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-Appellees.

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

BRIEF OF APPELLANTS

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JURISDICTIONAL STATEMENT

In this action for declaratory and injunctive relief asserting preemption of state laws by § 1 of the Sherman Act, 15 U.S.C. § 1, the district court had subject matter jurisdiction under 28 U.S.C. §§ 1331 and 1337(a). This Court has jurisdiction under 28 U.S.C. § 1291 to review the district court's final order, dated September 27, 2007, disposing of all parties' claims, declaring the challenged laws preempted, and issuing

a permanent injunction. A timely notice of appeal was filed on October 26, 2007. (VII J.A. 5680.)

ISSUE PRESENTED FOR REVIEW

Did the district court err by invalidating the challenged Maryland alcoholic beverage laws, where the State substantiated its justification for those laws in serving the core Twenty-first Amendment interests of promoting temperance and encouraging orderly market conditions for the distribution of alcoholic beverages and where no irreconcilable conflict exists between the promotion of those interests and the federal interests at stake?

STATEMENT OF THE CASE

This is the fourth appeal in this case. In June 1999, the plaintiff, TFWS, Inc., filed a one-count complaint for declaratory and injunctive relief against officials of the State of Maryland, alleging that two aspects of the State's alcoholic beverage distribution laws and their implementing regulations violate and are preempted by § 1 of the Sherman Act. (I J.A. 15, 16, ¶¶ 1, 3, 4.) Specifically, the suit challenged §§ 12-102 and 12-103 of Article 2B of the Maryland Code and Code of Maryland Regulation ("COMAR") 03.02.01.05, to the extent that those provisions (1) authorize the prohibition of quantity discounts by wholesalers of wine and liquor in sales to retailers (the "volume discount ban") and (2) require wholesalers of wine and liquor

to file with the regulatory authority each month the prices for each product offered and to adhere to those prices for the month (the "price filing system" or "post-and-hold requirement"). (I J.A. 18-24.) TFWS's complaint alleged that the enforcement of the challenged laws "constitutes a *per se* violation of section 1 of the Sherman Act" because those laws:

- "encourage inter-brand price fixing and stabilization, both horizontally and vertically";
- "artificially inflate wholesale prices for wines and liquors in the State of Maryland"; and
- "stabiliz[e]" and "rais[e] the wholesale prices for wines and liquors over and above the levels that would exist absent . . . enforcement."

(I J.A. 23-25, ¶¶ 14, 19, 20, 23.) TFWS alleged that these effects of the volume discount ban and the price filing system would require TFWS to "purchase its inventory at wholesale prices higher than would otherwise prevail, and to sell wines and liquors to its own retail customers at correspondingly higher prices, thereby losing sales volume. . . ." (I J.A. 25-26, ¶¶ 21, 24).

A. PROCEEDINGS IN TFWS I.

On the State's motion to dismiss the complaint, the district court held that the challenged laws constituted a *per se* violation of § 1 of the Sherman Act and rejected defenses asserted by the State, including the state-action immunity doctrine and the

absence of concerted action by the regulated private entities. (I J.A. 28-39.) The district court nevertheless dismissed the complaint, on the ground that the State's alcoholic beverage distribution regulations were "'rescue[d] . . . from preemption'" because they "serve[] a strong state concern" at the "'core of the State's power under the Twenty-First Amendment.'" (I J.A. 40, 43.)

TFWS appealed. This Court affirmed the determination of a *per se* Sherman Act violation based on TFWS's allegations that the State's regulatory scheme "restrains competition by allowing wholesalers to do two things: (1) match each other's prices at artificially high levels and (2) maintain those high prices." *TFWS, Inc. v. Schaefer*, 242 F.3d 198, 203 (4th Cir. 2001) ("*TFWS I*"). With respect to the Twenty-first Amendment defense, this Court observed that the trial court had based its analysis on "'rational perception and common sense' and 'upon facts extant in the real world,'" *id.* at 211 (quoting I J.A. 43), and that TFWS had not had the "opportunity to challenge these observations and conclusions," 242 F.3d at 212. This Court therefore vacated and remanded to permit the parties to "offer evidence and argument" regarding the Twenty-first Amendment defense. *See id.* at 212-13. The district court was directed to perform a three-step inquiry: (1) "examine the expressed state interest and the closeness of that interest to those protected by the Twenty-first Amendment," (2) "examine whether, and to what extent, the regulatory

scheme serves its stated purpose," and (3) "balance the state's interest in temperance (to the extent that interest is actually furthered by the regulatory scheme) against the federal interest in promoting competition under the Sherman Act." *Id.*

B. PROCEEDINGS IN TFWS II.

On remand, the State filed its answer, admitting each of TFWS's allegations regarding the impact of the volume discount ban and price filing system in elevating and stabilizing prices and their consequent effect of discouraging sales and consumption of wine and liquor. (I J.A. 49-54, ¶¶ 14, 19-21, 24.) After discovery, the district court entertained cross-motions for summary judgment. The court conducted the three-part analysis set forth in *TFWS I* and granted summary judgment for the State. *See TFWS, Inc. v. Schaefer,* 183 F. Supp. 2d 789 (D. Md. 2002).

TFWS again appealed, arguing that the court had improperly relied on disputed evidence in upholding the State's Twenty-first Amendment defense. *See TFWS, Inc. v. Schaefer*, 325 F.3d 234, 236 (4th Cir. 2003) ("*TFWS II*"). With respect to the first step of the analysis, this Court agreed with the district court's conclusion that the challenged laws' "express purpose of 'fostering and promoting temperance' and 'eliminat[ing] the undue stimulation of the sale of alcoholic beverages,'" constitutes "a proper objective under the Twenty-first Amendment." *TFWS, Inc. v. Schaefer* (*"TFWS II"*), 325 F.3d 234, 236-37 (4th Cir. 2003) (citing Md. Code Ann. art. 2B,

§§ 1-101(a), 12-102(a), 12-103(a)). With respect to the second step of the analysis, however, this Court determined that the district court had impermissibly engaged in factfinding at the summary judgment stage when it credited the empirical and theoretical evidence presented by the State's expert economists over that of the economist retained by TFWS. *See TFWS II,* 325 F.3d at 242. Accordingly, the Court reversed the ruling of the district court concluding that the State had "adequately substantiated" its Twenty-first Amendment defense, 183 F. Supp. 2d at 794, and the case was remanded a second time.[1]

C. PROCEEDINGS IN TFWS III.

The district court conducted a five-day trial, during which both parties' experts testified and presented analyses of the correlation between trends in price and consumption levels for alcoholic beverages and a state's implementation of regulations like the laws at issue in this case. Three weeks after the conclusion of trial, TFWS filed a motion to supplement the record, which the court granted the following day. (II J.A. 1132, 1141.) TFWS submitted Plaintiff's Exhibits 93 and 94 (VI J.A. 4689-4752, 4753-4754), two sets of price comparisons that were compiled by employees of TFWS owner David Trone at his direction and for purposes of the

[1] On remand, the case was reassigned from Judge Frederic N. Smalkin – who had taken senior status while the appeal was pending – to Judge William D. Quarles. (I J.A. 5.)

litigation (II J.A. 1134), that had not been disclosed before or during trial (I J.A. 114-16, III J.A. 2562-63, 2568-69, IV J.A. 2795, 2798), and that had not been reviewed or relied upon by TFWS's expert economist (VII J.A. 4907-11). The State then submitted an affidavit by health economist Frank J. Chaloupka, Ph.D., who opined that the analyses in TFWS's Exhibits 93 and 94 would not satisfy generally accepted requirements for price comparisons conducted by economists. (II J.A. 1142; IV J.A. 3628-3639.)

After the parties submitted proposed findings (II J.A. 1143-88, 1189-1237), the district court issued an opinion and order, finding that the volume discount ban and price filing system do not affect prices, declaring them preempted under the Sherman Act, and permanently enjoining their enforcement. *See TFWS, Inc. v. Schaefer,* 315 F. Supp. 2d 775 (D. Md. 2004) (II J.A. 1238-1251). In its opinion, the district court discussed evidence, based on regression analyses, that examined the experience of neighboring Delaware over a decade-and-a-half period, during which it abandoned its similar volume discount ban and relaxed its price filing requirement; the court observed that, following Delaware's 1992 regulatory changes, retail price trends in Delaware and Maryland "began to diverge," with Delaware experiencing lower prices than Maryland. *Id.* at 778 (II J.A. 1243). Ultimately, however, the district court relied primarily on the lay analysis contained in TFWS's Exhibit 94 in finding that,

over a seven-month period in 2003, the Maryland wholesale price "was lower than the lowest Delaware quantity discount price for 67.5 percent" of the 40 products selected by TFWS for comparison. *Id.* at 779-81 (II J.A. 1243-49). The district court thus concluded "that the post-and-hold and quantity discount ban regulations do not increase Maryland liquor prices." *Id.* at 782 (II J.A. 1249).

Because the district court concluded that the challenged laws do not raise and stabilize prices as alleged, the court considered it unnecessary to examine whether the regulations affect consumption, thereby serving Maryland's interest in temperance and orderly market conditions for alcoholic beverages. As a consequence, the district court did not proceed to the third step of the analysis set forth in *TFWS I* by balancing the State's interest in serving these objectives against the federal interests embodied in the Sherman Act.

The State appealed, arguing that the trial court had erred by improperly crediting inadmissible lay analyses over other evidence in the record and the testimony of the State's expert health economists in overturning a legislative judgment made within the powers conferred by the Twenty-first Amendment and in reaching a conclusion that was incompatible with the allegations of the complaint and its premise of an anti-competitive regime subject to challenge under the Sherman Act. *See* Brief of Appellants, 2005 WL 871015. In addition to procedural and evidentiary

objections to the lay analyses contained in post-trial Exhibits 93 and 94, the State pointed to three basic forms of error that infected the analyses and rendered them unreliable. *See id.* at 15-16. Specifically, the State argued, TFWS's wholesale price comparisons suffered from:

> (1) *measurement error* because they employed an outlier analysis, comparing the lowest monthly price for a product in each state over the observed period, regardless of the prices for the product in other months during that period;
>
> (2) *selection bias* because TFWS had provided no explanation of the basis for its selection of the 40-product sample in Exhibit 94 or the subset of its product inventory in Exhibit 93, and had not shown that its inventory and sales patterns were representative of the market as a whole in either state; and
>
> (3) *omitted variable error* because the comparison of wholesale prices in the two states failed to account for a significant explanatory variable – namely the large difference in excise tax levels in the two states, which are assessed at the wholesale level and reflected in retail prices to consumers.

