No.: 07-2108

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

TFWS, INCORPORATED, dba Beltway Fine Wine and 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, JR., UNITED STATES DISTRICT COURT JUDGE)

BRIEF OF THE NATIONAL BEER WHOLESALERS ASSOCIATION AND THE WINE & SPIRITS WHOLESALERS OF AMERICA, INC. AS *AMICI CURIAE* IN SUPPORT OF DEFENDANTS-APPELLANTS

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TABLE OF CONTENTS

TABLE OF AUTHORITIES iii

INTERESTS OF AMICI CURIAE 1

ARGUMENT 3

1. Introduction. 3

2. History of the Liquor Regulations. 4

3. The Volume Discount Ban and Post-and-Hold Law Must Be Considered and Analyzed Separately Under Both the Sherman Act and the Twenty-first Amendment. 9

4. The Sherman Act was Never Intended by Congress to Apply to State Liquor Laws in the Manner Contemplated by the District Court. 10

5 The Maryland Volume Discount Ban and Post-and-Hold Law Do Not Irreconcilably Conflict with the Sherman Act, Do Not Constitute Hybrid Restraints, Do Not Constitute Per Se Violations and Furthermore, are Immune Under Parker v. Brown. 12

6. The Challenged Regulations are Shielded by the Twenty-First Amendment. 20

7. The District Court Erred by Misconstruing the State's Interests, by Failing to Consider the Multitude of Federal Interests 27

CONCLUSION 31

TABLE OF AUTHORITIES

CONSTITUTIONAL PROVISIONS

U.S. Constitution Twenty-first Amendment .... *Passim*

CASES

324 Liquor Corp. v. Duffy,
479 U.S. 335 (1987) .... *Passim*

A.D. Bedell Wholesale Co., Inc. v. Philip Morris, Inc.,
263 F.3d 239, 256 (3rd Cir. 2001). 16

Beer & Pop Warehouse v. Jones,
41 F. Supp. 2d. 552, 560 n.10 (M.D.Pa 1999) 10

Beskind v. Easley,
325 F.3d 506 (4th Cir. 2003) 10

California Retail Liquor Dealers Association v. Midcal Aluminum Dealers,
445 U.S. 97, 100 S.Ct. 937, 63 L.Ed. 233 (1980) .... *Passim*

Canterbury Liquors Pantry v. Sullivan,
16 F.Supp 2d 41, 42 (D. Mass. 1998) 10

Capital Cities Cable, Inc. v. Crisp,
467 U.S. 691, 714 (1984) 21,23,29

City of Columbia v. Omni Outdoor Advertising, Inc.,
499 U.S. 365, 370, 377-79 (1991) 13,18

Costco Wholesale Corporation v. Maleng,
____ F.3d ___, 2008 W.L. 223121 (9th Cir. Jan. 29, 2008) .... *Passim*

Credit Suisse v. Billing,
127 S.Ct. 2583 (2007) 19,20

Exxon v. Maryland,
437 U.S. 117, 133 (1978).. 16

Fisher v. City of Berkeley,
475 U.S. 260, 264, 166, 267-268, 106 S.Ct. 1045, 89 L.Ed 206 (1986)
....*Passim*

Granholm v. Heald,
544 U.S. 460, 489 (2005).. 15

Hoover v. Ronwin,
466 U.S. 588, 568-69 (1984) 18

Leegin Creative Leather Products, Inc. v. PSKS,
127 S.Ct. 2705 (2007).. 19

Massachusetts Food Ass'n v. Massachusetts Alcoholic Beverages Control Commission,
197 F.3d 560, 564-65, 566 (1st Cir. 1999) 11, 15, 16

North Dakota v. United States,
495 U.S. 423 (1990).. 21, 22, 26, 27

Northern Pacific Ry. Co. v. United States,
356 U.S. 1, 4 (1958).. 10, 12

O.C. Taxpayers v. Ocean City,
280 Md. 585, 600, 375 A.2d 541, 550 (1977) 9

Parker v. Brown,
317 U.S. 341 (1943).. 11, 12, 13

Rice v. Norman Williams, Co.,
458 U.S. 654, 659 (1982)... 16

Sanders v. Brown,
504 F.3d 903, 915-16 (9th Cir. 2007) 16, 18

Schwegmann Bros. v. Calvert Distillers Corp.,
341 U.S. 384, 71 S.Ct. 745, 95 L.Ed. 1035 (1951) 17, 18, 19

TFWS, Inc. v. Schaefer,
183 F.Supp. 2d 789, 795 (D. Md. 2002) 12

TFWS, Incorporated v. Schaefer,
242 F.3d 198, 209, 213 (4th Cir. 2001) 9, 17, 19

TFWS, Incorporated v. Schaefer,
2007 W.L. 2917025 (D.MD.) 25, 26, 29

Trident International Corp. v. Commonwealth of Kentucky,
467 F.3d 547, 558 (6th Cir. 2006) 16

Turner v. State,
299 Md. 565, 576, 474 A.2d 1297, 1303 (1984) 9

United States Department of Treasury v. Fabe,
508 U.S. 491, 509, n.8 (1993) 9

FEDERAL STATUTES

Federal Alcohol Administration Act,
27 U.S.C. §201, *et seq* .... *Passim*

Robinson-Patman Act,
15 U.S.C. §13a, 13b & 21a .... *Passim*

The Sherman Anti-Trust Act,
15 U.S.C. §1 .... *Passim*

Webb-Kenyon Act,
27 USC § 122 .... *Passim*

The STOP Act,
Pub.L.No. 109-422, 120 Stat. 2890, amending 42 U.S.C. 290bb-25b
.... *Passim*

Liquor Enforcement Act,
H.R. 8368, 74th Cong. (2nd Sess. 1936): 49 Stat. 1928, ch. 815 (June 25, 1936). 4

