Case No. 3:99CV755

In the
UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Richmond Division

CLINT BOLICK, et al.
Plaintiffs,
v.
CLARENCE W. ROBERTS, et al.
Defendants.

VIRGINIA WINE WHOLESALERS ASSOCIATION, Inc.
Intervenor-Defendant.

THE ABC DEFENDANTS' AND VIRGINIA WINE WHOLESALER ASSOCIATION INTERVENOR DEFENDANT'S OBJECTIONS TO THE REPORT AND RECOMMENDATIONS OF THE MAGISTRATE JUDGE

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TABLE OF CONTENTS

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I. INTRODUCTION AND SUMMARY OF FACTS AND ARGUMENT

This is one of over a dozen cases in federal and state courts challenging the constitutionality of state liquor laws which, like those in Virginia, require that alcoholic beverages imported from out-of-state sources be shipped to wholesalers (or importers) licensed and regulated by state liquor authorities. The Report and Recommendations of the Magistrate Judge ("Report") reviewed here find that the Commonwealth of Virginia's licensing system is invalid because it authorizes shipments of alcoholic beverages to consumers by licensed in-state producers while, at the same time, it also specifies that imports must be received by licensed

[1] With the exception of those Objections raised by the ABC Defendants solely, which relate to the operation of State ABC stores, these Objections are filed on behalf of the ABC and Virginia Wine Wholesaler Association Intervenor-Defendants jointly. Consequently, for the sake of brevity, these Objections will reference these parties collectively as the "Defendants."

importers or wholesalers before they can be shipped to consumers.[2] According to the Report, this in-state shipment "preference" is facially discriminatory, violates the dormant Commerce Clause and is not saved by the 21st Amendment.[3] In addition, the Report finds that the statutory mandate that State ABC stores sell no wine other than Virginia wines is similarly unconstitutional. The Report recommends that this Court declare that these ABC store provisions of the Alcoholic Beverage Control Act ("ABC") are violative of the dormant Commerce Clause but that implementation of the proposed order be stayed to allow and appeal and to provide the General Assembly an opportunity to revise the ABC Act to remove the in-state shipment authority.

We believe that this Report is erroneous as a matter of law.

First, its Findings of Material Fact are cursory and incomplete. They fail to describe the purpose, structure, operation and effect of Virginia's ABC Act, even though extensive affidavits and numerous undisputed proposed findings of material fact were submitted by Defendants. Without a factual foundation, there is no basis for the Report's conclusions. See TFWS, Inc. v. Schaefer, 242 F.3d 198 (4th Cir. 2001) (reversing holding under 21st Amendment without adequate hearing and findings of fact).[4]

Second, the Report does not closely examine or evaluate the impact of the licensing burdens that in fact fall equally on the products of all producers (in-state or out-of-state). All products must pass through state licensees who are required to report inventories and transactions, make books and records available for inspection, and transmit taxes to the State on a timely basis. It ignores unrebutted evidence that shows that the cost of these burdens is no

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[2] Virginia's import controls do not explicitly ban out-of-state shipments to consumers; rather, they ban all shipments into the State consigned to anyone other than a lawful consignee.

[3] The Report also finds the State restrictions on distilled spirits facially neutral. We limit our Objections to the Report's findings and recommendations on wine and beer.

[4] In addition to the Objections herein, the Defendants object to the Magistrate Judge's rulings on the admissibility of the Defendants' evidence under Federal Rules of Evidence 402 and 706 as well as Federal Rules of Civil Procedure 26.

different for out-of-state as compared to in-state products. Thus, there is no basis for the Report's findings that the ABC Act is facially and economically discriminatory.

Third, the Report fails to consider uncontroverted record evidence that the licensure and compliance requirements of the ABC Act are specifically directed at deterring unlawful purchases and consumption by minors and at discouraging abuse by otherwise lawful purchasers. These valid temperance objectives form the foundation for the State's authority under the 21st Amendment to control closely the importation and distribution of all alcoholic beverages from wherever they are produced. The scope and significance of ABC enforcement efforts and funded programs designed to prevent illegal consumption and to discourage abuse were similarly demonstrated by numerous affidavits and studies submitted by Defendants.

Undisputed record evidence also shows that the State's ability to protect and further its legitimate interests in tight control over the importation of liquor products depends on the Commonwealth's jurisdiction over all sources of supply through strict licensure controls. Allowing shipments to unlicensed persons from unlicensed entities not subject to sanctions for noncompliance with the ABC Act would severely hamper State efforts to prevent diversion and unlawful consumption as well as to curb the misuse of liquor products. Thus, there is no basis for the Report's findings that the Commonwealth has no justification for its requirement that alcoholic beverages must pass through the hands of a Virginia licensee.

Fourth the Report unilaterally rewrites the 21st Amendment as granting states the authority to regulate imports only in states which totally prohibit all shipment, receipt, possession and sale of alcoholic beverages within their boundaries. This restrictive reading of the 21st Amendment misconstrues and misapplies the jurisprudence developed by the Supreme Court since 1936 that consistently has upheld selective state import controls challenged under the dormant Commerce Clause unless they transgress other constitutional provisions. It also ignores dormant Commerce Clause cases which have upheld state import controls under the 21st Amendment even though these cases are repeatedly cited and specifically relied on by recent Supreme Court and leading appellate court opinions.

Fifth, the Report effectively nullifies the Webb-Kenyon Act and other federal statutes wherein Congress exercised its powers under the positive Commerce Clause to validate selective state import controls and to provide for enforcement of state regulation of the importation, distribution and transportation of liquor products. It contorts the plain meaning of the terms of these statutes so as to apply them only to the total prohibition of the use of alcoholic beverages within a state. Under this novel reading, once importation of any amount is permitted, the state loses its authority under these statutes to control such imports. That is not what Congress intended or what the statutes, as written, say.

Sixth, the Report erroneously concludes that the ABC Defendants may not rely on the "market participation" doctrine to justify State ABC stores offering only Virginia wines for sale. That doctrine holds that the dormant Commerce Clause does not preclude a state from participation in the market as a purchaser or seller even if it favors its own citizens in the process. Contrary to the purpose and uniform application of the Doctrine, the Report incorrectly assumes that because the Commonwealth regulates the sale of alcoholic beverages, it cannot also legitimately choose to enter the market in alcoholic beverages and sell no wines but Virginia wines in its own stores.[5]

Seventh, the Report is in error because it does not make the following rulings:

(a) that the challenged statutes are a valid exercise of state authority under the 21st Amendment, and the dormant Commerce Clause does not apply; and

(b) that if the Commerce clause does apply, the challenged statutes are a valid exercise of state authority pursuant to positive Commerce Clause enactments by Congress, including the Wilson, Webb-Kenyon, 21st Amendment Enforcement and FAAA Acts; and such positive Commerce Clause action by Congress overrides

[5] This Objection is raised solely by the ABC Defendants.

application of the dormant Commerce Clause; and

(c) that if the dormant Commerce Clause does apply, then the challenged statutes are not facially discriminatory, and the local benefits are not outweighed by any burden on interstate commerce; and

(d) that if the dormant Commerce Clause does apply, and the challenged statutes are deemed to be facially discriminatory, then they nevertheless survive strict scrutiny and are demonstrably justified by a valid factor unrelated to economic protectionism, and there are no non-discriminatory alternatives adequate to preserve the local interests of the state; and

(e) that if the dormant Commerce Clause does apply, the challenged statutes are nevertheless saved by the application of the 21st Amendment; and

(f) that if the dormant Commerce Clause does apply, the challenged statutes are a valid exercise of the Commonwealth's "core powers" under the 21st Amendment.

Finally, the Report correctly recommends denial of plaintiffs' motion for summary judgment on their challenge to the constitutionality of the ABC Act import provisions requiring hat all shipments into the Commonwealth be consigned to a licensee of the Board. If (contrary to the Objections filed herein) this Court agrees that the different formalistic treatment of in- and out-of-state producers by the ABC Act with respect to direct shipments to consumers is unconstitutional, then the remedy of striking only the retail shipment authority of in-state producers of wine and beer is appropriate.[6] That remedy is directly responsive to the alleged violation and eliminates any supposed differential treatment based on the geographic location of

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[6] Similarly, to the extent that the District Court adopts the Report's conclusion regarding sale of Virginia wines by State ABC stores despite the ABC Defendants' Objections, they also would acquiesce in the remedy approved by the Report of prohibiting those types of sales as well.

the producer. It also is consistent with the intent of the General Assembly to favor severability of any provisions found unconstitutional and, in the case of the ABC Act, to eliminate exceptions found invalid because they discriminated in favor of Virginia producers.

II. OBJECTIONS REGARDING MATERIAL FACTS

A. The Report's Statement of Material Facts Not in Dispute omits much evidence regarding the purpose, structure, operation and practical effect of the ABC Act showing that the authority of licensed Virginia wine and beer producers to sell and ship beer and wine to consumers must meet the same obligations and bear the same burdens as those imposed on the importation of out-of-state products. [7]

1. Out-of-state producers of wine and beer pay no alcohol taxes to Virginia because beer and wine excise taxes are due when the wholesaler delivers the product to the retailer. §§ 4.1-235 & 236. Out-of-state producers may ship their products to Virginia without an ABC license, provided the shipment is made through a licensed importer. See §§ 4.1-207(3) & 208(3). Beer and wine must obtain label approval, whether produced in- or out-of-state, as specified in ABC regulations promulgated pursuant to § 4.1-111A. The ABC Department's enforcement of marketing controls (advertising and promotions within Virginia) and "Tied House" controls (prohibiting producers from holding an interest in retail establishments) apply to in-state

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[7] Some portions of Senate Document No. 5, and isolated facts in the affidavits of Coleburn and Adams were specifically noted in the Report. See ¶ 2, p. 5; ¶ 14, pp. 6-7; ¶¶ 16 & 18, p. 7; ¶¶ 22-24, pp. 7-8. Because of the Report's statement that it considered a detailed factual record unnecessary, this case, (p. 5, fn 6) the overwhelming majority of the uncontroverted facts contained in Defendants' exhibits apparently were not reviewed or considered. Consequently, while the Defendants have attempted to set out some of the relevant facts in this and the succeeding paragraphs, which should have been considered by the Magistrate, these Objections apply to every fact noted in the affidavits of Adams, ¶¶ 1-10, Coleburn ¶¶ 1-19, Curtis, ¶¶ 1-25, Mack ¶¶ 1-9, McCullom, ¶¶ 1-4, Sadler, ¶¶ 1-24, Schulte, ¶¶ 1-24, Stevens, ¶¶ 1-22, the Expert Report of James, V. Koch, the deposition transcripts and other exhibits contained in the Joint Appendix of the Defendants, and offered into evidence. Each of these Exhibits are expressly included herein by reference.

activities of all producers, both in-state and out-of-state. Coleburn Aff. ¶ 16. ABC exercises no other supervision over out-of-state producers. Stevens Aff. ¶ 19.

