No. 09-0627

In the Supreme Court of Ohio

ORIGINAL

DIRECTV, INC., and ECHOSTAR SATELLITE L.L.C.,

Plaintiffs-Appellants,

v.

RICHARD LEVIN, Tax Commissioner of Ohio,

Defendant-Appellee.

ON APPEAL FROM THE COURT OF APPEALS,
TENTH APPELLATE DISTRICT
CASE NO. 08AP-32

BRIEF OF AMICUS CURIAE SPECIALTY WINE RETAILERS ASSOCIATION IN SUPPORT OF PLAINTIFFS-APPELLANTS

E. JOSHUA ROSENKRANZ (pro hac vice)
New York Bar No. 2224889
Counsel of Record
ORRICK, HERRINGTON & SUTCLIFFE LLP
666 Fifth Avenue
New York, NY 10103
(212) 506-5000
Fax: (212) 506-5151
JRosenkranz@Orrick.com

PETER A. ROSATO (0068026)
CALFEE, HALTER & GRISWOLD LLP
1100 Fifth Third Center
21 E. State Street
Columbus, OH 43215
(614) 621-1500
Fax: (614) 621-0010
PRosato@Calfee.com

Counsel for Plaintiffs-Appellants

JOHN A. HINMAN (pro hac vice)
HINMAN & CARMICHAEL LLP
260 California Street, Suite 1001
San Francisco, CA 94111
(415) 362-1215
Fax: (415) 362-1494
jhinman@beveragelaw.com

Counsel for Amicus Curiae
Specialty Wine Retailers Association

PANTELIS MICHALOPOULOS (pro hac vice)
District of Columbia Bar No. 453179
MARK F. HORNING (Pro Hac Vice)
District of Columbia Bar No. 203323
STEPTOE & JOHNSON LLP
1330 Connecticut Avenue, NW
Washington, DC 20036
(202) 429-3000
Fax: (202) 429-3902
PMichalopoulos@steptoe.com
MHorning@steptoe.com

Counsel for Plaintiffs-Appellants

RICHARD CORDRAY
OHIO ATTORNEY GENERAL

LAWRENCE PRATT (0021870)
Counsel of Record
ALAN P. SCHWEPE (0012676)
JULIE E. BRIGNER (0066367)
DAMION M. CLIFFORD (0077777)
Assistant Ohio Attorneys General
Taxation Section
30 E. Broad Street, 25th Floor
Columbus, OH 43215
(614) 466-5967
Fax: (614) 466-8226

Counsel for Defendant-Appellee

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STATEMENT OF INTEREST OF AMICUS CURIAE

Amicus Curiae Specialty Wine Retailers Association ("Amicus") is a nonprofit trade association that represents the interests of specialty wine retailers and the consumers they serve across the United States. Its membership is diverse, spanning classic brick and mortar wine merchants, Internet-based wine retailers, wine cataloguers, auction retailers, mass-market merchants, and wine lovers who support and patronize these respective types of retailers. Amicus stand united in the view that national markets—whether they involve wine, liquor, or pay TV service—should be truly national in scope and operation. Amicus wants only to see the channels of interstate commerce opened so that Ohio residents, freed from protectionist tax burdens, can choose for themselves from among all the available alternatives in the national market.

INTRODUCTION

The Court of Appeals has taken a machete to the Commerce Clause and left in its place a doctrine that is ill-equipped to prevent even the most discriminatory of statutes. This is not just bad for satellite TV providers and their subscribers in Ohio—who pay 5.5% more in state taxes than cable TV subscribers simply because they chose a pay TV service that does not use local infrastructure to deliver its programming signals. It is bad for anyone who wants to do business in Ohio—whether it involves selling clothes to a parent in Cincinnati through a catalog or distributing auto parts to a repair shop in Huron.

It is especially troubling for Amicus, whose members are constantly subjected to discrimination at the hands of states that are advancing their own parochial interests at the expense of businesses who have operations outside of the state. The Court of Appeals' opinion has made it even more difficult for Amicus—and countless other businesses that rely upon the Commerce Clause as a shield against protectionist legislation—to challenge discriminatory regulations in court.

The result: Ohioans will have to pay a higher price for a smaller selection of goods and services—whether it's satellite TV service or a bottle of cabernet from Sonoma.

