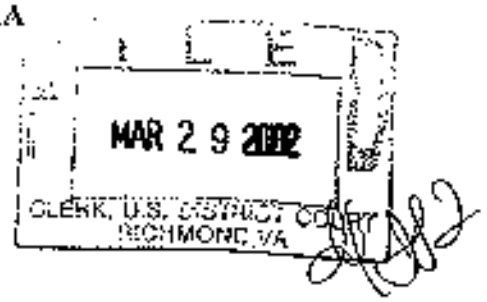
IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Richmond Division



CLINT BOLICK, et al.,

Plaintiffs,

v.

Civil Action No. 3:99CV755

CLARENCE ROBERTS, et al.,

Defendants.

FINAL ORDER

In accordance with the accompanying Memorandum Opinion, it is hereby ORDERED that:

1. The Report and Recommendation is ACCEPTED and ADOPTED WITH MODIFICATIONS, as stated in the accompanying Memorandum Opinion.

2. The objections filed by the Plaintiffs are OVERRULED IN PART and SUSTAINED IN PART, as stated in the accompanying Memorandum Opinion.

3. The objections filed by the defendants and intervenor are OVERRULED IN PART and SUSTAINED IN PART, as stated in the accompanying Memorandum Opinion.

4. Plaintiffs' motion for summary judgment is GRANTED, and the Clerk is DIRECTED to enter judgment in favor of the Plaintiffs.

5. Defendants' and Intervenor's respective motions for summary judgment are DENIED.

6. The Court specifically FINDS that the following sections of the Code of Virginia are unconstitutional, as stated in the Memorandum Opinion: 4.1-103(1); 4.1-119(A); 4.1-207(2), (4), (5); 4.1-208(3), (6), (7), (8); 4.1-209(2), (5); 4.1-302; 4.1-303; 4.1-310(B), (C).

7. The Defendants are ENJOINED from enforcing the provisions of the unconstitutional statutes.

8. The Court RESERVES RULING on whether the Defendants violated the provisions of 42 U.S.C. § 1983 and the Plaintiffs' request for attorneys' fees until the parties have given the Court further guidance on such issues in light of recent Fourth Circuit cases.

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9. The Clerk is DIRECTED to treat the Plaintiffs as the prevailing party for assessment of other costs associated with the litigation.

Let the Clerk send a copy of the Memorandum Opinion and Final Order to all counsel of record and to Magistrate Judge Dohnal.

It is so ORDERED.

/s/
Richard L. Williams
SENIOR UNITED STATES DISTRICT JUDGE

Date: MAR 29 2002
Richmond, Virginia

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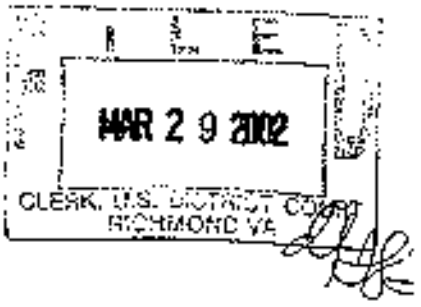

CLINT BOLICK, et al.,

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MEMORANDUM OPINION

Plaintiffs Clint Bolick and Robin Hearwole, individual consumers of wine, beer and distilled spirits, and plaintiffs Dry Comal Creek Winery, Miura Vineyards, and Hood River Vineyard, all out-of-state growers and producers of wine, brought this action against the defendants, Clarence Roberts, Sandra Canada, and Clater Mottinger, in their official capacities as appointed members of the Virginia Alcoholic Beverage Control Board (ABC Board or Board), challenging Virginia's regulatory scheme involving the shipment and distribution of alcoholic beverages. The plaintiffs' causes of action properly invoke this Court's federal question jurisdiction under the United States Constitution and relevant statutes, 42 U.S.C. §§ 1983, 1988 and 28 U.S.C. §§ 2201, 2202. The Virginia Wine Wholesalers, Inc. intervened as a defendant. Pursuant to United States Code Title 28, Section 636(b)(1)(A) and (C), and Federal Rule of Civil Procedure 72, the matter was referred to the United States Magistrate Judge for the handling of all pretrial motions. On July 27, 2001, the United States Magistrate Judge issued a Report and Recommendation addressing the various motions. The proposed opinion of the Magistrate Judge

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is attached hereto as an addendum.

I. PROCEDURAL HISTORY

The parties were given notice that they could file objections to the Report and Recommendation and were granted until August 29, 2001 to file any such objections. Plaintiffs, defendants and intervenor filed objections on August 29, 2001. Also on August 29, 2001, the plaintiffs filed objections to the Magistrate Judge's Order of July 27, 2001, regarding non-dispositive evidentiary motions. Those objections were overruled by Order of this Court on October 4, 2001. On August 30, 2001, the Virginia Wineries and Vineyards Associations filed a motion for leave to enter as amicus curiae, which was denied by Order of this Court on October 4, 2001.

II. STANDARD OF REVIEW

"The magistrate makes only a recommendation to this court. The recommendation has no presumptive weight, and the responsibility to make a final determination remains with this court." Estrada v. Witkowski, 816 F. Supp. 408, 410 (D.S.C. 1993) (citing Mathews v. Weber, 423 U.S. 261, 270-71 (1976)). This Court "shall make a de novo determination of those portions of the report or specified proposed findings or recommendations to which objection is made." 28 U.S.C. § 636(b)(1)(C). "The filing of objections to a magistrate's report enables the district judge to focus attention on those issues -- factual and legal -- that are at the heart of the parties' dispute." Thomas v. Arn, 474 U.S. 140, 147 (1985).