2. Any entity seeking a license to manufacture alcohol within the Commonwealth must own or lease a site within the State; the site must meet the requirements established by the governing body in which it is located; the entity must provide ABC with identifying information about all individuals who will have an interest in the licensed enterprise; it must provide ABC with copies of all management agreements, corporate documents, etc.; it must demonstrate financial responsibility; it must keep and maintain a complete and accurate set of business books and records on the premises; it must inform ABC of all changes in ownership or management; it must store the alcohol it manufactures in ABC-approved warehouses; and it must sell alcohol only to persons who may lawfully purchase it. Coleburn Aff. ¶ 14.

3. The Virginia farm winery, brewery and winery licenses entitle the holder to manufacture farm wine, beer and wine, respectively. In addition, all three categories of in-state producers may sell wine or beer at a retail store located at the farm winery, winery, or brewery. See §§ 4.1-207(5), 207(4) & 208(7). Like non-producer off-premise retailers of wine and beer, all three categories of in-state producers may deliver or ship wine or beer to consumers.[8] Coleburn Aff. ¶ 15.

4. Every farm winery, winery and brewery must physically segregate the wine or beer it sells from its own retail premises from the wine or beer which it sells to another wholesaler or, in the case of farm wineries, to retailers. In addition, each such licensee must keep accurate records which reflect this physical segregation. These separate storage and record-keeping requirements ensure that the wine excise tax is properly reported and collected and that

[8] For purposes of this discussion, there is no significant difference between a farm winery, winery, or brewery in their ability to ship their products directly to Virginia consumers or elsewhere.

the farm winery's product is not diverted to an inappropriate person or entity. Id.; Stevens Aff. ¶ 11.

5. Farm winery licensees, other producers, wholesalers and retailers of in-state or out-of-state products must comply with the same legal requirements and restrictions at each level of distribution. Farm wineries engaged in wholesale distribution of their farm wines are held to the same wholesale regulatory requirements as non-producer wine wholesalers. Coleburn Aff. ¶ 19. All Virginia wines and wines imported from out-of-state are taxed at the same rate. Id.; see also § 4.1-234. Likewise, all locally-made and imported beer pay the same Virginia beer excise tax. See § 4.1-236. Except for special storage, handling and record-keeping requirements imposed on producers (and producer-retailers), the ABC Act makes no distinction among retailers, breweries, wineries and farm wineries regarding retail license regulations. Coleburn Aff. ¶ 19. In-state producers have been investigated and fined for violation of ABC laws applicable to the retailing of wine or beer. Stevens Aff. ¶¶ 14-16.

6. ABC agents may investigate licensed establishments, including Virginia breweries, wineries and farm wineries, at any reasonable time during business hours to determine whether alcoholic beverages have been manufactured or purchased in accordance with ABC regulations. Curtis Aff. at ¶ 10. ABC actively enforces the requirement that only persons licensed by it may manufacture alcohol in Virginia. Curtis Aff. at ¶ 16.

7. ABC compliance agents inspect and monitor the activities of 67 wineries and farm wineries and 147 wholesale wine distributor licensees throughout the Commonwealth of Virginia. These agents also monitor the activities of 39 breweries and 87 wholesale beer distributors. Stevens Aff. at ¶ 4. Those agents performed 17 inspections and 446 investigations of suspected illegal activities in 1999 involving wineries, farm wineries and wine wholesalers;

they also performed 171 investigations of possible illegal activity by breweries, beer wholesalers, and others during this period. Id. at ¶ 6. These agents also conduct unannounced inspections. Id. at ¶ 7.

8. ABC agents have charged breweries, farm wineries and wineries in Virginia with producing and selling adulterated wine, selling to minors, filing fraudulent reports with BATF and failing to file monthly malt-beverage excise tax reports. Id. ¶¶ 14-16.

9. While ABC agents have no direct authority over out-of-state producers, the agents have uncovered substantial evidence that out-of-state producers have offered to ship alcohol to Virginia consumers without requiring any identification or proof of age before shipping. Curtis Aff. at ¶¶ 14-15.

10. Virginia breweries, wineries and farm wineries make virtually no use of their authority to ship alcohol directly to consumers. During the fiscal year which ended June 30, 1999, Virginia farm wineries shipped less than one percent of their production directly to Virginia consumers, and Virginia wineries and farm wineries shipped eight-tenths of one percent of their production to consumers in other states permitting such shipments. Exhibit C to Curtis Aff. During the same fiscal year, Virginia breweries produced over 152 million gallons of beer of which only 50 gallons were shipped directly to in-state and out-of-state consumers. Exhibit D to Curtis Aff.

11. There is no evidence that the cost of complying with ABC regulations regarding distribution and sale of i-state products is higher (or lower) for in-state producers (i.e., Virginia wineries and breweries, and Virginia Farm Wineries) than for beer and wine importers, wholesalers and retailers handling out-of-state products.

12. As of December 2000, Virginia had 63 licensed farm wineries, 5 licensed wineries, 39 licensed breweries, 337 licensed wine or beer importers, 174 licensed wine or beer wholesalers, 3 licensed distilleries, and 13,342 licensed on-and-off premises retailers of wine and beer. Coleburn Aff. at ¶ 4. ABC import controls channel 100,000 incoming shipments of alcohol a year into a closely regulated system of wholesaler and retail licensees. Curtis Aff. ¶ 21; Mack Aff. ¶ 6.

13. The ABC actively supervises and regulates all phases of the in-state manufacture of alcoholic beverages, the importation of out-of-state alcohol and the transportation, distribution and sale of all alcoholic beverages within the Commonwealth. Curtis Aff. at ¶ 11. During fiscal 1999, ABC conducted nearly 19,000 investigations of possible violations, made 3,567 arrests for violations of the Code of Virginia and imposed close to $1 million in fines and penalties. Id. at ¶ 19.

B. The Report omits material facts not in dispute which show that Virginia's import controls relate directly to core 21st Amendment interests of the state: preventing illegal diversion of alcohol imports; discouraging the abuse and misuse of alcoholic products; collecting excise and sales taxes and eliminating the bootlegger, by tracking and controlling the importation and distribution of beer and wine to thousands of retail licensees.

14. The importation of wine and beer from out-of-state sources to Virginia wholesale licensees and similar transactions by in-state producers may be made only by persons having permits from the ABC Board. ABC regulations also specify that only wholesale licensees of the Board may be consignees of such shipments and that they must keep accurate accounts of the disposition of wine and beer, maintain excise tax records and show that the product is not diverted outside of this control system. The ABC maintains records identifying taxes and fees generated by the sale of wine and beer and the issuance of ABC licenses. Id. at ¶¶ 21-22.

15. For the fiscal year ended June 30, 2000, 1,149 out-of-state vendors shipped wine to Virginia licensed wholesalers and approximately 60,000 out-of-state wine shipments came into Virginia, totaling 55,883,613 liters of wine. Mack Aff. ¶ 5. For the twelve months ended September 30, 2000, approximately 36,000 shipments of beer (53,451,413 cases) were made into Virginia (Id. ¶¶ 5-6) and 211 out-of-state vendors shipped beer into Virginia. Exhibit E to Curtis Aff. Thus, the ABC system for tracking imports and deliveries of out-of-state beer and wine monitors approximately 100,000 separate shipments of beer and wine received annually by Virginia wholesale licensees from over 1,350 out-of-state sources. Mack Aff. ¶¶ 5-6.

16. For the fiscal year ended June 30, 2000, ABC collected $21 million in wine excise taxes from wine wholesalers and $41 million in beer excise taxes from beer wholesalers. Id. at ¶ 8.

17. Underage consumption and the abuse of alcohol is a serious issue in Virginia (and elsewhere) that the Commonwealth's license control system seeks to address. For example, undisputed evidence submitted by the ABC Defendants outlined that binge drinking and other alcohol abuse is a problem at every college and university in the Commonwealth, that such misuse may have serious consequences to student health and performance, and that regulatory controls over the importation, distribution and sale of alcoholic beverages play an important role in addressing the problem. See Sadler Aff. ¶¶ 6, 7, 8, 9, 13; Schulte Aff. ¶¶ 9, 10, 11, 12, 14. Knowledgeable professionals in the field of abusive alcohol consumption and experienced ABC officials agree that without import and license controls, substantial state and private programs preventing unlawful use and encouraging moderation in any event will be impaired.

18. Since the repeal of Prohibition, Virginia has strictly controlled the importation of alcohol into the Commonwealth. Virginia’s original Alcoholic Beverage Control Act was

enacted as Chapter 94 of the 1934 Acts of Assembly. Section 58 of Chapter 94 -- the precursor of the current import control statute – prohibited importation of alcoholic beverages unless consigned to either the ABC Board or to appropriate Board licensees. A comparison of section 58 of Chapter 94 with §4.1-310 shows that, with minor exceptions not material here, Virginia's policy for controlling alcohol imports has remained essentially unchanged for 67 years.

19. At the time the import controls were first created, no private sector interests existed in Virginia's alcoholic beverage industry. See Senate Document 5 at 1 (quoted in Objection 21 infra). Thus, Virginia's import controls were adopted in 1934 not for reasons of economic protectionism but rather as a direct expression of Virginia's core 21st Amendment authority to control the importation, distribution and sale of alcohol.