How could a single opinion from the Court of Appeals have such a profound impact on so many people and businesses?

For starters, the Court ignored three decades of U.S. Supreme Court precedent and confined the Commerce Clause to the increasingly rare instance in which a statute explicitly favors a business that is entirely in-state (i.e., all of its operations and sales take place inside the state lines) and the disfavored business is out-of-state (i.e., all of its operations are located outside of the state). *DIRECTV, Inc. v. Levin,* 10th Dist. No. 08AP-32, 2009-Ohio-636, at ¶23-27.[1] This strained interpretation of the Commerce Clause leaves interstate businesses at the mercy of the General Assembly and other legislatures—including those of our members who use the Internet to sell and ship wine to homes and businesses in towns like Ashtabula or Oxford. The U.S. Supreme Court has made clear that the Commerce Clause applies equally to statutes that distinguish between interstate businesses on the basis of whether one performs a specific economic activity in-state and the other performs the same activity more efficiently outside of the state. See, e.g., *Lewis v. BT Inv. Managers, Inc.* (1980), 447 U.S. 27, 42 n.9 ("[D]iscrimination based on the extent of local operations is itself enough to establish the kind of local protectionism we have identified."); see also Appellants Brief at Proposition of Law No. 1 ("App. Br. at 17–24"); Amicus Brief of Constitutional Law Professors at ("Con Law Br. at 12–16"). This Court must reverse the decision below to ensure that this

[1]But see *Boston Stock Exch. v. State Tax Comm'n* (1977), 429 U.S. 318, 335 (recognizing that it was "constitutionally impermissible" for a state to "tax in a manner that discriminates between two types of interstate transactions in order to favor local commercial interests over out-of-state businesses …"); *Westinghouse v. Tully* (1984), 466 U.S. 388, 399-401; Peter D. Enrich, *Saving the States From Themselves: Commerce Clause Constraints on State Tax Incentives for Businesses*, 110 Harv. L. Rev. 377, 428 (1998) ("Over the past two decades the Court has repeatedly applied principles articulated in Boston Stock Exchange to invalidate state tax provisions that selectively reduce the tax burdens imposed on in-state goods or activities.").

protection—which is essential to the Framers' intent of a unified system of interstate commerce—remains intact.

This Court must also repair the damage the Court of Appeals has done to the Commerce Clause through its interpretation of the U.S. Supreme Court's decisions in *Exxon Corp. v. Governor of Maryland* (1978), 437 U.S. 117 and *Amerada Hess Corp. v. Director, Div. of Taxation, N.J. Dept. of Treasury* (1989), 490 U.S. 66. Those two cases stand for a simple and unremarkable proposition: A statute that discriminates between two types of businesses does not violate the Commerce Clause unless it discriminates on the basis of geography. The Court of Appeals, however, interpreted them to stand for something altogether different. In its view, *Exxon* and *Amerada Hess* carve out an exception to the Commerce Clause any time a statute can be characterized as discriminating between two businesses on the basis of some difference in their physical operations or "technological or commercial models." *DIRECTV, Inc.* at ¶¶23, 27.

As discussed below, this exception cannot be found in either of the two cases the Court of Appeals cited. Those cases make clear that if a statute discriminates on the basis of geographic location—whether by intent or effect—it violates the Commerce Clause, regardless of whether the statute is couched in "location-neutral" language or recast as distinguishing between the nature of how the beneficiary and the victim do business. Put simply, there is no exception or savings clause to the Commerce Clause. If a statute or regulation discriminates on the basis of the geographic location of a particular activity, it is presumptively unconstitutional; if it does not discriminate on those grounds, it is constitutional.

By creating a broad exception to this simple rule out of whole cloth, the Court of Appeals has wrought havoc with Commerce Clause jurisprudence, and given license to state legislatures to enact discriminatory statutes. At bottom, almost any discriminatory statute or regulation can be recast as a difference in the business model of the favored and disfavored entities—especially if other courts follow the Court of Appeals and (1) interpret the terms "mode of business" or "method of operations" to encompass differences in the physical operations or technology of the favored and disfavored businesses; and/or (2) refuse to consider anything other than the plain language of the statute when determining whether the state legislator acted with a discriminatory purpose.