STATE STATUTES AND ADMINISTRATIVE CODES

15 U.S.C. § 13a 30

27 U.S.C. § 205 30

MD Code, Art. 2B, § 12-103(a) 7

MD Code, Art. 2B, § 1-104 10

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12 Law and Contemporary Problems 665 (1940) 6

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INTERESTS OF *AMICI CURIAE*

Since 1938, the National Beer Wholesalers Association ("NBWA") has served as the national membership organization of the beer distributing industry representing over 2,000 family-owned licensed beer distributors, including beer distributors in Maryland[1]. Its members reside in all fifty states. In 2002, U.S. beer distributor direct sales reached $34.4 Billion Dollars. Beer distributors employed 101,032 individuals and paid $4.1 Billion Dollars in wages. The total economic activity directly generated by beer distributors was $8.2 Billion Dollars. The total state and local taxes paid directly by beer distributors was $2.4 Billion Dollars. *See* 2002 Economic Census, U.S. Census Bureau. *See* www.census.gov/econ/censu02/data/industry/E4248.HTM. As a whole, the beer industry pays over $5 Billion Dollars in state and local taxes. *See* www.census.gov/govs/www/statetax.html.

Wine & Spirits Wholesalers of America, Inc. ("WSWA") is a national trade organization and the voice of the wholesale branch of the wine and spirits industry. Founded in 1943, WSWA represents approximately 350 companies in all 50 States and the District Court of Columbia that hold state licenses to act as wine and/or spirits wholesalers and/or brokers. WSWA's

[1] This brief is filed with the written consent of all parties.

members distribute more than 80% of all wine and spirits sold at wholesale in the United States.

This case implicates the essential interests of NBWA, WSWA and their members. The District Court's decisions below threaten to dismantle complex state regulatory systems governing intoxicating liquor that have worked remarkably well for over seventy years. Through these regulatory schemes, states have addressed several fundamental interests relating to the distribution and sale of intoxicating liquor: preventing illegal sales to minors, keeping organized crime out of the liquor industry, inhibiting overly aggressive marketing, moderating, consumption, collecting taxes, creating orderly distribution and importation systems, and preventing a recurrence of the problems that led to the enactment of Prohibition.

ARGUMENT

1. Introduction.

In June 1999, TFWS, Inc. ("TFWS") filed a one-count Complaint for declaratory judgment and injunctive relief challenging Maryland's post-and-hold statute and volume discount ban. Thereafter, this case took on a life of its own and progressed, in serialized fashion, through four District Court proceedings, two District Court judges and four appeals. The impact of the dispositive District Court decisions are sweeping with far reaching national implications. The decision below extended the Sherman Act far beyond what Congress intended, unnecessarily and unjustifiably intruded upon the power of states not only to regulate intoxicating liquor but also to regulate other economic activity within their borders, and effectively ignored basic principles of federalism and the Twenty-first Amendment. If affirmed, the decision calls into serious question the legality of many states' liquor regulatory laws.

In a similar antitrust challenge to Washington liquor laws decided last week, the Ninth Circuit Court of Appeals upheld a volume discount ban, uniform pricing law, delivered pricing law, credit restriction law, minimum mark-up law, central warehouse ban, and a retail-to-retail ban. *See Costco Wholesale Corporation v. Maleng,* _____ F.3d ____, 2008 W.L. 223121 (9th Cir. Jan. 29, 2008) (hereinafter cited as "*Costco*, at"). Relying upon *Fisher*

v. City of Berkeley, 475 U.S. 260 (1986) and its progeny, the Ninth Circuit held that these laws were unilateral restraints and, as such, were not preempted by the Sherman Act. *Amici Curiae* NBWA and WSWA urge this Court to reverse the District Court and uphold Maryland's volume discount ban and post-and-hold law.

2. History of the Liquor Regulations.

Any review of liquor regulations must begin with the premise that intoxicating liquor is unique. The detrimental impacts on individuals, families, and society as a whole that result from alcohol abuse are dramatically different from those related to the use of other products, whether measured by scale, severity, nature, or remediability. As a consequence, intoxicating liquor has always been, and remains, one of the most heavily regulated products in the country. No other product has been the subject of one, let alone two, Constitutional Amendments.

The first paragraph of the Twenty-first Amendment ended National Prohibition. The second paragraph mandated that states were to be the primary authority for intoxicating liquor regulation and reflected a renewed belief that the manufacture, distribution, and sale of intoxicating liquor required comprehensive regulation. Federal statutes were enacted to facilitate state regulation. For instance, the Webb-Kenyon Act was re-enacted. In 1936, Congress also enacted the "Liquor Enforcement Act"

which was an act to "Enforce the Twenty-first Amendment to the Constitution." *See* H.R. 8368, 74th Cong. (2nd Sess. 1936): 49 Stat. 1928, ch. 815 (June 25, 1936).

> The regulation of the liquor problem is to be left to the States, with the assurance that the Federal Government will afford them affirmative protection against violations directed from outside their borders.

H.R.Rep. No. 74-258, at 4.

All state intoxicating liquor regulatory systems reflected certain shared concerns. The aim was moderation in consumption and sale of intoxicating liquor. The appetite for intoxicating liquor and the profit motive were each to be constrained. The norms and practices of the distribution, sale, and consumption of intoxicating liquor were not to be left to the private arrangements of sellers seeking profits and buyers seeking products. Such practices were to be shaped by the state. The aim was to restrict the profit-motive and control alcohol abuse by preventing certain aggressive competitive practices, including, particularly, tied-house arrangements, that had characterized pre-Prohibition intoxicating liquor distribution and sale. These conditions of unregulated distribution and over-stimulated sale arose "in part [owing] to the failure to recognize the effects of industrial organization on the manufacture and sale of intoxicating liquor. With the rise of the large distilling and brewing corporations seeking new markets through high-pressure sales organizations, the independent

tavernkeep, theretofore subject to the restraints imposed by local legislation and local public opinion, ceased to exist." Joe de Ganahl, "Trade Practice and Price Control in the Alcoholic Beverage Industry," 12 Law and Contemporary Problems 665 (1940), *citing* National Commission on Law Observance and Enforcement, (The Wickersham Commission), Report on the Enforcement of the Prohibition Laws of the United States, H.R. Doc. No. 722, 71st Cong., (3rd Sess. 1931) at 6-7.

