
CONSTITUTIONAL LAW — DORMANT COMMERCE CLAUSE — SEVENTH CIRCUIT HOLDS THAT STATE LAW DISPROPORTIONATELY BURDENING OUT-OF-STATE BUSINESSES HAS ONLY INCIDENTAL EFFECTS ON INTERSTATE COMMERCE. — *Baude v. Heath*, 538 F.3d 608 (7th Cir. 2008).

In 2005, the Supreme Court held in *Granholm v. Heald*¹ that the dormant commerce clause prohibited a state from discriminating against other states by “allow[ing] in-state wineries to sell wine directly to consumers in that State but . . . prohibit[ing] out-of-state wineries from doing so,” whether this discrimination was by the terms of the state law or by its effect.² However, the Court did not settle the issue of exactly what constitutes discrimination against out-of-state producers.³ In particular, it is unclear whether a state may require consumers to visit wineries in person before receiving direct shipments of wine, or whether such a requirement is discriminatory because it imposes disproportionate costs on wineries in distant states. While two district courts have found that these face-to-face requirements violate the dormant commerce clause,⁴ other courts to consider such requirements have found them not discriminatory.⁵ Recently, in *Baude v. Heath*,⁶ the Seventh Circuit held that Indiana’s face-to-face requirement did not violate the dormant commerce clause because the state’s interests in revenue collection and in the prevention of underage drinking outweighed any incidental burden the law might have on interstate commerce.⁷ While other courts to address the issue have reached a similar conclusion, the court’s oversimplified cost-benefit analysis highlights how careless economic analysis can confuse, rather than clarify, a court’s doctrinally sound opinion.

¹ 544 U.S. 460 (2005).

² *Id.* at 466. For a summary of the Supreme Court’s early Twenty-first Amendment jurisprudence, under which the Court once allowed states to regulate alcohol in a discriminatory fashion, see Jonathan M. Rotter & Joshua S. Stambaugh, *What’s Left of the Twenty-First Amendment?*, 6 CARDOZO PUB. L. POL’Y & ETHICS J. 601, 625–26 (2008).

³ See, e.g., *Cherry Hill Vineyard, LLC v. Baldacci*, 505 F.3d 28, 35 (1st Cir. 2007) (“[*Granholm*] provides less than complete guidance, and virtually no new elaboration, with respect to what does — or does not — constitute discrimination against interstate commerce.”).

⁴ See *Baude v. Heath*, No. 05-0735, 2007 WL 2479587, at *16 (S.D. Ind. Aug. 29, 2007) (finding face-to-face requirement discriminatory in effect), *rev’d in part*, 538 F.3d 608 (7th Cir. 2008); *Cherry Hill Vineyards, LLC v. Hudgins*, 488 F. Supp. 2d 601, 615–19 (W.D. Ky. 2006) (same).

⁵ See, e.g., *Baldacci*, 505 F.3d at 31, 35–36 (finding Maine law not discriminatory because farm winery permits for face-to-face sales were available on equal terms and direct shipment ban applied equally to all); *Hurley v. Minner*, No. 05-826, 2006 WL 2789164, at *6 (D. Del. Sept. 26, 2006) (finding Delaware law not discriminatory because direct shipment ban and direct sales provision were evenhandedly applied).

⁶ 538 F.3d 608 (7th Cir. 2008).

⁷ See *id.* at 615.

Indiana forbade direct shipment of alcohol to individuals,⁸ except that a winery could apply for a “direct wine seller’s permit” if it did not “hold a permit or license to wholesale alcoholic beverages issued by any authority,” and had not recently distributed its wine through a wholesaler in Indiana.⁹ This “prohibition against wholesale interests” effectively barred sales from wineries in states whose farm winery licenses automatically included wholesale privileges, including the major wine-producing states of California, Oregon, and Washington.¹⁰ Moreover, wineries could ship directly only to consumers who had “provided to the seller in one . . . initial face-to-face transaction at the seller’s place of business” their personal information and proof of age.¹¹ Fine wine connoisseurs seeking access to out-of-state wines joined with a Michigan winery to challenge the Indiana regime.

