No. 07-2108

IN THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

TFWS, INC., T/A BELTWAY FINE WINE & SPIRITS,

Plaintiff-Appellee,

v.

PETER FRANCHOT, *et al.*,

Defendants-Appellants.

On Appeal from the United States District Court
for the District of Maryland
(William D. Quarles, District Judge)

PETITION FOR REHEARING EN BANC

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STATEMENT OF PURPOSE

As explained below, en banc consideration is warranted for these reasons:

1. This proceeding involves questions of exceptional importance to the people of the State of Maryland. The State's long-standing statutory system for regulating alcoholic beverages has been struck down by the most recent panel decision on the ground that it is preempted by the Sherman Act, after the same statutes were twice upheld by the district court as a valid exercise of powers conferred upon the State by the Twenty-first Amendment. Maryland's highest court previously upheld the statutes on those same grounds, and the State's legislature has reaffirmed its commitment to these statutes by rejecting legislation to repeal them. In overriding those determinations by the State's judiciary and elected representatives, the panel's decision failed to accord the deference required by Supreme Court and Fourth Circuit precedent whenever a federal court reviews state social and economic regulation which, as in this case, does not implicate fundamental rights or suspect classifications. Instead, the panel insists that, except in the limited realm of due process analysis, a federal court is empowered to adjudicate the effectiveness of State social and economic regulation. Slip op. at 13. If allowed to remain the law of this Circuit, the panel decision's departure from the established balance of federal and state authority threatens to invite previously untenable challenges to the various state regulatory regimes maintained by each of the states in this Court's jurisdiction

2. Whether the challenged statutes are preempted also poses questions of exceptional importance to this Court, for at least four reasons:

(a) The preemption question "is better addressed by an en banc court," *Columbus-America Discovery Group v. Atlantic Mut. Ins. Co.*, 203 F.3d 291, 305 (4th Cir. 2000), because the panel considered its decision to be largely predetermined, if not compelled, by the perceived need to adhere to law of the case,[1] which does not pose an obstacle to consideration en banc. *See McMellon v. United States*, 387 F.3d 329, 332 (4th Cir. 2004) (en banc) ("[T]here is no doubt" that this Court sitting en banc has "the power to overrule" a prior panel decision upon concluding "it was wrongly decided."). Reconsideration of prior panel decisions rendered in this case is especially appropriate because the case "implicates significant state and federal interests" and "involves questions of statutory interpretation," *North Carolina Utilities Comm'n v. Federal Communications Comm'n*, 552 F.2d 1036, 1045 (4th Cir. 1977), and, as indicated by concurring opinions issued in both the most recent panel decision, Slip op. at 19, and in the original decision on which it relies,[2] there are meritorious reasons to believe that the decision to preempt Maryland's statutes was "wrongly decided." *Id.*

(b) Reconsideration by the full Court is especially appropriate here, because the law of the case on which the panel relied, *TFWS, Inc. v. Schaefer* ("*TFWS I*"), 242

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[1] *See* slip op. at 15 ("Finding no exceptions to the law of the case, we decline to revisit our prior holdings on these points."); *id*. at 19 (Howard, Senior District Judge, concurring) (agreeing that "law of the case controls" but opining that "[w]ere we writing on a clean slate," he would hold that the challenged statutes "do not run afoul of § 1 of the Sherman Act" and "constitute a proper exercise of Maryland's Twenty-first Amendment interests").

[2] *See TFWS, Inc. v. Schaefer* ("*TFWS I*"), 242 F.3d 198, 213-14 (4th Cir. 2001) (Luttig, J., concurring).

F.3d 198, 209 (4th Cir. 2001), was the product of procedural irregularity. That is, *TFWS I* decided the question of whether the challenged statutes violated the Sherman Act by affirming the district court's ruling on the issue, "acting on its own motion," *id*. at 202, which was rendered at a very preliminary stage before discovery or presentation of evidence, and, as that original panel acknowledged, "without benefit of a record." *Id*., 242 F.3d at 211. The record subsequently developed in the case yielded results that contradicted the original panel's understanding of the case, not least because TFWS engaged in a sustained effort to disprove its own allegation that the State's regulatory scheme results in stabilization of "prices at artificially high levels." *Id.* at 203.