Instability was not created by large and aggressive suppliers alone. The House Ways and Means Committee, considering what would become the Federal Alcohol Administration Act, observed that large and powerful buyers also threatened stability. In support of a tied-house ban and trade related practices regulation (including prohibiting consignment sales), the committee noted:

> "It has been brought to the attention of the committee that certain large buyers are in such a strategic position with respect to sellers that they often have sufficient economic power to compel the sellers to deal with them on a consignment or return basis. Buyers less powerful are unable to exact such terms from the seller. Such situations are in practical effect not essentially different from the exaction of price discriminations in favor of the large trade buyer."

See Wallace Alger Russell, "Legislative History of the Federal Alcohol Administration Act (Public no. 401, Seventy-fourth Congress) (H.R.8870)" Office of the General Counsel, September 15, 1935, at 64.

Over time, different states made different accommodations in controlling availability and price. Maryland, for instance, introduced the laws at issue here in the years after Repeal to make more effective its effort to separate the tiers and stabilize the marketing of intoxicating liquor. The prohibition against a supplier or distributor giving money or things of value to retailers was initially evaded by price concessions and by credit arrangements. This led in the 1940's to a prohibition of price discrimination. Quantity discounts were considered and rejected. Price posting was afterwards imposed to make these restrictions more easily enforceable. The purpose of the price discount restriction was "to eliminate price wars, which unduly stimulate the sale and consumption of wines and liquors and disrupt the orderly sale and distribution thereof." MD Code, Art. 2B, § 12-103(a). An excellent recitation of the specific history of Maryland's liquor regulations is set forth in the Brief of Appellees dated May 15, 2002, submitted to this Court in the first appeal, as well as the Brief of Appellants submitted in this appeal. In light of briefing limits, that history will not be repeated here.

The aim of state liquor regulation was balance; the method was not just to police drinkers or retailers, but to establish a controlled system. Tied house and related trade practices regulation were intended to and have succeeded in promoting stability and discouraging speculative strategies.

Compromise and balance were expressed in the concept of orderly markets, a term, like temperance, often used but never precisely defined in post-Repeal statutes. Orderly markets promote legal stability. Law abiding licensees were not unfairly undercut by competition from illicit distribution and sale. Economic stability and profits were not so precarious as to tempt licensees to engage in illicit behavior nor to focus upon short-term profits because of uncertainty about their economic future. Orderly markets foster transparent, accountable, and stable distribution and sale which forestalls unfair competition through evasion of law whether by bootlegging, special terms to favored customers, or otherwise burdening manufacturers, distributors, and retailers who operate within the comprehensive regulatory scheme governing the manufacture, distribution, and sale of intoxicating liquor. Liquor regulation strives for a balance between control and competition.

Maryland achieves its own balance between unfettered competition and availability, on the one hand, and strict control, on the other. The Maryland legislature determined how that balance was to be achieved and where the appropriate balance point was to be fixed.

3. **<u>The Volume Discount Ban and Post-and-Hold Law Must Be Considered and Analyzed Separately Under Both the Sherman Act and the Twenty-first Amendment</u>.**

Both the volume discount ban and the post-and-hold law were analyzed as if they were the single product of a private conspiracy rather than separate enactments, with separate goals and rationales, regulating different economic activity. *See TFWS, Incorporated v. Schaefer*, 242 F.3d 198, 209 (4th Cir. 2001) ("The volume discount ban is part of the hybrid restraint because it reinforces the post-and-hold system by making it even more inflexible.") As noted by the Ninth Circuit in *Costco,* it is "a mistake, however, to truncate the analysis by only looking at how these provisions interact with the post-and-hold requirement." *Costco* at 16.

The *Costco* Court relied upon Washington's severability doctrine in determining whether, in the absence of the post-and-hold law, the volume discount ban conflicted with and should be preempted by the Sherman Act. *Id.* at 5; (*citing United States Department of Treasury v. Fabe*, 508 U.S. 491, 509, n.8 (1993)). *Amici* submits that this Court should do so as well.

Under Maryland law, there is a "strong presumption 'that a legislative body generally intends its enactments to be severed if possible.'" *e.g., O.C. Taxpayers v. Ocean City*, 280 Md. 585, 600, 375 A.2d 541, 550 (1977); *Turner v. State*, 299 Md. 565, 576, 474 A.2d 1297, 1303 (1984). Furthermore, the Maryland alcohol regulatory scheme expressly includes a

severability provision. *See* MD Code, Art. 2B, § 1-104; *see also Beskind v. Easley*, 325 F.3d 506 (4th Cir. 2003) (construing North Carolina law).

Accordingly, it is simply incorrect to view the volume discount ban through the sole prism of the post-and-hold law. *Amici* urges the Court to reject a "truncated" analysis and examine each law separately. *See Costco*, at 16 (upholding the volume discount ban but striking the post-and-hold law).

4. The Sherman Act was Never Intended by Congress to Apply to State Liquor Laws in the Manner Contemplated by the District Court.

The tortured path of this litigation suggests – indeed compels – that a fresh look be given to the governing legal standards. State regulation of intoxicating liquor is specifically authorized by the Twenty-first Amendment, passed in 1933. It is unconceivable that such laws should face preemption by the Sherman Act, passed in 1890, with no greater deference than that accorded any other state law. The Sherman Act has been described as resting "on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality, and the greatest material progress." *Beer & Pop Warehouse v. Jones*, 41 F. Supp. 2d. 552, 560 n.10 (M.D.Pa 1999), quoting *Canterbury Liquors Pantry v. Sullivan,* 16 F.Supp 2d 41, 42 (D. Mass. 1998 and *Northern Pacific Ry. Co. v. United States*, 356 U.S. 1, 4 (1958)). The

lowest prices and widest availability, however, have never been the exclusive focus of intoxicating liquor regulation. No one believes that the terms and conditions for the sale of intoxicating liquor should be established by the greediest seller and the thirstiest drinker and neither state nor federal law has ever permitted such a regime.