See id. at 15-27.

This Court vacated and remanded for a third time. *TFWS, Inc. v. Schaefer*, 147 Fed. Appx. 330 (4th Cir. 2005) ("*TFWS III*"). The Court found that the price comparisons drawn from TFWS's post-trial Exhibits 93 and 94, upon which the district court had "relied heavily," were not "sufficiently reliable to provide an indication of the effect the challenged regulations have on Maryland prices." *TFWS III,* 147 Fed. Appx. at 333, 335. Having "examined all of the evidence in this case," the Court concluded that, aside from Exhibits 93 and 94, which failed to account for the excise differential, "there is no evidence showing that . . . the challenged

regulations do not raise prices." *Id.* at 335. "In fact," the Court stated, its review had "found only evidence to the contrary . . . which would appear to indicate that the challenged regulations raise prices in Maryland." *Id.*

Because the district court's reliance on these two exhibits was not accompanied by any analysis that would support its decision to ignore the excise differential in evaluating TFWS's price comparisons, this Court directed the trial court to undertake such an analysis and determine the degree to which retail prices reflect excise taxes; if, after doing so, the record continued to show that the challenged laws raise prices, the trial court was to proceed with the remaining steps of the three-part inquiry set forth in *TFWS I* by considering the effect on consumption and balancing the state and federal interests at stake. *See id.* at 335-36.

D. PROCEEDINGS IN TFWS IV.

On remand, the parties' experts submitted supplemental reports to address whether excise taxes should be taken into account in an analysis of wholesale prices designed to evaluate sales and consumption at the retail level. (VII J.A. 4838-70, 5389-5411.) After briefing, the district court issued its September 27, 2007 order, again declaring the challenged laws preempted and entering a permanent injunction. *See TFWS, Inc. v. Schaefer,* 2007 WL 2917025 (D. Md. 2007) (VII J.A. 5655-79). In its opinion, the court rejected TFWS's argument that there was no need to control

for excise taxes. *Id.* at *9 (VII J.A. 5675). The district court discussed the evidence and analyses presented by the parties at trial, as well as revised versions of TFWS's post-trial Exhibits 93 and 94 (VII J.A. 4772-835, 4773-4837), which included calculations adjusting the Maryland wholesale prices to reflect its lower excise tax levels (VII J.A. 4945-48). The court acknowledged limitations in the various sources of price data, but concluded that Exhibit 93A "presented the most reliable analysis of the challenged regulations on wholesale prices." 2007 WL 2917025, at * 9 (VII J.A. 5676). Based on that analysis, the court found that a Maryland retailer purchasing TFWS's 2003 sales volume for the subset of products represented in Exhibit 93A would pay $16,738 more than a Delaware retailer purchasing the same basket of goods, after adjusting for the difference in the two states' excise taxes; the court found that this sum amounted to approximately two cents more per bottle on average. *Id.* at *4, *9 (VII J.A. 5665, 5676).

In assessing the relation between price and consumption, the district court acknowledged "the general economic theory, supported by numerous empirical studies," regarding the elasticity of demand for wine and spirits, but questioned the applicability of the estimates derived from those studies, because "no economic study . . . indicates how a regulatory pricing scheme which causes non-uniform price increases [a]ffects consumption." *Id.* at *6, *9 (VII J.A. 5670, 5676). Proceeding to

the balancing of state and federal interests, the district court concluded that "the State has proven that the challenged regulations have at best only a minimal impact in furthering temperance, which is outweighed by the federal interest in promoting competition under the Sherman Act." *Id.* at *10 (VII J.A. 5677).

This appeal followed. (VII J.A. 5680.)

STATEMENT OF FACTS

TFWS challenges two aspects of the State's regulation of the distribution and pricing of wine and spirits at the wholesale level. The volume discount ban challenged by TFWS in this case is authorized by Article 2B, § 12-103(b) and implemented by COMAR 03.02.01.05B(3)(c), which prohibits "discounts of any nature," including quantity discounts. Section 12-102(a) also prohibits the use of discounts as part of its broad proscription of price discrimination by manufacturers and wholesalers. The price filing system is created by Article 2B, § 12-103(c) and implemented by COMAR 03.02.01.05B–D. These provisions are part of "a comprehensive scheme for the regulation, control and distribution of alcoholic beverages within th[e] State," *Coalition for Open Doors v. Annapolis Lodge No. 622,* 333 Md. 359, 371 (1994), through which "the General Assembly has chosen to closely control, with "uncommon precision," even "the more detailed aspects of the alcoholic beverage industry." *Board of Liquor License Comm'rs v. Hollywood*

Prod'ns, Inc., 344 Md. 2, 12, 13 (1996). The overall aim of this comprehensive regulatory scheme is to prevent the "undue stimulation of the sale of alcoholic beverages" and the "disorderly distribution of alcoholic beverages." Article 2B, § 12-102(a). The design of the three-tier distribution system in Maryland that incorporates these regulatory controls is rooted in the concerns that occupied policymakers at both the state and federal level upon the repeal of Prohibition and the ratification of the Twenty-first Amendment.

A. THE HISTORICAL DEVELOPMENT OF MARYLAND'S ALCOHOLIC BEVERAGE DISTRIBUTION AND PRICING REGULATIONS.

On October 6, 1933, two months before the final state ratified the Twenty-first Amendment, John D. Rockefeller, Jr., announced the publication of a study examining various approaches the states might take in regulating liquor following the repeal of Prohibition. *See* Harry Levine, *The Birth of American Alcohol Control,* 12 Contemp. Drug Probs. 63, 86 (1985). The study, commonly referred to as the Rockefeller Report, proposed detailed guidelines for implementation of two alternative plans for liquor control: state-run monopolies and state licensing systems. *See* Raymond B. Fosdick & Albert L. Scott, *Toward Liquor Control* (1933). The ideas expressed by the Rockefeller Report "were the dominant ideas which took flesh in the post-repeal legislation of the states." Dunsford, *State Monopoly and*

Price-Fixing in Retail Liquor Distribution, 1962 Wis. L. Rev. 454, 464. Maryland, like a majority of the states, chose to implement a three-tier licensing system that incorporated many of the ideas contained in the Rockefeller Report. *See* 1933 Laws of Maryland ch. 2 (Special Sess.) (enacting Article 2B).

The statutes implementing a three-tier regulatory system, "sought to forestall the generation of such evils and excesses as intemperance and disorderly marketing conditions that had plagued the public and the alcoholic beverage industry prior to prohibition." *California Beer Wholesalers Ass'n v. Alcoholic Beverage Control Appeals Bd.,* 487 P.2d 745, 748 (Cal. 1971). According to the Rockefeller Report, the "profit motive [was] the core of the problem" because it encouraged low prices that stimulated liquor consumption. Fosdick & Scott, at 52, 149. The so-called "tied house" system that had flourished in the years before Prohibition, in which retail establishments were owned or controlled by brewery, distillery or wholesaler interests, was to "be prevented by all available means" because of "its effect in stimulating competition in the retail sale of alcoholic beverages." *Id.* at 43. The three-tier regulatory system combatted the tendency toward vertical integration exemplified by the tied house: "Manufacturing interests were to be separated from wholesale interests [and] wholesale interests were to be segregated from retail interests." *California Beer Wholesalers,* 487 P.2d at 748.

When first adopted in 1933, Article 2B, like the federal Code of Fair Competition and the laws of other States, sought to eliminate the tied-house (§ 33) and made it unlawful for a manufacturer or wholesaler to "lend any money or other thing of value, or make any gift or to offer any gratuity to any retail dealer." (§ 28). As experience grew with the laws enacted directly after Repeal, regulators observed that suppliers and wholesalers were "endangering the independence of retailers by providing lavish credit," resulting in the adoption of "more detailed tied-house regulation." Stephen Diamond, "The Repeal Program," in *Social and Economic Control of Alcohol: The 21st Amendment in the 21st Century* 107 (Carole L. Jurkiewicz & Murphy J. Painter, eds. 2008). Maryland officials experienced firsthand the difficulty of "distinguishing price concessions from gifts of money," and additional legislation was determined to be necessary to enable the State to "take the position that all such secret concessions involve the giving of money or something of value." Joe de Ganahl, "Trade Practice and Price Control in the Alcoholic Beverage Industry," 12 Law & Contemp. Probs. 665, 675, 677 (1940) (III J.A. 1864, 1874, 1876).

In 1943, the General Assembly added provisions prohibiting secret discounts and price discrimination by wholesalers of wine and spirits. *See* 1943 Laws of Maryland ch. 996. However, the legislature rejected proposed language that would

have permitted wholesalers and manufacturers to offer quantity discounts on a limited basis. (III J.A. 1651.) The legislature's stated purpose in enacting the 1943 amendments was to eliminate the "undue stimulation of the sale of alcoholic beverages" and the "disorderly distribution" of such products. (J.A. 1656.) Enforcing a price discrimination prohibition with a price filing requirement, as the federal government chose to do in the Codes of Fair Competition, solved much of the difficulty of policing "thing of value" and inducement prohibitions, by enabling regulators to "take the position that any concessions not conforming to the declared prices would constitute the giving of something of value." De Ganahl, at 677 (III J.A. 1876.) Thus, following the enactment of the anti-discrimination provision that is now codified as Article 2B, § 12-102, Maryland's Comptroller emulated the prior federal model in issuing Regulation 206, which was similar to the price filing requirements now found in COMAR 03.02.01.05. *See Dundalk Liquor Co. v. Tawes* (*Dundalk I*), 197 Md. 446, 453 (1951).

