

TABLE OF CONTENTS

	Page
I. INTRODUCTION	1
II. IDENTITY OF THE PARTIES.....	4
III. STATEMENT OF THE CASE.....	5
A. Initiative 1183 Dramatically Changed the State’s Role in Washington’s Liquor Market.	5
B. The Board Promulgates Rules to Transition to a Private Marketplace.	9
1. WAC 314-23-030(3): The “10% Rule”	10
2. Parallel litigation over the “\$150 Million Rule”	11
3. The “Sell-and-Deliver Rule”: WAC 314-23- 020(2) & WAC 314-24-180(2)	13
C. Procedural Background.....	15
IV. STATEMENT OF ISSUES	17
V. ASSIGNMENT OF ERROR	17
VI. STANDARD OF REVIEW	18
VII. ARGUMENT	19
A. The 10% Rule Is Invalid and Unenforceable.	19
1. The Board’s justification for the 10% Rule fails because I-1183 imposes it only on spirits distributor licensees.....	20
a. RCW 66.24.055(3)(a) applies only to spirits distributor licensees.....	20
b. The Supreme Court’s decision controls the question of whether RCW 66.24.640 operates to extend Subsection (3)(a)’s fee to distillers.	21
c. With the Board’s reasoning invalidated, the 10% Rule must be invalidated.....	24

TABLE OF CONTENTS
(continued)

	Page
2. The Board Has No Authority to Impose the 10% License Fee on Distillers.	28
a. The Board has no authority to impose a revenue-based license fee when I-1183 chose not to impose it.	28
b. The Board does not have authority to impose significant new license fees untethered to its regulatory function or public safety.	32
3. The Board's 10% Rule Is Arbitrary and Capricious.	36
B. The Sell-and-Deliver Rule Is Invalid.	39
VIII. CONCLUSION.	44
Appendix A: Washington Administrative Code	
Appendix B: Joint Statement of Facts	
Appendix C: I-1183	
Appendix D: Administrative Record Excerpts	
Appendix E: <i>Ass'n of Wash. Spirits & Wine Distribs.</i> Briefing	

TABLE OF AUTHORITIES

STATE CASES

<i>Anderson, Leech & Morse, Inc. v. Liquor Control Bd.</i> , 89 Wn.2d 688 (1978).....	32, 34
<i>Ass'n of Washington Spirits & Wine Distribs v. Liquor Control Board</i> , 182 Wn.2d 342 (2015).....	passim
<i>City of Seattle v. Fuller</i> , 177 Wn.2d 263 (2013).....	31
<i>Dep't of Rev v. Bt-Mor, Inc.</i> , 171 Wn. App. 197, 286 P.3d 417 (2012), review denied, 177 Wn.2d 1002 (2013).....	30
<i>Edelman v. State ex rel. Public Disclosure Comm'n</i> , 152 Wn.2d 584 (2004).....	29
<i>H & H P'ship v. State</i> , 115 Wn. App. 164 (2003).....	28, 32
<i>Landmark Dev, Inc. v. City of Roy</i> , 138 Wn.2d 561 (1999).....	28
<i>Lightfoot v. MacDonald</i> , 86 Wn.2d 331 (1976).....	25
<i>Low Income Hous Inst. v. City of Lakewood</i> , 119 Wn. App. 110 (2003).....	40
<i>Port of Seattle v. Pollution Control Hearings Bd.</i> , 151 Wn.2d 568 (2004).....	36
<i>Puget Sound Harvesters Ass'n v. Dep't of Fish & Wildlife</i> , 157 Wn. App. 935 (2010).....	40, 44
<i>Somer v. Woodhouse</i> , 28 Wn. App. 262 (1981).....	25
<i>State ex rel. Port of Seattle v Dep't of Pub Serv.</i> , 1 Wn.2d 102 (1939).....	29

<i>State Ex. rel. Thornbury v. Gregory</i> , 191 Wash. 70 (1937).....	33
<i>State Hosp Ass'n v. Dep't of Health</i> , 183 Wn.2d 590 (2015).....	17
<i>Stewart v. Dep't of Soc. & Health Servs.</i> , 162 Wn. App. 266 (2011)	18, 19
<i>United Parcel Serv., Inc v. Dep't of Rev.</i> , 102 Wn.2d 355 (1984).....	30
<i>Wash. Ass'n for Substance Abuse & Violence Prevention v. State</i> , 174 Wn.2d 642 (2012).....	passim
<i>Wash. Indep. Tel. Ass'n v. Wash. Utilities & Transp. Comm'n.</i> , 148 Wn.2d 887 (2003).....	25, 36
<i>Wash. Indep. Tel. Ass'n v. Wash. Utils. & Transp. Comm'n.</i> , 149 Wn.2d 17 (2003).....	18, 35
<i>Wash. Pub. Ports Ass'n v. Dep't of Revenue</i> , 148 Wn.2d 637 (2003).....	18
<i>Waste Mgmt. of Seattle, Inc v. Utils. & Transp Comm'n.</i> , 123 Wn.2d 621, 869 P.2d 1034 (1994).....	19, 24