The Sherman Act was simply not intended by Congress to apply to state liquor law in the manner contemplated by the District Court. *See* discussion *infra* at 19-20. To do so would eviscerate effective liquor regulation. Most commercial law and regulation restrains competition and restricts particular profit-seeking tactics. As noted by Judge Garland (now sitting on the Court of Appeals for the District of Columbia Circuit), the "post-*Parker* cases constitute the Court's efforts to thread this needle – an effort to protect true state regulation, even if anticompetitive, but to ban mere state 'authorization' of private anticompetitive conduct. Garland, Antitrust and State Action: Economic Efficiency and the Political Process, 96 Yale L.J. 486, 500-501 (1987). On behalf of the First Circuit, Judge Boudin, formerly of the Antitrust Division of the Justice Department, expressed a similar view in *Massachusetts Food Ass'n v. Massachusetts Alcoholic Beverages Control Commission*, 197 F.3d 560, 565 (1st Cir. 1999), (rejecting a Sherman Act challenge to a state law limiting a retailer to no more than three licenses), "[t]he Sherman Act is a 'charter of economic

liberty'; *Northern Pacific Ry. Co. v. United States*, 356 U.S. 1, 4 (1958), but only as against private restraints."

Here, TFWS is <u>not</u> challenging "private restraints;" it is challenging laws designed to protect Maryland citizens from "crime, disease, and social deterioration." *TFWS, Inc. v. Schaefer*, 183 F.Supp. 2d 789, 795 (D. Md. 2002). These laws regulating the distribution and sale of intoxicating liquor are at the very core of the State's interests that the Twenty-first Amendment protects. *See*, *California Retail Liquor Dealers Association v. Midcal Aluminum Dealers*, 445 U.S. 97 (1980). The Court below should not be allowed to second-guess the Maryland Legislature's judgment in an area of law traditionally and constitutionally left to the states.

5. <u>The Maryland Volume Discount Ban and Post-and-Hold Law Do Not Irreconcilably Conflict with the Sherman Act, Do Not Constitute Hybrid Restraints, Do Not Constitute *Per Se* Violations and Furthermore, are Immune Under *Parker v. Brown*</u>.

The central issue presented on this appeal is whether the Maryland volume discount ban and post-and-hold law conflict with and are preempted by the Sherman Act. Resolution of this issue necessitates an examination of whether the challenged laws constitute unilateral versus hybrid restraints and are thereby immune under *Parker v. Brown*, 317 U.S. 341 (1943) or, expressed another way, whether the challenged laws irreconcilably conflict

with and constitute a *per se* violation of the Sherman Act. As discussed later, these inquiries are simply different sides of the same coin.

The Sherman Act regulates agreements, combinations, and conspiracies of private parties, not the actions or programs of states. This was clearly stated by the Supreme Court in *Parker v. Brown*, 317 U.S. 341, 350-51 (1943). As subsequently noted by the Supreme Court, the *Parker* doctrine rests upon "principles of federalism and state sovereignty." *City of Columbia v. Omni Outdoor Advertising, Inc.*, 499 U.S. 365, 370 (1991). The Supreme Court has outlined two seemingly competing inquiries to ascertain whether a particular restraint is state action entitled to immunity, or, alternatively, is merely state authorization of private anticompetitive conduct. The first is the "active supervision" inquiry under *California Retail Liquor Dealers Association v. Midcal Aluminum Dealers*, 445 U.S. 97 (1980)[2] and the second is the "hybrid/unilateral" inquiry under *Fisher v. City of Berkeley*, 475 U.S. 260 (1986). As discussed at length in the *Costco* opinion, *Fisher* held that certain regulations are entirely immune from the *Midcal* inquiry. *See Costco*, at 8; *Fisher*, at 267-68. Both the volume discount ban and post-and-hold law challenged here fall into this category.

[2] *Midcal* articulated a two-part test for evaluating *Parker* state action immunity: (1) was the challenged restraint clearly articulated and affirmatively expressed as state policy and (2) was it actively supervised by the state itself. *Id.* at 105.

In *Costco*, the Ninth Circuit began its analysis with an examination of whether the laws being challenged were "unilateral" or "hybrid" restraints.[3] *Costco*, at 6 (citing *Fisher v. City of Berkeley*, 475 U.S. 260, 267-68 (1986). A restraint is hybrid if it creates unsupervised private power in derogation of competition. A restraint is not hybrid if it is unilaterally imposed by government upon private parties to the exclusion of private control. If a restraint is unilateral, it does not constitute an actionable violation of the Sherman Act because it is immune from preemption. It is also not subject to *Midcal* analysis.

A restraint imposed unilaterally by government does not become concerted-action within the meaning of the statute simply because it has a coercive effect upon parties who must obey the law. The ordinary relationship between the government and those who must obey its regulatory commands whether they wish to or not is not enough to establish a conspiracy. *Fisher v. City of Berkeley*, 475 U.S. 260, 266 (1986). As expressed by the First Circuit (and quoted in *Costco*), "[w]hat is centrally forbidden is state licensing of arrangements between private parties that suppress competition – not state directive that by themselves limit or reduce

[3] The *Costco* court noted that there is substantial overlap between the federal antitrust preemption inquiry and the state action immunity inquiry. *Costco*, at 7.

competition." *Massachusetts Food Ass'n v. Massachusetts Alcoholic Beverages Control Commission*, 197 F.3d 560, 566 (1st Cir. 1999).

a. The Volume Discount Ban is a Unilateral Restraint Imposed by the Sovereign State.

