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Farm Wineries and the 60% Production Requirement

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March 8, 2012

This memorandum addresses the potential legal issues that could arise from the removal or significant reduction of the production requirement of K.S.A. 41-308a(c). Subsection (c) of K.S.A. 41-308a requires a farm winery licensee to use at least 60% Kansas grown product in the manufacture of its wine. Under K.S.A. 41-308a(a) the holder of a farm winery license is granted several privileges with respect to the sale and distribution of alcoholic liquor produced by the licensee. Among these privileges is the ability to:

(1) Manufacture and store up to 100,000 gallons of wine per year;

(2) Sell such manufactured wine to distributors, retailers, clubs, bars, restaurants, and temporary permit holders;

(3) Sell bottles of wine to consumers as a retailer;

(4) Serve free samples of manufactured and imported wine to consumers;

(5) Sell wine and other alcoholic liquor for consumption on the licensed premises if also licensed as a drinking establishment;

(6) Sell wine and other alcoholic liquor for consumption on an unlicensed premises if also licensed as a caterer;

(7) Sell and ship wine to out-of-state consumers; and

(8) Sell and ship wine to in-state consumers if also a holder of a wine shipping permit.

Such privileges permit the holder of a farm winery license to engage in certain business practices which are not granted to other licensees under the Kansas Liquor Control Act or the Club and Drinking Establishment Act. This includes the direct sales by a manufacturer to a retailer,

which bypasses the distributor that is usually required under the three-tier system, and the direct sales and shipping privileges.

These privileges give farm winery licensees a business advantage compared to out-of-state wineries. Such preferential treatment of in-state business by state law is generally a violation of the U.S. Constitution's Commerce Clause. Case law does not permit a state to enact laws that discriminate against out-of-state business to the advantage of in-state business. In *Granholm v. Heald*, 544 U.S. 460 (2005), the U.S. Supreme Court reaffirmed this constitutional requirement. There the Court held that Michigan and New York state laws, which placed either outright restrictions or onerous burdens on out-of-state wineries trying to sell their product to in-state consumers, were in violation of the Commerce Clause.

One important facet of Commerce Clause jurisprudence, however, is that a state may establish a discriminatory advantage for in-state business when it can show that such law "advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 278 (1988). Thus, if the state can demonstrate a legitimate advancement of a state interest that cannot be achieved otherwise, then the law may be upheld.

K.S.A. 41-308a was enacted, in part, to encourage the growth and development of the Kansas farm winery industry. This is arguably a legitimate local purpose in that it fosters the growth of Kansas vineyards and wineries. The requirement that 60% or more of the product used in the manufacturing of the wine be grown in Kansas is a key provision of the law in that it is tied directly to the legitimate local purpose of encouraging growth of domestic vineyards and wineries.

Removal of the 60% requirement would arguably remove that portion of the act that advances a legitimate local purpose. Without advancement of a legitimate local purpose, the law merely provides distinct business advantages to in-state wineries that are not granted to out-of-state wineries. Such a case would most likely be deemed a violation of the Commerce Clause by the courts following the *Granholm* decision. The consequence of such a ruling could be the invalidation of those privileges under K.S.A. 41-308a which are only granted to in-state wineries, such as distribution directly to retailers. Alternatively, such litigation could result in the granting of such privileges to all licensees as a means of rendering the statutory scheme more even-handed.

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The reduction of the production percentage to something less than 60% could also potentially have legal ramifications. Currently, K.S.A. 41-308a has not been challenged as a violation of the Commerce Clause. The presumption then has been that the 60% requirement is a sufficient advancement of a legitimate local purpose to save the law from a Commerce Clause challenge. However, there is little to no guidance from the courts as what minimum percentage could be enacted and still avoid a Commerce Clause challenge. Thus, any reduction, and especially a significant reduction, in the percentage raises the potential for a constitutional challenge to the law.