III. ANALYSIS

A. OBJECTIONS TO THE REPORT'S STATEMENTS OF MATERIAL FACTS NOT IN DISPUTE

A motion for summary judgment must be decided on undisputed material facts and reasonable inferences therefrom. In this case, deciding whether one party is entitled to judgment as a matter of law requires the Court to determine, based on the standards set forth by the Supreme Court and relevant Fourth Circuit precedent, whether certain of Virginia's ABC statutes violate the dormant Commerce Clause. As the Magistrate's Report makes clear, the challenge in this case is to the statutory scheme for regulating alcohol in Virginia. The Magistrate's Report outlines certain "Material Facts Not in Dispute" in order to place the nature of the parties' dispute in proper context. All parties have made objections to the findings of material facts. Although none of the parties' objections to these material facts create a "genuine issue of material fact" that would affect the outcome of the case or preclude summary judgment, the Court will nonetheless address each of them, sustaining some and overruling others, in order to provide a more complete record.

1. **Defendants' and Intervenor's objections**

The defendants and intervenor numbered each paragraph of their objections and the Court will refer to the objections by paragraph number.

a. **The defendants and intervenor argue that the Magistrate's Report omits evidence relating to the purpose, structure, operation and practical effect of the ABC Act which, if included, would show that the authority of licensed Virginia wine and beer producers to sell and ship beer and wine to consumers is subject to the same obligations and bears the same burdens as imposed on the importation of out-of-state products.**

The objections in defendants and intervenor's paragraph 1 deal with certain specific sections of the Virginia Code dealing with excise taxes and importation. How and when excise taxes are due and that importation must be to a Virginia licensed entity may be undisputably

governed by Va. Code Ann. §§ 4.1-235-236; 207(3), 208(3), but that does not diminish the impact of whether there is a state statute that permits direct shipment of beer and wine by in-state entities and prohibits direct shipment by out-of-state entities. Furthermore, the report contains citation to the entire ABC Act in its findings (*See* Report and Recommendation of the Magistrate Judge (R&R) ¶2 at 5) and importation sections are discussed throughout the report. Collection of excise taxes is an important function of the ABC, and while the questions of how the market will apportion the state excise taxes among participants and how it affects consumer choice are interesting, they are not questions that need to be answered considering the confines of the dormant Commerce Clause analysis. Further, considering the constitutional proscription on taxation of transactions which are wholly interstate in nature, the Commonwealth could not collect excise taxes from out-of-state entities for delivery directly to Virginia consumers. Quill Corp. v. North Dakota, 504 U.S. 298 (1992). Finally, this objection raised by the Defendants and Intervenor points directly to issues recognized in the report. For instance, the report adequately notes that there is no proscription on the importation of out-of-state alcohol products provided they first pass through a Virginia licensed importer. (R&R ¶ 11 at 6). Therefore, this objection by the defendants and intervenor is overruled.

In paragraph 2, the defendants and intervenor seek to include information about requirements for obtaining a license to manufacture alcohol within the Commonwealth of Virginia. A dormant Commerce Clause analysis requires a plaintiff to show that a statute or statutory scheme is facially or functionally discriminatory and it requires the defendant to show it has a legitimate purpose that can be accomplished by no other nondiscriminatory means. It is

relevant to consider the code provisions that establish these elements. To the extent that the Report fails to adequately explain that a manufacturer seeking a Virginia license must be sited in Virginia and that it must meet stringent corporate bookkeeping and management guidelines, the objection in defendants' and intervenor's paragraph 2 is well taken and is sustained.

Likewise, to the extent that the Report fails to adequately explain the statutory entitlements of the Virginia farm winery, brewery, and winery licensees, as outlined in paragraph 3 of the defendants' and intervenor's objections, the objection in paragraph 3 is sustained.

In their paragraph 4, the defendants and intervenor object to the facts contained in the Report regarding physical segregation of products at Virginia licensees. Because the Magistrate's Report adequately addresses this issue in its findings, and because the specificity raised by the defendants' and intervenor's objection, while perhaps not in dispute, is of no relevance, the objection in paragraph 4 is overruled.

In the objections in paragraphs 5 through 9, the defendants and intervenor urge the Court to consider facts relating to regulation, taxation, enforcement, inspection and monitoring of licensees, producers, wholesalers and retailers. Paragraph10 urges the Court to consider undisputed facts relating to the extent to which Virginia breweries, wineries and farm wineries direct-ship to consumers. Paragraph 11 complains that there is no evidence that the cost of complying with ABC regulations is higher or lower for in-state producers. None of the facts urged in these paragraphs is material to the resolution of this case. In a case of facial discrimination, the Court need not consider the quantum of the economic impact on either the in-state or out-of-state entities. New Energy Co. of Ind. v. Limbach, 486 U.S. 269, 277 (1988)

(citing cases). Therefore, the objections in defendants' and intervenor's paragraphs 5 through 11 are overruled.

In paragraphs 12 and 13, the defendants and intervenor object that the Magistrate's Report does not list the number of licensed wineries, importers, wholesalers, distilleries, on- and off-premises licensees, the incoming shipments, investigations, and enforcement actions by the ABC. While it is not clearly relevant, there is no dispute as to these facts and the information may be considered helpful to the defendants' and intervenor's argument that there are no other nondiscriminatory means to accomplish the legitimate functions served by Virginia's statutory scheme. Therefore, the objections in paragraphs 12 and 13 are sustained.

b. **The defendants and intervenor argue that the Magistrate's Report omits undisputed facts which, if included, would show that Virginia's import controls relate directly to core 21st Amendment interests of the state, including: 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.**

The Court has reviewed each and every exhibit proffered by the defendants and intervenor in connection with their motion for summary judgment together with the undisputed material facts upon which the Magistrate Judge relied. The information that the defendants and intervenor present in paragraphs 14, 18, and 19, regarding the ABC regulations for importation of wine and beer, the history of the regulations and policy regarding imports, and the records maintained by the ABC Board, is adequately addressed in the Magistrate's Report. The objections in these paragraphs are therefore overruled.