The Court of Appeals' opinion in this case will find its way into briefs across the country—if it has not already done so. It will assuredly be used by other states to defend cleverly drafted discriminatory statutes and regulations that deprive consumers of the right to purchase innumerable goods and services at the lowest possible price. And it will undoubtedly be used by courts in other jurisdictions to defend laws that were enacted for no other reason than to protect industries with local operations in the state—industries which, more often than not, also happen to have an army of lobbyists swarming through the state legislature. All of these cases are cited interchangeably, whether they involve trash haulers, out-of-state wineries, or oil producers and refiners.[2]

The issues presented in this case are hardly confined to a single industry; to the contrary, they go to the very heart of the dormant Commerce Clause. We know—our members have been and continue to be embroiled, both directly and indirectly, in scores of these types of challenges.[3] And the wine and satellite TV industry are just the tip of the iceberg. It does not take a crystal ball to predict that state legislatures will eventually turn to e-commerce, and will undoubtedly use the

[2] Indeed, as discussed below, the Court of Appeals relied heavily on two cases, *Exxon* and *Amerada Hess*, that both involved statutes that were alleged to discriminate against vertically integrated oil companies. See infra at 3.

[3] See, e.g., *Cherry Hill Vineyards, LLC v. Lilly* (C.A.6, 2008), 553 F.3d 423, 432 (holding that Kentucky "on premises" requirement for direct shipment of wine violated Commerce Clause; *Peoples Super Liquor Stores, Inc. v. Jenkins* (D. Mass., 2006), 432 F. Supp. 2d 200, 218-19 (Massachusetts statute that barred out-of-state liquor retailers from obtaining package store license violated Commerce Clause); *Siesta Village Market, LLC v. Perry*, (N.D. Tex. 2008), 530 F. Supp. 2d 848, 864-66 (holding that while law that limited right to ship wine to in-state consumers to in-state retail stores violated Commerce Clause, other in-state discriminatory requirements applied)

same devices at issue here to protect local "bricks-and-mortar" businesses from Internet retailers. It bears repeating—the real victims of these laws are not the disfavored businesses; they are the Ohio consumers who are forced to pay higher prices for a smaller selection of goods and services.

For the reasons set forth below and in the Appellants' Brief, we urge the Court to reverse the Court of Appeals' ruling and ensure that Ohio families will have access to the same goods and services at the same prices as families who live in other states.

STATEMENT OF FACTS

Amicus adopts and incorporates by reference the Statement of Facts set forth in the Appellants' Brief. See App. Br. at 6–8.

ARGUMENT

We agree with Appellants' arguments on Propositions of Law Nos. 1, 2, and 3 and adopt the arguments on those propositions that are set forth in Appellants' Brief. We write to embellish on Appellants' analysis of Proposition of Law No. 2.

Proposition of Law No. 2

The satellite-only tax of R.C. 5739.01(XX) cannot be saved from Commerce Clause challenge on the ground that the discrimination "results solely from differences between the nature of [two companies'] businesses, *not* from the location of their activities," *Amerada Hess Corp. v. Director, Div. of Taxation, N.J. Dept. of Treasury* (1989), 490 U.S. 66, 78 (emphasis added), because the discriminatory tax is inextricably tied to the *location* of a specified economic activity.

The Commerce Clause prohibits states from enacting statutes that discriminate against two types of business that compete in a single market on the basis of the location of a specified economic activity.[4] See *Amerada Hess*, 490 U.S. at 78, n. 10. Importantly, it does not matter

[4] The Court of Appeals acknowledged that satellite TV and cable TV are "two classes of competitors" that deliver the same pay TV programming to the same consumers' homes. *DIRECTV, Inc. v. Levin,* 10th Dist. No. 08AP-32, 2009-Ohio-636, at at ¶¶ 24-25. Based upon existing U.S. Supreme Court precedent, these two facts are sufficient, by themselves, to conclude that satellite TV and cable TV are similarly situated for purposes of the Commerce Clause. See *Gen. Motors Corp. v. Tracy* (1997), 519 U.S. 278, 300 ("[I]n the absence of actual or prospective competition