C. Many of the Report's Statements of Material Fact Not in Dispute inaccurately reference or make material omissions regarding critical provisions of state and federal law.

20. Report Finding # 1 summarizing the Federal Alcohol Administration Act fails to reflect that the Act authorized that agency (and now, its successor, the Bureau of Alcohol, Tobacco and Firearms) to exercise nonexclusive control over manufacturers and distributors of alcohol through the issuance of basic permits. The Act specifies that a permit shall be denied where the Administrator finds that "the operations proposed to be conducted by such person are in violation of the law of the state in which they are to be conducted." 27 U.S.C. § 204(a)(2)(C). Moreover, it further provides that basic permits, once issued, shall be conditioned upon "compliance with the 21st Amendment and laws relating to the enforcement thereof." Id. at § 204(d).

21. Report Finding # 2 fails to note that the drafters of Virginia's post-Prohibition alcohol regulatory system, that included import controls on alcohol which are basically the same

as those attacked by plaintiffs herein, stated: "Fortunately, the repeal of the Eighteenth Amendment and the proposed repeal of the State dry law (the Layman Act) will wipe the slate clean for a new experiment in liquor control. There will be no vested or proprietary interests to be considered." Senate Document No. 5, at 1.

22. Report Finding # 3 only incompletely describes the three-tier control system established by the VABC Act and should read as follows: "Virginia instituted what is commonly known as a three-tier system of alcohol distribution in response to the national repeal of Prohibition. Since 1934, Virginia law has required that only state licensees (or the Board itself) may import beer or wine into Virginia from out-of-state sources, including producers (first tier). In general, wine and beer are imported into the state by licensed beer and wine importers who may consign their shipments of beer and wine only to wholesale licensees (second tier) who are licensed to sell beer and wine to retail licensees (third tier). Retail licensees may only sell alcoholic beverages to individuals entitled to purchase alcohol for consumption."

23. Report Finding # 4 should have the following sentence added: "Likewise, every beer wholesaler must retain information identifying all vendors, both in-state and out-of-state, which shipped beer to the wholesaler and the wholesaler must file a monthly report with the ABC Board showing the dates of shipment, amounts, quantities and excise tax due to the state."

24. Report Finding # 7 is unclear and inaccurate and should be revised in accordance with Objections # 3 & 4, supra.

25. Report Finding # 14 is inaccurate and incomplete insofar as it implies that the purpose of the ABC Act is limited to "promoti[ing] temperance and prevent[ing] vertical integration." (P.7) In fact, beginning with the initial consideration of a state import control law in 1934 (see Senate Document No. 5, at 2), Virginia has always identified its interests as

encompassing (i) encouraging temperance, (ii) preventing diversion into unregulated markets, (iii) prohibiting underage drinking, (iv) protecting consumers from adulterated and misleading products, (v) collecting alcohol tax revenues, (vi) eliminating a black market in alcoholic beverages, and (vii) preventing criminal elements from engaging in alcohol related business as a disguise for other, criminal enterprises. See Memorandum of Law in Support of the Virginia ABC Defendants' Motion for Summary Judgment (Dec. 18, 2000) p.3; Intervenor-Defendant VWWA's Memorandum of Law in Support of Its Motion for Summary Judgment (Dec. 18, 2000) pp.33-40.

26. Report Finding # 15 is incomplete and should be revised to read as follows: "It is a misdemeanor criminal offense for an entity to ship alcoholic beverages into Virginia unless, in the case of wine or beer, such shipment is consigned to a Board licensee by a beer- or wine-licensed importer or, in the case of spirits, unless such shipment is consigned to the ABC Board. It also is a misdemeanor offense for any in-state person who is not licensed to sell any alcoholic beverages. See § 4.1-302. It is a misdemeanor criminal offense for any Virginia consumer or other entity to receive out-of-state alcohol products which have been shipped in circumvention of Virginia's licensing system. See § 4.1-310. Likewise, it is a misdemeanor criminal offense for any consumer or other entity to buy alcoholic beverages from an unlicensed source within the Commonwealth. See § 4.1-303.

III. OBJECTIONS REGARDING THE FINDING OF "FACIAL" AND "ECONOMIC" DISCRIMINATION

A. The ABC Act's import controls are facially neutral.

27. Contrary to the assertion in the Report (p. 13), § 4.1-310 does not constitute "facial discrimination" because all liquor products sold in the Commonwealth – whether manufactured in- or out-of-state – must pass through the hands of a state-licensed entity. The

Code requires that a licensed wholesaler with a fixed location within the state handle out-of-state imports in order to ensure local oversight and to prevent diversion; only a licensed in-state producer meeting the same tax and record-keeping and reporting requirements may distribute and sell products. See Objection # 2-9, supra. In addition, the wholesale and retail controls imposed on alcoholic beverages imported into Virginia apply whether the products were originally produced in-state or out-of-state. Thus, there is no facial discrimination between in- and out-of-state products. See Exxon Corp v. Governor of Maryland, 437 U.S. 117, 126 (1978) ("[T]he act does not prohibit the flow of interstate goods, place added costs upon them, or distinguish between in-state and out-of-state companies in the retail market. The absence of any of these factors fully distinguishes this case from those in which a State has been found to have discriminated against interstate commerce.")

B. The ABC Act's import controls do not constitute "economic discrimination."

28. The Report's finding of "economic discrimination" (e.g., pp. 13-14 & n.11, 24, 26-27, 50-51) is in error because state imposed burdens on in-state licensed producers are identical to the burdens placed on out-of-state producers. See Objections # 2-9, supra. Both licensing schemes require the licensee, whether a wholesaler, retailer or in-state producer, to comply with the very same accounting, reporting and inspection requirements.[9] The formal distinction between requiring that imports pass through wholesale and retail licensees while permitting licensed in-state producers to sell to consumers creates no separate economic effect and thus cannot constitute economic discrimination because all are subjected to the same regulations.

[9] And, in the case of Virginia breweries and wineries that have a retail license, they must comply with all the requirements imposed on producers, wholesalers and retailers .

29. The above analysis of the economic effects of the Virginia control system is further supported by Bridenbaugh v. Freeman-Wilson, 227 F.3d 848 (7th Cir. 2000), where, in reviewing a similar system of import controls in Indiana, the court found no economic discrimination. There formal license provisions varied between in-state and out-of-state producers because of geographic differences, but the economic burdens imposed by law did not. As the court explained:

> Wine originating in California, France, Australia, or Indiana passes through the same three tiers and is subjected to the same taxes. Where's the functional discrimination? Plaintiffs observe that holders of Indiana wine wholesaler or retailer permits may deliver directly to consumers' homes. But these permit holders may deliver California and Indiana wines alike; firms that do not hold permits may not deliver wine from either (or any) source; and even an Indiana citizen than [*sic*] is in the business of selling alcoholic beverages in another state or country is forbidden by [Indiana] law to deliver wine directly from out of state to a consumer in Indiana, no matter the source. (Id. at 853)[10]

This description also applies to the Virginia liquor control system because it permits shipments to consumers only by entities licensed to make retail off-premises sales. See, e.g., §§ 4.1-207(4)& (7), 209(5) (permitting retail shipment of wine and beer to consumers by holders of retail off-premises winery licenses, retail off-premises brewery licenses and non-producer retail off-premises beer and wine licensees). That the Commonwealth of Virginia created a different structure of one comprehensive licensing system for in-state wineries and breweries (and a separate structure for imports and in-state products sold to wholesalers) is of no economic significance at least as long as the burdens imposed on in-state producers are identical in their economic impact as those imposed on out-of-state producers. No state issues licenses to

[10] The Report contradicts itself by simultaneously asserting (p. 22) that Indiana requires all wine to pass through its three-tier system while noting (p. 22 n. 22) that Indiana, like Virginia, allows licensed wineries to make direct shipments to consumers. The Report then seeks to differentiate Indiana from Virginia even though it acknowledges that both systems allow licensed producers the direct shipment authority. The distinction is clearly false. Both states require alcohol to pass through its control system and both states have to some extent consolidated various features of that system for in-state producers.

manufacturers of alcohol at sites located out-of-state because it cannot exercise jurisdiction over such producers, and the vast majority of states confine the issuance of retail licenses to businesses located within the state.[11] If the burdens were different – e.g., if the in-state wine was taxed at a lower rate than out-of-state wines – economic discrimination would exist, see Bacchus Imports, Ltd v. Dias, 468 U.S. 263, 273 (1984) (invalidating exemption from 20% excise tax for locally grown brandy and fruit wine); but the Supreme Court has applied a functional test for finding discrimination looking to substance rather than form or structure in its dormant Commerce Clause jurisprudence. See, e.g., Oregon Waste Systems, Inc. v. Dept of Envtl Qual., 511 U.S. 93, 99 (1994).

30. The Report's finding of economic discrimination in the Act is based on a fundamental misunderstanding of how Virginia's control system is structured and operates. That is, the Report asserts that in-state entities with retail authorization allowing them to ship wine and beer directly to consumers gain a preference not available to out-of-state producers and that this is "actual discrimination." (P. 24) This conclusion, however, is based on two mistaken assumptions; first, that the in-state preference avoids a "price increase" that otherwise would occur (pp. 26-27), and second, that "the degree of control that is exercised under the state's authority of inspection in regard to the in-state preference is significantly less than what exists in regard to the full force of the three-tier system that applies to all out-of-state sources." (P. 51) Neither assumption has any basis in the record;[12] both are counter-factual since in-state

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[11] Plaintiffs acknowledge that only a handful of states issue permits to out-of-state entities to ship beer or wine directly to their citizens. Plaintiffs' Amended Memorandum of Points and Authorities Filed in Support of their Motion for Summary Judgment, filed December 18, 2000, p. 25.