The Southern District of Indiana held that both provisions violated the dormant commerce clause.¹² The court explained that the dormant commerce clause does not protect out-of-state businesses from natural disadvantages caused by geography, but only “forbids states from stripping out-of-state businesses of competitive advantages they have earned.”¹³ The wholesale interest prohibition violated this constitutional restriction by functioning as a discriminatory “concrete barrier” to bar ninety-three percent of all American-produced wine.¹⁴ Because Indiana did not demonstrate that the prohibition was effective at or necessary to the protection of the state’s three-tier alcohol distribution system, the court held it invalid.¹⁵ The court went on to find that the face-to-face requirement, although “less obviously discriminatory,”¹⁶ had the overall practical effect of disproportionately burdening out-of-state wineries, and was thus also discriminatory per se.¹⁷ Finding that the state could have used less burdensome methods to prevent

⁸ IND. CODE § 7.1-5-11-1.5 (West Supp. 2008) (“[I]t is unlawful . . . to ship or cause to be shipped an alcoholic beverage directly to a person in Indiana who does not hold a valid wholesaler permit . . .”).

⁹ *Id.* § 7.1-3-26-7(a).

¹⁰ *Baude v. Heath*, No. 05-0735, 2007 WL 2479587, at *16 (S.D. Ind. Aug. 29, 2007).

¹¹ IND. CODE § 7.1-3-26-6(4).

¹² *Baude*, 2007 WL 2479587, at *21 (wholesale interest prohibition); *id.* at *25 (face-to-face requirement).

¹³ *Id.* at *15.

¹⁴ *Id.* at *16–17.

¹⁵ *Id.* at *20–21. The three-tier model requires that producers sell their alcohol exclusively to wholesalers, who may sell exclusively to retailers, who may then sell to the consuming public. *See Granholm v. Heald*, 544 U.S. 460, 466–67 (2005). As Judge Easterbrook wrote in an earlier suit challenging Indiana’s pre-*Granholm* direct shipping ban, the three-tier system “facilitates what [the state calls] ‘orderly market conditions’ — a euphemism for reducing competition and facilitating tax collection.” *Bridenbaugh v. Freeman-Wilson*, 227 F.3d 848, 851 (7th Cir. 2000).

¹⁶ *Baude*, 2007 WL 2479587, at *21.

¹⁷ *Id.* at *23 (“The statute does not merely codify a natural geographic advantage. . . . As in *Granholm*, the law effectively requires out-of-state firms to become residents . . . to compete.”).

underage drinking, the court held that the face-to-face requirement could not withstand heightened scrutiny.¹⁸

The Seventh Circuit affirmed in part and reversed in part.¹⁹ Writing for the unanimous panel, Chief Judge Easterbrook²⁰ set out an analytical framework for assessing a state law affecting interstate commerce. A statute that discriminates “explicitly” or “on its face,” the court explained, is “almost always invalid under the Supreme Court’s commerce jurisprudence.”²¹ On the other hand, a statute that has “only incidental” effects on interstate commerce is subjected to the balancing test articulated by the Supreme Court in *Pike v. Bruce Church, Inc.*,²² and is “upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.”²³

After pointing out that “[p]laintiffs . . . do not contend that either of the two challenged provisions discriminates in terms,”²⁴ the court quickly disposed of the wholesale interest prohibition based on its discriminatory practical effect. “The statute is neutral in terms,” it held, “but in effect it forbids interstate shipments . . . while allowing intrastate shipments.”²⁵ The court then turned to the “more complex” question of the face-to-face requirement’s constitutionality under the *Pike* balancing test.²⁶ It explained that plaintiffs bore the burden of demonstrating that the costs the requirement imposed on interstate commerce outweighed its benefits to the state’s valid interest in preventing underage drinking.²⁷

In weighing the evidence of the face-to-face requirement’s marginal costs and benefits, the court proposed a hypothetical situation. A wine connoisseur, seeking to fulfill the requirement at as many wineries as possible in one trip, might be able to succeed in registering at thirty wineries in California at a lower cost than at thirty wineries in Indiana, due to the shorter distance between wineries in California’s wine regions.²⁸ Moreover, the court maintained that West Coast wine-producing states were not actually discriminated against, because they

¹⁸ *Id.* at *24–25.