whatsoever that this discrimination is not evident from the face of the statute. *Dayton Power & Light Co. v. Lindley* (1979), 58 Ohio St. 2d 465, 473-74, 391 N.E.2d 716 (noting that "[a]ny semblance of facial neutrality disappears in light of the facts relating to the geographical location and ability to mine low-sulphur coal in Ohio"). So long as the statute discriminates against a businesses—whether in purpose or effect—on the basis of geographic location, it is unconstitutional under the Commerce Clause. *See, e.g.*, *Bacchus Imports, Ltd. v. Dias* (1984),468 U.S. 263,270-71 (holding that tax exemption for fruit wine violated Commerce Clause where evidence showed that it was enacted to promote the local pineapple wine industry, despite fact statute did not specify an indigenous product).

The Court of Appeals overlooked this basic principle when it held that any disparity between the tax imposed on satellite TV (5.5%) and cable TV (0%) was constitutionally permissible due to the difference in the nature of their respective businesses. See *DIRECTV, Inc.* at ¶¶ 23, 27. In other words, it missed the most important part of the Commerce Clause analysis—i.e., does the statute discriminate, in either purpose or effect, against satellite TV on the *basis of the location of a specified economic activity*? Relying on two U.S. Supreme Court cases—*Exxon* and *Amerada Hess*—the Court of Appeals carved out an exception to the Commerce Clause where a statute purportedly distinguishes between two types of businesses on the basis of their "modes" of business or "business models." *DIRECTV, Inc.* at ¶23-24, 27.

But neither of those cases stands for this proposition. To the contrary, they stand for nothing more remarkable than the following: Where a statute discriminates between two similar competing businesses on the basis of a difference in the nature of their operations, and the

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between the supposedly favored and disfavored entities in a single market there can be no local preference."); see also *Bacchus Imports, Ltd. v. Dias* (1984), 468 U.S. 263, 269 (rejecting argument that okolehao and pineapple wine did not compete in the same market for the same customers with disfavored alcoholic beverages).

distinction drawn has nothing whatever to do with where specified business activities are performed, then it falls outside the scope of the Commerce Clause. *Amerada Hess*, 490 U.S. at 78. It bears repeating: Exxon and Amerada Hess did not create an exception to the Commerce Clause; they simply explained why statutes that arguably discriminated against a particular business did not violate the Commerce Clause.

In *Exxon*, the Supreme Court upheld a Maryland statute that prohibited oil producers and refiners from owning gasoline stations in the state. 437 U.S. at 121. Enacted in response to the 1973 fuel crisis, the statute was designed to address a widely-held belief in Maryland that oil producers had allocated more fuel to their own gas stations than to gas stations owned by independent dealers. Id. The oil companies challenged the statute, arguing that it discriminated against them in favor of independent retailers, many of which were local businesses, in violation of the Commerce Clause. Id. at 125. The Court rejected this contention out-of-hand, concluding that the statute served the legitimate state purpose of "controlling the gasoline retail market." Id. at 124-25.

But the Court did not stop there. It proceeded to hold that the statute could not discriminate against interstate oil producers in favor of in-state competitors because there were "no local producers or refiners." *Exxon*, 437 U.S. at 125. See also *Div. of Alcoholic Beverages & Tobacco v. McKesson Corp.* (Fla. 1989), 524 So. 2d 1000, 1007 ("'most critical factor'" in *Exxon* was "absence of discrimination between interstate and local producer-refiners because there were no local producer-refiners") (citation omitted). Turning to the retail market, the Court determined that the statute placed "no barriers whatsoever" on local competition because interstate dealers not owned by oil companies could freely compete with local retailers. Id. at 125-26. As such, the statute did not give preferences to local retailers and Maryland consumers continued to have access to a wide range of gas stations, all of which were supplied by the same oil producers and refiners. In other words, and as the U.S. Supreme Court later explained in *Lewis v. BT Inv. Managers*, *Exxon* dealt simply with a "statute [that] discriminated against vertical organization in the petroleum industry," because of the dangers that form of ownership created for consumers. *Lewis*, 447 U.S. at 41. It had nothing to do with the extent of oil producers' contacts with Maryland or any other form of location-based discrimination. See *Ford Motor Co. v. Texas Dept. of Transp.* (5th Cir. 2001), 264 F.3d 493, 502 ("The significant point of distinction, and why *Exxon* did not control *Lewis*, was because . . . the Florida statute [in *Lewis*] . . . discriminate[d] against affected business entities . . . according to the extent of their contacts with the local economy.").