FEDERAL CASES

<i>Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.</i> , 545 U.S. 967 (2005).....	37
<i>Nat. Res. Def. Council v. EPA</i> , 571 F.3d 1245 (D.C. Cir. 2009)	41
<i>Nat. Res. Def Council v. EPA</i> , 658 F.3d 200 (2d Cir. 2011)	41
<i>Rochester-Genessee Reg'l Transp. Auth v. Hynes-Cherin</i> , 531 F. Supp. 2d 494 (W.D.N.Y. 2008).....	37

<i>SEC v. Chenery Corp.</i>	
318 U.S. 80 (1943).....	25

WASHINGTON ADMINISTRATIVE CODE

WAC 314-23-020.....	passim
WAC 314-23-025.....	12
WAC 314-23-030.....	2, 10, 17
WAC 314-24-180.....	passim

STATUTES

Laws of 1933, ch. 62, § 79.....	32
Laws of 2012, ch. 2, § 101.....	passim
Laws of 2012, ch. 2, § 106.....	30
Laws of 2012, ch.2, § 204.....	34
Laws of 2012, ch. 2, § 206.....	26
Laws of 2013, ch. 3, § 9.....	34
RCW 19.85	16
RCW 19.85.011	16
RCW 19.85.030	9, 10
RCW 34.05 <i>et seq.</i>	18
RCW 34.05.570	18, 24, 36, 40
RCW 64.24.640	22
RCW 66.08.020	4
RCW 66.08.030	passim
RCW 66.24.055	passim

RCW 66.24.630	8
RCW 66.24.640	passim
RCW 66.28.330	22
RCW 82.08.150	30
Washington's Administrative Procedure Act, RCW 34.05.570(2)	17

I. INTRODUCTION

In November 2011, the People of Washington enacted Initiative 1183 and “dramatically changed the State’s approach to regulating the distribution and sale of liquor in Washington.” *Wash. Ass’n for Substance Abuse & Violence Prevention v. State*, 174 Wn.2d 642, 649 (2012) (upholding constitutionality of I-1183) (hereinafter “*WASAVP*”). The Initiative sought to “[g]et the state government out of the commercial business of distributing, selling, and promoting the sale of liquor, allowing the State to focus on the more appropriate government role of enforcing liquor laws and protecting the public health and safety concerning all alcoholic beverages.” *Id.* at 649-50 (quoting I-1183, Laws of 2012, ch. 2, § 101(2)(b)).

While the People embraced the privatization of Washington’s liquor market, the state agency charged with oversight of licensing the sale of liquor staunchly opposed, and continues to resist, changes wrought by the legislation. In I-1183’s wake, the Liquor Control Board¹ promulgated dozens of rules purportedly implementing privatization—but in fact, many of the rules contradicted or truncated rights specifically granted by I-1183.

The Superior Court invalidated all of these rules because the Board failed to follow the procedure mandated by state law, abdicating its duty to

¹ In 2015, the “Liquor Control Board” was renamed the “Liquor and Cannabis Board.”

consider the impact of its rulemaking on Washington's smaller businesses. But in fact, the Board's cavalier attitude towards I-1183 and the rulemaking process goes beyond the failure to prepare a Small Business Economic Impact Study. At issue in this appeal are two specific rules that are neither authorized by nor consistent with I-1183.

The first rule at issue is the "10% Rule." WAC 314-23-030(3)(b).² This rule imposes a "license fee" equal to 10% of total revenue on certain license holders that sell spirits directly to retailers.³ The Board's justification for imposing this fee was a strained interpretation of RCW 66.24.640, which states that an industry member "operating as a distributor" must also "comply with the applicable laws and rules relating to distributors." The Board reasoned that because I-1183 imposed the 10% license fee on spirits distributors, that same fee must be an "applicable law" that also extends to those industry members that exercise limited self-distribution rights, such as distillers. The Washington Supreme Court has since rejected that interpretation. The holding in *Association of Washington Spirits & Wine Distributors v Liquor Control Board*, 182 Wn.2d 342 (2015), controls here. The Board's justification for

² The WACs at issue are included in Appendix A for the convenience of the Court.

