in the state of Massachusetts fell below the 30,000 gallon production limit and because the Bill's author stated on the floor of the Massachusetts Senate that the 30,000 production limit was selected for precisely this reason. This illustrates that it is important for states to set their production limits with reference to their desire to nurture all small businesses rather than a parochial desire to only assist in-state businesses.

III. House Bill 291

- A. As it currently exists, Liquor Code § 431 is vulnerable to challenge under Granholm because it appears to facially differentiate between in-state and out-of-state brewers. Accordingly, I applaud the committee and the Pennsylvania Legislature for addressing this situation before you are challenged in a court of law. As proposed, House Bill 291 addresses this vulnerability. Once technical drafting issues are addressed, as I understand is contemplated, it will be clearly facially neutral. It maintains the integrity

of the three tier system by requiring that most sales of beer in Pennsylvania have to be effectuated through the system but permits a limited exception for small brewers (wherever located) who produce 75,000 barrels or less per year. This production limit, in my view, falls within the range of legislative judgment and is appropriate because it is neither discriminatory in effect nor purpose. It would equally benefit out-of-state and in-state small brewers and it would equally burden out-of-state and in-state large brewers. Specifically, it is my understanding that there are Pennsylvania brewers who produce less than this limit and Pennsylvania brewers who produce more than this limit. It is consistent with the federal definition of small brewers for purposes of tax policy which is 60,000 barrels. There are many states that have no exceptions to the three-tier system. Of those that do, however, their production limits generally range between 10,000 to 75,000 barrels. Accordingly, while on the high end, the 75,000 barrel limit is consistent with the direct shipment limits adopted by other states.

IV. Conclusion

A very limited three-tier exemption for small brewers producing 75,000 barrels or less represents a reasonable legislative accommodation of legitimate state goals: maintaining a tightly regulative, transparent, and accountable system for the distribution and sale of alcohol beverages; and nurturing small breweries while guaranteeing their access to market. Other states have passed similar laws.

V. Questions