Amerada Hess is even easier to distinguish. That case also involved oil producers, this time challenging a New Jersey statute that prevented them from deducting a federal "windfall profit" tax from their state tax returns. 490 U.S. at 70-71. The companies argued that the state's decision not to offer such a deduction discriminated against interstate commerce because only oil producers—none of whom were located in New Jersey—were required to pay the "windfall profit tax." Id. at 75-76. In rejecting this argument, the Court explained that the statute was not limited to the windfall profit tax, but applied more generally to *any* federal tax on "income or profits." Id. at 76. Because every company, regardless of location, is subject to the federal income tax, the Court concluded that the challenged statute did not "*discriminate[ ] on the basis of geographic location.*" Id. at 77 (citing *Bacchus Imports*, 468 U.S. at 271; emphasis added).

Since the oil producers in *Amerada Hess* had already conceded that a discriminatory purpose claim did not exist—hardly surprising given the fact the New Jersey statute was enacted 22 years *before* the federal windfall profit tax—the Court had no choice but to conclude that the statute at issue was "solely" about the mode of business. In other words, the intent of the challenged statute was to prohibit businesses whose profits were taxed at the federal level from deducting those taxes at the state level—not to "discriminate on the basis of geographic location." *Amerada Hess*, 490 U.S.

at 77. Indeed, the Court acknowledged that the outcome of the companies' dormant Commerce Clause challenge might have been different if there was evidence that the state "single[d] out for special tax burdens a form of business activity that is conducted only in other jurisdictions." Id. (citation omitted).

In reaching its decision in this case, the Court of Appeals ignored significant aspects of the *Exxon* and *Amerada Hess* decisions. Instead of focusing on those parts of the opinions that evaluated whether the challenged statute discriminated on the basis of location, *Amerada Hess*, 490 U.S. at 77-78, *Exxon*, 437 U.S. at 124-26, the court instead seized on a single strand from each decision. The result: The Court of Appeals created a new exception to the Commerce Clause for statutes or regulations that purportedly distinguish between two types of businesses on the basis of the "modes" of operation or "business models." *DIRECTV, Inc.* ¶¶ 23-24. No such exception exists in either of those cases. It bears repeating: *Exxon* and *Amerada Hess* stand for the unremarkable proposition that if a plaintiff cannot show that a statute discriminates against it on the basis of the geographic location of a specified economic activity it cannot establish a claim under the Commerce Clause. That doesn't mean the State is not discriminating between the plaintiff and a similarly situated business on some other ground. It just means that the discrimination is on grounds other than geography, and thus falls outside of the Commerce Clause.

The Amerada Hess exception announced by the Court of Appeals threatens to swallow the Commerce Clause whole. As Appellants point out in their brief, any statute or regulation—including laws that are location-specific, like here—can be characterized as discriminating on the basis of "modes" of business or methods of operation. App. Br. at 5. A prime example is the statute in *Granholm v. Heald* (2005), 544 U.S. 460, where the U.S. Supreme Court struck down a New York law prohibiting any winery from directly shipping wine to New York customers, unless the winery had distribution operations in New York. 544 U.S. at 474. The statute there could easily have been characterized as being based on a difference in delivery models -- in particular, the difference between direct shipment of wine from anywhere, on the one hand, and distribution of wine from brick-and-mortar in-state distribution centers, on the other. The *Granholm* court, however, had "no difficulty concluding that New York . . . discriminates against interstate commerce through its direct-shipping laws." 544 U.S. at 476.