(c) Consideration by the full Court is necessary to secure or maintain uniformity of the Court's decisions because the panel decision conflicts with a prior decision of this Court addressing the same two Maryland statutes challenged here. *See Melrose Distillers, Inc. v. United States*, 258 F.2d 726 (4th Cir. 1958). *Melrose* was affirmed by the Supreme Court, 359 U.S. 271 (1959), and has never been overruled. In affirming a conviction for violations of Sections 1 and 2 of the Sherman Act, *Melrose* expressly rejected as "without merit," *id*., 258 F.2d at 729, what the panel below identified as the basis for its conclusion that the State statutes are preempted by the Sherman Act. *Compare*, Slip op. 9 n.9[3] ("We based our conclusion . . . explicitly on our finding that Maryland's scheme constituted *horizontal* price

[3] Citing *TFWS I*, 242 F.3d at 209.

fixing."), *with Melrose*, 258 F.2d at 729, 730 (rejecting as "without merit" the contention that horizontal price fixing was "in any way permitted, sanctioned, or encouraged by" Maryland's price filing and antidiscrimination provisions for alcoholic beverages).

(c) The panel's adherence to law of the case and failure to acknowledge the contrary holding in *Melrose* has yielded a decision that conflicts with authoritative decisions of two other United States Courts of Appeals with respect to the same issue of Sherman Act preemption of state alcoholic beverages regulation. *See* Slip op. at 11 n.10 (acknowledging the conflict with *Costco Wholesale Corp. v. Maleng*, 522 F.3d 874, 898-900 (9th Cir. 2008), which upheld Washington's volume discount ban as a valid unilateral restraint not preempted by the Sherman Act). *See also Battapaglia v. New York State Liquor Auth'y,* 745 F.2d 166 (2d Cir. 1984).

REASONS FOR GRANTING REHEARING

I. THE PANEL DECISION IMPROPERLY ENDORSES A HEIGHTENED MEANS-END SCRUTINY OF THE STATE'S ALCOHOLIC BEVERAGE PRICING REGULATIONS THAT IS INCONSISTENT WITH ESTABLISHED STANDARDS FOR JUDICIAL REVIEW OF ECONOMIC REGULATION.

The panel decision rejects the State's argument that the district court proceedings in this case failed to accord proper deference to legislative determinations concerning the effectiveness of state regulation in the economic sphere, disregarding repeated pronouncements by the Supreme Court and this Court rejecting the notion that federal courts have "a license to judge the effectiveness of legislation," *Keystone Bituminous Coal Ass'n v. Benedictis,* 480 U.S. 470, 487 n.16

(1987), because such a task is ill-suited to the judicial function and can too easily result in one fallible trial judge invalidating a law that another might uphold on an identical factual record. In its briefs, the State explained at length the basis for a court's adherence to the "paradigm of restraint" represented by deferential review of legislation in the economic sphere, on the sensible grounds that "legislatures are better equipped to consider and evaluate the profound and far-reaching consequences that such legislation may have." *Star Scientific Inc. v. Beale,* 278 F.3d 339, 349, 351 (4th Cir. 2002).

The panel decision, however, rejects the well-established principle that a "legislative choice is not subject to courtroom fact-finding," *Federal Communications Comm'n v. Beach,* 508 U.S. 307, 315 (1993), asserting that the State's reliance on *Exxon Corp v. Governor of Maryland,* 437 U.S. 117 (1978), as a case exemplifying and prescribing this deferential review, is misplaced. According to the panel, *Exxon* is "inapposite" because it does no more than "reiterate[] the Supreme Court's long-standing jurisprudence that due process challenges to economic regulations receive only the highly deferential rational basis review." Slip op. at 13-14. This overlooks the fact that *Exxon* involved not only a due process challenge, but also a federal antitrust preemption challenge. *See* 437 U.S. at 120. It is an untenable interpretation of the Supreme Court's holding in that case to assume that, while "the Due Process Clause does not empower the judiciary to sit as a superlegislature to weigh the wisdom of legislation," slip op. at 13 (citing *Exxon,* 437 U.S. at 124), the Sherman Act does authorize a federal court to sit as a superlegislature to second-guess

legislative judgments.