[12] In fact, the undisputed evidence also makes clear that in-state operations of producers, wholesalers and retailers of alcoholic beverages are subject to comprehensive regulation, supervision and inspection and that violations of the ABC Act and regulations are investigated thoroughly and prosecuted

producer-retailers, unlike their out-of-state counterparts, may be investigated by ABC and fined for manufacturing, wholesale or retail violations. Steven Aff. ¶¶ 14, 16-17. Furthermore, plaintiffs made no showing (and the Magistrate made no finding) that in-state wines were sold at a lower price,[13] that the cost of services provided by wholesalers and retailers was different from the cost of the same functions performed by the in-state producer, or that the state's inspection and record-keeping requirements for in-state produced wine and beer was less rigorous than that imposed on out-of-state products. Indeed, the record is just the opposite. It shows that the in-state producer must meet the very same record-keeping, inspection and accountability requirements as wholesalers and retailers. See Objections # 2-9, supra & Coleburn Aff. ¶¶ 15 & 19. If the authority of in-state producers to ship directly to consumers gave them an advantage, one would expect that such shipments would be the norm rather than the rare exception. See Objection # 9, supra (less than 1% of in-state wine and only 50 gallons of 152 million gallons of in-state beer shipped directly to consumers); cf. Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 588 (1986) (applying economic analysis to evaluate likelihood of alleged anticompetitive conduct and effects). Nor is there any suggestion in theory or practice that these costs are lower for in-state producers or that wholesaler and retailer mark-ups are greater for out-of-state products. There can be no economic discrimination when products produced within the state and those produced outside the state face identical burdens even though they are regulated by differently structured licensing schemes. No dormant Commerce Clause cases apply such a

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severely. Curtis Aff. ¶¶ 15-19. Such licensees must collect excise (wholesale) and sales (retail) taxes on all in-state sales of alcoholic beverages. If unlicensed out-of-state producers not subject to Board control were allowed to ship their alcoholic products directly to Virginia consumers without first passing through a wholesale and retail licensee, they could (and undoubtedly would) wholly evade such regulatory burdens and tax collection/remission obligations borne by licensed in-state wineries and breweries. See Stevens Aff. ¶ 22.

sterile formalistic analysis – and the Report cites none to support its assertions. Here, the difference in the structure of Virginia's regulation of in- and out-of-state products simply tracks the reality that only the former are available to be inspected, regulated and taxed by the ABC Board at their place of production.

C. The application of the dormant Commerce Clause to this case, if correct, nevertheless depends on the Court making findings upon a factual record demonstrating, (i) the absence of justification the controls imposed on the importation and distribution of alcoholic beverages, and (ii) that these controls are not the least restrictive controls available.

31. The Report is incorrect in its finding that the Defendants have failed to produce "any meaningful evidence which the Court can accept as creating a genuine issue of material fact regarding any justification for the discriminatory policy." (P. 52) This conclusory statement is made in the face of the Magistrate Judge's ruling that this "facial challenge to a state statutory scheme … does not necessitate the resolution of any material factual dispute." See Report (p. 5 of 6), Order of the Magistrate Judge regarding evidentiary motions by the parties (July 27, 2001). Moreover, the Report also concludes that the Defendants "failed to present evidence that there are no other nondiscriminatory means to promote the same core concerns …" (P. 52). To the contrary, the Defendants have offered — and the Magistrate Judge erroneously declined to consider — ample undisputed record evidence demonstrating that the volume of alcoholic beverages imported into the Commonwealth, that the number of producers of wine and beer which make their products available in this state, and that the limited jurisdiction of the ABC Board to inspect, monitor and regulate only in-state entities would severely impair (and possibly destroy the integrity of the Virginia Regulatory control system if unlicensed and unregulated shipment were permitted. See Curtis Aff. ¶ 18; Stevens Aff. ¶ 19. Based on this unrebutted

[13] In fact, Virginia wine sold at State ABC stores is taxed at a higher rate than the tax imposed on

evidence, the Report should have found that the Commonwealth had ample justification for its controls, and that as a matter of law, let alone practicality, there were no other means by which the ABC could perform its duties to inspect monitor, and regulate all these out-of-state producers in the manner it does with in-state entities.

IV. OBJECTIONS REGARDING APPLICATION OF THE 21ST AMENDMENT[14]

A. The 21st Amendment immunizes state controls on the importation, distribution and transportation of alcoholic products from challenge under the dormant Commerce Clause.

32. The Report incorrectly concludes that the 21st Amendment's sole function is to serve as a futile, last ditch attempt for rescuing a statute that otherwise would be found to violate the dormant Commerce Clause. In doing so, the Report ignores the defining feature of this case, namely, that it is a frontal assault on the challenge to a state ban on the importation and distribution of alcoholic beverages directly to consumers outside of the state's regulated liquor license control system. No Supreme Court decision has ever applied, the dormant Commerce Clause so broadly as to challenge state controls focused directly on imports. No Supreme Court decision has ever read the 21st Amendment's import control immunity so narrowly as to jeopardize basic state regulatory authority over alcoholic beverage license systems. This is not a case about discriminatory internal taxes or external (i.e., extra-territorial) price controls on liquor; nor is it about special rules for non-liquor items such as waste that are routinely condemned as violative of the dormant Commerce Clause. Rather it is about state controls on the importation and distribution of alcoholic beverages, a species of commerce afforded unique

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wine sales at other retail stores. See § 4.1-234; Coleburn Aff. ¶ 19 (4% additional tax).

[14] Section 2 of the 21st Amendment provides as follows:

> 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.

Constitutional dimension, and for which the states have been granted extraordinary powers of control free of the strictures of the dormant Commerce Clause. The 21st Amendment permits the ban on imports outside of a state's license system — even where licensed in-state producers are permitted to ship their products to consumers because they are subject to strict state license controls. Thus, as argued by the Defendants before the Magistrate Judge, the appropriate analysis in this case begins and ends with the 21st Amendment; the dormant Commerce Clause has no place where import controls — and nothing else — are at issue.

33. In addition, the Report erroneously contends that the 21st Amendment does not override claims under the dormant Commerce Clause even where the control laws focus on the importation, distribution and transportation of alcoholic beverages into a state for use contrary to state law. (See pp. 19, 25-26, 41)[15] The Report would confine the exercise of state authority under §2 of the 21st Amendment to a total ban of liquor imports but nothing else. And this leads the Report to apply dormant Commerce Clause jurisprudence to conclude that any seeming conflict between it and the 21st Amendment requires application of a "balancing" test (p. 37) weighing state interests under the "core concerns" (p. 46) of the Amendment (i.e., temperance, diversion, taxation, criminal elements and bootlegging) against the alleged harms to free trade in liquor products in interstate commerce and the availability of less onerous alternatives.[16] See

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[15] Despite the conclusion in the Report (pp. 20-21), Healy v. Beer Inst., 491 U.S. 324 (1989), is not to the contrary because that case involved the state's effort to require an extraterritorial effect through its pricing policies, not impose an import restriction.

[16] This "balancing" test is not to be confused with the two-tier test applied in dormant Commerce Clause cases involving non-liquor products where the 21st Amendment is inapplicable. The two-tier test under the dormant Commerce Clause provides that: (1) where the state regulation is "direct," strict scrutiny applies and the state statute will be upheld only where it advances a legitimate state interest that cannot be adequately served by reasonably nondiscriminatory alternatives; but (2) where the state regulation is only "indirect" it will be upheld unless the state interest is not legitimate or the burden on interest commerce clearly exceeds the "putative" local benefits. See, e.g., Waste Management Holdings,

California Retail Dealers Assn v. Midcal Aluminum, Inc., 445 U.S. 97, 109-10 (1980) ("Midcal") (court must make a "pragmatic effort to harmonize state and federal powers" where non-import controls are at issue). In fact, the 21st Amendment was specifically designed to avoid a "reconciliation" requirement and to preclude dormant Commerce Clause claims challenging import controls. See id. at 110 (reconciliation applicable only where the state regulation does not involve "control over whether to permit importation and sale of liquor and how to structure the liquor distribution system"). Craig v. Boren, 429 U.S. 109, 206 (1976), reh'g denied, 429 U.S. 1124 (1977) (21st "Amendment primarily created an exception to the normal operation of the [dormant] Commerce Clause") (emphasis added). Harmonization applies only where other, express constitutional terms may conflict with the state law. See Objection # 38-39, infra. Had only limited state authority to ban but not regulate liquor imports been the intent of the 21st Amendment, § 2 would have simply provided that "States may prohibit the importation of intoxicating liquors." But the terms of § 2 were deliberately written to grant states much broader authority; i.e., § 2 extended state authority to limit "[t]he transportation or importation into any State . . . for delivery or use therein of intoxicating liquors, in violation of the laws thereof." Thus, the Amendment by its terms is not limited to total import bans. See Midcal at 110; see also State Bd of Equalization v. Young's Market Co., 299 U.S. 59, 63 (1936) ("Surely the state may adopt a lesser degree of regulation than total prohibition."). Importantly, the additional terms in § 2 have been given meaning and respect by the Supreme Court in upholding state import controls as described further below.

34. The Supreme Court has never applied the dormant Commerce Clause to condemn state import restrictions or conditions since the adoption of the 21st Amendment because the

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Inc. v. Gilmore, 2001 WL 604325 at 10 (4th Cir. 2001) (quoting Envtl. Tech. Council v. Sierra Club, 98 F.3d 774 (4th Cir. 1996)).