After the Court of Appeals determined that regulations promulgated by the Comptroller were not authorized by the statute, *see id.*, the General Assembly promptly amended the statute to authorize the price filing regulations, *see* 1951 Laws of Maryland chs. 566, 711. The 1951 amendments to the statute declared a policy to regulate the sale of alcoholic beverages "to foster and promote temperance" and

directed that the Comptroller and other State and local officials were to administer the State's liquor laws "for the protection, health, welfare and safety of the people of this State." Article 2B, § 1-101(a). The 1951 amendments also strengthened the prohibitions against price discrimination by requiring advance posting of wholesale prices and adherence to the posted prices for a period of time and by authorizing the Comptroller to limit or prohibit altogether discounts in the sale of wine and spirits. *See Dundalk Liquor Co. v. Tawes* (*Dundalk II*), 201 Md. 58 (1952).

In 1983, the General Assembly again acted to emphasize the public policy aim of preventing price discrimination in the sale of alcoholic beverages. *See* 1983 Laws of Maryland ch. 510. Specifically, the legislature amended Article 2B, in response to developments in antitrust law, to expressly state the legislative intent to regulate the alcoholic beverage market in ways that "may displace or limit economic competition." Article 2B, § 1-101(b). In 1998, the legislature again acted to strengthen the prohibition on price discrimination. *See* 1998 Laws of Maryland, ch. 305. (The bill was approved by votes of 133-0 and 47-0.)

TFWS and its owner, David Trone pursued efforts in the legislature in 1998 and 1999 (I J.A. 585, 634-35; V J.A. 3890), seeking to amend the State's alcoholic beverage laws to permit volume discounts by manufacturers and wholesalers, *see* H.B. 896 (1998 Sess.); S.B. 689 (1998 Sess.); H.B. 575 (1999 Sess.) (III J.A. 1282,

1284, 1286.) The 1998 and 1999 House bills were defeated in committee by votes of 19-2, and the 1998 Senate bill was defeated in committee by a vote of 11-0. In a letter to legislators urging passage of the 1998 legislation, Mr. Trone stated: "Volume discounts mean a lower cost of goods. Every course in economics will state unequivocally that this means the availability of lower prices to the consumer." (III J.A. 2594 (emphasis in original).)

B. THE OPERATION OF THE VOLUME DISCOUNT BAN AND PRICE FILING SYSTEM.

Article 2B, § 12-102(a) prohibits manufacturers and wholesalers from discriminating among retailers in the sale of alcoholic beverages, including wine, spirits, and beer. *See* Article 2B, § 1-102(a). Section 12-103(b) authorizes the Comptroller to prescribe maximum discounts that may be allowed by any manufacturer or wholesaler" of wines and spirits, or, in his discretion, to prohibit discounts "of any and all quantities or kinds of wines and liquors." This provision is implemented by COMAR 03.02.01.05B(3)(c), which prohibits "discounts of any nature," including quantity discounts.[2]

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[2] Maryland's "mini-Robinson-Patman Act" generally prohibits price discrimination, but permits discounts based on quantity if the discount reflects differences in cost and is functionally available to similarly situated purchasers. *See* Md. Code Ann., Com. Law § 11-204(a)(4), (5), (b)(1).

The price filing system is created by Article 2B, § 12-103(c) and implemented by COMAR 03.02.01.05B–D. Under that system, wholesalers submit price schedules to the Comptroller for the products they will carry in a particular month on the 5th day of the preceding month; filings for new brands or new sizes of existing brands are submitted on the 13th day of the preceding month. COMAR 03.02.01.05B(2), C(2). The Comptroller processes and reviews the filed price schedules, which are then made available to the industry, including through publication in the *Maryland Beverage Journal.* COMAR 03.02.01.05D(2). Wholesalers are required to sell to retailers at the prices established in the posted schedule for the month following the filings. COMAR 03.02.01.05B.

Although § 12-103(c) contains language authorizing the Comptroller to issue regulations postponing the effective date of a proposed price decrease in order to allow similar price decreases by competitors, this provision is not implemented. Also, in 1997, the Comptroller repealed the part of the price filing regulation that permitted the filing of amended price schedules to match a competitor's price. *See* 23:26 Md. Reg. 1862, 1863 (Dec. 20, 1996); 24:4 Md. Reg. 290 (Feb. 14, 1997).[3]

[3] The price affirmation provision of § 12-103(c)(1) is not enforced in light of *Brown-Forman Distillers Corp. v. New York State Liquor Authority,* 476 U.S. 573 (1986), and *Healy v. Beer Institute,* 491 U.S. 324 (1989). *See* 17:11 Md. Reg. 1348 (June 1, 1990); 17:15 Md. Reg. 1853 (July 27, 1990).

SUMMARY OF ARGUMENT

This case embodies a paradox because the suit is aimed at invalidating laws that are avowedly intended to limit competition, the challenge is based on the grounds that the laws do in fact limit competition, and the State's defense in turn rests upon its assertion that the laws serve their express and legitimate purpose precisely because they limit compeition. The State of Maryland, as *the defendant*, has been asked to defend its laws by proving that *the plaintiff's* allegations are true, namely, that the challenged laws raise and stabilize prices for alcoholic beverages. The unavoidable consequence of the litigation, then, is to produce what one leading antitrust treatise described as the "*odd result*" that Maryland's alcoholic beverage regulatory scheme "violates the Sherman Act and is not constitutionally immune if it *fails to raise prices,* but is immune if it *does raise them*." 1A Phillip Areeda & Herbert Hovenkamp, Antitrust Law ¶ 218 (2d ed., 2006 Supp.), at 52 n.16 (emphasis added). The result is "odd" because neither of these outcomes would vindicate the asserted federal interest, yet the basis for the challenge to the Maryland laws is federal preemption doctrine, which "enjoins seeking out conflicts between state and federal regulation where none clearly exists." *Exxon Corp. v. Governor of Maryland,* 437 U.S. 117, 130 (1978).

The case is odder still, because Maryland adopted the challenged laws to regulate the manner of distribution of alcoholic beverages within the borders of the

State of Maryland, as an exercise of the State's powers under the Twenty-first Amendment, which "grants the States virtually complete control over . . . how to structure the liquor distribution system." *Granholm v. Heald,* 544 U.S. 460, 488 (2005). The regulations, furthermore, concern transactions between wholesalers and retailers, the lower and intermediate tiers in the State's "three-tier" system, which the Supreme Court has pronounced "unquestionably legitimate." *Id.* at 489. Nevertheless, as the bizarre course of this litigation demonstrates, the legitimacy of these laws has been subjected to – and has withstood – a degree of scrutiny that far exceeds that generally applied to economic legislation affecting ordinary articles of commerce that are not subject to the Twenty-first Amendment.

Within its three-tier system, Maryland has sought to ensure orderly market conditions and to promote temperance by forbidding price discrimination, including price discrimination in the form of volume discounts by wholesalers, and it has created an administrative mechanism to implement and enforce these regulatory controls. The General Assembly has affirmed its intent to displace competition through its regulation of transactions between wholesalers and retailers, and the State has consistently maintained throughout this litigation that the challenged laws *do* serve to limit competition.

The volume discount ban and price filing system do not, however, create an irreconcilable conflict with federal law and they are therefore not preempted. First, the conduct required to comply with the challenged laws – to refrain from providing discounts based on volume purchases, and to submit prices to the Comptroller and adhere to those prices the following month – is conduct that is compelled by the State rather than by an agreement among private actors. In other words, the restraints are unilateral, not hybrid. Accordingly, enforcement of the challenged laws does not create a *per se* violation of the Sherman Act, because neither law "mandate[s] or authorize[s] conduct that necessarily constitutes a violation of the antitrust laws in all cases." *Rice v. Norman Williams Co.,* 458 U.S. 654, 661 (1983). The challenged laws are therefore not subject to preemption on antitrust grounds.

Second, the State has demonstrated that its Twenty-first Amendment interests are advanced by the volume discount ban and price filing system. Under a properly deferential approach to reviewing whether the State's justification for its laws has been adequately substantiated, the answer would clearly be "yes." In fact, however, the answer is even clearer in this case, because the approach that emerged over the course of this litigation for judging the "efficacy" of the challenged laws was utterly lacking in deference to the State's legislative judgments; as a consequence, the justification for those laws has been even more thoroughly substantiated. The district

court's determination that the laws have only a minimal effect on the prices of wine and spirits is no more tenable than its earlier determination that the laws have zero effect on prices. The court's revised conclusion results from the same disregard for the abundant record evidence supporting the State's position and the same deeply flawed analysis that led this Court to reverse, as clearly erroneous, the district court's conclusion finding no price effect in *TFWS III*.

Finally, the balancing of state and federal interests requires a court to review the challenged laws by making a "pragmatic effort to harmonize state and federal powers." *Capital Cities Cable, Inc. v. Crisp,* 467 U.S. 691, 714 (1984). As part of this effort to weigh state and federal interests, "each must be considered in light of the other and in the context of the issues and interests at stake in a[] concrete case." *Bacchus Imports, Ltd. v. Dias,* 468 U.S. 263, 275 (1984). Accordingly, that analysis must take into account that the asserted conflict with the federal interest in competition was established in this case through the operation of a legal presumption, under an increasingly beleaguered *per se* doctrine rather than through the proof that would be required under a rule-of-reason analysis; that the *per se* conclusion was based upon an allegation that the plaintiff has since disavowed and attempted to disparage; that the federal government's interest is broader than the goal of facilitating unfettered competition; and that many important federal interests *coincide*

with the public health and safety interests of the State advanced by its pursuit of core Twenty-first Amendment objectives in ensuring orderly market conditions and promoting temperance.

The State's laws implementing the volume discount ban and price filing system should be upheld.