It would be remarkable if the Sherman Act, which was not "intended to restrain state action or official action directed by the state," *Parker v. Brown,* 317 U.S. 341, 351-52 (1943), or to "invade the legislative authority of the several States or even to occupy doubtful grounds," H.R. Rep. No. 1707, 51st Cong., 1st Sess., 1 (1890) (statement of Sen. Sherman), justified more intrusive scrutiny of state legislation than provisions of the Fourteenth Amendment, which was specifically directed at restraining state action. Nor has the Supreme Court or this Court confined its deferential approach to review of state legislation to the due process clause. Thus, for instance, in *Lingle v. Chevron,* the Supreme Court rejected a test for Takings Clause claims that asked whether regulations affecting private property "substantially advance legitimate state interests." 544 U.S. 528, 540 (2005). Such a test would "present serious practical difficulties" because "it would require courts to scrutinize the efficacy of a vast array of state and federal regulations – a task for which the courts are not well suited." *Id.* at 544. "Moreover," the Court cautioned, such a test for effectiveness "would empower – and might often require – courts to substitute their predictive judgments for those of elected legislatures and expert agencies." *Id.* Likewise, in the *Pike* balancing test utilized to evaluate Dormant Commerce Clause challenges, courts do not engage in extensive courtroom fact-finding to evaluate the "putative local benefits" of state legislation. *See, e.g., Brown v. Hovatter,* 561 F.3d 357, 367 (4th Cir. 2009) (crediting a "rational legislative judgment [that] could reasonably be expected to yield putative benefits" that outweighed the asserted

burden on commerce).

The approach that emerged over the course of this litigation, applying heightened means-end scrutiny to evaluate the effectiveness of Maryland's alcoholic beverage price regulations, is particularly inappropriate in light of the presumption against preemption, in general, *see Omega World Travel, Inc. v. Mummagraphics, Inc.,* 469 F.3d 348, 352 (4th Cir. 2006), and the "strong presumption of validity," *Beskind v. Easley,* 325 F.3d 506, 519 (4th Cir. 2003), that attaches to laws enacted in furtherance of a state's Twenty-first Amendment powers, in particular. Although it has not fared well in this litigation, the presumption against preemption is alive and well, as the Supreme Court reaffirmed earlier this year in *Wyeth v. Levine,* 129 S.Ct. 1187, 1194-95 & n.3 (2009), and both this Court and the Supreme Court have recognized the continued vitality of the "strong presumption of validity" afforded to state regulations like those at issue here, which are integral components of the State's "unquestionably legitimate" three-tier system for regulating the distribution and sale of alcoholic beverages. *Brooks v. Vassar,* 462 F.3d 341, 352 (4th Cir. 2006) (quoting *Granholm v. Heald,* 544 U.S. 460, 489 (2005)).

The panel decision insists that "[t]he nature of the [preemption] challenge here is fundamentally different." Slip op. at 14. This claim is based on the mistaken belief that Supreme Court precedent in the specific context of antitrust preemption challenges to state alcoholic beverage laws "instruct[s] that judicial determination of the effectiveness of a state's liquor regulations is necessary when those regulations violate the Sherman Act." *Id.* The same misapprehension infects the analysis in the

Court's decision in the first appeal. The ostensible justification for subjecting state alcoholic beverage laws to intrusive judicial scrutiny stems from the Supreme Court's comment in *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.,* stating that "unsubstantiated state concerns" could not prevail over the Sherman Act's *per se* condemnation of resale price maintenance restraints. 445 U.S. 97, 114 (1980). This comment, however, did not reflect a failure by California to prove, or "substantiate," at trial the efficacy of its laws. Rather, the state concerns were considered to be "unsubstantiated" because *California's highest court* had determined that the concerns, particularly an asserted goal of protecting small retailers, were not justified. *Id.* at 111-12. In both *Midcal* and *324 Liquor Corp. v. Duffy,* 479 U.S. 335, 351 (1987), the Supreme Court gave deference to a state court's determination that the challenged laws did not serve the asserted state interest. Here, by contrast, Maryland's highest court has unequivocally "substantiated" the State's interest in the challenged laws, providing a cogent discussion of their operation and effect that dovetails with the explanation offered by the State in this litigation. *See Dundalk Liquor Co. v. Tawes,* 197 Md. 446, 453 (1951). Supreme Court precedent provides no justification for the departure from ordinary standards of judicial deference, merely because a law is being evaluated against a claim of antitrust preemption.

