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IN THE UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF CALIFORNIA

ORION WINE IMPORTS, LLC and PETER E. CREIGHTON, *Plaintiffs* vs JACOB APPLESMITH, in his official capacity as Director of the California Dept. of Alcoholic Beverage Control *Defendant*	No. 2:18-cv-01721-KJM-DB **PLAINTIFFS' MEMORANDUM IN OPPOSITION TO DEFENDANT'S MOTION TO DISMISS THE SECOND AMENDED COMPLAINT** Date: December 21, 2018 Time: 10:00 am Courtroom: 3 Judge: Hon. Kimberly J. Mueller

I. Introduction

In the Second Amended Complaint [Dkt. No. 32], plaintiffs challenge the constitutionality of provisions in the California Alcoholic Beverage Control Act that authorize merchants located in California to import wine and resell it to restaurants and other retailers, but prohibit those located outside the state from doing so. Out-of-state wine importers may only sell their wine to in-state importers (their competitors), who become responsible for distributing the wine to retailers. This is an extra step not required of California importers that adds cost and reduces the out-of-state importers' control over distribution. Orion Wine Imports contends that this disparate treatment violates the Commerce Clause, U.S. CONST. ART. I, § 8, and Peter Creighton contends that it violates the Privileges and Immunities Clause, U.S. CONST. ART IV, § 2. The defendant, ABC Director Jacob Applesmith, has filed a motion to dismiss the complaint [Dkt. No. 33].

Applesmith makes two arguments why the Commerce Clause claim should be dismissed:

1) The ABC Act does not discriminate against out-of-state importers because everyone who wants to sell wine in California is required to use an in-state distributor. [Dkt. 33-1 at 3-6]. If there is no discrimination, the local processing rule is subject only to minimal scrutiny, and is constitutionally valid because it furthers the state's interests and does not place significant burdens on interstate commerce.

2) Even if the local processing rule for wine distribution had a discriminatory effect on out-of-state entities, it would be valid because the Twenty-first Amendment gives states virtually unlimited power to regulate the importation of alcohol. Therefore, California may constitutionally require that wine originating outside the state must be processed by an in-state importer before being distributed through the state's three-tier system. [Dkt. 33-1 at 5-6].

Director Applesmith makes three arguments why the Privileges and Immunities claim (Count II) should be dismissed:

1) Mr. Creighton lacks standing because his injuries flow solely from harm done to Orion Wine Imports, Inc. (which he owns), and corporations may not assert Privileges and Immunities claims. [Dkt. No. 33-1 at 7].

2) Selling wine is not the kind of interest protected by the Privileges and Immunities Clause. [Dkt. No. 33-1 at 7].

3) Even if Mr. Creighton had standing and selling wine were a protected activity, the claim would fail because California does not discriminate against nonresidents. Everyone who wants to sell wine in California is required to follow the same ABC rules, including using an in-state importer. [Dkt. No. 33-1 at 7-8].

II. Standard of Review

Rule 12 motions to dismiss are determined based on the face of the complaint with all factual assertions and reasonable inferences therefrom taken in the light most favorable to the non-moving party. If the pleadings plausibly suggest a legitimate claim that would entitle plaintiffs to relief, the motion should be denied. *Moss v. U.S. Secret Serv.*, 572 F.3d 962, 969 (9th Cir. 2009). Parties are generally entitled to their day in court, so motions to dismiss are "viewed with disfavor and ... rarely granted." *Hall v. City of Santa Barbara*, 833 F.2d 1270, 1274 (9th Cir.1986). This standard applies to Rule 12(b)(6) dismissals for failure to state a claim upon which relief can be granted and also to Rule 12(b)(1) dismissals for lack of jurisdiction. *See Tilikum ex rel People for the Ethical Treatment of Animals, Inc., v. Sea World Parks & Enter., Inc.*, 842 F.Supp. 2d 1259, 1261 (S.D. Cal. 2012).