In paragraphs 15 through 17, the defendants and intervenor present facts relating to the

number of shipments of wine and beer in the fiscal year 2000 and the amount of excise taxes collected in that year, as well as statements regarding underage consumption and abuse of alcohol. These matters are irrelevant to resolving the dormant Commerce Clause question in this case and the objections outlined in paragraphs 15 through 17 are therefore overruled.

c. **The defendants and intervenor make the objection that many of the statements of material fact included in the Magistrate's Report inaccurately reference or make material omissions regarding critical provisions of state and federal law.**

The Court has reviewed each of the defendants' and intervenor's arguments and assignments of error outlined in objection paragraphs 20 through 26. The Federal Alcohol Administration Act and Senate Document No. 5 are relevant to the resolution of this case; however, the Court notes that the Magistrate's Report contains sufficient detail and citation to the relevant state and federal statutes as well as to Senate Document No. 5. It would be ridiculous to require every court to enumerate every sentence of each of these acts. It is sufficient to provide adequate citation to and analysis of relevant provisions. The defendants' and intervenor's complaints that the Report "incompletely describes the tree-tier control system" and that particular findings are "unclear or inaccurate" are without merit. The Magistrate's Report cites and analyzes the relevant laws and the defendants' and intervenor's objections in paragraphs 20 through 26 are overruled.

2. **Plaintiffs' Objections**

As to the material facts, plaintiffs outlined their objections by referencing the paragraph numbers in the Report's section of "Material Facts Not in Dispute." The Court, therefore, addresses them in the same manner.

a. **Plaintiffs argue that certain facts included in the Report need to be corrected or omitted.**

Similar to the defendants and intervenor, the plaintiffs object to certain of the material facts in the Magistrate's Report regarding the summary, quoted portions, or citation to certain Virginia and federal statutes contained in the Report. The Court has reviewed the plaintiffs' objections and addresses each as follows.

The plaintiffs object to the Report's first statement of material fact, arguing that it misstates the Federal Alcohol Administration Act by stating that "purchasers for resale" must have an ATF basic permit, when it is only "purchasing for resale at wholesale" for which a permit is required. The Court notes that the Report's citation to the statute speaks for itself, however the plaintiffs are correct as to the exact words of the statute, and their objection is sustained.

Plaintiffs object to the statements of fact in paragraphs 4, 22, 23, 24, 26, and 28 of the Report, arguing that these statements, while accurate, are not material. Plaintiffs are correct that a "material" fact is one that has the potential to "affect the outcome of the suit under the governing law." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1986). The facts objected to by plaintiffs as immaterial include references to record keeping requirements, alcohol content by volume of liquor, beer, and wine, the relationship of federal funds and states' minimum drinking ages, and federal and private grant money. The Court agrees that these matters are not material to the outcome of this case and need not be included. Therefore, plaintiffs' objection on this point is sustained.

Plaintiffs object to the Report's statement of fact number 7, which states that retail off-

premises winery and beer licensees are authorized to ship products directly to purchasers both inside and outside of Virginia in accordance with Board regulations. Plaintiffs argue that this statement is incorrect, asserting that shipments may be made only inside of Virginia. The Court finds that the statute does not limit shipment within the Commonwealth, but rather limits it to that authorized by the Board regulations. This objection by the plaintiffs is overruled.

Plaintiffs object to the Report's statement of fact number 8, arguing that it is misleading in its inclusion of the phrase, "but all out-of-state wine sources must ship their product to a licensed wholesaler or other licensee." Plaintiffs correctly state that when purchasing other than Virginia-produced wines, wholesalers in Virginia must deal only with licensed importers regarding the purchase of wine produced outside of the Commonwealth bought for resale pursuant to the statute, which reads:

> No wholesaler wine licensee shall purchase wine for resale from a person outside the Commonwealth who does not hold a wine importer's license unless such wholesale wine licensee holds a wine importer's license and purchases wine for resale pursuant to the privileges of such wine importer's license.

Va. Code Ann. § 4.1-207(2). While the result is the same if the licensee receiving out-of-state products also holds an importer's license, the plaintiffs' objection to this paragraph of the Report is well-taken and is therefore sustained.

Plaintiffs object that in paragraph 9, the statement that Virginia's ABC stores may sell only Virginia-produced wine is incorrect. To the extent that the Report is unclear that the ABC stores sell strictly Virginia farm wines as opposed to all Virginia wines, plaintiffs' objection is sustained.

Plaintiffs object to the Report's use of the word "consigned" in statement of fact number

11. The Court finds that this objection is without merit, although the Court notes that "sale by consignment" and "to consign" may be distinct terms of art. It is prohibited by 27 U.S.C. § 205(d) for alcoholic beverages to be sold by the practice of consignment sales, defined as "a transaction in which goods are delivered by a consignor to a dealer or distributor (the consignee) primarily for sale by the consignee, and the consignee has the right to return any unsold commercial units of the goods in lieu of payment." Malone v. Microdyne Corp., 27 F.3d 471, 476, n.6 (4th Cir. 1994). To consign a good simply means to transfer it. Black's Law Dictionary 303 (7th ed. 1999). Plaintiffs' objection to this paragraph is overruled.

Plaintiffs next argue that the statement of fact number 12 makes incomplete reference to licensing restrictions. The Report makes sufficient reference to Virginia Code section 4.1-223 to overcome this objection, but because the licensing restriction is important to the Magistrate Judge's and this Court's reasoning with respect to the finding of discrimination, plaintiffs objection is sustained. The Court agrees that the more correct statement is that an out-of-state entity cannot obtain a Virginia wholesale or import license. This, of course, creates a barrier to out-of-state participation by direct shipment in Virginia.