Similarly, several states have enacted statutes that prohibit manufacturers from shipping wine to a consumer who has not visited the premises or had an "in-person" meeting with the seller. Since it is far easier for a consumer to visit a winery in his or her home state, these statutes have the effect of discriminating against out-of-state businesses. Compare *Cherry Hill Vineyards, LLC*, 553 F.3d at 433 ("It is impractical for customers to travel hundreds or thousands of miles to purchase wine in-person, and out-of-state wineries are clearly burdened by Kentucky's regulatory scheme") with *Black Star Farms, LLC v. Oliver* (D. Ariz., 2008), 544 F. Supp. 2d 913, 925 (upholding Arizona's "on premises" requirement for direct shipment of wine). In defending these discriminatory statutes, states will undoubtedly cite to the Court of Appeals' decision in this case, and argue that the challenged statute merely distinguishes between wineries that sell their goods "on-site" to consumers and wineries that rely upon catalogs or the Internet to sell the same goods. In other words, despite the fact these statutes typically include "location specific" language—i.e., "in person" or "on the premises"—and are enacted for the sole purpose of favoring local wineries at the expense of out-of-state wineries, states will defend these statutes as doing nothing more than distinguishing between two "modes" of selling wine to consumers.

The Court of Appeals' opinion will also make it harder for out-of-state wine retailers to sell wine to customers via the Internet or through catalogs where a statute prohibits sales explicitly on the basis of a distinction between "in-state" and "out-of-state" status. See, e.g., *Dickerson v. Bailey* (5th Cir. 2003), 336 F.3d 388, 398. Again, relying on the Court of Appeals' ruling, a court could uphold the statute on the grounds that it discriminates between two modes of doing business: out-of-state stores that depend upon direct shipment on one hand, and bricks and mortar wine and liquor stores that make "in person" sales on the other hand.

And these are just the ramifications of the Court of Appeals' opinion with respect to statutes or regulations that include location-specific language. It will be even easier for states to use the "business mode" exception to defend statutes or regulations that have been cleverly drafted to appear location neutral. In the past three years, at least five states (including Ohio) have amended their direct shipping statutes to permit only wineries producing less than a specified amount of wine to ship directly to those states' consumers. See Maureen K. Ohlhausen & Gregory P. Luib, *Moving Sideways: Post Granholm Developments in Wine Direct Shipping and Their Implications for Competition*, 75 Antitrust L.J. 505, 533-34 (2008). These limitations fall entirely on out-of-state wineries, while in-state wineries remain unaffected. Nonetheless, states have used the same reasoning as the Court of Appeals to defend these statutes—i.e., production limitations do not discriminate on the basis of the location of a specific economic activity but instead distinguish between large wineries and small wineries. See *Black Star Farms, LLC*, 544 F. Supp. 2d at 922-25 (upholding Arizona's 20,000 gallon production limit); *Cherry Hill Vineyards, LLC v. Hudgins* (W.D. Ky., 2006), 488 F. Supp. 2d 601, 613, aff'd, 553 F.3d 423 (C.A.6, 2008) (upholding Kentucky's 50,000 gallon production limit). But cf. *Island Silver & Spice, Inc. v. Islamorada* (C.A.11, 2008), 542 F.3d 844, 846-47 (holding that regulation that effectively prevented the establishment of new formula retail stores violated Commerce Clause despite fact that it only applied to a subset of out-of-state retailers); *McKesson Corp.* 524 So. 2d at 1006 (questioning Colorado court's application of *Exxon* to statute that discriminated against gasohol facilities that produced more than a specified amount of gas per year). It should not be long before we receive a brief that includes a cite to the Court of Appeals' decision—and specifically its interpretation of *Exxon* and *Amerada Hess*—in support of such discriminatory laws.

The Court of Appeals' flawed interpretation of *Exxon* and *Amerada Hess* is deeply troubling for Amicus and its members. The wine industry has been and continues to be subject to a plethora of discriminatory statutes and regulations that limit, and in some cases outright prohibit, their sale of wine to out-of-state consumers. The Court of Appeals's application of the dormant Commerce Clause leaves a shell of a constitutional doctrine, and exposes out-of-state manufacturers, distributors, and retailers—particularly those that operate primarily through the Internet—to the uncertainty of protectionist legislation in all 50 states. Its ruling will be the centerpiece of states' efforts to defend statutes and regulations that discriminate—both in purpose and effect—against out-of-state wine producers, merchants and retailers.