In reviewing claims brought under the Commerce Clause, courts employ a two-tier review process. If a law regulates even-handedly, the inquiry is whether the burden imposed on interstate commerce is clearly excessive in relation to the putative local benefits. Even-handed laws are usually constitutional. However, if a state law discriminates against interstate commerce it is virtually per se invalid. *Oregon Waste Sys., Inc. v. Dept. of Env'l Quality,* 511 U.S. 93, 99 (1994). A discriminatory law will be upheld only if it advances a legitimate local purpose that cannot adequately be served by reasonable nondiscriminatory alternatives. *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 278 (1988). This review standard is summarized (and made applicable to state liquor laws) in *Black Star Farms, LLC v. Oliver*, 600 F.3d 1225, 1230 (9th Cir. 2010).

In reviewing claims brought under the Privileges and Immunities Clause, courts use a three-step inquiry. (1) Are residents of other states being denied the privilege to engage in an activity upon terms of substantial equality with state citizens? (2) Is the activity "fundamental," i.e., is it sufficiently basic to the livelihood of the nation so as to fall within the purview of the Clause? (3) If so, the law is unconstitutional unless there is a legitimate reason for the difference in treatment that bears a substantial relationship to the State's regulatory objective and there are no reasonable less discriminatory alternatives. *Sup. Ct. of N.H. v. Piper,* 470 U.S. 274, 284 (1985); *Council of Ins. Agents & Brokers v. Molasky-Arman*, 522 F.3d 925, 934-35 (9th Cir. 2008).

III. California's wine import laws are discriminatory

Director Applesmith repeatedly asserts that California's laws governing wine importation do not discriminate against out-of-state interests. If he were right, then the complaint would have to be dismissed, because it rests upon an allegation of discrimination. However, Director Applesmith is wrong, and the discrimination is obvious.

California generally uses a three-tier system for distributing alcoholic beverages, including wine. *See* Cal. Bus. & Prof. Code § 23501 (legislative findings). The top tier is the producer, either a domestic winery or an importer acting as the agent of a foreign winery. The middle tier is the wholesaler, who acquires the wine from the producer and distributes it to restaurants and other retailers, which make up the third tier. California regulates the three tiers through a licensing system that typically requires wine to go from producer to wholesaler to retailer, although there are exceptions. For example, California allows wineries to both produce wine and sell it at retail from their tasting rooms without the wine passing through a wholesaler. Cal. Bus. & Prof. Code § 23358.

Discrimination for purposes of the Commerce and Privileges and Immunities Clauses simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter. *Oregon Waste Sys.,* 511 U.S. at 99. The Complaint alleges that importers located in California are legally permitted to import wine and distribute it to retailers, SAC ¶¶ 7-9, but those located outside the state may not. Out-of-state importers must sell their wine to an in-state importer and let the in-state importer distribute it to retailers. SAC ¶¶ 8-10. This is exactly the kind of differential treatment of in-state and out-of-state interests concerning the sale of goods which is prohibited by the Constitution's nondiscrimination principle.

California has created a beer and wine importer license called a "Type 9," Cal. Bus. & Prof. Code § 23320(a)(9), and a beer and wine wholesaler license, called a "Type 17." Cal. Bus. & Prof. Code § 23320(a)(17). An importer of wine located in California may obtain both licenses. Cal. Bus. & Prof. Code § 23775. It may then import wine into California pursuant to its importer license, Cal. Bus. & Prof. Code § 23017, transfer the imported wine to itself (importer to wholesaler), Cal. Bus. & Prof. Code § 23374, and use its wholesaler license to sell and deliver

that wine to California restaurants, wine shops, and other entities licensed to resell the wine at retail. Cal. Bus. & Prof. Code § 23378.