Plaintiffs object that statement of fact number 14 incorrectly assumes a disputed fact by stating that the Federal Alcohol Administration Act was designed to promote temperance. The Court agrees with the plaintiffs in this respect, but the Court does not go so far as to agree with plaintiffs' assertion that the Act was "designed to preclude consumer deception as well as vertical integration," although the Court recognizes that two courts have found consumer deception and vertical integration to be among the concerns of the Act. See, e.g., Taylor Wine

Co., Inc. v. Dept. of Treasury, 509 (D. D.C. 1981); Levers v. Berkshire, 151 F.2d 435 (10th Cir. 1945). To the extent that it is relevant, the statute speaks for itself in this regard. The plaintiffs' objection is sustained.

Plaintiffs object that statement of fact number 15 is incomplete in failing to more completely quote the statutory requirements. Although the Court notes that the Report's citation to the statute is sufficient, plaintiffs' objection is sustained as it is a more complete statement of the relevant statute that, "[i]t is a misdemeanor criminal offense for any entity to ship alcoholic beverages into Virginia to other than an entity licensed by Virginia to receive it." Va. Code Ann. § 4.1-310.

Plaintiffs object that statement of fact number 16 is incorrect for the same reason they objected to statement number 9, that the Report refers to "Virginia-produced wine" and should more accurately refer to "Virginia-produced farm wine." Consistent with the Court's ruling on the objection to statement number 9, plaintiffs' objection to statement number 16 is sustained.

b. **Plaintiffs argue that certain additional material facts should be included as relevant to the Court's analysis.**

The Court has reviewed all fifteen of the "material facts" that the plaintiffs proffer. The Court concludes all are immaterial or improperly offered, particularly those which relate to any affidavits offered by counsel. Therefore, the plaintiffs' objections regarding inclusion of additional facts not specifically stated in the Report are overruled.

B. OBJECTIONS TO THE REPORT'S ANALYSIS AND APPLICATION OF THE TWENTY-FIRST AMENDMENT AND FEDERAL STATUTES

1. Defendants' and intervenor's objections

a. **Defendants and intervenor object to the Magistrate's finding of facial and economic discrimination.**

i. **Defendants and intervenor argue that the ABC Act's import controls are facially neutral because whether manufactured in- or out-of-state, all liquor must pass through the hands of a state-licensed entity.**

The Court has reviewed the statutes in question and finds that this objection must be overruled. Regardless of defendants' and intervenor's characterization of the statutes, on its face, the scheme establishes a system whereby Virginia wineries, farm wineries, breweries, and off-premises licensees may directly ship beer and wine to Virginia and out-of-state consumers, where legal, whereas out-of-state vendors may neither obtain a Virginia license nor directly ship beer or wine to Virginia consumers. This is the very definition of a facially discriminatory law and the defendants' and intervenor's objection stated in paragraph 27 is therefore overruled.

ii. **Defendants and intervenor argue that the ABC Act's import controls do not constitute "economic discrimination."**

In paragraph 28, the defendants and intervenor assert that the Magistrate's Report is in error, arguing that state imposed burdens on in state licensed producers are identical to the burdens placed on out-of-state producers. The Court finds this objection to be without merit. The Virginia scheme does not place the same burdens on in-state and out-of-state producers because it allows in-state producers and off premises licensees to not only obtain licenses, but also to directly ship products to Virginia and out-of-state consumers while it is impossible for an out-of-state entity either to direct ship or to obtain a Virginia license. The scheme has both the purpose and effect of prohibiting an out-of-state entity from participating in direct marketing and shipment of wine and beer to Virginia residents. In fact, throughout most of this case, it is

apparent that the defendants and intervenor have been trying to convince the Court that the in-state entities bear a greater burden than do the out-of-state entities simply because the ABC has physical jurisdiction under Virginia's regulatory scheme. The objection made by defendants and intervenor in their paragraph 28 that 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" is disingenuous. The regulations prevent out-of-state products from entering the market on the same terms as in-state products because they must go to a Virginia wholesaler and/or off-premises licensee before reaching a consumer. A Virginia producer may obtain its off-premises license, market directly to consumers, ship directly to consumers, and eliminate any requirement to pass its product through any other mechanism other than its own production and distribution line. The objection in defendants' and intervenor's paragraph 28 is therefore overruled.

In paragraph 29, defendants and intervenor argue that the Seventh Circuit's decision in Bridenbaugh v. Freeman-Wilson, 227 F.3d 848 (7th Cir. 2000), is persuasive and supports their argument that Virginia's statutory system does not constitute economic discrimination. The Court agrees with the Magistrate's analysis that the Bridenbaugh case is inapplicable to this case and also improperly decided because it does not rely upon the established dormant Commerce Clause analysis. Although the dormant Commerce Clause jurisprudence may be unpopular among some jurists and litigants, it is the law by which this Court is bound. The defendants' and intervenor's objection stated in paragraph 29 is therefore overruled.

In paragraph 30, defendants and intervenor object to the Magistrate's finding of economic discrimination on the theory that the finding was based on a fundamental misunderstanding of the structure and operation of Virginia's control system. Defendants and intervenor complain that the Report's conclusion that the ban against out-of-state direct shipment is against the evidence because Virginia's producers and in-state licensees bear the costs of compliance with Virginia's laws, including the payment of excise taxes. They argue that because out-of-state entities do not have to comply with Virginia's laws and are permitted to direct-ship, the cost of delivering out-of-state products to Virginians directly would actually be lower than for Virginia producers and in-state licensees. Considering the Virginia enforcement scheme, the relevant inquiry is whether the in-state entities and out-of-state entities are permitted to enter and compete in the market on the same terms. Here, it is not disputed that in-state entities properly licensed may direct-ship to consumers while out-of-state entities may neither obtain a license nor direct-ship.