It should not be long before we receive a brief that includes a cite to the Court of Appeals's decision—and specifically its interpretation of *Exxon* and *Amerada Hess*—in support of such discriminatory laws. And once the federal moratorium on discriminatory taxation of e-commerce expires in November 2011—assuming it is not repealed beforehand, there is no question that states will cite to opinions like the Court of Appeals' to support statutes that impose a higher tax on Internet sales than on brick-and-mortar sales—again on the grounds that the statute falls within the court's "mode of business" exception. See Internet Tax Freedom Act Amendments of 2007 § 1101(a)(2), Pub. L. No. 110-108, § 2, 121 Stat. 1024, 1024 (2007) (codified at 47 U.S.C. § 151 note). Indeed, the Ohio legislature does not even need to wait that long to impose a 5.5% tax on online video providers like Hulu.com, YouTube.com, and Netflix. It can just point to the reasoning followed by the Court of Appeals, and take the position that a tax on online video providers but not on cable does not run afoul of the Commerce Clause because of the different technology employed by cable vis-à-vis Internet or satellite TV.

In sum, the Court of Appeals' opinion puts millions of Ohioans at risk of losing the wide selection of goods and services that they have become accustomed to purchasing at the lowest possible price, by unconstitutionally discriminating against businesses on the basis of the location of their operations.

CONCLUSION

For the foregoing reasons, and the reasons set forth in Appellant's Brief, this Court should reverse the decision of the Court of Appeals on each of the propositions of law raised in this appeal

Dated: October 23, 2009

Respectfully submitted,

JOHN A. HINMAN (pro hac vice)
HINMAN & CARMICHAEL LLP
260 California Street, Suite 1001
San Francisco, CA 94111
(415) 362-1215
(415) 362-1494 – fax jhinman@beveragelaw.com

Counsel for Amicus Curiae
Specialty Wine Retailers Association

Certificate of Service

This is to certify that the undersigned mailed a copy of this Brief of Amicus Specialty Wine Retailers Association in Support of Plaintiffs-Appellants by ordinary U.S. mail to counsel listed below on October 23, 2009.

Lawrence Pratt
Alan P. Schwepe
Julie E. Brigner
Damion M. Clifford
OFFICE OF RICHARD CORDRAY
OHIO ATTORNEY GENERAL
Assistant Ohio Attorneys General
Taxation Section
30 East Broad Street, 25th Floor
Columbus, Ohio 43215
Attorneys for Defendant-Appellee

Peter A. Rosato
CALFEE, HALTER & GRISWOLD LLP
1100 Fifth Third Center
21 E. State Street
Columbus, OH 43215
Attorneys for Plaintiffs-Appellants

E. Joshua Rosenkranz
ORRICK, HERRINGTON & SUTCLIFFE LLP
666 Fifth Avenue
New York, NY 10103
Attorneys for Plaintiffs-Appellants

Pantelis Michalopoulos
Mark F. Horning
STEPTOE & JOHNSON LLP
1330 Connecticut Avenue, NW
Washington, DC 20036
Attorneys for Plaintiffs-Appellants

Douglas R. Cole
Erik J. Clark
JONES DAY
325 John H. McConnell Blvd., Ste. 600
Columbus, Ohio 43215
Attorneys for Amicus Curiae Constitutional Law Professors

Jeffrey Pearlman
PUBLIC KNOWLEDGE
1875 Connecticut Avenue., NW
Suite 650
Washington, D.C., 20009
Attorney for Amici Curiae Consumer Federation of America, et al.

Keith C. Nusbaum
Howard R. Rubin
Hannah F. Preston
SONNENSHEIN NATH & ROSENTHAL
1301 K. Street, NW
Suite 600, East Tower
Washington, D.C. 20005
Attorneys for Amicus Curiae National Taxpayer's Union

Gerhardt A. Gosnell II
Donald C. Brey
CHESTER, WILLCOX & SAXBE, LLP
65 East State Street, Suite 1000
Columbus, Ohio 43215-3413
Attorneys for Amici Curiae Satellite Broadcasting and Communications Association, et al.

Mark C. Ellison
Senior Vice President & General Counsel
National Rural Telecommunications Cooperative
2121 Cooperative Way
Herndon, VA 20171

Counsel for Amicus Curiae National Rural Telecommunications Cooperative

John A. Hinman By [illegible] per consent 0076293

Attorney for Amicus Curiae