By contrast, no license or combination of licenses is available that would allow importers located out of state to sell and deliver wine directly to retailers. SAC ¶¶ 8-11. Every drop of wine entering California that is destined for retail sale must first be delivered to a the premises of a licensed importer located in the state. Cal. Bus. & Prof. Code §§ 23661, 23666. The only way the Plaintiffs could sell the wine they have imported from other countries directly to California retailers would be to open a new import/wholesale business in California with physical premises in the state which could import the wine from them and sell it to retailers. Cal. Bus. & Prof. Code §§ 23661. This is not a constitutionally acceptable solution for two reasons: (1) Plaintiffs cannot afford to do so, SAC ¶¶ 15, 28, and the Supreme Court has said that the high cost of opening a second facility in a distant state is relevant in assessing discriminatory effect. *Granholm v. Heald,* 544 U.S. 460, 475 (2005). (2) The Supreme Court has said that requiring an out-of-state firm to establish in-state premises in order to compete on equal terms would itself violate the Commerce Clause. *Granholm v. Heald,* 544 U.S. at 475.

IV. The Commerce Clause prohibits discriminatory state liquor laws.

Count I of the Second Amended Complaint contends that California's discriminatory wine distribution laws violate the Commerce Clause. Director Applesmith argues that the discrimination is justified because Section 2 of the Twenty-first Amendment provides that the "transportation or importation into any State ... for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited." The states therefore have vast authority to regulate importation, so regulations such as these are "per se constitutional." [Dkt. No. 33-1 at 5]. The argument is complicated by the fact that Applesmith mischaracterizes the content of Orion's

complaint as seeking to do business in California without complying with the ABC Act. [Dkt. 33-1 at 1, lines 25-27]. The complaint clearly alleges the opposite --that Orion would comply with California regulations if California would issue it a license. SAC § 14.

Applesmith's argument is without merit. In *Granholm v. Heald*, the Supreme Court held to the contrary, that although states have broad power to regulate liquor distribution, "state regulation of alcohol is limited by the nondiscrimination principle of the Commerce Clause." 544 U.S. 487. "[D]iscrimination is neither authorized nor permitted by the Twenty-first Amendment." *Id.* at 466. Although the Amendment gives states extensive authority to pass even-handed restrictions on the sale of alcoholic beverages, it does not supersede other provisions of the Constitution and, in particular, does not displace the fundamental rule that states may not give a discriminatory preference to in-state business interests. 544 U.S. at 486. "[D]iscrimination is contrary to the Commerce Clause and is not saved by the 21st Amendment." 544 U.S. at 489. The Ninth Circuit has also held that the Twenty-first Amendment does not permit a state to "favor in-state economic interests over out-of-state interests." *Black Star Farms LLC v. Oliver*, 600 F.3d at 1231 (quoting *Granholm*, 544 U.S. at 487).

Director Applesmith cites a number of cases for the proposition that states have broad authority to regulate interstate commerce in alcoholic beverages as long as the burdens are not excessive. [Dkt. 33-1 at 4-5]. These cases are not germane because they concerned the validity of even-handed regulations that harmed local and interstate commerce alike, not discriminatory regulations. The courts have long distinguished the two and have applied strict scrutiny (virtually per se invalidity) to laws that discriminate. *Oregon Waste Sys., Inc. v. Dept. of Env'l Quality,* 511 U.S. at 99. In addition, courts have "viewed with particular suspicion state statutes requiring business operations to be performed in the home State that could more efficiently be performed

elsewhere." *Granholm v. Heald,* 544 U.S. at 475.

Once plaintiffs have made a prima facie showing that state laws discriminate against out-of-state economic interests, the burden shifts to the State to demonstrate that its laws "advance a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." *Granholm*, 544 U.S. at 489. These are questions of fact requiring evidence from the defendant. 544 U.S. at 490-92. They cannot be decided on a Rule 12(b)(6) motion, so the motion to dismiss Count I should be denied.

V. Peter Creighton has stated a valid Privileges and Immunities Clause claim

A. Standing

Director Applesmith contends that Peter Creighton lacks standing to bring a claim based on the Privileges and Immunities Clause, U.S. Const. Art. IV., § 2. The argument is without merit.