The Court finds, however, that there is some merit to the defendants' and intervenor's objection that the Magistrate's Report assumes, and therefore finds, that the actual discrimination is based on two mistakes of fact: 1) that the in-state preference avoids a price increase; and 2) 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." First, the actual discrimination occurs as a result of the in-state preference for entry into the market and direct shipment to consumers; it is based on the language and function of the ABC Act. Because it is unnecessary to measure the

quantum of the economic impact to determine whether the statute is facially discriminatory, the statement that the in-state preference avoids a price increase is superfluous whether supported by the evidence or not. Second, the record demonstrates that the "three-tier" system is a misnomer when applied to in-state producer/licensees. It is accurate to state that in-state producer licensees do not have to pass their products through each tier that an out-of-state entity must. Because it is clear that in-state producers/licensees are subject to the same enforcement provisions, it may not be accurate to find that they are subject to significantly less control by the state.

While the Court does not accept the defendants' and intervenor's characterization of the objection in paragraph 30, it does have some merit. Therefore, the objection to the finding that the in-state preference necessarily results in a price increase is sustained, but only to the extent that it is an unnecessary finding. Further, the objection to the finding that in-state producers/licensees are subject to significantly less control is also sustained in part. The appropriate finding is that off-premises licensees who are also producers and importers may not be required to pass the product through a wholesaler or retailer to deliver the product to consumers, and thus they are subject to less than the full-force and exposure of the three-tier system.

iii. **Defendants and intervenor object to the Magistrate Report's findings related to the dormant Commerce Clause analysis, alleging that the factual record demonstrated that the importation controls were justified and that the controls are the least restrictive controls available.**

In paragraph 31, defendants and intervenor complain that the Report erroneously concluded that the defendants 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." The argument is that the Magistrate should have found that Virginia's justification for its controls were the only means by which it could inspect, monitor, and regulate out-of-state products given the volume of imports and the limited jurisdiction of the ABC within the state. The defendants and intervenor produced mounds of evidence relating to their business practices and enforcement activities. They also produced evidence that there were violations of practically every state law by both in- and out-of-state entities. However, they did not produce evidence tending to show that there are no other nondiscriminatory means of enforcing their legitimate interests. The question is not whether the state can perform the type of enforcement in which it currently engages or whether is the three-tier system per se the only framework for consideration of a system by which it can function. The question is whether the state can accomplish its legitimate interests without discriminating against out-of-state direct shippers of wine and beer. This, they have not done. See Waste Mgmt. Holdings, Inc. v. Gilmore, 87 F. Supp. 2d. 536, 543 (E.D. Va. 2000). The defendants' and intervenor's objection in paragraph 31 is therefore overruled.

b. **Defendants' and intervenor's objections regarding application of the Twenty-first Amendment.**

i. **Defendants and intervenor argue that the Twenty-first Amendment immunizes state controls on the importation, distribution, and transportation of alcoholic products from challenge under the dormant Commerce Clause.**

In paragraphs 32 through 39, defendants object to the Magistrate Judge's application of the Twenty-first Amendment. The defining feature of defendants' and intervenor's argument is

that the Twenty-first Amendment, and not the dormant Commerce Clause, is the only means by which the Court should analyze whether Virginia has the authority to control the importation and distribution of alcoholic beverages "free of the strictures of the dormant Commerce Clause." They argue that no Supreme Court case has ever applied the dormant Commerce Clause to a case which focused strictly on imports, and that the state's control over importation and distribution is unfettered. Therefore, the defendants and intervenor object to the mere fact that the Magistrate Judge applied the dormant Commerce Clause analysis to this case. In addition to objecting to its relevance to this case, the defendants and intervenor also object to the Magistrate Judge's interpretation of the dormant Commerce Clause analysis and the manner in which it was applied to the facts of this case. The defendants and intervenor narrowly focus their argument and interpretation of the dormant Commerce Clause only in the context of the nature of the violation – that Virginia's import controls include a ban on direct shipment of out-of-state beer and wine to Virginia consumers while permitting such shipment by Virginia entities. Rather than focus on this case as an import case, the Magistrate's Report analyzed the challenged statutes under the dormant Commerce Clause by determining first whether the statute was facially discriminatory. Because the question in this case required application of the dormant Commerce Clause analysis, and because the Court agrees with the Magistrate's analysis in this respect, the defendants' and intervenor's objections outlined in their paragraphs 32 through 39 are overruled.

ii. Defendants and intervenor assign error to the Magistrate's rejection of circuit court decisions upholding state import control statutes.

In paragraph 40, the defendants and intervenor object to the Magistrate's rejection of the Seventh Circuit's decision in Bridenbaugh v. Freeman-Wilson, 227 F.3d 848 (7th Cir. 2000).

This Court is not bound by any decision of the Seventh Circuit, and the Court agrees with the Magistrate Judge's analysis of this case. The defendants' and intervenor's objection is overruled.

In paragraph 41, the defendants and intervenor object to the Magistrate's differentiation between the statutory scheme in Indiana, addressed in the Bridenbaugh decision, and the scheme in Virginia. There is some merit to the observation that the burdens imposed on in-state and out-of-state producers under the Virginia ABC Act for compliance and taxation are "identical in economic or functional impact." The Court finds, however, that the Bridenbaugh decision is inapplicable for other reasons outlined by the Magistrate's Report, namely that the Seventh Circuit did not apply the dormant Commerce Clause, which this Court finds must be applied. Therefore, the objection is overruled.