"special protection afforded to state liquor control policies by the Twenty-First Amendment" overrides all claims under the dormant Commerce Clause.[17] U.S. v. North Dakota, 495 U.S. 423, 432 (1990); see also Bridenbaugh, 227 F.3d at 853 ("No decision of the Supreme Court holds or implies that laws limited to the importation of liquor are problematic under the dormant Commerce Clause.") (emphasis added). In its most recent decision in 1996 involving the 21st Amendment, a First Amendment challenge to restrictions on the advertising of liquor products (44 Liquormart, 517 U.S. at 514-515), the plurality opinion for the Court repeatedly acknowledged that the 21st Amendment trumps any Objection under the dormant Commerce

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[17] The Court has often said that state import control authority is virtually unlimited. See State Board of Equalization v. Young's Market Co., 299 at 62 (license fee upheld because "the words used [in the 21st Amendment] confer upon the state the power to forbid all importations which do not comply with the conditions which it prescribes"); Ziffrin, Inc. v. Reeves, 308 U.S. 132, 138 (1939) (state regulatory power over commerce in liquor products is "unfettered by the [dormant] Commerce Clause"); Duckworth v. State of Arkansas, 314 U.S. 390, 399 (1941) (Jackson, J., concurring) (prohibition of transportation without a state permit upheld because "[r]egulated transportation of liquor is a necessary incident of regulated consumption and distribution"); Carter v. Virginia, 321 U.S. 131, 137 (1944) ("By interpretation of this Court the [21st] Amendment has been held to relieve the states of the limitations of the Commerce Clause on their powers over such transportation or importation.") (emphasis added); United States v. Frankfort Distilleries, 324 U.S. 293, 600 (1945) (Frankfurter, J., concurring) (states "freed from the restrictions upon state power which the [dormant] Commerce Clause implies as to ordinary articles of commerce"); Hostetter v. Idlewild Bon Voyage Liquor Corp., supra at 330 (1964) ("a State is totally unconfined by traditional Commerce Clause limitations when it restricts the importation of intoxicants destined for use, distribution, or consumption within its borders") (emphasis added); Department of Revenue v. James B. Beam Distilling Co., 377 U.S. 341, 346 (1964) (each state has "plenary power to regulate and control . . . the distribution, use, or consumption of intoxicants within her territory"); Craig v. Boren, 429 U.S. at 206 ("This Court's decisions since [1933] confirmed that the [21st] Amendment primarily created an exception to the normal operation of the [dormant] Commerce Clause."); Midcal, 445 U.S. at 110 (§2 granted "States virtually complete control over whether to permit the importation or sale of liquor and how to structure the liquor distribution system") (emphasis added); Capital Cities Cable, Inc. v. Crisp, 467 U.S. 681, 712 (1984) (§2 reserved to the states the power to impose "burdens on interstate commerce in intoxicating liquor that, absent the [21st] Amendment, would clearly be invalid under the Commerce Clause"); Brown-Forman Distillers Corp. v. N.Y. State Liquor Authority, 476 U.S. 573, 584 (1986) (21st "Amendment gives the States wide latitude to regulate the importation and distribution of liquor within the territories"); North Dakota v. United States, 495 U.S. 423, 431 (1990) (plurality) ("The Court has made it clear that the States have the power to control shipments of liquor during their passage through their territory and to take appropriate steps to prevent the unlawful diversion of liquor into their regulated intrastate market."); 44 Liquormart, Inc. v. Rhode Island, supra at 516 ("the Twenty-first Amendment limits the effect of the dormant Commerce Clause on a State's regulatory power over the delivery or use of intoxicating beverages within its borders").

Clause as long as the state regulation is limited to the importation, distribution or transportation of liquor products. Id. at 514-16 ("the state's regulatory power over this segment of commerce is therefore "largely 'unfettered by the [dormant] Commerce Clause'" (quoting Ziffrin, 308 U.S. at 138); "[the 21st Amendment] grants the States authority over commerce that might otherwise be reserved to the Federal Government" under the Commerce Clause; "the Twenty-first Amendment limits the effect of the dormant Commerce Clause on a State's regulatory power over the delivery or use of intoxicating beverages within its borders"). The purpose of these recitals was to contrast the 21st Amendment's override of the dormant Commerce Clause for state regulation of importation and distribution with the Amendment's inapplicability to violations of "obligations under other provisions of the Constitution." 44 Liquormart, 517 U.S. 516 (citations omitted). Thus, the 21st Amendment "does not in any way diminish the force of the Supremacy Clause, the Establishment Clause, or the Equal Protection Clause" or, as decided in 44 Liquormart, the First Amendment. Id. 516-17. See also South Dakota v. Dole, 483 U.S. 203, 206 (1987) (spending power not overridden by 21st Amendment). Only in that circumstance is a harmonization test applicable. In other words, the decisions of the Supreme Court finding state regulations of liquor products contrary to the Sherman Act, due process, equal protection, separation of church and state, spending power or free speech do not in any way limit the state's broad authority to regulate liquor products contrary to the dormant Commerce Clause so long as that regulation does not contravene those express constitutional provisions and otherwise is within the importation, distribution and transportation terms of the 21st Amendment. Thus, the 21st Amendment's immunity for state import controls applies here because no other constitutional interests are challenged by plaintiffs' Amended Complaint.

35. The Report's narrow reading of the 21st Amendment -- that it immunizes only total state bans on imports from claims under the dormant Commerce Clause (pp. 19, 25-26, 41) — also is contrary to all leading cases. No Supreme Court decision has ever read the Amendment in such a restrictive fashion, and broad dicta in virtually every case discussing the 21st Amendment is to the contrary. See note16, supra and accompanying text. Only four Supreme Court decisions have found state liquor-related laws unprotected by the 21st Amendment against a dormant Commerce Clause challenge — Bacchus Imports, Ltd. v. Dias,, 468 U.S. 263, 267 (1984); Brown-Forman, supra; Healy v. Beer Institute, supra; Hostetter v. Idlewild, supra. In each, the state restrictions were not related to or imposed on the channels of importation and distribution. Thus, an excise tax exemption for locally grown wines (Bacchus), and a price affirmation or other regulation having only extraterritorial effects (Brown-Forman; Healy; Idlewild), were not within the protection of the 21st Amendment provided for imports. None of these state restrictions protected against diversion of liquor products into unregulated markets, none was designated to prevent evasion of state excise taxes paid by all other liquor products, and none related (directly or indirectly) to the prevention of unauthorized purchase or consumption.

36. On the other hand, where the restriction on alcoholic beverages is limited to the importation, distribution or transportation of alcoholic beverages into or within state, it has always been upheld against claims under the dormant Commerce Clause. Young's Market, supra (license fee on imports upheld); Indianapolis Brewing Co. v. Liquor Commission, 305 US. 391, 394 (1939) ("the right of a state to prohibit or regulate the importation of intoxicating liquor is not limited by the [dormant] commerce clause") (emphasis added); see also Carter v. Virginia, 321 U.S. 131 (1944) (Frankfurter, J. concurring) ("And since Virginia derives the power to

legislate from the Twenty-first Amendment, the [dormant] Commerce Clause does not come into play.").

37. No case involving a clash solely between the dormant Commerce Clause and the 21st Amendment over state regulation focused on import restrictions has ever required a balancing or harmonizing of those interests. More recent cases denying protection to state laws under the 21st Amendment have all involved challenges under express constitutional provisions that, unlike the dormant Commerce Clause, were not the focus of the 21st Amendment and thus are not constrained by it to the same degree. See, e.g., supra; Capital Cities supra (Supremacy Clause); Midcal, supra (Supremacy Clause). It is in these cases that a "pragmatic effort to harmonize state and federal powers" (Midcal, 445 U.S. at 109, quoted in TFWS, 242 F.3d at 198) is applied to measure the state's interests under the 21st Amendment against other interests also protected by the Constitution. In each of these cases, the Court's analysis has made it clear that the harmonization test applied only when the asserted 21st Amendment interests collided with other express constitutional protections (e.g., the positive Commerce Clause) and had no application to claims based on the dormant Commerce Clause. See, e.g., Capital Cities, 467 U.S. at 714; cf., TFWS, Inc. v. Schaeffer, 242 F.3d 198, 204 (4th Cir. 2001), discussed in Objection # 40, infra.

38. The Magistrate's approach to the application of the 21st Amendment to claims based on the dormant Commerce Clause (p. 11) is directly contrary to the framework applied in 1990 by the Supreme Court in North Dakota v. U.S., supra. There the federal government had argued that it was being discriminated against as a distributor of alcoholic beverages shipped through the State for sale within an enclave subject to concurrent federal-state jurisdiction because it had to satisfy reporting and labeling requirements not demanded of distilled spirits

sold by wholesalers within the state. The Supreme Court rejected that claim, however, because there was no economic discrimination and because the State's controls against diversion of unregulated tax-free distilled spirits were within the State's authority under the 21st Amendment. It recognized that in-state licensees had to meet similar reporting requirements and to pay substantial state excise taxes which offset the burden of the reporting and labeling requirements imposed on federal shippers/distributors. 495 U.S. at 437-39.[18] The Court relied heavily on the fact that the North Dakota control system was within the State's core powers under the 21st Amendment and thus the State interests out-weighed the intergovernmental immunity claims. Citing an early dormant Commerce Clause case among others (Young's Market), the Court stated that "the State has 'virtually complete control' over the importation and sale of liquor and the structure of the liquor distribution system" including "the power to control shipments of liquor during their passage through their territory and to take appropriate steps to prevent unlawful diversion of liquor into their regulated intrastate markets." Id. at 432 (emphasis added); see also Capital Cities, 467 U.S. at 713 ("[direct regulation of] the sale or use of liquor within its borders [is] the core § 2 power"). As a result, it found that the State's reporting and labeling requirements to prevent diversion fell "within the core of the State's powers under the Twenty-first Amendment":

> [I]n the interests of promoting temperance, ensuring orderly market conditions, and raising revenue, the State has established a comprehensive system for the distribution of alcohol within its borders. That system is unquestionably legitimate. See Carter v. Virginia, 321 U.S. 131 (1944); Board of Equalization v. Young's Market Co., 299 U.S. 59 (1936).

[18] In concurrence, Justice Scalia agreed that the federal government faced no adverse discrimination because even if the in-state burden were less, the federal government had the option of purchasing the liquor from in-state wholesalers. Id. at 446-47.

Id. at 432 (Stevens, J., plurality opinion) (emphasis added).[19] This established "a strong presumption of validity [that] should not be set aside lightly" (id. at 433) and which was not overtaken by intergovernmental immunity claims.