II. THE PANEL DECISION'S ADHERENCE TO THE PRIOR CHARACTERIZATION OF THE MARYLAND'S PRICING REGULATIONS AS HYBRID RESTRAINTS PERPETUATES A MISAPPLICATION OF ANTITRUST PREEMPTION PRINCIPLES, DEEPENING A SPLIT IN THE CIRCUITS, AND IS BASED ON A MISAPPREHENSION OF THE LAWS' OPERATION AND EFFECTS.

As discussed above, the Court's determination in *TFWS I* that the two laws challenged here are hybrid restraints was made without benefit of a record and in accordance with the obligation at that stage of the proceedings to accept well-pled allegations of the plaintiff's complaint as true. However, the record subsequently developed failed to support those allegations, which asserted that the challenged laws compel collusive price-setting by private parties. They do not. Contrary to the suggestions of the complaint, the pricing regulations do not serve to "cast[] . . . a gauzy cloak of state involvement over what is essentially a private price-fixing arrangement." *Midcal,* 445 U.S. at 106; rather, as explained in greater detail in the State's brief in this appeal, the wholesalers subject to the pricing regulations are required simply to submit to a "restraint imposed unilaterally by government," and their compliance with this regulatory command "does not become concerted action within the meaning of the [Sherman Act] simply because it has a coercive effect upon parties who must obey the law." *Fisher v. City of Berkeley,* 457 U.S. 260, 267 (1986); *see also Massachusetts Food Ass'n v. Massachusetts Alcoholic Beverages Control Comm'n,* 197 F.3d 560, 565 (1st Cir. 1999) ("The Sherman Act is a charter of economic liberty, but only as against private restraints."). Neither the volume discount ban nor the price filing system authorizes wholesalers to fix prices, either horizontally or vertically; the State therefore does not "enforce private marketing decisions" reached by the agreement of "*separate* entities." *Fisher,* 457 U.S. at 266, 268 (emphasis in original). If the wholesalers collude in setting the prices the State requires them to file with the State and maintain for 30 days, they are doing so in

violation of state law, not in compliance with it. For this reason, the concerted action requirement essential to a hybrid restraint finding is absent, and a price-fixing wholesaler cannot excuse its conduct by pointing to laws that compel independent price-setting, not coordinated price-setting, as demonstrated by this Court's own precedent in *Melrose Distillers, Inc. v. United States,* 258 F.2d 726 (4th Cir. 1958). There, this Court rejected the arguments made by private entities accused of price-fixing that their conduct was authorized by Maryland law, holding that Maryland's "system of regulation . . . could no by any stretch of the imagination be denominated 'horizontal' price fixing. . . . None of the [private entities'] acts is in any way permitted, sanctioned, or encouraged by the announced governmental policy and law of the State of Maryland." 258 F.2d at 729.

By disregarding TFWS's failure to demonstrate the existence of the essential element of concerted action in the requirements imposed by Maryland's pricing regulations, the panel decision brings this Circuit's law into conflict with that of the Second Circuit, which has upheld a New York price filing regime like the Maryland law invalidated by the district court here, *see Battapaglia v. New York State Liquor Auth'y,* 745 F.2d 166 (2d Cir. 1984), and with that of the Ninth Circuit, which recently upheld a Washington State volume-discount prohibition like the other Maryland law invalidated by the district court in this case, *see Costco Wholesale Corp. v. Maleng,* 522 F.3d 874 (9th Cir. 2008). En banc review is warranted to address the Court's erroneous determination that the challenged Maryland laws are hybrid, rather than unilateral, restraints.

III. THE PANEL DECISION'S REFUSAL TO CONDUCT A SEVERABILITY ANALYSIS IS CONTRARY TO SUPREME COURT AND FOURTH CIRCUIT PRECEDENT.

Subsequent to this Court's decision in the first appeal, the Court held, in *Beskind v. Easley,* that, "as a matter of comity and harmony," in a preemption challenge to state alcoholic beverage regulations, a federal court must apply a "'minimum-damage' approach" and must "take the course that least destroys the regulatory scheme that [the state] has put in place pursuant to its powers under the Twenty-first Amendment." 325 F.3d 506, 519-20 (4th Cir. 2003). The course that least destroys Maryland's regulatory scheme is the one that gives effect to the severability provision in Article 2B § 1-104 and upholds the State's volume-discount ban, even if the price filing system is invalidated. Maryland law demands that severability be considered when a court finds a portion of a statute invalid, *see, e.g., Board of Supervisors v. Smallwood,* 327 Md. 220, 245-46 (1992), and Circuit precedent requires that state law be applied in determining whether severance is appropriate, *see, e.g., Sons of Confederate Veterans, Inc. v. Commissioner, Virginia Dep't of Motor Vehicles,* 288 F.3d 610, 627 (4th Cir. 2002); *see also Leavitt v. Jane L.,* 518 U.S. 137 (1996) (per curiam) (reversing lower court judgment for failure to apply state severability law).