In paragraph 42, defendants and intervenor object to the Magistrate's assertion that Virginia's scheme can be differentiated from that in Bridenbaugh because Virginia's three-tier system applies differently depending on whether the producer is in- or out-of-state. As previously discussed, the Magistrate found that Virginia's scheme allows Virginia producers and off-premises licensees to direct ship wine and beer to Virginia and out-of-state consumers where permitted by law. Thus, these licensees are not truly subject to the full-force of the three-tier system, meaning that they are spared the requirement to pass products through each tier. Though Virginia wineries, farm wineries, breweries and off-premises licensees must all be residents of Virginia to obtain a license and all licensees are subject to compliance, taxation and enforcement at all tiers, the Magistrate's conclusion is correct that the Virginia scheme is discriminatory because it: 1) does not permit out-of-state entities to obtain Virginia licenses; and 2) forbids out-

of-state licensed or federal licensed entities to direct-ship products to Virginia consumers, instead requiring delivery of the product first to a wholesaler or Virginia-licensee before that licensee can ship to a consumer. This is a functional difference in treatment between in-state and out-of-state producers and purveyors of wine and beer. Therefore, the objection is overruled.

In paragraph 43, defendants and intervenor object to the Magistrate's criticism of Judge Easterbrook's focus in Bridenbaugh on the language of the Twenty-first Amendment as support for his conclusion that state laws limited to import controls are free of dormant Commerce Clause claims. While defendants, intervenors, and the Seventh Circuit may correctly observe that no Supreme Court case specifically holds that laws limited to the importation of liquor are problematic under the dormant Commerce Clause, the Court agrees with the Magistrate's report that it is nonetheless bound to analyze a question of facial discrimination under an established dormant Commerce Clause analysis, which Judge Easterbrook declined to do. Therefore, there is no error in the Magistrate's refusal to accept the reasoning and decision in Bridenbaugh that the dormant Commerce Clause was inapplicable to importation cases. The objection in paragraph 43 is overruled.

In paragraph 44, defendants and intervenor object to the Magistrate's discrediting of the holding in Kronheim v. District of Columbia, 91 F.3d 193 (D.C. Cir. 1995). Defendants and intervenor argue that the Kronheim court held that states have absolute power over liquor control. This reading by the defendants is incorrect. The Kronheim court held that despite a legitimate motive mixed with a protectionist motive to enforce territorial warehousing laws, under Craig v. Boren, 429 U.S. 190, 206 (1976), once liquor entered the District of Columbia, the District had

"plenary power to regulate and control . . . the distribution, use, or consumption of intoxicants within her territory after they have been imported." 91 F.3d at 399. The Court agrees with the Magistrate's interpretation and application of this case. Moreover, this Court is not bound by the decision in a case outside this Circuit, even if the Court were to find it persuasive. The defendants' and intervenor's objection is overruled.

iii. **Defendants and intervenor argue that the Heublein decision of the Virginia Supreme Court does not support the Magistrate's Report.**

In objection number 45, the defendants and intervenor argue that the Magistrate's Report improperly relies on Heublein Inc. v. ABC, 237 Va. 192, 376 S.E.2d 77 (1989), to support a decision to strike down import controls. The defendants and intervenor are correct that the Heublein case did not involve import controls. Rather, it involved unconstitutional, retroactive and extraterritorial application of another of Virginia's protectionist statutes, the Wine Franchise Act. This is entirely consistent with the Magistrate's analysis. (Report and Recommendation at 27.) The Magistrate found that the Heublein case provided guidance inasmuch as it exemplifies that the Virginia Supreme Court applies the dormant Commerce Clause analysis in cases where it is presented with facially discriminatory statutes. Unlike Bridenbaugh where the Seventh Circuit found that the Indiana Supreme Court had not decided how to reconcile its own competing statutes, here the Magistrate had guidance from the Virginia Supreme Court in Heublein as to how to analyze a facially discriminatory state statute. The Court agrees with the Magistrate's analysis on this point and the objection is overruled.

c. **Objections regarding federal statutes.**

i. **The Wilson and Webb-Kenyon Acts**

In paragraphs 46 - 51, the defendants and intervenor object to the Magistrate's Report because it concluded that the sole purpose of the Wilson and Webb-Kenyon Acts was to assist states which imposed a total ban on possession for personal use, and that the Webb-Kenyon Act prohibits the transportation of intoxicating liquor in violation of any law of the state in contravention of James Clark Distilling Co. v. Western Maryland R. Co., 242 U.S. 311 (1916) and West Virginia v. Adams Express Co., 219 F. 794 (4th Cir. 1915). Based on the language, history, and application of the Wilson and Webb-Kenyon Acts, two things are clear. First, the Acts were reinstated following the repeal of prohibition to assist states in maintaining the status quo if they desired to remain dry. Second, even though no state has chosen to remain dry sixty-seven years later, their option to resort to the protections provided in these statutes remain in force. Furthermore, a state retains the right under the Twenty-first Amendment to control the importation and distribution of liquor within its borders as long as it is not discriminatory. The most important aspect of these Acts are that they do no not provide defendants and intervenor with the authority they seek to invoke – the right to ignore the dormant Commerce Clause during the lawful exercise of their Twenty-first Amendment rights. Therefore, the objections made in paragraphs 46 through 51 are overruled.

ii. The Twenty-first Amendment Enforcement Act

In paragraph 52, the defendants and intervenor contend that the Report makes no effort to synthesize its view of the Webb-Kenyon Act as a "useless relic" with the Twenty-first Amendment Enforcement Act passed by Congress in 2000. First, the Magistrate's Report does not find that the Webb-Kenyon Act was a "useless relic," even if the Report does not adopt the

defendants' and intervenor's interpretation of the Act. Second, it is correct that the Court should not construe a statute to render it meaningless. However, the defendants and intervenor asserted in their motions for summary judgment that the Twenty-first Amendment Enforcement Act conclusively supported their entire position that Congress "clearly and positively spoke to the issue of alcoholic beverage commerce in the states, thereby rendering the 'dormant' or 'negative' Commerce Clause inapplicable." (Defs.' Amend. Mot. in Supp. of Summ. J. at 2); *see* Pub. L. 106-386, effective Jan. 25, 2001. Although, as mentioned above, it would be ridiculous to require every Court to set out in full the provisions of every statute upon which it relies, it is important to look at the full scope of what is provided under such a clear mandate.