ARGUMENT

I. STANDARD AND SCOPE OF APPELLATE REVIEW

This Court reviews *de novo* as a question of law whether the challenged State laws are preempted by the Sherman Act, *see Cox v. Shalala*, 112 F.3d 151, 153-54 (4th Cir. 1997) (reviewing *de novo* whether federal Medicare statute preempted state statute), and any related mixed questions of law and fact requiring consideration of legal concepts and underlying values, *see Lewin v. Comm'r of Internal Revenue*, 335 F.3d 345, 349 (4th Cir. 2003). The Court also reviews *de novo* questions as to legislative facts, including those that bear upon "social factors and happenings" not "specifically related to this one case or controversy . . .," such as alcohol beverage regulation and consumption. *Dunagin v. City of Oxford*, 718 F.2d 738, 748 n.8 (5th Cir. 1983) (*en banc*) (addressing correlation between alcohol advertising and consumption); *accord A.L. Lockhart v. McCree*, 476 U.S. 162, 169 n.3 (1986);

Anheuser-Busch, Inc. v. Schmoke, 63 F.3d 1305, 1312 (4th Cir. 1995).[4] In conducting this *de novo* review, a Court may not "substitute [its] evaluation of legislative facts for that of the legislature." *Minnesota v. Clover Leaf Creamery*, 449 U.S. 456, 464 (1981).

The district court's findings of adjudicative facts, *i.e.,* those facts that pertain specifically to "the particular case" at bar, Fed. R. Evid. 201, Advisory Comm. Note, are reviewed for clear error, *see* Fed. R. Civ. P. 52(a)(6). The focus of the clearly erroneous standard "channel[s] [the Court's] review 'upon fact-finding processes rather than directly upon fact-finding results.'" *Jimenez v. Mary Washington College*, 57 F.3d 369, 379 (4th Cir. 1995) (quoting *Miller v. Mercy Hosp., Inc.,* 720 F.3d 356, 361 (4th Cir. 1983)).

As to the scope of this Court's review in this latest of four appeals, "[l]aw of the case directs [the] court's discretion," but "it does not limit the tribunal's power," *Arizona v. California*, 460 U.S. 605, 618 (1983); nor does it supersede this Court's "ultimate responsibility," which is "to reach the correct judgment under law." *American Canoe Ass'n, Inc. v. Murphy Farms, Inc.*, 326 F.3d 505, 515 (4th

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[4]Legislative facts include those having "relevance to legal reasoning and the lawmaking process, whether in the formulation of a legal principle or ruling by a judge or court or in the enactment of a legislative body." *See* Fed. R. Evid. 201, Advisory Comm. Note; *see also United States v. Singleterry*, 29 F.3d 733, 740 (1st Cir. 1994) (citing *A.L. Lockhart*, 476 U.S. at 169 n.3; *Dunagin*, 718 F.2d at 748 n.8; *Menora v. Illinois High Sch. Ass'n*, 683 F.2d 1030, 1036 (7th Cir. 1982).

Cir. 2003). Although in general, prior appellate decisions are to be "followed in all subsequent proceedings in the same case in the trial court or on a later appeal," this Court need not adhere to a previous decision in this case to the extent (1) "a subsequent trial produce[d] substantially different evidence" from what was alleged or understood from the record at the time of the prior decision, (2) "controlling authority has since made a contrary decision of law applicable to the issue," or (3) "the prior decision was clearly erroneous and would work manifest injustice." *United States v. Aramony*, 166 F.3d 655, 661 (4th Cir. 1999). A prior ruling is not binding "if the decision rests on authority that subsequently proves untenable." *Hoffman v. Hunt*, 126 F.3d 575, 584 (4th Cir. 1997).

II. THE REQUIREMENTS FOR COMPLYING WITH THE STATE'S VOLUME DISCOUNT BAN AND ITS PRICE FILING SYSTEM ARE IMPOSED UNILATERALLY, AND NEITHER LAW COMPELS CONDUCT THAT IS A PER SE VIOLATION OF THE SHERMAN ACT.

A. The Court Should Reconsider its Ruling in *TFWS I* that the Challenged Laws Are Hybrid Restraints that Constitute *Per Se* Violations of the Sherman Act.

This Court should exercise its discretion to revisit the preemption analysis in *TFWS I* in light of intervening Supreme Court authority that renders untenable the precedents that were central to the panel's holding and cast doubt on the soundness of its reasoning. In *TFWS I,* this Court held that the State's price filing system was

a hybrid restraint that satisfies the Sherman Act's requirement of "concerted action" by market participants, rather than a restraint imposed unilaterally by the State. *See* 242 F.3d at 208-09. The Court also held that the "volume discount ban is a part of the hybrid restraint because it reinforces the post-and-hold system by making it even more inflexible." *Id.* at 209. The Court proceeded to find that the conduct compelled by the price filing system, characterized as "the exchange of price information" and "adherence to the publicly announced prices," constituted a *per se* violation of the Sherman Act, noting that the Comptroller lacks authority to set prices or review them for reasonableness. *Id.* With respect to the volume discount ban, the Court held that an agreement among competitors "to eliminate discounts . . . falls squarely within the traditional *per se* rule against price fixing," *id.* at 210 (quoting *Catalano, Inc. v. Target Sales, Inc.,* 446 U.S. 643, 648 (1980) (*per curiam*)); the Court concluded that the prohibition of volume discounts imposed by the State therefore also created a *per se* violation of the Sherman Act.

The Court's conclusions were reinforced by its examination of three Supreme Court precedents that had found state laws to be preempted by the Sherman Act as hybrid restraints that created a *per se* violation of the Sherman Act: *324 Liquor Corp. v. Duffy,* 479 U.S. 335 (1987), *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.,* 445 U.S. 97 (1980), and *Schwegmann Bros. v. Calvert Distillers*

Corp., 341 U.S. 384 (1951). *See TFWS I,* 242 F.3d at 206-09. Judge Luttig wrote separately to express his view that Maryland's volume discount ban and price filing system "represent classic unilateral state action, which is, of course, exempt from the Sherman Act," because "there is no voluntary agreement, independently reached, between private parties that is either authorized or enforced by the State." *Id.* at 213-14 (Luttig, J., concurring). Nevertheless, Judge Luttig concluded, the characterization of Maryland's price filing system as a hybrid restraint was compelled by its similarity to the New York regulations at issue in *324 Liquor*. *See id.* at 214.

The State urges the Court to reconsider its prior decision finding the challenged laws to constitute hybrid restraints that create *per se* antitrust violations, because "the decision rests on authority that [has] subsequently prove[d] untenable." *Hoffman,* 126 F.3d at 584.[5] Following the Supreme Court's decision last term in *Leegin Creative Leather Products, Inc. v. PSKS,* 127 S. Ct. 2705 (2007), resale price maintenance is no longer subject to *per se* analysis under federal antitrust law, but must instead be judged under a rule-of-reason standard. That conclusion is directly pertinent to the preemption analysis because a challenge to a state statute on antitrust

[5] The State also continues to maintain (and to preserve the argument for further appellate review) that its laws are immune from TFWS's challenge under the state-action immunity doctrine defined in *Parker v. Brown*, 317 U.S. 341 (1943), contrary to this Court's conclusion in *TFWS I, see* 242 F.3d at 210-11.

preemption grounds can succeed only if "the conduct contemplated by the statute is in all cases a *per se* violation." *Rice,* 458 U.S. at 661. "If the activity addressed by the statute does not fall into that category, and therefore must be analyzed under the rule of reason" (as retail price maintenance must today), preemption is inappropriate. *Id.* Consequently, *Schwegmann, Midcal,* and *324 Liquor* would all be decided differently today, and the laws challenged there would be upheld as valid, because "[a]ll three of these cases," upon which the *TFWS I* decision rested, "dealt with the liquor or wine industry and some form of state-sanctioned *resale price maintenance*." *TFWS I,* 242 F.3d at 208. Thus, the basic hybrid restraint analysis contained in the precedents on which this Court relied has been undermined by the Supreme Court's decision in *Leegin.*

B. The Challenged Laws do not Enforce Private Agreements in Restraint of Trade.

The challenged laws do not serve to conceal concerted action by private actors by "casting . . . a gauzy cloak of state involvement over what is essentially a private price-fixing arrangement." *Midcal,* 445 U.S. at 106. Rather, the pertinent private actors – here, wine and liquor wholesalers – 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). The State's enforcement of the challenged laws therefore does not confer upon "private actors . . . a degree of private regulatory power" that would create a hybrid restraint equivalent to the types of concerted action with which § 1 of the Sherman Act is concerned. *Id.* at 268.

1. The price filing system does not authorize or require private agreements to fix prices.

The price filing system does "require[] wholesalers to set prices and stick to them," *TFWS I,* 242 F.3d at 208-09, but it does not operate in such a way as to allow wholesalers to "match each other's prices" and then have this price-fixing arrangement enforced by the State, *id.* at 198 (reciting allegations in TFWS's complaint). When the wholesalers "set" their prices, they do so independently, not

by reaching an agreement to "match" prices. A wholesaler that finds that the price of one of its products was not set competitively must nevertheless adhere to the price for the filed month. There is an opportunity to try to match the pricing of the competitor the following month, but the competitor may set and file a different price for that month, frustrating the first wholesaler's attempt to engage in parallel conduct.

The pricing decisions made by wholesalers while complying with the price filing system can be analogized to the familiar game of "Rock, Paper, Scissors." In the game, two players show their hands simultaneously in the form of a rock (which can crush scissors), scissors (which can cut paper) or paper (which can cover the rock). One scenario is that both players show the same hand, say "rock." Neither player wins, *i.e.* obtains a competitive advantage. Another scenario involves Player A showing "rock" at the same time that Player B shows "scissors." Player A wins, at least until the next round, which under the price filing system will be played a month hence. To be sure, during that month, Player B is stuck with his hand; the less competitive price-filer has no opportunity during the month to make the competitive move of switching to "paper." But neither can he make the *non*-competitive move of matching Player A by changing his hand to "rock."

A series of games in which two players regularly show the same hand would be consistent with conscious parallelism. But mere "conscious parallelism" or

"parallel conduct" does not establish concerted action, and indeed an allegation of parallel conduct does not constitute "plausible" grounds, under federal antitrust law, for inferring the existence of concerted action sufficient to withstand a motion to dismiss. *See Bell Atlantic Corp. v. Twombly,* 127 S. Ct. 1955, 1964-66 (2007). If the players *agree* beforehand how they will each play their hands, then we have witnessed not merely parallel conduct, but collusion.