Here, any anticompetitive effect arising out of the volume discount ban "is the result not of private discretion, but of the sovereign's command." *Costco*, at 16. There is no "'meeting of the minds' to determine how much discounts will be." *Id.* As such, it is a unilateral restraint imposed by the State of Maryland, with no degree of discretion delegated to private actors. In this respect, the volume discount ban is like rent control ordinances, usury laws, license restrictions limiting the number of taxicabs, license restrictions limiting the number of retail intoxicating beverage licenses, or, finally, laws enforcing the "unquestionably legitimate" three-tier system by restricting wholesaler sales to licensed retailers only. *See Granholm v. Heald*, 544 U.S. 460, 489 (2005). All of these arrangements would be prohibited by the Sherman Act if established through private agreement. All are unquestionably valid when imposed by law. *See,* e.g., *Fisher v. City of Berkeley,* 475 U.S. 260 (1986); *Massachusetts Food Ass'n v. Massachusetts Alcoholic Beverages Control Commission*, 197 F.3d 560, 566 (1st Cir. 1999).

The District Court focused exclusively on whether the challenged laws had an anticompetitive effect rather than whether they facilitated

private collusion. This approach has been rejected by many courts. *See Massachusetts Food Ass'n v. Massachusetts Alcoholic Beverages Control Commission*, 197 F.3d 560, 564-65 (1st Cir. 1999); *Costco, at 9-10*; *Sanders v. Brown*, 504 F.3d 903, 915-16 (9th Cir. 2007); *Trident International Corp. v. Commonwealth of Kentucky*, 467 F.3d 547, 558 (6th Cir. 2006); *but see A.D. Bedell Wholesale Co., Inc. v. Philip Morris, Inc.*, 263 F.3d 239, 256 (3rd Cir. 2001). The rejection of the "similar effects" argument follows from three Supreme Court decisions. *See Exxon v. Maryland*, 437 U.S. 117, 133 (1978); *Fisher v. City of Berkeley*, 475 U.S. 260, 264 (1986); *Rice v. Norman Williams, Co.*, 458 U.S. 654, 659 (1982).

b. The Post-and-Hold Law Does Not Mandate or Facilitate Price-Fixing and is a Unilateral Restrain Imposed by Law.

The post-and-hold law admittedly poses a more difficult question because it is sometimes confused with a resale price maintenance provision. Nonetheless, even the post-and-hold law does not rise to the level of a hybrid restraint. It does not mandate nor facilitate a private price-fixing agreement that is either authorized or enforced by the state. It likewise does not delegate private regulatory power. *See* Brief of Appellants, at 30-33. Furthermore, it does not constitute "concerted action" within the meaning of the Sherman Act. As such, the post-and-hold law simply is not a *per se* violation of the Act.

Neither *California Retail Liquor Dealers Association v. Midcal Aluminum Dealers*, 445 U.S. 97 (1980) nor *324 Liquor Corp. v. Duffy*, 479 U.S. 335 (1987) apply here. As noted by Judge Luttig in the first appeal of this case,

> I believe it possible, however, although the State of Maryland certainly does not make the argument, that the Supreme Court in *324 Liquor Corp.* misunderstood its own prior precedents in *Fisher v. City of Berkeley*, 475 U.S. 260, 106 S.Ct. 1045, 89 L.Ed 206 (1986), *Schwegmann Bros. v. Calvert Distillers Corp.*, 341 U.S. 384, 71 S.Ct. 745, 95 L.Ed. 1035 (1951), and *California Retail Liquor Dealers Association v. Midcal Aluminum Dealers*, 445 U.S. 97, 100 S.Ct. 937, 63 L.Ed. 233 (1980) in holding that the regulations in that case in fact constituted a so-called hybrid restraint.

TFWS, Incorporated v. Schaefer, 242 F.3d 198, 213 (4th Cir. 2001) (Luttig, J. concurring). The Maryland post-and-hold law is materially different and distinguishable from those hybrid restraints involved in *Schwegmann* and *Midcal* because there is no opportunity for agreement and no concerted action. The Maryland laws also differ from *324 Liquor Corp.*, in which the Court noted that the State had granted private parties a degree of "private regulatory power."[4] In *324 Liquor Corp.*, as in *Midcal*, one tier was

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[4] "At first blush, the statute itself, rather than the wholesaler, seemed to set the retail price, for it prohibited resales at less than 112 percent of the wholesale <u>bottle</u> price. But wholesalers were permitted to charge a <u>case</u> price that was less than the bottle price multiplied by the number of bottles in a case. The wholesale bottle price was, in effect, a fictitious number that could be manipulated as wholesalers desired – independently of the case

authorized to set the minimum sale price for a lower-tier transaction, i.e. engage in resale price maintenance. Maryland law provides no such grant or authorization. In Maryland, there is no agreement and no delegation of private regulatory authority. There is only law, unilateral law[5].

In addition, *324 Liquor Corp.* involved a challenge to vertical restraints. The Supreme Court has never found Sherman Act preemption, in the absence of an agreement, in a case involving horizontal restraints. This is not surprising. After all, private parties, whose actions are not accorded the deference provided to state law, do not violate the Sherman Act when they engage in parallel pricing.

The court below determined that the post-and-hold law was *per se* illegal and thus preempted by the Sherman Act. This analysis was based on *Dr. Miles* and the *per se* illegality of resale price maintenance. "All three of these cases," – *Schwegmann, Midcal*, and *324 Liquor Corp.* – upon which the court based its earlier decision in this case, "dealt with the liquor or wine

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prices they actually charged retailers – to fix the retail price they desired." I. Philip Areeda and Herbert Hovencamp, *Antitrust Law.*

[5] A state need not show it "actively supervises" private parties, as long as the state itself, acting as sovereign, created the restraint of trade. *See Hoover v. Ronwin*, 466 U.S. 588, 568-69 (1984); *City of Columbia v. Omni Outdoor Advertising, Inc.*, 499 U.S. 365, 377-79 (1991); *Sanders v. Brown*, 504 F.3d 903, 915-16 (9th Cir. 2007). *Hoover*, or *Omni*, rather than *Midcal* and *324 Liquor Corp.*, therefore establishes the standard by which Maryland's laws and regulations are reviewed.

industry and some form of state-sanctioned resale price maintenance." *TFWS, Inc. v. Schaefer*, 242 F.3d 198, 208 (4th Cir. 2001).