First, Applesmith asserts that the Privileges and Immunities Clause applies only to individuals and not corporations. Even assuming that were still a correct statement of the law after *Citizens United v. Fed. Election Comm'n*, 558 U.S. 310, 342 (2010) (holding that there was no constitutional distinction between individuals and corporations in First Amendment context), it is an irrelevant observation because Peter Creighton is not a corporation. SAC ¶¶ 5, 23.

Second, Applesmith contends that the Privileges and Immunities Clause does not apply to individuals whose claims are derived solely from those of a corporation, and that Peter Creighton's claim falls into this category. The cases cited by Applesmith for this principle have nothing to do with the nature of the claim made by Mr. Creighton. They bar shareholders from bringing personal claims based solely on an injury to the corporation when the shareholder has no other stake in the dispute. In *Chance Mgmt., Inc. v. South Dakota*, 97 F.3d 1107 (8th Cir. 1996), the individual plaintiff was a shareholder of an out-of-state corporation denied a video lottery

license. He did not allege any intent to do business personally in the state, so any injury he suffered came entirely from his status as a shareholder. 97 F.3d at 1116. In *Smith Setzer & Sons, Inc. v. S. C. Procurement Review Panel*, 20 F.3d 1311 (4th Cir. 1994), the individual plaintiff was a shareholder in a nonresident corporation that had lost profits, and the only injury he suffered was losing a share of the profits. He did not seek personally to do business in South Carolina. 20 F.3d at 1316-17. Neither case is germane because Peter Creighton has alleged that he wants personally to engage in the wine distribution business in California independently of whether Orion Wine Imports may do so, and has been personally harmed by being prevented from doing so. SAC ¶¶ 27, 29.

An individual who has been prevented from engaging in his occupation or doing business in another state has a right to bring a claim under the Privileges and Immunities Clause. The Supreme Court "repeatedly has found that one of the privileges which the Clause guarantees to citizens of State A is that of doing business in State B on terms of substantial equality with the citizens of that State." *Sup. Ct. of N.H. v. Piper,* 470 U.S. at 280-81 (internal citation omitted). Director Applesmith has cited no authority that individuals lose their privileges because they happen to also own a business, and the case law is to the contrary. The leading Ninth Circuit case is *Council of Ins. Agents & Brokers v. Molasky-Arman*. The individual plaintiff was Rebecca Restropo who was the managing director and a salaried employee of ABD Insurance and Financial Services, a California corporation. 522 F.3d at 929, 931. The Ninth Circuit found that she had standing as an individual to bring a Privileges and Immunities challenge to a Nevada law that treated nonresident insurance agents differently than resident agents, despite the fact that she also worked for a corporation with a similar interest in doing business in Nevada. 522 F.3d at 922-23.

Cases from other circuits concur. *E.g.*, *A.L. Blades & Sons, Inc. v. Yerusalim*, 121 F.3d 865, 868 n.4 (3d Cir. 1997) (individual employees of a business may challenge a residency rule that prevents them from plying their trade and earning money in another state). Indeed, one of the plaintiffs in *McBurney v. Young*, 569 U.S. 221 (2013), the Supreme Court's most recent Privileges and Immunities case, was Roger Hurlbert, the owner of Sage Information Service, a California Corporation. Hurlbert challenged a Virginia law that denied nonresidents access to its Freedom of Information process. He had standing as an individual, even though it was his company that had contracted to supply the information to clients. *See McBurney v. Ciccinelli*, 616 F.3d 393, 398 (4th Cir. 2010).

Peter Creighton has clearly alleged that he wants to do business personally in California. SAC ¶¶ 23, 27. California allows individuals to apply for licenses, not just corporations. Bus. & Prof. Code § 23008. He has alleged standing.

B. The Privileges and Immunities Clause violation

First, Director Applesmith contends that even if Peter Creighton had standing, his Privileges and Immunities claim would have to be dismissed because the Alcoholic Beverage Control Act does not discriminate against nonresidents. The Director does not develop or explain this argument, which is plainly incorrect in any event.