In Maryland's price filing system, any agreement among wholesalers to set their prices in a non-competitive fashion would include terms that go beyond what the price filing system requires.[6] In other words, the agreement arises only through concerted action among private actors; any price-fixing would be compelled not by Maryland law, nor by the conferral of "a degree of regulatory power" upon private actors, but by the private actors' concerted action. An agreement to do more than independently set prices might be prosecuted under either the Sherman Act or the Maryland Antitrust Act, *see* Md. Code Ann., §§ 11-201 *et seq*. Such prosecutions have in fact occurred, overcoming unsuccessful arguments by the targets of the prosecutions contending that their private price-fixing arrangements were endorsed by Maryland's alcoholic beverage pricing regulations and protected by the Twenty-

[6] In more than eight years of litigation, there has not been any allegation or evidence of collusion among the entities subject to the price filing system.

First Amendment. *See, e.g., Melrose Distillers, Inc. v. United States,* 258 F.3d 726 (4th Cir. 1958). Indeed, many of the participants in the Maryland alcoholic beverages market, including the two largest wholesalers, remain subject to a consent judgment restricting anti-competitive practices that are not authorized by Maryland law. *See United States v. Maryland State Licensed Beverage Ass'n,* 1958 Trade Cases (CCH) ¶¶ 69,142, 69,213.

While it is conceivable that market participants in the alcoholic beverage industry could reach collusive agreements in restraint of trade, that conduct is prohibited by state law, not compelled by it. The conduct that is actually compelled by the price filing system does not involve the exercise of any "degree of private regulatory power." *Fisher,* 457 U.S. at 268. The law therefore does not create a hybrid restraint, and it is unnecessary to inquire whether it meets the "active supervision" requirement set forth in *Midcal* for laws that constitute hybrid restraints. The price filing system does not create a *per se* violation of the Sherman Act.

2. The volume discount ban is a purely unilateral restraint, and is severable from the price filing system.

Even if this Court adheres to its prior determination that the price filing system is a hybrid restraint, the Court should nevertheless uphold as valid the separate and easily severable volume discount ban. Wholesalers may not offer volume discounts,

and it is clear that this prohibition results from Article 2B, §§ 12-102 and 12-103 and the implementing regulation in COMAR 03.02.01.05B(3)(c), not from a private agreement among the wholesalers. While it may be true, as this Court stated in *TFWS I,* that such an agreement among private parties would be a *per se* violation of the Sherman Act, *see* 242 F.3d at 210, the ban unilaterally imposed by Maryland is another matter: "What is centrally forbidden is state licensing of arrangements between private parties that suppress competition – not state directives that by themselves limit or reduce competition." *Massachusetts Food Ass'n,* 197 F.3d at 565.

The price filing system facilitates monitoring and enforcement of the volume discount ban (and the State's other restrictions on price discrimination), but the volume discount ban can stand on its own. Standing alone, it is clearly a unilateral restraint, prohibiting price discrimination; the Supreme Court upheld a similar prohibition on selective discounting against a Sherman Act challenge in *Exxon.* 437 U.S. 117. This Court has held 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 into place pursuant to its powers under the Twenty-First Amendment." *Beskind v. Easley,* 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 and upholds the volume discount ban, even if the price filing system is invalidated. *See* Md. Ann. Code art. 2B § 1-104; *see also Board of Supervisors of Elections v. Smallwood,* 327 Md. 220, 245-46 (1992) ("There is a strong presumption that if a portion of an enactment is found to be invalid, the intent is that such portion be severed. . . . Inclusion of a severability clause [in the statute] reinforces the presumption."); *cf. Leavitt v. Jane L.,* 518 U.S. 137 (1996) (*per curiam*) (reversing decision failing to apply state severability law).

III. THE TWENTY-FIRST AMENDMENT JUSTIFICATION FOR THE STATE'S VOLUME DISCOUNT BAN AND PRICE FILING SYSTEM HAS BEEN AMPLY SUBSTANTIATED.

A. The Course of this Litigation Has Departed From Appropriate Standards of Deference to State Legislative Judgments Concerning the Regulation of Alcoholic Beverages.

"In all pre-emption cases, and particularly in those in which Congress has 'legislated . . . in a field which the States have traditionally occupied,'" a federal court must "start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress." *Medtronic, Inc. v. Lohr,* 518 U.S. 470, 485 (1996) (quoting *Rice v. Santa Fe Elevator Corp.,* 331 U.S. 218, 230 (1947)). Because adoption of the Twenty-first Amendment effectively withdrew from Congress a measure of power

under the Commerce Clause and transferred that power to the states, *see Beskind,* 325 F.3d at 519, a heightened level of judicial solicitude for state interests is warranted when the preemption analysis ventures into the area of state alcoholic beverage regulations. Thus, when a court "is asked to set aside a regulation at the core of the State's powers under the Twenty-first Amendment . . . it must proceed with particular care," *North Dakota,* 495 U.S. at 439-40, and accord "deference" to state "laws enacted to combat the perceived evils of an unrestricted traffic in liquor," *Bacchus Imports,* 468 U.S. at 276.

"Given the special protection afforded to state liquor control policies by the Twenty-first Amendment, they are supported by a strong presumption of validity and should not be set aside lightly." *Beskind,* 325 F.3d at 519 (quoting *North Dakota,* 495 U.S. at 433). This Court has recognized the continuing vitality of the "strong presumption of validity" afforded to state alcoholic beverage regulations, and has emphasized the Supreme Court's observation that the three-tier system for regulating the distribution and sale of alcoholic beverages is "unquestionably legitimate." *Brooks v. Vassar,* 462 F.3d 341, 352 (4th Cir. 2006) (quoting *Granholm,* 544 U.S. at 489). Therefore, when "the interests implicated by a state regulation are so closely related to the powers reserved by the Twenty-first Amendment," *Capital Cities Cable,* 467 U.S. at 714 (1984), and those interests are pursued through a three-tier

system for regulating the "transportation, importation, and use of alcoholic beverages, *Brooks,* 462 F.3d at 354, deference to state legislative judgments is appropriate.

Maryland's volume discount ban and its price filing system, which govern distribution and sales between the second and third tier of the State's three-tier system and which act directly on transactions described by § 2 of the Twenty-first Amendment, are not alleged to impinge upon fundamental rights or discriminate against interstate commerce. Accordingly, TFWS, as the party "challenging the legislative judgment[,] must convince the court that the legislative facts" on which these alcoholic beverage regulations are based "could not reasonably be conceived to be true by the governmental decisionmaker." *Minnesota v. Clover Leaf Creamery,* 449 U.S. 456, 464 (1981); *see also Anheuser-Busch, Inc. v. Schmoke,* 63 F.3d 1305, 1311 (4th Cir.1995) ("If it appears to the court that the legislative body could reasonably have believed, based on data, studies, history, or common sense, that the legislation would directly advance a substantial governmental interest, the government's burden of justifying it is met."), *reaffirmed on remand,* 101 F.3d 325, 327 (4th Cir.1996). The proper approach to judicial review of the state regulations in this case is exemplified by the Supreme Court's analysis in *Exxon,* which rejected preemption challenges under federal antitrust law to a state regulation that included provisions prohibiting price discrimination and effectively banning wholesale

quantity discounts for gasoline. *See* 437 U.S. at 124-29, 131-34. Whereas TFWS has relied on the testimony of its owner and one economist to dispute the legislature's conclusion, the plaintiffs in *Exxon* presented the testimony of four economists opining that the Maryland statute would not serve its purpose of encouraging competition and protecting consumers; like TFWS, the plaintiffs in that case persuaded the trial court to find in their favor and to invalidate the state statute on the basis of those findings. *See Governor of Maryland v. Exxon Corp.,* 279 Md. 410, 419 (1977). In reversing that conclusion, the Supreme Court deferred to the determination of the state legislature and held that it was not the judiciary's role to evaluate either "the economic wisdom of the statute" or the "ultimate economic efficacy of the statute." *Exxon,* 437 U.S. at 124-25.

More recently, the Supreme Court has commented on the doctrinal and practical problems associated with judicial review of the "efficacy" of economic regulation. In *Lingle v. Chevron,* the 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). This 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 courts are not well suited." *Id.* at 544. "Moreover," the Supreme 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.* In *Lingle,* the review of state regulations by the trial court required it to "choose between the views of two opposing economists" and decide which was "more persuasive," an undertaking that the Supreme Court found "remarkable, to say the least, given that we have long eschewed such heightened scrutiny when addressing substantive due process challenges to government regulation." *Id.* at 544-45.

The Supreme Court's precedents have repeatedly rejected the notion that federal courts have "a license to judge the effectiveness of legislation." *Keystone Bituminous Coal Ass'n v. DeBenedictis,* 480 U.S. 470, 487 n.16 (1987); *see also id.* at 511 n.3 (Rehnquist, C.J., dissenting). Regulation in the economic sphere "may not be successful in achieving its intended goals," but "whether in fact the provisions will accomplish the objectives is not the question" that federal courts are authorized to ask or to answer. *Hawaii Housing Auth'y v. Midkiff,* 467 U.S. 229, 242 (1981). Because such empirical "debates over the wisdom" of socioeconomic legislation "are not to be carried out in the federal courts, *id.* at 243, "a legislative choice is not subject to courtroom fact-finding," *Federal Communications Comm'n v. Beach,* 508 U.S. 307, 315 (1993).