With *Leegin Creative Leather Products, Inc. v. PSKS*, 127 S.Ct. 2705 (2007), the Supreme Court overturned *Dr. Miles*, ruling that minimum resale price maintenance would no longer always be viewed as *per se* illegal, but would in the future be reviewed under a *rule of reason* analysis. This fundamental change in antitrust jurisprudence alters the analysis conducted in *Schwegmann, Midcal*, and *324 Liquor Corp.* – cases which the lower court relied upon for the basis of its hybrid restraint analysis.

c. **Federal and State Intoxicating Liquor Regulatory Schemes Impliedly Preclude Application of the Sherman Act.**

This Court, when taking a fresh review of the governing legal standards, should also consider the Supreme Court's recent decision in *Credit Suisse v. Billing*, 127 S.Ct. 2583 (2007). In that case, the Court was asked to determine whether federal securities laws – which do not explicitly exclude application of the antitrust laws – impliedly exclude their application in the context of conduct otherwise regulated by securities laws. *Id.* at 2389. The Court applied for a four-part test:

1. Is there authority under the federal and state alcohol beverage regulatory schemes which addresses the challenged conduct;

2. Does the federal government and State of Maryland exercise that authority;

3. If both the Sherman Act and the Maryland alcohol beverage statutes applied, would there be a risk of conflicting results; and

4. Does that challenged conduct fall squarely within the area that the regulatory authorities are designed to regulate.

Id. at 2392. The Court held that securities laws impliedly exclude application of federal antitrust law. *Credit Suisse* illustrates that judicial consideration of an antitrust preemption challenge must examine all relevant federal law and the general regulatory environment, as well as the Sherman Act, in determining the intent of Congress. As set forth below, the challenged laws are consistent with the policies and provisions of the Webb-Kenyon Act, the Federal Alcohol Administration Act, the Sober Truth on Preventing Underage Drinking Act ("STOP Act"), and the Robinson-Patman Act. Applying *Credit Suisse* analysis, this Court should find that the federal and state regulatory schemes impliedly precludes application of federal antitrust law, including the Sherman Act.

6. The Challenged Regulations are Shielded by the Twenty-First Amendment.

The scope of state power to regulate intoxicating liquor under the Twenty-first Amendment, when in apparent conflict with federal law, has

been the subject of several Supreme Court cases. *See*, e.g. *North Dakota v. United States*, 495 U.S. 423 (1990); *324 Liquor Corp. v. Duffy*, 479 U.S. 335 (1987); *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691 (1984); *California Retail Liquor Dealers Association v. Midcal Aluminum Dealers*, 445 U.S. 97 (1980). The Court has repeatedly recognized that Section 2 of the Twenty-first Amendment "grants the states virtually complete control over whether to permit importation or sale of liquor and how to structure the liquor distribution system." *Midcal*, 445 U.S. at 110.

State liquor laws enjoy a unique legal status under the Constitution and, "[g]iven the special protection afforded to state liquor control policies by the Twenty-first Amendment, <u>they are supported by a strong presumption of validity and should not be set aside lightly</u>." *North Dakota*, 495 U.S. at 433 (emphasis added) (also citing *e.g. Capital Cities Cable, Inc. v. Crisp*, 467 U.S. at 714). This constitutional deference to state liquor control policies not only gives rise to a strong presumption of validity but also imposes the burden of proof on those challenging the policies. Because the Supreme Court has imposed not just a presumption of validity but a "strong presumption of validity", the party challenging the state liquor control policy must establish its invalidity by "clear and convincing evidence" or at least "substantial evidence." Without allocating the burden of proof in this fashion, the "strong presumption" would have no meaning.

a. **<u>The District Court Erred in the Application of the Burden of Proof.</u>**

Notwithstanding the unequivocal language in *North Dakota*, the District Court held that the State bore the burden of proof to demonstrate that the challenged regulations were shielded by the Twenty-first Amendment.[6] Accordingly, not only did the lower court fail to require "clear or convincing" or at least "substantial" evidence that the challenged regulations did not promote temperance, create or maintain orderly markets, or further other legitimate state goals, it actually imposed the burden on the state to establish these causal relationships. As such, the District Court acted in a manner inconsistent with Supreme Court jurisprudence respecting the special status conferred on those regulations by the Twenty-first Amendment of the U.S. Constitution.

b. **<u>The District Court Erred in its Interpretation of the Twenty-first Amendment as Applied in This Case.</u>**

Regarding the State's Twenty-first Amendment defense, the District Court's formulation of the applicable legal standard was simply incorrect. The Court engaged in a subjective analysis of whether and to what extent the "regulatory scheme" was "effective". This analysis is not only hostile to the

[6] The District Court ignored the strong presumption of validity mandated by *North Dakota v. United States*, 459 U.S. 423 (1990) because it erroneously believed that the case was decided under the dormant commerce clause. *North Dakota*, however, was decided under the Supremacy clause which is ultimately at issue here.

Supreme Court's dictate that such policies are entitled to a "strong presumption of validity", but it also results in the substitution of one judge's opinion on an important policy question of public health for that of the Maryland Legislature. To be consistent with the Supreme Court decisions in *Midcal* and *324 Liquor Corp.,* "effective" must necessarily mean only that the law has an "effect" or bears some relationship to the State's interests under the Twenty-first Amendment, not that it is the best means among all policy alternatives to achieve that result. As expressed by the *Costco* court, that means "showing some degree of fit between [that state's] interests and its regulatory scheme". *Costco* at 20, n.24.