¹⁹ *Baude*, 538 F.3d at 615.

²⁰ Chief Judge Easterbrook was joined by Judges Bauer and Posner.

²¹ *Baude*, 538 F.3d at 611.

²² 397 U.S. 137 (1970).

²³ *Baude*, 538 F.3d at 611 (quoting *Pike*, 397 U.S. at 142) (internal quotation mark omitted). The “clearly excessive” standard is also discussed as the “undue burden” standard. See David S. Day, *The “Mature” Rehnquist Court and the Dormant Commerce Clause Doctrine: The Expanded Discrimination Tier*, 52 S.D. L. REV. 1, 1 (2007).

²⁴ *Baude*, 538 F.3d at 611.

²⁵ *Id.* at 612. The prohibition protected Indiana wholesalers. *Id.*

²⁶ *Id.*

²⁷ See *id.*

²⁸ *Id.* at 613.

could sell their wines in Indiana through wholesalers.²⁹ In fact, the court concluded, the face-to-face requirement probably benefited all large wineries with wholesaling arrangements at the expense of all small wineries, whether in Indiana or elsewhere.³⁰ Such “[f]avoritism for large wineries over small wineries does not pose a constitutional problem.”³¹

In the absence of reliable empirical data demonstrating the deterrent effect of the face-to-face requirement, the court laid down its bottom line: “The face-to-face requirement makes it harder for minors to get wine. Anything that raises the cost of an activity will diminish the quantity — not to zero, but no law is or need be fully effective.”³² Referring to the Supreme Court’s decision in *Crawford v. Marion County Election Board*,³³ which upheld Indiana’s voter identification law, the court concluded that if “Indiana thinks that in-person verification with photo ID helps to reduce cheating on legal rules,” it would be “awfully hard to take judicial notice that in-person verification with photo ID has no effect on wine fraud and therefore flunks the interstate commerce clause.”³⁴

When, as in *Baude*, a *Pike* case is also a facial challenge, the court can dispose of the challenge easily, without extensive cost-benefit analysis, by describing any plausible conditions under which the law would be constitutional.³⁵ A court that goes on to undertake a cost-benefit analysis to justify its conclusion does so in the face of recent anxiety on the part of the Supreme Court about the *Pike* balancing test in general, and the use of cost-benefit analysis in *Pike* cases in particular. Justice Scalia has long campaigned against the use of the *Pike* balancing test under any circumstances, considering it a judicial usurpation of legislative judgment.³⁶ Some commentators have argued

²⁹ *Id.* at 615.

³⁰ *Id.*

³¹ *Id.*

³² *Id.* at 614. The court refused to officially acknowledge “that minors who are determined to drink will find a way to beat any system,” despite plaintiffs’ urging that it do so. *Id.*

³³ 128 S. Ct. 1610 (2008).

³⁴ *Baude*, 538 F.3d at 614.

³⁵ See, e.g., *Wash. State Grange v. Wash. State Republican Party*, 128 S. Ct. 1184, 1194 (2008) (“As long as we are speculating about the form of the ballot — and we can do no more than speculate in this facial challenge — we must . . . ask whether the ballot could conceivably be printed in such a way as to eliminate the . . . threat to the First Amendment.”). On the Court’s approach to facial challenges, see *Crawford*, 128 S. Ct. at 1622, and *Ayotte v. Planned Parenthood of Northern New England*, 126 S. Ct. 961, 967–68 (2006).