³ The fee consists of "ten percent of the total revenue from all sales of spirits to retail licensees made during the month" for the first 27 months of licensure, and then drops to five percent. WAC 314-23-030(3)(b) & (c).

imposing the 10% licensing fee on distillers is legally unjustified, and the 10% Rule must fail as a result.

Nor may the Board now raise new reasons for the rule and argue that the Board had some independent authority to impose a 10% licensing fee on distillers. Allowing such post hoc arguments to support a rule vitiates the Washington Administrative Procedure Act's safeguards against an agency overstepping its legislative authority.

In any event, even the Board's late-developed alternative theory falls flat. While the Board's attorneys now claim that the license fee was motivated by a desire to raise more revenue for the state, such decisions should be left to the Legislature or the People—and the People chose *not* to impose such a fee on any licensee other than a spirits distributor licensee. Even if this Court finds the Board might have such authority, the decision-making process the Board engaged in here was flawed enough to be arbitrary and capricious.

Appellants also challenge the Board's "Sell-and-Deliver Rule,"⁴ which bans a delivery method chosen by licensed buyers and sellers. The issue presented is simple: may the Board pass a rule that is facially inconsistent with the purpose of the Initiative at the request of a lone

⁴ The Board included this "sell-and-deliver" requirement in two different rules: one applying to spirits distributors, WAC 314-23-020(2), and one applying to wine distributors, WAC 314-24-180(2). Because these two rules are identical in their language, and for ease of discussion, this brief will refer to both as one rule.

stakeholder (the intervening association) and refuse to disclose the basis for its decision on the record? The APA explicitly prohibits such rulemaking. It is no excuse that the rule may seem minor: the refusal to engage in a public and reasoned decision-making process requires the rule's invalidation.

This Court should invalidate both rules.

II. IDENTITY OF THE PARTIES

Appellants are two trade associations, the Washington Restaurant Association and the Northwest Grocery Association, and Costco Wholesale Corporation. All three participated in the drafting and defense of Initiative 1183. *See WASAVP*, 174 Wn.2d at 646. The Washington Restaurant Association is a not-for-profit association of over 5,000 Washington restaurant industry members. CP 123 (Joint Statement of Facts at 7 ¶ 26(a)) (attached as Appendix B). Northwest Grocery Association is a not-for-profit organization of grocery retailers, wholesalers, suppliers, brokers, buyers, and manufacturers in Oregon, Washington, and Idaho. *Id.* (CP 124 ¶ 26(b)). And Costco Wholesale Corporation is a Washington corporation headquartered in Issaquah. *Id.* (CP 124 ¶ 26(c)).

The Board is the state agency charged with oversight of RCW Title 66. RCW 66.08.020.

The Association of Washington Spirits & Wine Distributors (the “Association”) intervened to defend the rules.⁵ Appendix B (CP 126 ¶ 29). The Association represents the two largest distributors in Washington: Southern and Young’s Market. Mot. for Substitution of Party as Intervenor at 2-3 (Apr. 27, 2016). Together, these two companies accounted for 93% of the distribution business in the state in the year following privatization. Appendix E-91 (Br. of Intervenor-Resp’ts at 5).

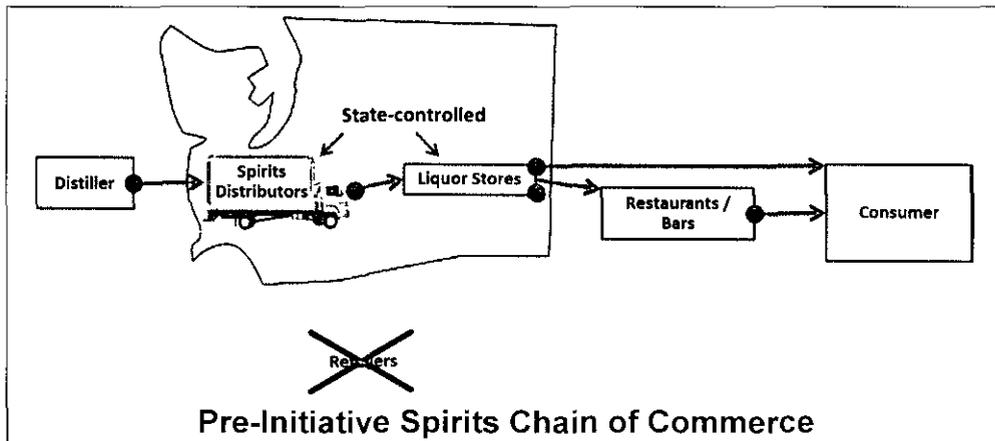
III. STATEMENT OF THE CASE

The analysis of the two challenged rules requires some background into both the structure of Washington’s liquor market and the Board’s approach to I-1183.