The legal standard that should have governed the validity of the challenged regulations was that outlined by the Supreme Court in *California Retail Liquor Dealers Association v. Midcal Aluminum Dealers* 445 U.S. 97 (1980) and *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691 (1984). That standard was framed by the Court as follows:

> [W]hether the interests implicated by a state regulation are so closely related to the powers reserved by the Twenty-first Amendment that the regulation may prevail, notwithstanding that its requirements directly conflict with express federal policies. As in *Hostetter* and *Midcal Aluminum*, resolution of this question requires a "pragmatic effort to harmonize state and federal powers" within the context of the issues and interests at stake in each case.

Capital Cities, 467 U.S. 691, 714 (citing *Midcal*, 445 U.S. at 109).[7]

The *Midcal* standard requires a court to examine whether there is a demonstrated effect between the "interests implicated by a state liquor regulation" and the state's core powers reserved by the Twenty-first

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[7]In *Midcal,* the Supreme Court affirmed California state court decisions that invalidated a resale price maintenance scheme. The Supreme Court saw no reason not to accept a state court finding in an earlier case that there was no evidence that the challenged laws did not serve the purposes that the state had claimed they did. The state actually only half-heartedly defended its laws, and was not even a party to the appeal to the Supreme Court.

The Court treated the New York laws and regulations at issue in *324 Liquor Corp.* as very similar to those rejected in *Midcal,* characterizing them as a resale price maintenance scheme. The New York Court of Appeals had upheld the regulatory scheme. The New York court, however, like that in California, had found that temperance was not directly advanced because per capita consumption was increasing. It did find that support of small retailers, another avowed interest, was advanced by the scheme. The Supreme Court saw no reason to disagree with the state court in its rejection of temperance as an interest sufficient to justify the challenged statutes and rules. It rejected the New York court's conclusion that the support of small retailers gave the challenged provisions a safe harbor. It found that part of the scheme actually undercut and threatened the viability of small retailers. This was because it found that, while the statutory mandate of minimum mark-ups did tend to protect small retailers, the rule that permitted post-offs in case purchases by retailers worked to the disadvantage of small retailers. Large retailers, by buying in bulk, could use their purchasing power to reduce their costs and increase their profit margins, given that the mandated minimum mark-up was based on the unreduced bottle and not the reduced case price. This worked to the long-term disadvantage of small retailers. To the Court, it was clear that the challenged rule did not tend to advance the State's professed justification for its regulation. The Court was not substituting its judgment on the effectiveness of the law for that of the legislature. The Court did not weigh the effect of the law and find it to be insufficient. It either found that there was no effect or that the law actually worked to frustrate rather than achieve its professed purpose.

Amendment. If that effect exists, the regulation in question is shielded from challenge and must be sustained.

In its last two opinions, the District Court misconstrued and misapplied the *Midcal* standard. The District Court did not confine itself to an examination of whether there was a demonstrated effect between the interests underlying the regulation and the State's core Twenty-first Amendment powers. Rather, the Court engaged in a subjective analysis of how well the regulations served State interests. In addition, while the District Court purported to examine the extent to which the challenged regulations served the state interests, it specifically refused to examine the extent to which the challenged regulations "damaged" the federal interest in competition and further failed to examine any federal interest other than competition. Accordingly, it could not meaningfully balance or harmonize those interests. *TFWS, Inc. v. Schaefer*, 2007 W.L. 2917025 (D.Md.), at 8. As such, the Court inappropriately substituted its judgment on policy for that of the Maryland Legislature.

Here, the challenged regulations unquestionably have an effect on, and show some degree of fit with, the State's interests in regulating the distribution and sale of intoxicating liquor, promoting temperance, and maintaining orderly markets, all of which are at the core of the State's interests under the Twenty-first Amendment. *See Midcal,* 445 U.S. at 109;

North Dakota, 495 U.S. at 423. If the Court had adopted the correct legal standard, accorded the proper presumption of validity, and imposed the appropriate burden of proof, the challenged regulations would have been upheld. For instance, the Court found that the price of wine and liquor in Maryland was at least somewhat higher by virtue of the challenged regulations. *TFWS, Inc. v. Schaefer*, 2007 W.L. 2917025 (D.Md.) at 9. The Court further found, and indeed both parties agreed, that price increases led to proportionate decreases in consumption. Indeed, as noted by the National Institute on Alcohol Abuse and Alcoholism ("NIAAA"), Maryland has one of the lowest per capita consumption rates for alcohol in the country. *See* NIAAA Study, Surveillance Report #82, Apparent Per Capita Alcohol Consumption: National, State, and Regional Trends, 1977-2005, at 26 (August 2007). Finally, the Court noted that there were no reliable studies on the role that the regulations played in achieving temperance rates. *Id.*

Accordingly, there was a measurable effect of the challenged laws on, and some degree of fit with, the State's temperance interest under the Twenty-first Amendment. This distinguishes this case from *Midcal* and *324 Liquor Corp. See* n. 6 *supra*. The District Court should have required TFWS to show that these laws played no role in the achievement of one of the country's lowest rates of per capita consumption.

Finally, the Court ignored the State's interest in orderly markets. The Supreme Court, however, has expressly acknowledged the validity of "orderly markets" as a goal of liquor regulation. *See e.g.*, *North Dakota v. United States*, 495 U.S. 423 (1990). Such markets discourage irresponsible speculation, trade practice violations, and undue sale pressure which upset a level, retail playing field and jeopardize the financial viability of many retailers.

7. **The District Court Erred by Misconstruing the State's Interests, by Failing to Consider the Multitude of Federal Interests.**

a. **The Purpose of Maryland's Post-and-Hold Law and Volume Discount Ban.**

While preserving competition, the challenged laws create a level, economic playing field among retailers by guaranteeing that the terms and conditions of sale by each supplier and wholesaler must be offered equally to its retailers. This prevents large retail chains from achieving monopolistic domination of the sale of intoxicating liquor, thereby promoting stability at the retail tier and reducing pressure to stimulate sales and marketing incentives to consumers. Without these laws, there would be significant disruptions in the retail market.