³⁶ See, e.g., *United Haulers Ass’n v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 127 S. Ct. 1786, 1798–99 (2007) (Scalia, J., concurring in part) (“I am unable to join Part II-D of the principal opinion, in which the plurality performs so-called ‘*Pike* balancing.’ Generally speaking, the balancing of various values is left to Congress — which is precisely what the Commerce Clause (the *real* Commerce Clause) envisions.”); *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 312 (1997)

that the Court, perhaps in response to Justice Scalia's campaign, has indicated its disapproval of the *Pike* test more generally by declining to invoke it in recent years.³⁷ Indeed, in *Department of Revenue v. Davis*,³⁸ the Court declined to undertake a *Pike* balancing analysis because it determined "that the Judicial Branch is not institutionally suited to draw reliable conclusions of the kind that would be necessary."³⁹ Commenting more generally, the Court suggested that "[w]hat is most significant about these cost-benefit questions is . . . the unsuitability of the judicial process and judicial forums for making whatever predictions and reaching whatever answers are possible at all."⁴⁰ Having undertaken nonetheless to bolster its conclusion in *Baude* with cost-benefit analysis, the Seventh Circuit could have provided a cogent explanation of the marginal costs and benefits of the Indiana direct-shipment law and the incentive effects of possible outcomes in the case. Instead, the court produced a problematic and only nominally economic analysis, which obscured rather than clarified the court's consideration of the benefits and burdens at stake.

The court based its discussion of the requirement's costs to interstate commerce on the premise that wine connoisseurs would be likely to go on a winery vacation to sign up at "dozens of wineries," and that the clustered wineries of California would be cheaper per winery to visit in bulk than would the scattered wineries of Indiana, once the high fixed cost of travel to California was apportioned over many winery visits.⁴¹ However, it is highly unlikely that this empirical assertion about costs is true, because it underestimates travel costs to California and overestimates the distance between wineries in Indiana.⁴² Even if

(Scalia, J., concurring) ("[T]he so-called 'negative' Commerce Clause is an unjustified judicial invention, not to be expanded beyond its existing domain.")

³⁷ See Day, *supra* note 23, at 4 ("[I]t should be noted that no [dormant Commerce Clause] decision [from 1992 to 2005] explicitly relied upon the [undue burden] standard. . . . By having a broad notion of discrimination, the Court was able to avoid the apparently troublesome balancing called for by the undue burden standard. . . . [T]he . . . Court also avoided any need to re-examine the soundness of the undue burden standard." (footnotes omitted)). But see *United Haulers*, 127 S. Ct. at 1797 (applying cursory *Pike* analysis to uphold county ordinances where, despite "years of discovery," the factual record failed to reveal "any disparate impact on out-of-state . . . businesses").

³⁸ 128 S. Ct. 1801 (2008).

³⁹ *Id.* at 1817. The challenge involved the particularly complex workings of the market for municipal bonds and the state taxation of income from those bonds. *Id.* at 1804–05.

⁴⁰ *Id.* at 1818.

⁴¹ *Baude*, 538 F.3d at 613. The court's opinion considered both the average and marginal costs of the requirement. Here, the court considered the *average cost* of visiting each winery in Indiana and California. The *marginal cost* of the face-to-face requirement — the burden it imposes on interstate commerce — is the difference between the average cost of visiting a winery in California and the average cost of visiting a winery in Indiana.

⁴² See, e.g., Dan Stockman & Krista Stockman, *Uncorked: Wine-shipment Rules Still Not Settled*, J. GAZETTE (Fort Wayne, Ind.), Aug. 23, 2008, at 8D. Pricing three-day winery trips for

it is true, it is only due to the court's arbitrarily high choice of thirty wineries, which spreads out the fixed cost of travel to California while requiring a visit to nearly all of Indiana's wineries — not only the state's own winery clusters but also its farther-flung wineries.⁴³ Judge Easterbrook acknowledged that "it *may* be more costly for a person living in Indianapolis to satisfy the face-to-face requirement at five Oregon wineries than at five Indiana wineries,"⁴⁴ but he should have more seriously considered that West Coast winery visits are *likely* more expensive over any range of visits.

