CSDI Policy Brief 2013-07

Adjudicating the Commerce Clause: How Price Effects Can Help to Evaluate State "Wine Wars"

Benjamin Franklin once famously mused that, "Wine is sure proof that God loves us and wants us to be happy." Over the past several centuries, Americans' pursuit of this liquid form of happiness has certainly been met with some resistance and controversy, including its outright prohibition. More recently, debate over the means by which citizens purchase wine has surfaced in the courts as barriers to the interstate shipping of alcohol have come under fire for potentially violating the Commerce Clause. In 2005, the Supreme Court ruled in *Granholm v. Heald* that state laws could not simultaneously allow in-state wineries to ship directly to consumers while also forbidding their out-of-state counterparts from doing the same.

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Yet state regulations passed in the wake of *Granholm v. Heald* have still found ways to differentiate between various competitors by instituting laws that prohibit out-of-state retailers (but not wineries) and producers of certain sizes from shipping their products across state lines. Do such rules violate the spirit of the Commerce Clause by discriminating against interstate economic interests? In a recently published article in the *Journal of Empirical Legal Studies*, Alan Wiseman, Associate Professor of Political Science and Law at Vanderbilt University and CSDI co-director, and Jerry Ellig, Senior Research Fellow at George Mason University's Mercatus Center, address this topic by studying the price effects of these various interstate shipping laws. In doing so, their work provides insight into a method that the courts might employ to determine whether or not ostensibly discriminatory laws alter marketplace outcomes in state "wine wars," as well as a host of other cases that speak to debates in interstate commerce.

The doctrine known as the dormant Commerce Clause—a legal descendent of the commerce clause in Article I, Section 8 of the Constitution—effectively empowers the courts to overturn state legislation that interferes with, limits, or burdens interstate commerce. In keeping with this goal, the Supreme Court ruled in *Granholm* that states cannot enact laws that burden out-of-state wine producers solely for the purpose of advantaging in-state interests. Yet *Granholm* also allowed for regulations that separate alcohol production, wholesaling and retailing into distinct tiers. Taken together, the decision was interpreted to mean that state laws must effectively remain neutral "enough" to be upheld in subsequent court challenges. Perhaps unsurprisingly, the tension between these two perspectives has given rise to much confusion and litigation as courts have grappled with their implications for the interstate shipping of wine.

To aid in the adjudication of this issue, Ellig and Wiseman advocate analyses of price effects as indicators of the discriminatory nature of such laws. Should the excluded competitors actually affect the local market by impacting the prices of in-state producers, then the neutrality of these laws should be called into question. Building on previous work that employed similar methods, the authors use price effects to assess two types of state regulations that were established in the wake of *Granholm v.*

Heald: laws that exclude retailers (but not wineries) from interstate shipping, and those that prohibit certain sellers from shipping into states based on production caps. By doing so, the authors demonstrate how price effects can be used to inform Commerce Clause decisions by clearly identifying the laws' marketplace outcomes.

In pursuit of their analysis, Ellig and Wiseman focus on wines identified in the 2002 and 2004 "Top 50" wine lists compiled by *Wine and Spirits* magazine. Research teams collected price data from bricks-and-mortar stores during the summers of 2002 and 2004 by visiting every wine retailer within 10 miles of McLean, Virginia, while online prices were extracted from various wineries' Web sites or Winesearcher.com, a shopbot that lists the prices of online retailers. Drawing on this data, the authors demonstrated in earlier research that Virginia's ban on direct wine shipment from out-of-state producers deprived its residents of significant price savings in two ways. First, Ellig and Wiseman found that repealing the prohibitive law provided Northern Virginians access to lower online prices than those available to them in their own bricks-and-mortar stores. Second, the removal of the ban also created incentives for Northern Virginia wine stores to lower their prices in an effort to be more competitive with their online counterparts. With both of these forces at work, the legalization of direct shipment decreased the percentage price spread between online and offline prices by approximately 26-40 percent.

In their most recent study, the authors' statistical analyses echo their previous work by suggesting that the exclusion of retailers from interstate shipping largely affects whether or not consumers have access to the greatest online price savings. That is, by only allowing wineries to ship their products, customers generally miss out on the benefits of competitive pricing given that retailers—not wineries—usually offer the lowest prices. Thus, eliminating out-of-state retailers from market competition removes the greatest incentive for bricks-and-mortar stores to offer lower prices, a finding that holds regardless of whether a consumer seeks to purchase a case or individual bottlings.