A perusal of this Act demonstrates that it creates a civil cause of action to enforce state laws in federal court by way of injunction. Sections 2(e)(1) and (2) specifically set out that the statute is to be construed as applicable to state law as the Twenty-first Amendment has been interpreted by the Supreme Court, including as it relates to other constitutional provisions. This statute cannot possibly be interpreted as the defendants and intervenor would have the Court do: that the Act "render[s] the 'dormant' or 'negative' Commerce Clause inapplicable." (Defs.' Mem. at 2). Although it is true that the legislative history of the Twenty-first Amendment Enforcement Act includes letters from many states attorneys general, including the attorney general of Virginia, professing the perceived need for the statute to prevent, among other things, direct shipments to juveniles in order to diminish underage drinking and driving, the plain language of the statute creates only a federal forum for states to seek injunctive relief to enforce their otherwise valid constitutional statutes relating to intoxicating beverages. Therefore, the

objection in paragraph 52 is overruled.

iii. The Federal Alcohol Administration Act

In paragraphs 53 and 54, defendants and intervenor generally object to the Report's view of the federal statutes, namely the Federal Alcohol Administration Act, and their impact on a state's powers to enforce its own laws regulating the importation, distribution, and sale of alcohol as grounds for denial or revocation of a federal permit. To the extent it is relevant, the Court does not read the Magistrate's Report to ignore this fact. As long as a state's statutes are constitutional or otherwise enforceable, violation of a state law are grounds for denial or revocation of a federal permit. Because this is true, where an out-of-state entity has violated a valid state law, the out-of-state entity is subject to having its entire national business shut down permanently – the ultimate commercial sanction. Therefore, it is proper to accept this as a fact, but it does not support the state's argument that its prohibition on interstate direct shipment is the least discriminatory means of enforcing its legitimate laws to prevent, for instance, its diversion, drinking age, and purity laws.

While it is correct to state that the exercise of federal jurisdiction in enacting certain alcohol control statutes is an exercise of Congress' duties and powers under the Commerce Clause, it is incorrect to conclude that "[c]entral to the Report's conclusions is its mistaken view that there are no federal policies adopted pursuant to Congress' positive powers . . . to regulate interstate commerce." Nowhere in the Report is this stated or implied. In fact, the Magistrate discussed the very instances where the Congress has exercised its positive commerce clause powers and what impact such action has on the interstate trade in alcohol. No manufacturer,

distributor, importer, or retailer of wine is without the jurisdiction of these federal acts. Any business or individual found in violation of a valid state law may forfeit its license – its lifeblood – under the federal statutes. The Twenty-first Amendment Enforcement Act even creates a federal civil injunctive remedy where there is a violation of a state's valid laws. There is nothing in the Magistrate's report to the contrary. Therefore, defendants' and intervenor's objections in paragraphs 53 and 54 are overruled.

iv. **"Market Participant" doctrine**

In paragraphs 55 and 56, defendants and intervenors object that the Magistrate's Report engages in an "erroneous and tortured analysis that is not sanctioned by existing precedent" in finding that the ABC impermissibly discriminates against out-of-state wine by limiting its preference to retailing only in-state wine in its state-owned liquor stores. While the Magistrate may have been tortured by this case, the analysis is not.

Even though it is an important case, the market-participant question does not rise and fall solely on the facts of the Hughes v. Alexandria Scrap Corp. case. 426 U.S. 794 (1976). The Magistrate specifically found that as a matter of public policy, a state has legitimate interests in protecting, promoting, and even subsidizing its citizens when the state acts as a market participant. See Id. at 810; See also Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. at 593-594. In this case, there is no question that the state, even in the context of its control over the ABC stores, is not only a market participant but the regulator of the market in Virginia. The subsidy to the local wine market is not permissible when it excludes all others based on out-of-state status. New Energy Co. of Ind. v. Limbach, 486 U.S. at 277. In this case, there is no

error in the Magistrate's finding that the state's argument that its regulatory role is distinct from its market participant role cannot be sustained. Therefore, the objections in paragraphs 55 and 56 are overruled.

2. Plaintiffs' Objections

Plaintiffs object that the Report does not include important legislative history regarding the Twenty-first Amendment, Webb-Kenyon Act, and Wilson Act. The Court agrees that the history and context of the Twenty-first Amendment and the Acts are important and the Court sustains the plaintiffs' objection to the extent that it seeks a declaration that the Congressional Record is relevant.

Plaintiffs next objection argues that the Report overlooks the argument that the language of the Wilson Act itself does not permit discriminatory regulation by states. The language of the Act speaks for itself and is reproduced in full in the Report, however, the plaintiffs are correct that the Report neglects to mention that the Act provides states the authority to regulate intoxicating liquors "to the same extent and in the same manner as though such . . . liquors had been produced in such State or Territory . . . ." Therefore, the objection is sustained on the basis of this language.

Plaintiffs also make the objection that the Report "needlessly" analyzes the state's discriminatory laws as weighed against the core powers endowed by the Twenty-first Amendment. Plaintiffs argue that such an analysis is necessary only when the state's police powers under the Twenty-first Amendment conflict with a federal power exercised under the positive Commerce Clause. The Court finds this argument to have some merit, as discussed

above in relation to the defendants' and intervenor's objections, but the objection is overruled because the core concerns analysis provides context for determining whether there is a legitimate exercise of the state's police powers which may assist it in overcoming the discriminatory nature of its statutes. See Bacchus, 468 U.S. at 263.