39. The ruling by the Supreme Court in the North Dakota case has particular relevance for the case at bar because the Court applied a functional test for economic discrimination (see Objection ## 2-9, supra, explaining why Virginia's state control system does not result in economic discrimination) and because it relied on earlier liquor import cases (Carter and Young's Market) finding state regulation valid against dormant Commerce Clause claims without applying a "harmonization" test. The Report's argument herein that under the North Dakota framework the State could not bar shipments to the federal-state enclave (p. 33) is wholly beside the point and was never mentioned as relevant in the Supreme Court's application of the 21st Amendment. What the Court said is that a state, pursuant to its import control powers under the 21st Amendment, could impose restrictions on shipments to federal-state enclaves in order to prevent diversion of unregulated alcoholic beverages into the state. That is exactly what Virginia has done in § 4.1-310 to ensure that all alcoholic beverages sold to consumers in the Commonwealth are regulated by the State by passing through state wholesale and retail licensees to ensure compliance with reporting requirements and the payment of excise and sales taxes.

B. The Magistrate's Report erroneously rejects the application of leading Court of Appeals precedents upholding state import control statutes.

40. The Magistrate's Report improperly rejects as unpersuasive the opinion by Judge Easterbrook of the Seventh Circuit in Bridenbaugh upholding Indiana's similar state import controls. The Report first contends that the Bridenbaugh ruling is contrary to Supreme Court and Fourth Circuit precedent (citing only Bacchus, 468 U.S. 263, 273 (1984), and TFWS v.

[19] Justice Scalia was even more emphatic and specific: "The Twenty-first Amendment . . . empowers North Dakota to require that all liquor sold for use in the State be purchased from a licensed in-state wholesaler." Id. at 447 (emphasis added).

Schaeffer, 242 F.3d 198, 204 (4th Cir. 2001)) when the Seventh Circuit ruled that state import regulations within the specific terms of the 21st Amendment precluded any claim under the dormant Commerce Clause. The Magistrate Judge argues that existing case law requires that the State's regulatory regime must in every case be evaluated under the strict scrutiny test applied to facially discriminatory statutes under the dormant Commerce Clause. However, neither Bacchus nor TFWS supports the Report's conclusion. Bacchus is not an "import" case. Instead, it involved a state's tax system that provided an exemption for locally produced alcoholic beverages from the State's 20% excise tax. The State of Hawaii did not even invoke the 21st Amendment until the case reached the Supreme Court. 468 U.S. at 274 n.12. Thus, the tax did not relate to the Amendment's specified concern to control the importation, distribution or transportation of intoxicating liquors. The Report's reliance on the Fourth Circuit decision in TFWS is even more off point because that case did not involve the dormant Commerce Clause despite the Report's erroneous claims to the contrary. (P. 22)[20] In fact, TFWS is nothing more than a traditional application of the Supremacy Clause to potentially invalidate a state's price posting/volume discount statute in accordance with the principles announced in Midcal and Capital Cities. In those cases, statutes were invalidated because they eliminated price competition and conflicted with federal law (the Sherman Act) where Congress had exercised its full powers under the positive Commerce Clause.[21] Even then, the Fourth Circuit held that the state statute might be saved by the 21st Amendment if on remand Maryland could produce evidence of the "closeness" of the state interest to interests protected by the 21st Amendment by

[20] This erroneous understanding of TFWS is repeated at pp. 29 & 35 n.30 of the Magistrate's Report.

[21] See United States v. Sharpnack, 355 U.S. 286 (1958); J. Nowak & R. Rotunda, Constitutional Law § 8.5 at 288 (5th ed. 1995).

showing "the extent [to which] the regulatory scheme serves" the state's avowed purpose and by the favorable "balance [between] the state's . . . [and] the federal interest." 242 F.3d at 213.

41. Second, the Report distinguished Bridenbaugh because the Seventh Circuit found that the Indiana import controls involved no facial discrimination whereas the Virginia statute resulted in economic discrimination. However, as we have explained in detail above, the Report's attempt to differentiate Indiana's and Virginia's system is incorrect. See Objections # 29-30, supra. More importantly, the Report's comparative analysis of the allegedly different burdens imposed on in-state and out-of-state producers under the Virginia ABC Act is clearly erroneous because the burdens of compliance with reporting and tax requirements for in- and out-of-state products in fact are identical in economic or functional impact. See Objection # 30, supra.[22]

42. Third, the Report erroneously differentiates Bridenbaugh from this case by asserting that unlike Indiana's statutory scheme, Virginia in-state producers may ship their product to consumers without passing their products through the three-tier system while out-of-state producers are prohibited from doing so. (P. 22) As previously noted, however, the Defendants have presented evidence that this is simply not the case because Virginia producers are held to the same requirements imposed on each of the three tiers. See Objection # 30 & n.9, supra; id. # 4 & 5 (Stevens Aff. ¶¶ 11, 14-16 & Coleburn Aff. ¶ 99, 15 & 19.

43. Finally, the Report's criticism of Judge Easterbrook's focus in Bridenbaugh on the language of the 21st Amendment as support for his conclusion that state laws limited to import controls are free of dormant Commerce Clause claims is wholly off the mark. The Report

[22] In addition, as described below, the Report's effort to distinguish Bridenbaugh for its alleged misreading of the Wilson and Webb Kenyon Acts fails because it ignores both the terms of those statutes and wholly misreads how they have been applied. See Objections # 46-51, infra.

identifies no Supreme Court case "hold[ing] or imply[ing] that laws limited to the importation of liquor are problematic under the dormant commerce clause" (Bridenbaugh, 227 F.3d at 853) because there are none. No one disputes that this is the clear approach taken by the Supreme Court in the early dormant Commerce Clause cases (e.g., Young's Market, Indianapolis Brewing, Carter); that they have never been overruled; and that they are still cited as good authority by the Supreme Court in its most recent 21st Amendment rulings (e.g., Midcal, North Dakota, 44 Liquormart).[23]

44. The Report's mistaken view that the 21st Amendment provides no safe harbor to state import controls also led it to incorrectly discredit the D.C. Circuit's holding in Milton S. Kronheim & Co. v. District of Columbia, 91 F.3d 193 (D.C. Cir. 1995). There the appellate court, relying on Supreme Court decisions in Craig v. Boren, 429 U.S. at 203 and Dept of Revenue v. James B. Beam Distilling Co., 377 U.S. at 346, reiterated the absolute protections given state import control statutes and rejected a dormant Commerce Clause claim challenging a local warehousing law because its geographic proximity requirement promoted core state import control interests of "auditing company records, monitoring compliance with the ABC laws, monitoring licenses, checking tax forms for audits, etc." Id. at 203-04. The Report again mistakenly relies on TFWS — as noted, a Supremacy Clause case that did not and cannot involve a dormant Commerce Clause claim (see note 20, supra and accompanying text) — to reject this approach. See also Bainbridge v. Bush, 148 F. Supp. 2d 1306 (M.D. Fla. 2001); House of York, Ltd v. Ring, 322 F. Supp. 530 (S.D.N.Y. 1970) (3 judge court including Friendly, J.).

C. The Heublein decision of the Virginia Supreme Court did not involve import controls and thus it does not support the Report.

[23] Bacchus is not to the contrary because, as already noted, the state statute at issue there did not involve import controls.

45. The Report's assertion that its ruling is supported by Heublein Inc. v. ABC, 237 Va. 192, 376 S.E. 2d 77 (1989), is similarly in error. Like Bacchus and Healy, the challenged provisions of the ABC Act in Heublein related solely to the retroactive and extraterritorial application of the Wine Franchise Act's contract restraints, not to any import controls. Thus, the state regulation in Healy was not within the specific terms of the 21st Amendment. In addition, the Brown-Forman and Midcal decisions principally relied upon by the Virginia Supreme Court were Supremacy Clause cases where a harmonization test is always required.

V. OBJECTIONS REGARDING APPLICATION OF FEDERAL STATUTES' ENFORCEMENT OF STATE IMPORT CONTROL LAWS

A. The Report misapplies the Wilson and Webb-Kenyon Acts.

46. The Report concludes that the Wilson Act (27 U.S.C. § 121) and the Webb-Kenyon Act (27 U.S.C. § 122) were re-enacted following passage of the 21st Amendment "to allow 'dry states' to remain so following the repeal of national prohibition. (P. 38 n.32) The Wilson Act, by its terms, made alcohol transported into a state "subject to the operation of the laws" of such state "upon arrival in such state or territory . . ." The Report does not explain why it in effect re-writes these words to mean that such alcoholic beverages are only "subject to the operation of [state] laws" if these laws impose a total ban on possession for personal use. Nothing in the Supreme Court decisions leading up to or following the enactment of the Wilson Act suggests that its sole purpose was to assist states in retaining Prohibition if they chose to remain dry. In fact, a number of Supreme Court and lower court decisions, discussed below, have reached the opposite conclusion.

47. The Report summarily dismisses the Webb-Kenyon Act, re-enacted in 1935 two years after the 21st Amendment was ratified, with the conclusion that the purpose of the Act was

"to allow dry states to remain so by prohibiting direct shipment in interstate commerce. . . . Virginia chose a different course and the Webb-Kenyon Act is therefore to no avail. . . ." (Pp. 41-42) This conclusion is reached despite the fact that the Act by its terms provides:

> The shipment or transportation, in any manner of by any means whatsoever, of any . . . intoxicating liquor of any kind from one state . . . or from any foreign country into any state which said . . . intoxicating liquor is intended, by any person interested therein to be received, possessed, sold or in any manner used either in the original package or otherwise in violation of any law of such state . . . is prohibited.

27 U.S.C. § 122 (emphasis added). The phrase "any law" in Webb-Kenyon embraces a wide range of state alcohol policies ranging from an outright ban on the importation, distribution, sale and possession of alcohol, to control systems, such as Virginia's, where comprehensive state alcohol regulations allow for importation, distribution, sale and possession of alcohol but only on clear and certain terms and conditions. Nothing in the language of Webb-Kenyon supports the view of the Report that the Act was intended merely to allow states to retain Prohibition.

