

Stock Market Reaction to Court Decisions related to Differential Treatment of In-State and Out-of-State Internet Wine Sales

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Abstract

This paper analyzes stock market reactions to the court decisions related to differential treatment of in-state and out-of-state internet wine sales by different states. Several states had differential laws governing internet wine sales directly to consumers for in-state and out-of-state wineries. Supreme Court of the United States (henceforth Supreme Court) in a decision on May 16, 2005 declared these practices unconstitutional. Prior to Supreme Court granting the writ of certiorari there was a circuit split on the issue. The seventh and the second circuit had found the laws constitutional where eleventh, fourth fifth and sixth had found these laws unconstitutional. Our study seeks to measure the impact of these events on stock prices of large wineries using standard event study methodology.

In the 2005 term, Supreme Court in *Granholm v. Heald* (2005) decided that state laws which permitted in-state wineries to ship directly to the consumer, but prohibited out-of-state wineries to ship directly to consumer are unconstitutional. The case stems from state laws providing differential treatment for in-state and out-of-state wineries. Similar laws for other products would have been considered unconstitutional under the dormant commerce clause. States had however enacted such laws for wine claiming protection under the Twenty First Amendment. Thus both parties in the cases were using a different part of the constitution to foster their case.

Various cases worked through the different states worked their way through the courts. In *Brindenbaugh v. Freeman-Wilson*, 227 F. 3d 848 (7th Cir. 2000), Seventh Circuit ruled that differential treatment laws were constitutional. However subsequently Eleventh, Fourth, Fifth

and Sixth Circuit courts found similar laws to be unconstitutional¹. Lastly in February 2004 second circuit court found differential treatment laws to be constitutional². Supreme Court agreed to hear the case in 2004 and decided the case in May of 2005 declaring the laws to be unconstitutional³.

The differential treatment laws were especially detrimental to the small wineries. Large wineries had clout over distributors, thus could force them to carry their products. However a small winery could only access another state's market through distributors. The distributors may not be willing to carry the products due to limited volume or may extract economic rents. Thus declaration of these laws unconstitutional is expected to help small wineries. It would also have an adverse effect on the value of the large wineries as consumers substitute their consumption.

This paper analyzes stock price reaction of publicly traded wineries around examines the stock price reaction of the various events leading up to the final Supreme Court decision. Schwert (1981) advocates use of financial data to examine the effects of new regulations or changes in regulations. As with other studies utilizing the event study methodology we also assume financial markets are assumed to be semi-strong form efficient as described in (Fama 1970). Using standard event study methodology we find stock prices of publicly traded wineries react negatively to Supreme Court decision. The results show that elimination of differential treatment laws has a negative effect on stock prices of the publicly traded wineries.

¹ Bainbridge v. Turner, 311 F. 3d 1104 (11th Cir. 2002), Beskind v. Easley, 325 F. 3d 506 (4th Cir. 2003), Dickerson v. Bailey, 336 F. 3d 388 (5th Cir. 2003), Heald v. Engler, 342 F. 3d 517 (6th Cir. 2003)

² Swedenburg v. Kelly. 358 F. 3d 223 (2nd Cir. 2004)

³ <http://www.law.indiana.edu/webinit/tanford/wine/mihome.html>