The panel's explanation for disregarding this well-established principle is that the Court's prior rulings and arguments made by the State explained that the two

challenged laws are part of a comprehensive regulatory scheme. Slip op. at 11-12.[4] But severability is an issue *only* when the provisions to be severed are "parts" of a larger whole; if they were not, there would be no question of the invalidation of one provision leading to the invalidation of the second provision, and no occasion to consider whether that result should be avoided (as it should here).

IV. THE PANEL'S ENDORSEMENT OF THE DISTRICT COURT'S PERFUNCTORY WEIGHING OF STATE AND FEDERAL INTERESTS DOES NOT COMPORT WITH THE SENSITIVE BALANCING OF FEDERAL AND STATE POWERS DEMANDED BY SUPREME COURT PRECEDENT.

The district court improperly substituted its judgment for that of the Maryland General Assembly in assessing the effectiveness of Maryland's pricing regulations, based on a faulty analysis and in disregard of abundant record evidence supporting the legislative judgment. The court then compounded its error by employing a balancing test in which the unexamined impact of the State's regulations on federal interests was simply assumed to trump the State's interests, even though those interests indisputably lie "at the core of the State's powers under the Twenty-first Amendment." *North Dakota v. United States,* 495 U.S. 423, 439-40 (1990).

The district court's analysis does not comport with the Supreme Court's direction requiring a "pragmatic effort to harmonize state and federal powers," *Capital Cities Cable, Inc. v. Crisp,* 467 U.S. 691, 714 (1984), in which the two

[4] The opinion implies both that the State had previously conceded that severability is not appropriate and that the Court had previously refused to conduct a severability analysis. Neither implication is accurate.

sovereigns' interests "must be considered in light of the other and in the contest of the issues and interests at stake in a[] concrete case." *Bacchus Imports, Ltd. v. Dias,* 468 U.S. 263, 275 (1984). While the federal interest expressed in the Sherman Act of promoting economic competition is a substantial one, it is not the only one, and the federal government has never endorsed an approach favoring unfettered competition in the market for alcoholic beverages without regard to the social ills such market conditions generate. To the contrary, as the State has pointed out in its briefs, in multiple enactments, Congress has pursued interests that coincide with those advanced by Maryland's laws limiting price competition in the sale of alcoholic beverages. The Federal Alcohol Administration Act, to take one obvious example, embodies provisions that manifestly value control over competition. *See* 27 U.S.C. § 205. The presumption against preemption applies with "special force" when the state and federal "governments are pursuing common purposes." *Pharmaceutical Mfgrs. v. Walsh,* 538 U.S. 644, 666 (2003). Yet the analysis undertaken by the district court ignores those common purposes and attributes to the federal government an interest in unbridled competition that may exist with regard to potatoes, rye, hops, and grapes, but not to the distilled, brewed, or fermented products made from those commodities that are the special province of the Twenty-first Amendment.

The sensitive balancing of state and federal interests required by Supreme Court precedent cannot be conducted without some weighing of the degree to which the asserted federal interest in promoting competition in the market for alcoholic beverages is actually offended and without considering the degree to which federal

interests other than those expressed in the Sherman Act coincide with the interests advanced by Maryland's alcoholic beverage pricing laws. The proper balancing approach has been displaced in the district court's analysis by an uncritical assumption that the interest in economic competition trumps all other interests, even where, as here, the anticompetitive injury is speculative – and if TFWS is to be believed, its magnitude is *de minimis*. The operation of a per se presumption of antitrust injury, where the evidence adduced in this litigation undermines the presumption, cannot outweigh the State's legitimate interest in regulating the distribution and sale of alcoholic beverages through policies that have been a part of Maryland law for more than half a century, and to which the General Assembly has repeatedly reaffirmed its commitment.

CONCLUSION

The Court should grant rehearing by the panel or en banc to address the issues raised in this petition.

Respectfully submitted,

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