A. Initiative 1183 Dramatically Changed the State’s Role in Washington’s Liquor Market.

After the repeal of Prohibition in 1933, Washington was one of the country’s few “control” states, and all sales of spirits (hard alcohol) were exclusively routed through a state-owned distribution center and sold only in state liquor stores. *See WASAWP*, 174 Wn.2d at 647-50 (setting out history of Washington’s liquor laws). (Wine and beer could be sold by other retailers, such as grocery stores, with appropriate licenses. *Id.*)

⁵ The Association was recently substituted for the prior Intervenor, Washington Beer & Wine Distributors Association. Ruling on Mots. (May 3, 2016)

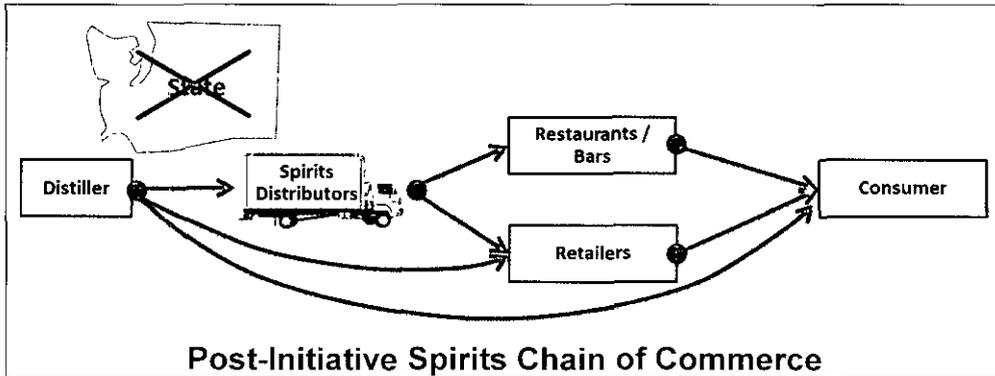


The limited channels of distribution and the imposition of multiple layers between the distiller and the consumer increased costs, reduced product choice, and unnecessarily complicated the market; each of these layers was governed by its own rules, regulations, and taxation schemes. The state occupied the two largest roles in this scheme, acting as both the sole distributor and sole retailer of spirits by the bottle.

In November 2011, Washington voters approved Initiative 1183, which ended the “state government monopoly on liquor distribution and liquor stores in Washington.” Laws of 2012, ch. 2, § 101(1) (I-1183)⁶; *see also* Appendix B (CP 118-119 ¶¶ 6-7). I-1183 removed the state government from the commercial business of distributing, selling, and promoting the sale of liquor and redirected the state’s “focus on the more appropriate government role of enforcing liquor laws and protecting

⁶ For the convenience of the Court, a copy of the Initiative is included herewith as Appendix C.

public health and safety concerning all alcoholic beverages.” Laws of 2012, § 101(2)(b); *see also* Appendix B (CP 119). After the Initiative, the market for spirits was significantly altered.



Part of the Initiative’s goal was to remove “state government regulations that arbitrarily restrict the wholesale distribution and pricing of wine,” declaring such regulations “outdated, inefficient, and costly to local taxpayers, consumers, distributors, and retailers.” Laws of 2012, ch. 2, § 101(1). And in creating regulations to govern the new spirits market, the People had the same goal: removing arbitrary and costly barriers in the liquor marketplace.

The state’s monopoly was replaced by new rights and licenses created by the Initiative. The new market allowed multiple channels for distribution, but the primary new vehicle to replace the state’s distribution business was the spirits distributor license, codified at RCW 66.24.055. This license grants broad authority to buy and resell spirits with few

restrictions as to the source or destination of the liquor. RCW 66.24.055. I-1183 also provided distilleries with limited direct distribution rights. RCW 66.24.640.