In *Dunagin v. City of Oxford,* the Fifth Circuit, in a case involving state regulation concerning alcoholic beverages, explained the problems that arise when application of a constitutional rule turns on judicial fact-finding about the efficacy of legislation. 718 F.2d 738. The law challenged in that case was the subject of separate actions before two district court judges, who reached opposite conclusions, based on different findings concerning the effectiveness of the law. *See id.* at 739-40; *Dunagin v. City of Oxford,* 489 F. Supp. 763 (N.D. Miss. 1980) (upholding challenged law); *Lamar Outdoor Adver., Inc. v. Mississippi,* 539 F. Supp. 817 (S.D. Miss. 1982) (invalidating same law). The court of appeals was thus confronted with conflicting judgments as to the validity of the same law, where what has been ruled "constitutionally protected in one jurisdiction" might be "illegal in another." 718 F.2d at 748 n.8; *cf. CTS Corp. v. Dynamics Corp. of America,* 481 U.S. 69, 95 (1987) (Scalia, J., concurring) (empirical issue about a law's benefits was "a highly debatable question, but it is extraordinary to think that the constitutionality of the Act should depend on the answer"). The answer is to recognize that the legislative decision "carries great weight" and "certainly . . . cannot be thrust aside by two experts and a judicial trier of fact." *Dunagin,* 718 F.2d at 748 n.8 (cited with approval in *A.L. Lockhart,* 476 U.S. at 169 n.3).

The course of this litigation illustrates the danger of allowing the constitutional validity of a state law to depend on a judicial assessment of its effectiveness. Such an inquiry is ill-suited to the judicial function, and it can too readily result in one fallible trial judge invalidating a law that another has upheld, as in *Dunagin*. Indeed, *in this case,* two different trial judges have reached three different conclusions regarding the effectiveness of the challenged laws. Judge Smalkin determined in 2002 that the record compiled at the summary judgment stage, including the analyses of the parties' experts, demonstrated the "direct effect that the scheme has on keeping prices high and the correlation between high prices and lower demand for alcohol," which he found to have been "convincingly substantiated by the defendant's evidence." 183 F. Supp. 2d 789. In 2004, Judge Quarles determined that the same laws are ineffective because they "do not increase Maryland liquor prices." 315 F. Supp. 2d at 782. Most recently, in 2007, Judge Quarles has concluded that the evidence shows "slightly higher wholesale wine and liquor prices," but that a "second inference must be made" before concluding that higher retail prices also result from the challenged laws, and that "evidence of the impact of the increased wholesale prices on consumption is tenuous," leading to the ultimate conclusion that the laws have "at best only a minimal impact" and are therefore invalid. 2007 WL 2917025, at *5, *9, *10 (VII J.A. 5667, 5676-77).

The conflicting determinations underlying three separate final judgments in this case is made even more incongruous when one considers that all parties to the litigation challenging similar regulations in Washington State stipulated to the existence of a price-elevating effect, based on the opinions uniformly held by each party's experts. *See Costco Wholesale Corp. v. Hoen,* 2006 WL 1075218, No. C04-360P (W.D. Wash. April 21, 2006) (unpublished), *on appeal,* Nos. 06-35538, 06-35542, 06-35543 (9th Cir.). All four testifying experts, including both of the economists retained by the plaintiff, agreed that the Washington price filing and anti-price-discrimination regulations both raised prices and reduced consumption of the alcoholic beverages subject to the regulations. (VII J.A. 5529-31, 5532-34, 5536-37, 5538-41.) Whereas the trial court in this case estimated that Maryland's volume discount ban and price filing system resulted in a 0.2% increase in prices, one expert retained by the plaintiff in the *Costco* case provided estimates of price increases attributable to the challenged Washington laws of 4.1%, 4.8%, and 8.1% (VII J.A. 5551-52); the other plaintiff's expert found that "5% is a conservative estimate" (VII J.A. 5562).

B. The Record Evidence Demonstrates that the Volume Discount Ban and Price Filing System Limit Competition, Raise and Stabilize Prices, and Moderate the Consumption of Alcoholic Beverages.

The evidence in this case supports the allegation in TFWS's complaint that the State's volume discount ban and price filing system "inflate wholesale prices for wines and liquors," which results in lower levels of consumption, and produces important benefits for public health, safety, and welfare. These regulatory impacts have been substantiated both through the application of basic economic principles that TFWS does not dispute and through expert economic analysis of empirical data and accumulated research.

TFWS's post-trial comparisons of Delaware and Maryland wholesale prices were not "sufficiently reliable" to gauge the effect of the regulations on price, as this Court found in TFWS III. 147 Fed. Appx. at 335. On remand, once the two states' different excise tax levels were taken into account, the results of the analysis previously relied upon by TFWS were completely reversed. Even so, this analysis, which the district court adopted, remained deeply flawed and was incapable of overcoming the abundant evidence of a significant impact of the laws on price and consumption levels.

1. The evidence at trial thoroughly demonstrated that Maryland's alcoholic beverage regulations raise prices and reduce consumption levels.

The trial in this case resulted from this Court's determination that there was a genuine dispute of material fact, generated primarily by disagreements between the parties' experts, as to whether the challenged laws reduce consumption by their price effect. *See TFWS II*, 325 F.3d at 242. With respect to the disputes over theory, the anticipated "battle of the experts" never materialized at trial, because TFWS's expert, Dr. Overstreet, was unable to substantiate the theoretical effects of the pricing regulations he had hypothesized. With respect to the disputes over empirical evidence, the battle of the experts resulted in an accord, as the analyses of price and consumption data by both sides' experts showed that Maryland's laws do raise prices and reduce consumption.

a. TFWS failed to substantiate the theoretical effects it posited.

The State's experts demonstrated, through the application of accepted economic principles and empirical analysis, how and why the challenged laws work to raise and stabilize prices. (IV J.A. 2640-93, 2720-33, 3543-83.) Dr. Overstreet, however, hypothesized three theoretical effects of the regulations that might "attenuate" this acknowledged demand-reducing effect on consumption:

(1) consumer substitution or brand-shifting, (2) increased non-price competition by wholesalers, and (3) proliferation of small retailers. *See TFWS II*, 325 F.3d at 238; (VI J.A. 4333-36). Despite the central role these theories played in TFWS's arguments at the summary judgment stage, Dr. Overstreet did not presented *any* empirical evidence at trial to test or substantiate these theories directly; he also admitted that he had no empirical evidence to support them and did not claim that they would significantly offset the effect on consumption of higher prices. (II J.A. 920-22, 929, III J.A. 1409-10, 1420, 1424-34.) The State, by contrast, showed that available empirical evidence undermines each of the theoretical non-price effects posited by Dr. Overstreet. Contrary to his brand-shifting theory, a body of research estimating the overall price elasticity of demand for alcoholic beverages has taken into account the phenomenon of substitution, and yet shows that higher prices will significantly reduce overall consumption. (IV J.A. 2642-43; I J.A. 178-85.) Non-price competition by wholesalers in the form of assistance to retailers is deterred by Maryland's regulation of such activities and, to a lesser extent by federal law. *See, e.g.,* 27 C.F.R. part 6 ("Unlawful inducements"). And the number of retailers, which is controlled by licensing requirements, *see* Article 2B, § 9-201(a)(1), has declined since the regulations were adopted, despite a doubling of the State's population (III J.A. 1432-33, 1691-92, 1701, 2002-06).

b. Empirical analysis confirmed the price and consumption effects predicted by economic theory.

Dr. Overstreet did not conduct any analysis of the regulation's effects using price data, and agreed with the State's economists that the challenged regulations result in higher prices. (III J.A. 1375-76, 1400-09, 1413-14, 1420). The State's experts' conclusion was supported by their empirical analyses of actual retail prices, collected by an independent consumer price database widely used in peer-reviewed studies.[7] (IV J.A. 2640-93, 2720-33, 3543-83.)

The State also presented evidence that its relatively high and stable prices result in lower consumption levels than would occur without the regulations. (IV J.A. 2679-91, III J.A. 1762-68.) The State's experts examined price and consumption trends over a 16-year period in Delaware, demonstrating that, after that state

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[7] This "ACCRA" retail price data was widely relied upon by researchers in the field of health economics and has a very high correlation (better than 95%) with other price indices for alcoholic beverages, including the Consumer Price Index. (III J.A. 1769, IV J.A. 2659-73). Dr. Overstreet could suggest no better or more reliable available source of retail price data. (III J.A. 1375.)

Notably, the federal government (whose interests TFWS purportedly seeks to vindicate in this litigation) regularly relies on studies based on these data. *Compare, e.g.,* Office of the Surgeon General, *The Surgeon General's Call to Action to Prevent and Reduce Underage Drinking* 58 (2007), *available at* www.surgeongeneral.gov/topics/underagedrinking, *with* III J.A. 1769 (partial list of studies employing ACCRA data; *see also TFWS II,* 325 F.3d at 240 (affirming admissibility of ACCRA data)

abandoned its volume discount ban and relaxed its price filing requirement in 1992, retail prices dropped both in absolute terms and in comparison to Maryland prices, despite a significant increase in Delaware excise tax levels. (IV J.A. 2721-32, 3573-83.) Consumption trends indicated that Delaware's regulatory change had a statistically significant upward impact over time, so that by the end of the year 2000, per capita wine consumption was 14.3% higher and spirits consumption was 54.4% higher than would have been predicted had the regulations remained in effect. (III J.A. 1765-68, IV J.A. 2678, 3567-83, VII J.A. 5501-17.) As the district court observed, *see* 315 F. Supp. 2d at 778, these trends also showed a marked departure from the Maryland consumption patterns, which had been similar to Delaware's before the regulatory change. (*Id.*) This divergence is evident even in the graphs created during trial by Dr. Overstreet, which show a statistically significant upward departure from predicted consumption trends in Delaware following the change in its laws. (VI J.A. 4611, 4681, 4683-87, VII J.A. 5518-21; *see also* II J.A. 1025-50, IV J.A. 3553-83.)

The State's evidence of both higher prices and lower consumption is consistent with an extensive body of research examining the price elasticity of demand for alcohol and showing that higher and more stable prices for alcohol result in (1) lowering consumption by existing drinkers; (2) reducing the number of drinkers in

the population as a whole; (3) encouraging quitting by current drinkers; (4) discouraging non-drinkers, especially youth, from taking up alcohol; and (5) discouraging former drinkers from resuming. (IV J.A. 2844-3480.)

c. TFWS's lay price comparisons were unreliable.