Second, not only does stabilizing the market preserve competition in the long run, but it also serves the goal of temperance. The stability achieved by the challenged regulations make it less likely that smaller

retailers will face such economic pressure that they will resort to selling practices that are outside the letter, and also the spirit, of the law. They are also less likely to market aggressively to "get rich quick" before their circumstances become untenable. Furthermore, a locally-based liquor retailer will be more accountable to liquor regulatory authorities as well as more responsive to positive and responsible local social influences.

Third, by their nature, volume discounts may encourage retailers to purchase excessive inventories which again would create incentives to sell to minors, or otherwise violate the law. Uniformly prohibiting such discounts serve society's interest in temperance and orderly markets.

Maryland's intoxicating liquor laws are working. Maryland has a lower per capita consumption rate than a majority of states and its position vis-à-vis other states continues to improve. *See* NIAAA, *supra*, at 26. No one disputes the inverse relationship between price and consumption. Similarly, it is uncontested that the challenged laws have some impact on price. It is the extent of the increase that is disputed. Under these circumstances, surely there is a measurable effect or some degree of fit between the challenged laws and Maryland's consumption patterns.

The post-and-hold laws are one way of ensuring compliance with nondiscrimination laws. By requiring suppliers and wholesalers to post and hold their prices, regulators have a means of enforcing the nondiscrimination

laws. In this sense, the post and hold laws (at least as to the "hold"), are ancillary to the nondiscrimination laws.

b. <u>By Striking Down the Challenged Laws, the District Court Failed to "Harmonize" the Federal and State Interests Implicated by the Regulations.</u>

The U.S. Supreme Court requires that when a state liquor regulation is challenged under federal law the court must make a "'pragmatic effort to harmonize state and federal powers' within the context of the issues and interests at stake in each case." *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691, 714 (1984) (quoting in part *Midcal*, 445 U.S. at 109). The District Court failed to make such an effort here. While it did purportedly assess the effectiveness of the challenged laws with respect to the State's interests, the District Court pointedly refused to assess the actual impact of the challenged laws on the goals underlying the Sherman Act (i.e. competition). In light of its holding that the challenged laws had little impact on price, the effect of the challenged laws on competition was obviously negligible. Furthermore, the **only** federal interest identified, considered, and analyzed by the District Court was "the federal interest in promoting competition." *TFWS, Inc. v. Schaefer*, 2007 W.L. 2917025 (D.Md.). Unfettered competition, however, has never been the goal of intoxicating liquor regulation.

There were other, substantial federal interests implicated by these laws, however, namely those underlying the Webb-Kenyon Act, the Federal

Alcohol Administration Act, the Robinson-Patman Act, and the STOP Act. The Webb-Kenyon Act evidences the continuing Federal interest in promoting the effectiveness of state alcoholic beverage regulation. In pertinent part, the Federal Alcohol Administration Act embodies tied-house prohibitions (27 U.S.C. § 205) which are consistent with and well served by the challenged laws. Similarly, the Robinson-Patman Act embodies non-discrimination provisions (15 U.S.C. § 13a) which are consistent with and well served by the challenged laws. Finally, Congress in 2006 enacted the STOP Act. This law amends section 519B of the Public Health Service Act with the following language:

> (7) Alcohol is a unique product and should be regulated differently that other products by the States and Federal Government. States have primary authority to regulate alcohol distribution and sale, and ***the Federal Government should support and supplement these State efforts.*** States also have a responsibility to fight youth access to alcohol and reduce underage drinking. ***Continued State regulation and licensing of the manufacture, importation, sale, distribution, transportation and storage of alcoholic beverages are clearly in the public interest*** and are critical to promoting responsible consumption, preventing illegal access to alcohol by persons under 21 years of age from commercial and non-commercial sources, maintaining industry integrity and an orderly marketplace, and furthering effective State tax collection.

Pub.L.No. 109-422, 120 Stat. 2890, amending 42 U.S.C. 290bb-25b (emphasis added). This is an explicit expression by Congress that unfettered

competition is not its goal with regard to the distribution and sale of alcoholic beverages.

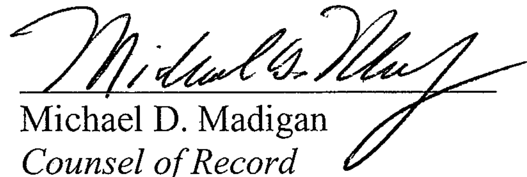
Not only did the District Court ignore these equally important federal interests, it also entirely discounted the fact that these laws serve at least some of the Sherman Act's goals by preventing monopolization in the socially sensitive liquor industry, by prohibiting vertical integration in the manufacturing, distributing, and retailing tiers, and by promoting a level, economic playing field in alcohol markets. No matter where the burden of presumption is placed, the District Court should have upheld the challenged laws had it accurately assessed the federal interest in the regulation of intoxicating liquor in general and in state regulation of intoxicating liquor in particular.

Conclusion

For the foregoing reason, NBWA and WSWA urge the Court to reverse the District Court in all respects.

Respectfully Submitted,

Dated: Feb 6, 2008



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STATEMENT OF RELATED CASES

So far as is known to *Amici Curiae* National Beer Wholesalers Association and Wine & Spirits Wholesalers of America, Inc. there are no related cases pending in the Fourth Circuit Court of Appeals.

CERTIFICATE OF COMPLIANCE WITH RULE 32(a)

Pursuant to Fed. R. App. P. 29 (d) and 9th Cir. R. 32-1 the attached amici brief is proportionally spaces, has a typeface of 14 points or more, including footnotes, and contains 6,994 words excluding the parts of the brief exempted by Fed. R. App. P. 32(A)(7)(B)(iii).

Feb. 6, 2008
Date

Signature of Filing Party