Neither did the court seriously question the benefits of the face-to-face requirement to Indiana's interest in preventing underage drinking. It is true that in the single-good market for direct-shipped wine, consumers will demand a lower quantity when the requirement makes direct-shipped wine more expensive in time, effort, risk, or money. However, in the more complex reality of interdependent goods markets, underage consumers' demand for substitute goods⁴⁵ — any type of alcohol purchased with fake identification or purchased for them by others — will increase to make up for the loss of demand for direct-shipped wine.⁴⁶ Moreover, by all accounts the market for direct-shipped wine is small, with underage consumers representing very little of that demand;⁴⁷ the diversion of underage consumer demand for wine to the general alcohol market will cause no more than a negligible increase in the price underage consumers must pay for alcohol.⁴⁸ Therefore, underage alcohol consumption will only decrease to the extent that underage consumers' overall attempts to acquire alcohol illic-

two, the Stockmans calculate that gas, hotels, and meals for a tour of thirty Indiana wineries would cost \$750. On the other hand, to travel to California, "[t]he cheapest flight we could find from Fort Wayne to Napa was \$497 each. . . . Driving there is even worse." While flights between the major cities of Indianapolis and San Francisco can be found in advance for as little as \$250 round-trip, the resulting \$500 for two round-trip flights results in a total estimate of \$1070. A single traveler would find the California trip more expensive: \$685 rather than \$615. Moreover, most Indiana residents live near enough to wineries to stay in their own homes rather than in hotels. See Wineries of Indiana, State Map with Wineries, <http://www.indianawines.org/wineries/?loc=map> (last visited Dec. 7, 2008).

⁴³ See Wineries of Indiana, *supra* note 42 (showing that while most of Indiana's thirty-five wineries are located in the southern half of the state, a consumer wishing to visit thirty wineries would be required to visit isolated wineries as well as clustered wineries).

⁴⁴ *Baude*, 538 F.3d at 613 (emphasis added).

⁴⁵ See ROBERT S. PINDYCK & DANIEL L. RUBINFELD, MICROECONOMICS 22–23 (6th ed. 2005) (introducing substitute goods); *id.* at 72–73 (explaining that consumers value perfect substitutes and original goods equally).

⁴⁶ See *id.* at 579–81 (describing general equilibrium). This assertion assumes that underage drinkers consider all types of alcohol relatively fungible.

⁴⁷ See FED. TRADE COMM'N, POSSIBLE ANTICOMPETITIVE BARRIERS TO E-COMMERCE: WINE 5, 11–12 (2003), available at <http://www.ftc.gov/os/2003/07/winereport2.pdf>.

⁴⁸ See PINDYCK & RUBINFELD, *supra* note 45, at 579–81 (describing increase in price of substitute good).

itly are generally unsuccessful. However, a 2003 Federal Trade Commission report discussed in both *Baude*⁴⁹ and *Granholtm*⁵⁰ revealed that ninety-five percent of twelfth-graders find it “fairly easy” or “very easy” to acquire alcohol⁵¹ — despite the face-to-face transaction requirements in place in every state.⁵² The court denied this reality that the face-to-face requirement simply diverts demand into a market with regulations underage consumers find easy to evade.

Moreover, while it was certainly well within the court’s discretion to hold summarily that Indiana’s interest in its underage citizens’ safety and welfare outweighed the burden the face-to-face requirement placed on interstate commerce,⁵³ once the court undertook to provide a more nuanced economic justification based on the requirement’s effects on underage consumer demand for alcohol, it could have presented a more compelling explanation of the incentive effect of eliminating the requirement going forward. Without the requirement, a market would likely develop in cheaper, bulk wine with overnight shipment and no age verification, perhaps resulting in a significant increase in underage demand for direct-shipped wine. The requirement prevents such a renegade market from developing and limits the access points at which states must police underage consumers’ attempts to acquire alcohol. Such an account of the consequences of eliminating the face-to-face requirement would have done far more to offset the costs the requirement imposes on out-of-state wineries.

The court’s efforts to analyze the face-to-face requirement’s effects were complicated by the nature of the costs and benefits at issue in facial challenges under the *Pike* test. First, the relevant benefits are usually of a nonpecuniary nature.⁵⁴ Here, for instance, the value of the face-to-face requirement’s deterrent effect would be extremely difficult to establish due to difficulties in estimating the level of deter-

⁴⁹ *Baude*, 538 F.3d at 613–14.

⁵⁰ *Granholtm v. Heald*, 544 U.S. 460, 466–68, 490–92 (2005).