TFWS sought to remedy the deficiencies in its evidence and analysis by introducing lay price comparisons purportedly drawn from the inventory records of its Maryland store and its Delaware affiliates. The trial court found the first of these (VI J.A. 4377), and the only one disclosed prior to trial, to be "of no value" because the wholesale prices it showed were not actually the ones available that month (II J.A. 807); other price comparisons (VI J.A. 4410-85, 4488-4608) suffered from similar flaws (IV J.A. 3481-3542.)

After trial, TFWS submitted two more price comparisons, Exhibits 93 and 94, which contained Maryland and Delaware wholesale price data from 2003.[8] (VI J.A. 4689-4754) These spreadsheet analyses had been compiled for litigation purposes at the direction of TFWS owner David Trone, by his employees, (II J.A. 1134-35), presented a subset of products that was not based on representative samples from the market, (II J.A. 762-63, VI J.A. 4609-10, 4410-85), did not cover a period of time

[8] Because Delaware wholesalers are not required to adhere to the published prices, these data did not necessarily represent the price available to or paid by TFWS. (II J.A. 1136, IV J.A. 2766-67, 3629.)

equivalent to the retail price and consumption trend studies presented by the State, and made no attempt to account for the large excise tax differential between Maryland and Delaware. Dr. Overstreet did not review or analyze these exhibits. (VII J.A. 4906-11.) The State's expert health economist, Dr. Chaloupka, did review them, and he explained why TFWS's data and methodology would not satisfy generally accepted standards for economic analysis. (IV J.A. 3629-37.) He also demonstrated that, setting aside the deficiencies in the data set, when the figures were properly analyzed, they tended to show that prices were lower in Delaware, not higher, as TFWS claimed. (IV J.A. 3635-39, VII J.A. 5523.) The district court nevertheless "relied heavily" on these flawed analyses, and this Court reversed, finding that they were not "sufficiently reliable to provide an indication of the effect the challenged regulations have on Maryland prices." *TFWS III,* 147 Fed. Appx. at 333, 335.

2. The evidence on remand continued to demonstrate that Maryland's alcoholic beverage regulations raise prices and reduce consumption levels.

This Court directed remand proceedings to determine the degree to which excise taxes reflected in wholesale prices are also reflected in retail prices and, if the evidence then shows that the regulations do raise prices, to examine the effect on consumption. *See id.* at 336. The evidence shows that the challenged laws do raise prices and result in lower levels of consumption.

a. Alcoholic beverage excise taxes are reflected in the prices paid by consumers.

Dr. Overstreet did not provide analysis on the degree to which excise taxes paid by wholesalers are "passed through" in the form of higher retail prices charged to consumers. (J.A. 4838-53.) Dr. Chaloupka did, reviewing the relevant economic literature related to excise taxes generally and excise taxes for alcoholic beverages in particular. (VII J.A. 5391-97, 5402-08.) That literature indicates that the full amount of an excise tax, and perhaps significantly more, is passed through to the retail price, and Dr. Overstreet did not disagree with this conclusion. (VII J.A. 5032-34.) In the calculations supplied by TFWS to Dr. Overstreet for his analysis, and in the analysis of the TFWS data conducted by Dr. Chaloupka, the full excise tax differential was used as an adjustment to the wholesale figures, which Dr. Chaloupka noted was "relatively conservative . . . given the empirical evidence in the literature." (VII J.A. 5398.)

b. After controlling for excise taxes, the results of TFWS's price comparisons were reversed.

After they were adjusted to reflect excise tax differences, TFWS's price comparisons produced results that were completely contrary to the conclusions TFWS had previously advanced and instead supported the State's position. On remand, TFWS revised its post-trial price comparisons to account for the excise tax

differential (designating them as Exhibits 93A and 94A (VII J.A. 4772-4835, 4836-37)) and provided them for the first time to Dr. Overstreet (VII J.A. 4907-11), but did not remedy any of the other deficiencies that the State pointed out in its post-trial submission or on appeal. The analytical flaws that condemn Exhibit 93/93A are even more pronounced with respect to Exhibit 94/94A, on which the district court declined to rely, and it merits no further discussion here.

TFWS's own analysis of Exhibit 93A produced results diametrically opposed to those of its predecessor, upon which the district court had relied. Each of the measures it had employed to show that Delaware prices were higher than Maryland's result in the opposite conclusion after the figures are adjusted to account for excise taxes:

Plaintiff's Exhibit 93 (2004) vs. Plaintiff's Exhibit 93A (2006)

Measure	Before: Exhibit 93	After: Exhibit 93A
Percentage of 2637 selected products found to be cheaper (lowest monthly price to lowest monthly price)[9]	53.6% **cheaper in Md.**	54.5% **cheaper in Del.**
Percentage of units sold found to be cheaper (lowest monthly price to lowest monthly price)[10]	57.5% **cheaper in Md.**	58.5% **cheaper in Del.**
"Basket of Goods" comparison (cost of buying 2003 TFWS sales volume for each item (770,308 units) at cheapest price during 2003)[11]	$256,448 **cheaper in Md.**	$16,738 **cheaper in Del.**

c. When properly analyzed, TFWS's price comparisons contradict its earlier evidence and fully support the State's position.

The analysis employed by TFWS suffered from a number of methodological flaws. The most conspicuous, in light of this Court's opinion in *TFWS III*, was omitted variable error – *i.e.,* failing to account for the significant explanatory variable of the excise tax differential, which was corrected in TFWS's revised price comparisons. The others that the State identified post-trial, on appeal, and on remand, were not. These included deficiencies in the data set and measurement error, *i.e.* including only outliers (the lowest monthly price for the entire year) in the

[9] *Compare* VI J.A. 4720; II J.A. 1137, 1218-19 *with* VII J.A. 4835.

[10] *Compare* VI J.A. 4689-4752 *with* VII J.A. 4772-4835.

[11] *Compare* VI J.A. 4752; II J.A. 1218-19, 1138-39 *with* VII J.A. 4835.

calculations. Some of these problems were recognized by Dr. Overstreet, but he received TFWS's spreadsheet "as it is," and did not perform additional calculations or seek to acquire data that would have made the spreadsheets more informative and the analysis more robust. (VII J.A. 4911-15, 4929-30, 4935-36, 4942-43, 4945-4950, 4953-56, 4967, 4998-99.) Dr. Chaloupka did seek additional data, but was thwarted. (VII J.A. 5295-96, 5380-81.)

Dr. Chaloupka did not simply accept the calculations performed by TFWS, as Dr. Overstreet did, but instead attempted to compensate for the measurement error. TFWS's price analyses compare, for each product, the lowest monthly price offered over the course of the year in Delaware to the lowest monthly price offered over the course of the year in Maryland, implicitly assuming that retailers buy their stock exclusively in the months when the prices are lowest. This assumption is used even though the lowest price for a particular product in one state may appear only once during the year, yet be consistently higher than the price in the other state the remaining 11 months. TFWS's model essentially discards 1/12th of the price-month data points in the data set, and constructs unrealistic comparisons among the outliers it has retained. The data provided by TFWS in Exhibit 93A did not reveal when it or its sister store in Delaware *actually* made its purchases, so TFWS's analytic model

is grounded entirely on the *ipse dixit* of its owner, who claims that the assumption is realistic because retailers engage in "bridge buying."

In fact, however, this assumption is thoroughly undermined by the evidence in the case, including Mr. Trone's own testimony. As both parties' experts explained, there are practical limitations on the ability of a retailer to "bridge buy," including storage limitations, tying up working capital, and the ability to forecast wholesale prices months in advance of their posting. (IV J.A. 3634-35, VII J.A. 4929-32, 5345-46.) While such constraints would likely be felt more strongly by smaller retailers, Mr. Trone's own testimony establishes that his own large stores, which he acknowledges are not representative of other retailers (II J.A. 821, 849, V J.A. 3924, 3938-43), do not engage in the type of long-range purchasing and inventory stocking strategy that is the premise for TFWS's analytic model (II J.A. 769-73, 776, 780, V J.A. 3712, 3952-53, 4108-52, 5345-46). Whereas Mr. Trone was not knowledgeable about other retailers' practices, the largest wine and spirits wholesaler in the State explained that most of its purchasers lacked the credit and storage capacity to engage in the extreme form of bridge buying assumed by TFWS's analytic model. (VII J.A. 5524-26.)

Notwithstanding all of this evidence casting doubt on claims of widespread and extreme forward purchasing by Maryland retailers, TFWS sought to overcome the

abundant trial evidence of the price-elevating effect of Maryland's regulations by constructing a price comparison premised on the assumption that bridge buying rendered outlier price data determinative and all other price data irrelevant. The consequences of relaxing the heroic assumption underlying TFWS's price comparisons was demonstrated by Dr. Chaloupka, who instead compared each product against each product for each month. (VII J.A. 5523.) This more realistic approach produces starkly different results, even more thoroughly refuting the evidence upon which TFWS had previously relied to argue that wholesale prices are lower in Maryland than in Delaware:

Pl's. Ex. 93 (2004) vs. Pl's. Ex. 93A (2006) vs. State's Analysis (2006)

Measure	TFWS Ex. 93	TFWS Ex. 93A	State's Analysis[12]
Percentage of products found to be cheaper	53.6% cheaper in Md.	54.5% cheaper in Del.	**62.6% cheaper in Del.**
Percentage of units sold found to be cheaper	57.5% cheaper in Md.	58.5% cheaper in Del.	**71.4% cheaper in Del.**
"Basket of Goods" comparison (cost to buy 2003 TFWS sales volume)	$256,448 cheaper in Md.	$16,738 cheaper in Del.	**$251,404 cheaper in Del.**

The sensitivity of the TFWS analytic model to the bridge buying assumption and the deficiencies in the underlying data severely undermine its reliability.

[12] *See* VII J.A. 5399, 5523.

Nevertheless, to the extent it bears on relative prices in Maryland and Delaware in 2003, it supports the State's position that its prices are substantially higher. Using the district court's price-per-bottle measure, Dr. Chaloupka's analysis shows that the price difference is, "on average, *one-third higher than the average Maryland excise taxes* applied to wine and spirits." (J.A. 5392.)

c. The record as a whole, including trial evidence regarding price effects, trial evidence regarding consumption effects, and TFWS's own post-trial price comparisons, demonstrates that the volume discount ban and price filing system serve their stated purpose.