The authors also examine the price effects of laws that discriminate against sellers whose production levels exceed certain quantities. Ellig and Wiseman demonstrate that laws banning direct shipment from wineries with production levels that exceed a very low cap effectively prohibit direct shipment for a large portion of their sample. Moreover, those wines that remain eligible for shipment under such caps are typically not available in bricks-and-mortar stores and are unlikely to pose a competitive threat. For laws that allow shipment from wineries producing less than 250,000 gallons, cheaper online wineries actually remain eligible for direct shipment; hence, consumers' access to most of the products associated with online price savings are retained. Yet the same result cannot be obtained for an intermediate cap of 150,000 gallons. In this case, wineries offering lower prices are largely excluded from direct shipment. Thus, establishing this cap would prevent consumers from reaping the benefits of online price savings.

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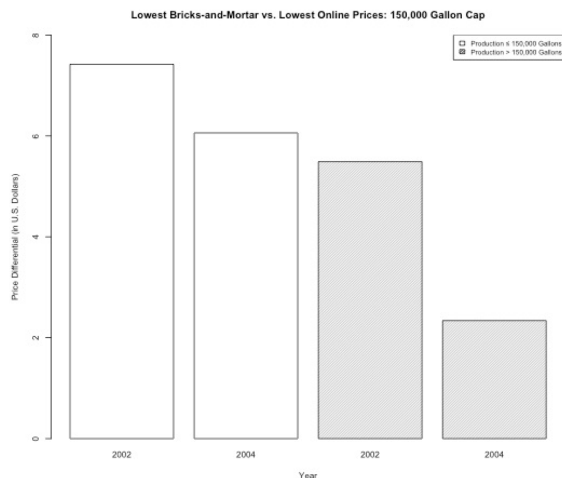
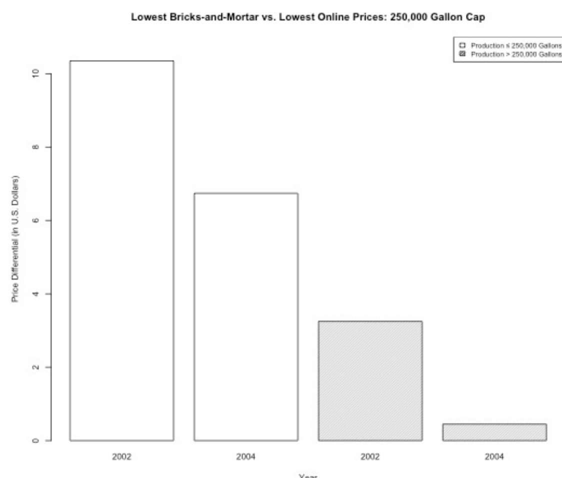
Additional analyses complement this finding. For example, the average percentage price difference between online and offline retailers was approximately 24 percent for bottles

originating from wineries producing less than 250,000 gallons following the legalization of direct shipment. Yet similar results are not obtained if one focuses only on those wineries that produced less than 150,000 gallons annually. This disparity suggests that the wineries that produce between 150,000 and 250,000 gallons annually make precisely those products that put competitive pressure on bricks and mortar wine stores, leading to significant reductions in the online-offline price differential. Bluntly stated, had Virginia instituted a production cap between 150,000 and 250,000 gallons, it would have excluded sales from the very retailers who offer lower prices and create incentives for bricks-and-mortar stores to slash their prices. Thus, Ellig and Wiseman find that instituting an intermediate cap prevents customers from effectively realizing the price benefits that accompany greater market competition.





Though it is unlikely that the Founding Fathers foresaw the online purchasing and shipment of wine as a threat to the spirit of the Commerce Clause, its present day applicability to this context is undeniable. The fate of these laws is less certain, however, and the question of whether or not they will continue to withstand judicial challenge is ultimately a matter to be resolved by the courts. Regardless, Wiseman and Ellig's analysis makes several points that should hopefully be considered by the courts in weighing the de facto consequences of many of these laws. And besides their application to state "wine wars," the methods employed by the authors also have implications for other arenas of interstate commerce, as the analysis of price effects can serve as a useful tool for the courts in evaluating similar questions extending far beyond alcohol sales.

—*Allison Archer*

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The research summarized in this policy brief can be found in CSDI Working Paper 8-2012, "Price Effects and the Commerce Clause: The Case of State Wine Shipping Laws." Jerry Ellig and Alan E. Wiseman.

http://www.vanderbilt.edu/csdi/research/CSDI_WP_08-2012.pdf

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