48. The Report's discussion of the Webb-Kenyon Act, relying entirely on Adams Express Co. v. Kentucky, 238 U.S. 190 (1915) ("Adams Express"), as supporting its conclusion that the Act became a nullity in all the states when Prohibition was repealed, is also in error. There the Adams Express Company was indicted for violating a Kentucky statute which prohibited carriers from delivering alcohol in any Kentucky county if "the sale of intoxicating liquors has been prohibited" therein. Id. at 193. However, Kentucky law did not prohibit possession of alcohol, even in dry counties. Id. at 199. And the Kentucky buyers had arranged for the purchase of the alcohol in Tennessee and had already paid for the product. Id. at 194. The Supreme Court therefore rejected Kentucky's argument that the Webb-Kenyon Act prohibited the interstate transportation of alcohol into a dry state because the Act only prohibits the transportation of liquor "into the state to be dealt with therein in violation of local law." Id. at 199. That is, since possession of liquor was not illegal in Kentucky and since the sale had not occurred in the state, no state law had been broken. Id. at 202. But nothing in Adams Express

suggests that the existence of a state law banning possession of alcohol for personal use is a prerequisite to the application of the Webb-Kenyon Act to sales made within the state.

49. The Report's misreading of Adams Express may stem from the Report's misquote of critical language in the opinion. Omitting critical language, it attributes to Adams Express the statement that the Court found that Webb-Kenyon was enacted as a further aid to the states "to extend the prohibition against the introduction of liquors into the states by means of interstate commerce." (P. 40) The actual language in the Supreme Court's opinion is: "Thus far and no farther has Congress seen fit to extend the prohibitions of the Act in relation to the interstate shipments." Id. at 199 (emphasis added). The deletion of the scored language from the Magistrate Report's discussion of Adams Express drastically alters the meaning of that quotation. As corrected, it is clear that the Supreme Court used the word "prohibition" to refer to the terms of the Webb-Kenyon Act rather than to the totality of the restriction in state prohibition laws. Thus, Webb-Kenyon applies to all state controls on importation and distribution and cannot be narrowly limited as applying only to state laws banning all imports.

50. In fact, the gloss which the Report seeks to place upon Adams Express was argued and rejected in James Clark Distilling Co. v. Western Maryland R. Co., 242 U.S. 311 (1916) ("Clark"), a challenge to West Virginia's prohibition of the manufacture and sale of intoxicating liquors. A lower court had held that the West Virginia law did not prohibit personal use of alcohol and therefore did not forbid shipments for such use – and since there was no actual state prohibition involved, the Webb-Kenyon law did not apply. While Clark was pending in the lower court, the Fourth Circuit held in West Virginia v. Adams Express Co., 219 F. 794 (4th Cir. 1915), that the West Virginia law prohibited both shipments and solicitations for personal use even though personal use was permitted. Thus, in Clark the Supreme Court dismissed as erroneous the shipper's arguments (which the Report mistakenly adopts here) that Webb-Kenyon was only intended to protect against importation into dry states as follows:

> Indeed, the meaning which it is sought to affix to the Webb-Kenyon Act, if accepted, would cause that Act to have the effect of compelling the States to

> prohibit personal use, since if all the prohibitions of state laws against manufacture, sale, receipt and possession of intoxicants remained subject to the danger of indirect violation by permitting [direct] shipment, receipt and possession for personal use, it would follow that a necessary and immediate incentive was imposed upon the States by the Webb-Kenyon Act to enact a provision against personal use.
>
> . . . Reading the Webb-Kenyon law in the light thus thrown upon it by the Wilson Act and the decisions of this court which sustained and applied it, there is no room for doubt that it was enacted simply to extend that which was done by the Wilson Act; that is to say, its purpose was to prevent the immunity characteristic of interstate commerce from being used to permit the receipt of liquor through such commerce in states contrary to their laws, and thus in effect afford a means by subterfuge and indirection to set such laws at naught. In this light it is clear that the Webb-Kenyon Act, if effect is to be given to its text, but operated so as to cause the prohibitions of the West Virginia law against shipment, receipt and possession to be applicable and controlling irrespective of whether the state law did or did not prohibit the individual use of liquor.

242 U.S. at 322-24 (emphasis added).

51. The Fourth Circuit's decision in West Virginia v. Adams Express Co., supra, also decided the very issue raised by the Report's erroneous view of the Webb-Kenyon Act. In that decision, the Fourth Circuit ruled that Webb-Kenyon applied to protect West Virginia's import controls notwithstanding the fact that West Virginia was not a dry state. The ruling offers a view of the intent of Congress in enacting Webb-Kenyon which is consistent with Bridenbaugh and entirely inconsistent with the Report:

> The Webb-Kenyon Act is the result of a growing public conviction that it was an abuse of interstate commerce that even under the Wilson bill liquor dealers in one state were protected in impairing or defeating the efforts of another state to root out or to minimize the evil of the use of liquor as a beverage. This statute prohibits the shipment or transportation of liquor from one state into another, not only when it is intended to be sold in violations of any law of such state, but when it is to be received or possessed or in any manner used in violation of the state law. This is a direct recognition of the right of the state to prohibit the receipt or delivery as well as the possession and use of liquor, without trespassing upon the power of Congress to regulate interstate commerce.

209 F. at 800-01 (emphasis added). The Fourth Circuit's long-standing review of the history and intent of Webb-Kenyon was recently cited with approval by the Eleventh Circuit in Florida v.

Zachy's Wine & Liquor, 125 F.3d 1399 (11th Cir. 1997), thus placing the Report's view of applicable federal statutes at odds with the Fourth, Seventh and Eleventh Circuits.

B. The 21st Amendment Enforcement Act.

52. Last year Congress enacted the Twenty-first Amendment Enforcement Act of 2000. It amended Webb-Kenyon by providing states a federal cause of action to obtain injunctive relief against any person engaged in "any act that would constitute a violation of a State law regulating the importation or transportation of any intoxicating liquor." 27 U.S.C., §122, as amended by Pub. L. 106-386 (Oct. 27, 2000). While the Report discusses the 21st Amendment Enforcement Act, it makes no attempt to synthesize its view of Webb-Kenyon as a useless relic (because no state has retained Prohibition) with the fact that Congress obviously intended in the Enforcement Act to facilitate Webb-Kenyon's role as a source of authority for enforcement of state alcohol laws. Basic hornbook law forbids construction of a statute to render it meaningless. See, e.g., Dunn v. CFTC, 519 U.S. 465, 472 (1997).

C. The Federal Alcohol Administration Act.

53. The Report's flawed interpretation of federal legislation sanctioning Virginia's right to enforce its import control laws also includes its review of the Federal Alcohol Administration Act. While the Report summarizes that legislation accurately, it fails to mention the provisions directly bearing on this case, namely, the subsections which make the violation of state laws regulating the importation, distribution and sale of alcohol grounds for denial or revocation of a federal permit. 27 U.S.C. §§ 204(a)(2)(c) & (d).

54. The Wilson, Webb-Kenyon, 21st Amendment Enforcement and FAAA Acts were enacted pursuant to Congress' powers under the positive Commerce Clause to enact federal policies removing any dormant Commerce Clause impediments to enforcement of state authority

over alcohol importation, distribution and sale in violation of the laws of the states. Central to the Report's conclusions is its mistaken view that there are no federal policies adopted pursuant to Congress' positive powers under Article I, § 8, Cl.3 to regulate interstate commerce. See Bainbridge v. Bush, 2000 WL 826642 n.10 (M.D. Fla. 2001). Once that misunderstanding is corrected, the analytical foundation for the Report's analysis of various statutes assimilating state laws into federal law collapses because the dormant Commerce Clause is no longer applicable.

VI. OBJECTION REGARDING DENIAL OF THE APPLICATION OF THE "MARKET PARTICIPATION DOCTRINE TO THE SALE OF VIRGINIA WINES BY STATE ABC STORES

55. In arriving at its conclusion that the ABC Defendants cannot take advantage of the "market participation" doctrine to defend against the Plaintiffs' dormant Commerce Clause claim regarding the sale of distilled spirits, the Report engages in an erroneous and tortured analysis that is not sanctioned by existing precedent.[24]

56. Insofar as the State ABC stores' sale of Virginia wine is concerned, however, the Report erroneously concludes that the statutory mandate — that such stores sell no wine but Virginia wine — violates the dormant Commerce Clause and may not be justified under the "market participation" doctrine. While it is true that the State ABC stores are a retail arm of the ABC, the fact that ABC also regulates the trade in alcoholic beverages does not, as the Report suggests, preclude application of the doctrine. The Report's analysis and conclusion on this point is simply flawed and ignores the underlying facts in Hughes v. Alexandria Scrap Corp., 426 U.S.

[24] It approaches the issue by first determining the status of the Commonwealth's involvement in the alcoholic beverage trade, and appears to conclude that since the Commonwealth maintains a monopoly in the sale of distilled spirits, that this precludes application of the doctrine. The Report nevertheless concludes, that under a dormant Commerce Clause analysis, that the State ABC stores' sale of "distilled spirits" is facially neutral, and thus not prohibited. While the ABC Defendants strenuously object to this analysis, they do not object to the Reports' recommendation that the State ABC store system for the importation and distribution of distilled spirits be found not to violate the dormant Commerce

794 (1976) the seminal case dealing with the "market participation" doctrine. In that case, the State of Maryland enacted a comprehensive regulatory scheme to reduce the number of junk cars in the state. While, on one hand, requiring wreckers of junk automobiles to be licensed and penalizing them with fines for retaining those automobiles on their lots for longer than one year, it also provided certain monetary incentives or "bounties" to in-state processors of scrap for the destruction of each automobile formerly titled in Maryland. The scheme came under dormant Commerce Clause attack for its perceived preference of in-state processors who could apply to the state for the bounty for each vehicle, with what they claimed was less proof of ownership than that required of out-of-state entities engaged in the same business. Nevertheless, and despite the fact that the documentation required to secure the bounty from the State gave in-state processors an advantage not shared by their out-of-state competitors, the Supreme Court held that as a purchaser of these vehicles the State was acting as a "market participant" and thus was protected from a challenge under the dormant Commerce Clause. That the State regulated the possession and disposal of junk vehicles as well (in the form of penalizing possession of junk automobiles in excess of one year; licensing processors, etc.) was of no moment to the Court. As the Court stated "[n]othing in the Commerce Clause prohibits a State, in the absence of congressional action from participating in the market and exercising its right to favor its own citizens over others. Id. at 809. The Report's contrary conclusion is justified by no analysis or effort to review and distinguish Hughes. Thus, the Report's assertion that State ABC stores may not available themselves of the "market participation" doctrine when the Commonwealth otherwise regulates other aspects of the market is wrong both as a matter of precedent and policy.