The parties do not dispute the estimates of the price-elasticity of demand for alcoholic beverages, (VII J.A. 4892-93), which when applied to the evidence of price effects in the record, show that the challenged laws reduce consumption. Moreover, the evidence at trial regarding consumption effects based on consumption data, rather than on inferences from price data, remain undisturbed by TFWS's attempts to diminish the evidence of the price effects.

The 2004 determination by the district court in this case that the challenged laws do not raise prices or reduce consumption was erroneous, as a result of the court's decision to discount or disregard credible social science evidence and to instead embrace a methodologically unsound analysis based on assumptions contradicted by the evidence. The court's 2007 determination that the laws do not

appreciably raise prices or reduce consumption is also erroneous, for the same reason. The district court reached its 2004 conclusion by relying upon two price comparisons that were not "sufficiently reliable to provide an indication of the effect the challenged regulations have on Maryland prices." *TFWS III,* 147 Fed. Appx. at 335. This Court's review of the record found no other evidence supportive of the district court's conclusion, but instead "found only evidence to the contrary." *Id.* On remand, the district court continued to give short shrift to the abundant evidence in the existing record that demonstrated the price-elevating effect of the regulations, and it again relied on an unreliable lay price comparison generated by TFWS. The evidence establishes that the challenged laws serve the State's interest in promoting temperance.

IV. THE STATE'S REGULATORY INTERESTS ADVANCED BY THE VOLUME DISCOUNT BAN AND PRICE FILING SYSTEM OUTWEIGH THE FEDERAL INTEREST EXPRESSED IN THE SHERMAN ACT.

Maryland's volume discount ban and price filing system are integral components of its three-tier system regulating the distribution and sale of alcoholic beverages, which was adopted by Maryland and many other states following ratification of the Twenty-first Amendment and which is "unquestionably legitimate." *Brooks,* 462 F.3d at 352 (quoting *Granholm,* 544 U.S. at 489). The "interests implicated by" the laws challenged in this case are "closely related to the powers

reserved by the Twenty-first Amendment," *Capital Cities Cable,* 467 U.S. at 714, and enjoy a "strong presumption of validity," *North Dakota,* 495 U.S. at 433. That presumption has been validated in this case, as the State has thoroughly substantiated its justifications for the volume discount ban and price filing system.

Whereas the State has amply demonstrated the effectiveness of its laws in accomplishing Twenty-first Amendment objectives, TFWS has made no effort to demonstrate the degree to which the marketplace or the principle of "free competition" is damaged by enforcement of regulations designed to "eliminate price wars," Article 2B, § 12-103(a), by limiting price discrimination in the form of volume discounts and creating an administrative mechanism for detecting violations. Federal antitrust laws, including the Sherman Act, do not "expressly pre-empt state laws" but instead were intended by Congress "to supplement, not displace" State laws. *California v. ARC America Corp.*, 490 U.S. 93, 101-02 (1989). Even if TFWS's challenge to Maryland's longstanding alcohol regulations did involve an Act of Congress *expressly* preempting State laws,[13] however, TFWS would still be required to "bear the considerable burden of overcoming 'the starting presumption that

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[13] Of course, the Sherman Act does *not* contain an express preemption provision, as it 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 Senator Sherman).

Congress does not intend to supplant state law'" in the field of alcoholic beverage regulation, which "'has been traditionally occupied by the States.'" *De Buono v. NYSA-ILA Medical and Clinical Services Fund*, 520 U.S. 806, 814 (1997) (applying presumption against preemption to uphold state law against challenge under express ERISA preemption provision); *see also ARC America Corp*., 490 U.S. at 101 (Sherman Act preemption challenge "must overcome the presumption against finding preemption of state laws in areas traditionally regulated by the States").

In light of the general presumption against preemption and the special force with which it applies when a state's Twenty-first Amendment powers are implicated, it is not sufficient for TFWS to point to a finding of a *per se* violation of § 1 of the Sherman Act and leave it at that. Rather, a "pragmatic effort to harmonize state and federal powers" is mandated. *Capital Cities Cable,* 467 U.S. at 714. In weighing the state and federal interests, "each must be considered in light of the other and in the context of the issues and interests at stake," *Bacchus Imports,* 468 U.S. at 275, which requires careful scrutiny in *a concrete case*." *TFWS I,* 242 F.3d at 206 (emphasis added). By definition, a finding of a *per se* violation is not based on scrutiny of the facts in a concrete case.[14]

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[14] A *per se* violation of the Sherman Act arises from "agreements or practices which because of their pernicious effect on competition and lack of any redeeming (continued...)

The finding of a *per se* violation was based on the allegations in TFWS's complaint that the volume discount ban and price filing system serve to raise and stabilize prices. Because the *per se* analysis was applied instead of a rule-of-reason analysis, there has been no demonstration of how seriously the core objectives of the Sherman Act are hindered by the State's laws regulating the sale and distribution of alcoholic beverages. As the State has argued above, the challenged laws do not give rise to a *per se* violation in the first place. If TFWS is to be believed, moreover, the effect of the regulations on competition is *de minimis.* TFWS complains that it is "unable to attain a competitive advantage on pricing that [it] should be able to attain by leveraging [its] strengths" with respect to "capital," "cash position" and the size of its facility. (I J.A. 590.) But the purpose of the antitrust laws is the protection of competition, not competitors." *Atlantic Richfield Co. v. USA Petroleum Co.,* 495 U.S. 328, 338 (1990); *accord Leegin,* 127 S. Ct. at 2724. TFWS's ability to obtain quantity discounts would be at best a by-product, not an objective, underlying the federal interest expressed in the Sherman Act. *See Exxon,* 437 U.S. at 127 ("We

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[14](...continued)
virtue are conclusively *presumed* to be unreasonable and therefore illegal *without elaborate inquiry as to the precise harm they have caused* or the business excuse for their use." *Continental T.V., Inc. v. GTE Sylvania, Inc.,* 433 U.S. 36, 50 (1977) (emphasis added).

cannot accept . . . appellants' underlying notion that the Commerce Clause protects the particular structure or methods of operation in a retail market.").

The federal government has exercised its Commerce Clause power not only to eliminate restraints of trade under the Sherman Act, but also to prohibit price discrimination in the Robinson-Patman Act, 15 U.S.C. § 13(a), an objective that coincides with the pricing provisions of Article 2B, as well as other restrictions on price discrimination under state law, *see, e.g.,* Md. Code Ann., Com. Law § 11-204(a)(5). Congress has also utilized its commerce power to permit state officials to enforce state liquor laws in federal court under the Twenty-first Amendment Enforcement Act, *see* 27 U.S.C. § 122a, and has enacted other legislation to reinforce state authority in this area, including the Webb-Kenyon Act, *see* 27 U.S.C. § 122, and the Wilson Act, *see* 27 U.S.C. § 121. These congressional enactments do not merely acknowledge the states' power under the Twenty-first Amendment to regulate commerce in alcoholic beverages; they augment that power,[15] which counsels against a preemption analysis that blindly equates the federal interest with the promotion of free-market competition. It is also important to recognize that, just as the federal

[15] Generally, Congress may "redefine the distribution of power over interstate commerce by [permitting] the states to regulate the commerce in a manner which would otherwise not be permissible." *South-Central Timber Dev't, Inc. v. Wunnicke,* 467 U.S. 82, 87-88 (1984).

government's interests are not confined to those expressed in the Sherman Act, the interests of the State go beyond the core Twenty-first Amendment interests in promoting temperance and ensuring orderly market conditions. The State's inherent police power to regulate the sale of alcoholic beverages also must be factored into the balance, and this police power has been recognized as independent of the authority conferred by the Twenty-first Amendment. *See Rice v. Rehner,* 463 U.S. 713, 724 (1983); *see also California v. LaRue,* 409 U.S 109, 114 (1972).

The perfunctory balancing approach utilized by the trial court in *Costco* and urged by TFWS below, *see* 2007 WL 2917025, at *8-*9 (quoting *Costco,* 2006 WL 1075218, at *13), cannot substitute for the harmonization of federal and state interests called for by the Supreme Court's precedents. Under the *Costco* court's reasoning, a state's exercise of its Twenty-first Amendment powers must always "yield to the national goals of a competitive, free market economy" whenever the state could achieve its objectives through such measures as higher excise taxes, stricter licensing requirements, or more vigorous public education initiatives. *Costco,* 2006 WL 1075218, at *13. In concept, excise taxes could always be increased, and further increased. But as the Second Circuit observed, the "'weighing' process prescribed by *Midcal* cannot mean that whenever a state statute has some anticompetitive effect, the federal interest prevails; unless there is some anticompetitive effect, there is no

occasion to weigh" in the first place. *Battapaglia v. New York State Liquor Auth'y,* 745 F.2d 166, 179 (2d Cir. 1984).

Maryland's volume discount ban and price filing system have been demonstrated to elevate wholesale and retail prices, reducing consumption, and furthering the State's core Twenty-first Amendment interests, and the only evidence TFWS has produced to the contrary is refuted once that evidence is analyzed correctly. Because the challenged regulations serve Maryland's "legitimate interests in promoting temperance and controlling the distribution of liquor," *North Dakota,* 495 U.S. at 439, the regulations are "unquestionably legitimate," *Granholm,* 544 U.S. at 489, and the State's interest in maintaining these laws for the health and protection of Marylanders must prevail over any contrary federal interest expressed in the Sherman Act.

CONCLUSION

The decision of the United States District Court for the District of Maryland should be reversed, and judgment should be entered in favor of the appellants, Peter Franchot and Thaddeus S. Russell.

Respectfully submitted,

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REQUEST FOR ORAL ARGUMENT

The appellants submit that oral argument would aid the Court in its disposition of this appeal, and respectfully request that oral argument be heard.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that, on this 29th day of January 2008, two copies of the foregoing Brief of Appellees were served by first-class mail on:

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