California discriminates against nonresidents who wish to engage in their occupation as wine merchants in the state. A California resident may obtain both an importer and wholesaler license. Cal. Bus. & Prof. Code § 23775. They may then import wine into California pursuant to their importer license, Cal. Bus. & Prof. Code § 23017, transfer the imported wine to themselves (importer to wholesaler), Cal. Bus. & Prof. Code § 23374, and use the wholesaler license to sell and deliver that wine to California restaurants, wine shops, and other retailers. Cal. Bus. & Prof.

Code § 23378. Peter Creighton may not do so because he lives outside the state. No license or combination of licenses allows nonresidents to sell and deliver imported wine directly to retailers from their location outside the state. Wine may be shipped into California from outside the state "only when consigned to the premises of [a] licensed importer" located inside the state. Cal. Bus. & Prof. Code §§ 23661. The privilege to sell directly to retailers is given to residents and denied to nonresidents. This is the whole point of the Complaint, and nowhere in his motion does the Director claim that we have misread the ABC Act.

Second, Director Applesmith contends briefly that this case does not involve an interest protected by the Privileges and Immunities Clause [Dkt. 33-1 at 7, lines 25-26], but does not develop or explain this argument or cite any authority for it. Unexplained arguments unsupported by citation of authority are generally waived. *United Nurses Ass'n of Cal. v. NLRB,* 871 F.3d 767, 789 n. 19 (9th Cir. 2017). Applesmith presumably means that selling wine is not an activity protected by the Clause, but that argument is without merit. The Clause protects privileges that are "fundamental" to the vitality of the nation, including owning property, having access to the courts, and (as relevant to this case) engaging in a trade, business or occupation. *McBurney v. Young*, 569 U.S. at 226-27. The courts have repeatedly held that having the opportunity to earn a livelihood is a fundamental privilege. *Id. at* 227-28 (2013) (collecting prior cases)*; Internat'l Org. of Masters, Mates & Pilots v. Andrews*, 831 F.2d 843, 845-46 (9th Cir. 1987). Jobs are vital to the national economy, whether a person is practicing law, *Sup. Ct. of N.H. v. Piper*, 470 U.S. at 280-81, working on the Alaska pipeline, *Hicklin v. Orbeck*, 437 U.S. 518, 524 (1978), fishing for shrimp, *Toomer v. Witsell*, 334 U.S. 385, 398-99 (1948), working construction, *United Bldg. & Const. Trades Council v. City of Camden*, 465 U.S. 208, 210-11 (1984), or selling goods by mail-order. *Ward v. Maryland,* 79 U.S. 418, 424-25 (1870). The State may regulate (or even ban)

occupations that pose a risk to the public, but if it allows residents to engage in such a trade, it must also allow nonresidents to do so on equal terms. *Sup. Ct. of N.H. v. Piper*, 470 U.S. at 280-81 (practice of law).

Director Applesmith has not argued that the Twenty-first Amendment is important, overrides the Privileges and Immunities Clause, and/or sanctions discrimination against nonresidents whose occupations involve alcoholic beverages, so that potential issue is not before the Court. Such an argument would be futile in any event, because the Supreme Court has said that the Twenty-first Amendment affects the Commerce Clause but "places no limit whatsoever on other constitutional provisions ... and does not license the States to ignore their obligations under other provisions of the Constitution." *44 Liquormart, Inc. v. Rhode Island,* 517 U.S. 484, 515-16 (1996).

VI. Conclusion

For the foregoing reasons, Director Applesmith's motion to dismiss the Second Amended Complaint should be denied.

Respectfully submitted,
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CERTIFICATE OF SERVICE

I hereby certify that on the 7th day of November, 2018, I electronically filed the foregoing document with the Clerk of the Court using the CM/ECF system. All participants in the case are registered CM/ECF users and will be served through that system.

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