C. OBJECTIONS TO THE REPORT'S ANALYSIS OF THE PROPER REMEDY

With the exceptions noted above in reference to the parties' objections, the Court agrees with the Magistrate's analysis of the issues in this case, and the Magistrate's conclusion that the statutes at issue are unconstitutional forms of discrimination in their in-state preferences for Virginia wine and beer. The Court's remaining task is to address the appropriate remedy for these violations.

The defendants' and intervenor's position with respect to the remedy proposed by the Magistrate's Report is that, although they dispute the existence of an unconstitutional in-state preference, they agree with the Magistrate's proposal that only the violating sections should be severed from the Act as a whole and stricken.

The plaintiffs, on the other hand, argue that the proper remedy, and the only remedy that would vindicate the constitutional rights violated by Virginia's current statutory scheme, is a declaration that the ban on direct shipment from out-of-state sources is unconstitutional, and an injunction prohibiting the state from enforcing the direct shipment ban against citizens of the Commonwealth who would purchase wine and beer from out-of-state and have it shipped to them in Virginia, as well as against those who would sell and ship to them.

The plaintiffs first object that the Magistrate's Report fails to apply settled remedial

precedent. Where a statute is defective because of underinclusion, as in this case, federal remedial law provides two alternatives: the Court may "either declare [the statute] a nullity and order that its benefits not extend to the class that the legislature intended to benefit, or it may extend the coverage of the statute to include those who are aggrieved by the exclusion." Welsh v. United States, 398 U.S. 333, 361 (1970) (Harlan, J., concurring). The Supreme Court has held that courts should generally apply a presumption of extension of benefits rather than nullification. See California Fed. Sav. & Loan Ass'n v. Guerra, 479 U.S. 272, 291-92 (1987); Nguyen v. I.N.S., 533 U.S. 53, 95-96 (2001) (Scalia, J., with Thomas, J., concurring) ("[I]n the absence of legislative direction *not* to sever [an] infirm provision, 'extension, rather than nullification' of a benefit is more faithful to the legislative design.") (emphasis in original, citations omitted). Additionally, the Fourth Circuit has followed this practice in dormant Commerce Clause cases. See Envtl. Tech. Council v. Sierra Club, 98 F.3d 774 (4th Cir. 1996) (striking down caps on out-of-state hazardous waste rather than applying them to in-state waste). Given this precedent, the Court finds that the ban against directly shipping wine and beer from out-of-state is unconstitutional and that, perforce, all of the challenged statutes are unconstitutional. The plaintiffs' objection in this regard is sustained.

As discussed in the Magistrate's Report, the issue then becomes whether the offending statutes are severable from the rest of the Act. The plaintiffs second objection is that the offending statutes are not severable in the way the Magistrate's Report suggests. The question of severability is controlled by state law. Leavitt v. Jane L., 518 U.S. 137, 139 (1996). Under Virginia law, to determine whether the offending portions of the statute can be severed, this

Court must determine whether the General Assembly would have passed the Act without the preference for in-state wine and beer. See Heublein, inc. v. Dept. of Alcoholic Beverage Control, 237 Va. 192, 200 (1989). If not, the entire statutory scheme must fail.

The Court agrees with the plaintiffs and respectfully disagrees with the Magistrate's conclusion that the provisions at issue in this case are severable. First, the Virginia ABC Act contains no severability clause indicating legislative intent for a portion of the Act to survive if the rest is declared invalid. Second, there are no special circumstances at issue in this case that rebut the presumption in favor of extension of a remedy over nullification, and there is no indication of contrary legislative intent. Finally, this Court is guided by the Virginia Supreme Court's analysis in Heublein.

The Heublein case addresses how much of Virginia's ABC Act is affected by a statute being declared unconstitutional. Essentially, Heublein instructs that the Court has three options: 1) to declare only the three core statutes criminalizing out-of-state direct marketing unconstitutional and enjoin their enforcement; or 2) to declare each of the challenged statutes unconstitutional and enjoin their enforcement; or 3) to declare each of the separate Titles of the ABC Act in which the unconstitutional sections are located (in this case, all of the Titles) to be unconstitutional. The Court agrees with the plaintiffs that the second option is the most preferable in this case. Declaring unconstitutional and enjoining the enforcement of each of the challenged statutes effects the intent of the legislature, serves the interests of the consumer and the dormant Commerce Clause, and preserves the police powers of the Commonwealth to further its legitimate interests under the ABC regime. For these reasons, therefore, plaintiffs' objection

to the remedy is sustained.

Finally, plaintiffs object to the Magistrate's analysis of the parameters of the "in-state interests" that the ban on direct shipment was designed to serve. Plaintiffs argue that the wholesalers and importers comprise the "real" state interest, rather that the "quaint fiction" that the state interest is the promotion of temperance and enforcement of the ABC regulations. Plaintiffs assert that such a determination is a defining element of the extent of the discrimination as well as the appropriate remedy for it. Plaintiffs argue that the fact that all wine, beer, and liquor produced out-of-state must pass through a Virginia importer and wholesaler before it can reach a consumer makes the market for these products subject to the "whims" of the wholesaler. In other words, the plaintiffs seek to introduce the argument that the legislature is in cahoots with the wealthy special interest groups in order to preserve the wholesaler/importer monopoly in Virginia. The Court rejects this argument. While there may be a supportable argument that protecting in-state wholesalers and importers is the true and illegitimate interest behind the statutes at issue in this case, it is truly unnecessary for the Court to entertain this argument in order to resolve the dormant Commerce Clause question. The plaintiffs' objection is therefore overruled.

IV. CONCLUSION

Upon review of the record, the Magistrate Judge's findings, and the objections, the Report and Recommendation will be accepted and adopted with the modifications made by the sustained objections, as stated above.

An appropriate Order shall issue.

MAR 2 9 2002
DATE

Richard L. Williams
SENIOR UNITED STATES DISTRICT JUDGE