Clause on this point is objected to by the ABC Defendants, the ultimate decision on this point — approving laws related to the sale of distilled spirits by the State ABC — is not challenged.

VII. OBJECTIONS REGARDING THE REMEDY PROPOSED BY THE REPORT AND RECOMMENDATIONS

57. Accepting arguendo the Report's conclusion that "in-state preferences for Virginia wine and beer are unconstitutional" (p. 57), we agree with the Magistrate Judge's conclusion that "the unconstitutional provisions [regarding the authorization of shipments of wine and beer to consumers by in-state producers and the limitation of wine sales in State ABC stores to wine produced in Virginia][25] can be segregated from the Act as a whole." (p. 59) Responding to the Magistrate Judge's request for "clarification" (p. 60 n.47) identifying specifically what changes should be made to achieve this Objection, we propose that the words "or ship" be deleted from §§ 4.1-207(4) & 208(7), and the words "and shipment" be deleted from § 4.1-207(5). (The revised sections showing the specific deletions are set forth in an Appendix hereto.) These deletions respond directly to the Report's finding that "permitting direct shipment of [wine and beer] products [by in-state producers] to the consumer without having to first pass through a licensed wholesaler or retailer" violates the dormant Commerce Clause. (P. 61) With these proposed deletions from §§ 4.1-207 & 208, in-state producers of wine and beer would no longer be authorized to ship their products directly to consumers. So too, deletion of the words "and wine not produced by farm wineries" in §§ 4.1-103(1) & 4.1-119(A) (as shown in the Appendix), also would remove the restriction allowing State ABC stores to sell only Virginia wines.[26]

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[25] The Intervenor-Defendant (VWWA) takes no position regarding the remedy relating to the sale of wine at State ABC stores.

[26] The Report's recommendation that this Court's order be stayed pending appeal and pending action by the Virginia General Assembly (p. 60-61) may restrict the finality of the order and thus not constitute a final appealable order. The Defendants, nevertheless, are proceeding on the assumption that the Report intended that the District Court stay its order, so that an appeal could be pursued. But if, during the pendency of this appeal, the General Assembly were to modify the ABC Act in conformance with the Court's order, this would then render moot any pending appeal.

58. This focused remedy is supported by an important precedent. In Lorretto Winery Ltd. v. Duffy, 761 F.2d 140, 141 (2d Civ. 1985), the Second Circuit reversed the lower court's order in a dormant Commerce Clause case invoking the exclusive sale of in-state wines at private grocery stores because it provided relief that went beyond curing the impact of the of the in-state preference. The Court of Appeals instead struck the in-state preference rather than the broader remedy initially ordered by the District Court which would have mandated that grocery stores also be allowed to carry out-of-state wines.

59. The Report's conclusion that the "in-state preferences for Virginia wine and beer" are severable under Virginia law is further supported by authorities not noted in the Report. In particular, § 1-17.1 of the Virginia Code provides:

> The provisions of statutes in this Code or the application thereof to any person or circumstances which are held invalid shall not affect the validity of other statutes, provisions or applications of this Code which can be given effect without the invalid provisions or applications. The provisions of all statutes are severable unless (i) the statute specifically provides that its provisions are not severable; or (ii) it is apparent that two or more statutes or provisions must operate in accord with one another. (1986, c. 239; 1987, c. 56.) (emphasis added).

This general severability provision of the Virginia Code applies to the ABC Act because no separate severability clause is included in the Act**.** The specific terms of § 1.17.1(ii) create a presumption that the unconstitutional provisions of the ABC Act are severable and the plaintiffs herein have the burden of showing that the challenged provision is not severable. That burden is heavy and requires "that the two or more . . . provisions must operate in accord with one another" and cannot be reasonably separated. See also Robinson v. Commonwealth, 217 Va. 684, 686 (1977) (test is "whether the legislature would be satisfied with the remainder after the invalid portions have been eliminated"; or "has the governing body 'manifested an intention to

deal with a part of the subject-matter covered, irrespective of the rest of the subject-matter?'"); City of Portsmouth v. Citizens Trust Company, 216 Va. 695 (1976).

60. The intent of the Virginia General Assembly on the severability of "in-state preferences" is revealed by the terms of the original ABC Act, subsequent amendments, and the Assembly's response to judicial rulings regarding the interpretation and validity of certain provisions. The 1934 Act provided that both wine and beer (but not distilled spirits) imported into the Commonwealth must be consigned to the ABC Board or "to persons holding wholesale wine distributors licenses" or, in the case of beer, to "persons licensed to sell it." 1934 Act, §§ 58(a), (b) & (c). This language is virtually identical to the provisions of §4.1-310 in force today.[27] The ABC Act provisions giving in-state producers authority to ship products directly to consumers were added much later. See ch. 324, 1980 Acts of Assembly (direct shipments by farm wineries); ch. 646, 1997 Acts of Assembly (direct shipments by breweries).

61. In earlier instances, the General Assembly responded to adverse judicial interpretations by modifying the "offending" terms of the Act without altering its structure and operation. Within less than a year after the Supreme Court's decision in Bacchus striking a state statute exempting local alcohol products from a 20% state excise tax, the Assembly repealed a provision granting a similar excise tax exemption to farm wineries. See ch. 457, 1985 Acts of Assembly. Similarly, less than two months after the Virginia Supreme Court's Heublein decision, the legislature re-enacted the Wine Franchise Act after deleting the "offending" exemption for farm wineries. See ch. 10, 1989 Acts of Assembly.

[27] The Report's analysis of the ABC Act's history (p. 58) is contradictory and misleading. It claims that the original ABC Act contained no ban on direct shipment to consumers but in the same breath it acknowledges that all imports consigned to anyone other than the ABC were prohibited. In fact, the Act as adopted prohibited all imports consigned to anyone other than the Board or its licensees. See § 58, ch. 94, 1934 Acts of Assembly.)

62. Thus, it is clear that (a) the legislature has consistently intended that alcohol imports be limited to the Board or its licensees; (b) the ABC Act provisions relating to the authority of in-state producers to deliver their products directly to consumers were enacted as separate laws after the basic act was adopted; and (c) the state's fundamental policy requiring that all imports be subject to state licensing conditions before being delivered to consumers has never been subservient to the delivery authority granted licensed in-state producers. Applying the separate "subject-matter" test set forth in Robinson, the challenged provisions authorizing in-state wineries to make direct deliveries to consumers as well as provision requiring State ABC stores to sell only Virginia wines are distinctive subjects that the legislature undoubtedly would have severed from the ABC Act in response to an adverse decision of this Court.

63. Practical considerations also support the recommended remedy of striking the particular shipment provisions in the ABC Act applicable to in-state producers of wine and beer. None of the in-state producer categories ships appreciable amounts of wine or beer to consumers. See discussion Objection # 10, supra. Indeed, it is inconceivable that the General Assembly would intend that a seldom-used provision authorizing direct shipments by in-state producers must be retained if it were to result in the collapse of import controls which channel over 100,000 shipments of alcohol annually into a closed loop system of approximately 15,000 wholesale and retail licensees. Similarly, striking the requirement that State ABC stores sell no wine but Virginia wines would be more practical then requiring the converse, i.e., that they sell no wines at all. Such a remedy may be difficult if not impossible for the ABC Defendants to comply with due to lack of shelf space in stores or insufficient warehouse facilities to accommodate these products.

64. Finally, the Report is correct in rejecting plaintiffs' request to delete the import controls set forth in §4.1-310 requiring that all imported products, whether originally produced in Virginia or elsewhere, pass through a licensed wholesaler and retailer. By themselves these import restrictions are neither facially nor economically discriminatory as found by the Magistrate; their terms apply equally to all imported products whether produced within or outside the Commonwealth. With the elimination of the authority for in-state producers to ship their products directly to consumers and for the State ABC stores to sell only Virginia wines, the different treatment for in-state producers that is the foundation of the Report's finding disappears – and the ABC Act would satisfy the Report's Objections based on the dormant Commerce Clause.

VIII. CONCLUSION

For the foregoing reasons, we respectfully urge that this Court reject the Magistrate's Report and Recommendation insofar as the Defendants' Objections are concerned. Alternatively, if the Court uphold's the Report's findings and recommendation, the Defendants respectfully request that this Court adopt the recommendation in the Report of striking those portions of the ABC Act authorizing shipment of wine and beer to consumers by in-state producers and restricting State ABC stores from selling non-Virginia wines.

The Defendants respectfully request that they be provided an opportunity to provide oral argument on this matter.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and exact copy of the foregoing was mailed first-class, postage prepaid, this 29th day of August, 2001 to Matthew S. Hale, Esquire, HALE AND ASSOCIATES, P.L.L.C., 1769 Jamestown Road, Suite 2-A, Williamsburg, Virginia 23185, and Daniel Ortiz, Esquire, UNIVERSITY OF VIRGINIA SCHOOL OF LAW, 580 Massie Road, Charlottesville, Virginia 22903-1738, counsel for the plaintiffs; and to William C. Kinzler, General Counsel, Coalition for Free Trade, 1100 Rose Drive, Suite 250, Benicia, California 94510 and Mary Chlopecki, Esquire, Law Offices of Douglas C. Herbert, 1000 Connecticut Avenue, N.W., Suite 301, Washington, D.C. 20036, counsel for *amicus curiae* Coalition for Free Trade.

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