⁵¹ FED. TRADE COMM’N, *supra* note 47, at 11 (“[M]ost minors . . . report that they have easy access to alcohol. In 2002, approximately 68% of eighth graders, 85% of tenth graders, and 95% of twelfth graders said that it is ‘fairly easy’ or ‘very easy’ to get alcohol.” (citing Press Release, Univ. of Mich. News and Info. Serv., *Ecstasy Use Among American Teens Drops for the First Time in Recent Years, and Overall Drug and Alcohol Use Also Decline in the Year After 9/11* (Dec. 13, 2002), <http://monitoringthefuture.org/pressreleases/o2drugpr.pdf>)).

⁵² *See id.* at 11–12 (describing state efforts to prevent sales of alcohol to underage consumers).

⁵³ *See, e.g., Raymond Motor Transp., Inc. v. Rice*, 434 U.S. 429, 443–44 (1978) (discussing qualitative importance of state’s interest in highway safety as significant enough to outweigh nearly any incidental burden on interstate commerce).

⁵⁴ Sometimes a state’s interests are pecuniary and may therefore be more susceptible to quantification, as when a burdensome policy is meant to facilitate the state’s collection of revenue. *See, e.g., Doran v. Mass. Turnpike Auth.*, 348 F.3d 315, 322 (1st Cir. 2003) (attributing great weight to state’s interest in funding highway improvements, but not attempting to place a monetary value on the challenged policy’s benefits to that interest).

rence and in placing a monetary value on a decrease in underage drinking. One solution would be to “rank” the particular state interest at stake in importance relative to the universe of valid state interests, as the Supreme Court did in *Pike* itself. There, the Court did not attempt to quantify Arizona’s admittedly legitimate desire “to promote and preserve the reputation of Arizona growers,” but deemed it sufficient to determine that this interest was less weighty than, for example, a state’s interest in the safety of its residents.⁵⁵ Second, in a facial challenge, the statute’s aggregate costs may also be difficult for courts to estimate, in contrast to *Pike* itself, where the plaintiffs brought an as-applied challenge and demonstrated that the statute they challenged would cost their business \$200,000.⁵⁶ In *Baude*, however, the dispersion of Indiana residents, airports, and wineries throughout the state introduced great variation into the cost estimate.⁵⁷ Such difficulties in estimation should lead courts to take particular care when they undertake the types of complex, variable- and fact-driven cost-benefit analyses presented by facial challenges.⁵⁸

The Seventh Circuit’s holding in *Baude* that the face-to-face requirement must survive facial challenge may well have been sound, judging from the similar conclusions reached by other courts to consider the issue.⁵⁹ That a sound conclusion was paired in *Baude* with such problematic reasoning highlights the challenges confronting courts that use cost-benefit analysis to assess facial challenges to state statutes under the dormant commerce clause. In order to mitigate the risks that attend decisionmaking in the face of meager data about the real world effects of a statute, such an analysis must provide a logical account of the statute’s costs and a reasonable explanation of, rather than mere assumptions about, the statute’s benefits.

⁵⁵ *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 143 (1970); see also *Raymond Motor Transp.*, 434 U.S. at 443–44 (ranking safety as the weightiest of legitimate state interests and therefore giving great weight to the benefits side of the *Pike* test in a challenge to state highway safety regulation).

⁵⁶ *Pike*, 397 U.S. at 144.

⁵⁷ Brief of Plaintiffs-Appellees at 9, *Baude*, 538 F.3d 608 (Nos. 07-3323 & 07-3338), 2007 WL 4454121 (describing types of travel costs).

⁵⁸ Indeed, Professor Edward A. Hartnett has suggested that courts should strongly discourage facial challenges for a similar reason: he argues that courts’ institutional competencies lie in such activities as “unbundling” constitutional from unconstitutional applications of a statute in as-applied challenges rather than in undertaking the complex cost-benefit questions presented by facial challenges. Edward A. Hartnett, *Modest Hope for a Modest Roberts Court: Deference, Facial Challenges, and the Comparative Competence of Courts*, 59 SMU L. REV. 1735, 1735, 1751–53 (2006).

⁵⁹ See cases cited *supra* note 5.