The spirits distribution business is lucrative. “In 2012, businesses holding spirits distributor licenses generated nearly \$450 million in sales.” *Ass'n of Wash. Spirits & Wine Distribs*, 182 Wn.2d at 349. “The overwhelming majority of sales in Washington were from spirits distributors,” with other sellers, such as distillers distributing their own product, making up the rest. *Id.* To “replace the revenue that the State lost when spirits distribution was privatized,” *id.* at 348, and to effectively sell the distribution business to private distributors, the Initiative imposed two license fees on the new spirits distributors. Subsection (3)(a) imposed a monthly license fee of 10% of revenue, but it dropped to 5% after 27 months. RCW 66.24.055(3)(a). The Initiative also required that these license fees amount to at least \$150 million in the first year of the spirits distributors’ operations, and Subsection (3)(c) required spirits distributor licensees to make up any shortfall. RCW 66.24.055(3)(c).

The Initiative created a number of other license fees, including a 17% fee on spirits retailers. *See* RCW 66.24.630(4)(a) (spirits retail license). The Initiative did not, however, impose such a revenue-based

license fee on any entity other than the spirits distributor and spirits retailer licensees.

B. The Board Promulgates Rules to Transition to a Private Marketplace.

The Board filed emergency implementing rules on December 7, 2011 (a month after the Initiative was passed) and proceeded to circulate largely identical permanent draft rules over the next six months. *See* Appendix D (First Emergency Rules, LCB00000995-96, LCB000001410-21; Second Emergency Rules, LCB00000954-59; First Draft Rules, LCB00001178-1206; Second Draft Rules, LCB20000298-331).

By August 2012, the Board had adopted approximately 40 rules, enacted in two sets, purportedly to effect the transition from a state monopoly to a privately run (but state-monitored) marketplace for spirits.⁷ For both sets of rules, the Board chose not to prepare an SBEIS pursuant to RCW 19.85.030(1) because of the alleged “positive impact on businesses or individuals who wish to sell spirits in the state of Washington.” Appendix B (CP 121-122 ¶¶ 18-19). Thus, no information regarding the anticipated regulatory impact on small businesses or on

⁷ On May 30, 2012, the Board adopted the first set of permanent rules. Appendix B (CP 122 ¶ 21). The Board filed the rules, along with a Concise Explanatory Statement (“CES”) on June 5, 2012. *Id.* (CP 123 ¶ 22). On August 1, 2012, the Board adopted and filed the second set of permanent rules and a CES. *Id.* (CP 123 ¶¶ 23-24)

public safety was collected and considered by the Board. *Id.* (CP 122 ¶ 20). Two of the rules are the subject of this appeal.

1. WAC 314-23-030(3): The “10% Rule”

The Board needed to create a number of new licenses to permit the importation, distribution, and sale of spirits by private entities. In addition to the new spirits distributor license, the Board also created a spirits certificate of approval for distillers located out of state.⁸ WAC 314-23-030(1). For an additional, nominal fee, these distillers may obtain an endorsement that allows sales of the distiller’s product not just to Washington distributors, WAC 314-23-030(2), but directly to licensed liquor retailers, WAC 314-23-030(3).

As part of this new licensing structure, the Board imposed the 10% license fee that is charged to spirits distributor licensees under RCW 66.24.055(3)(a) on distillers that exercise the right to self-distribute. WAC 314-23-030(3)(b) (requiring payment “to the board a fee of ten percent of the total revenue from all sales of spirits to retail licensees”). Because the Initiative itself did not impose the 10% license fee on distillers, the Board based this fee on RCW 66.24.640, which states in relevant part that “[a]n industry member operating as a distributor and/or

⁸ For ease of reference, this brief will use the term “distiller” instead of “spirits certificate of approval licensees” to refer to manufacturers of spirits with direct retail rights, which could be in-state, out-of-state, international distillers or importers possessing a variety of underlying licenses

retailer under this section must comply with the applicable laws and rules relating to distributors and/or retailers.” RCW 66.24.640. The Board reasoned that RCW 66.24.055(3)(a), which expressly imposed a 10% fee only on spirits distributor licensees, must be an “applicable law[]” that extends to distillers when they self-distribute. Appendix D (CES for first rules set, LCB00001035). The Board relied on this justification before the Superior Court. CP 971 (Br. of Resp’ts at 21); RP at 63-67; *see also Ass’n of Wash Spirits & Wine Distribs.*, 182 Wn.2d at 354-55 (recounting Board’s representations to the Superior Court in this matter).

However, in parallel litigation brought against a related rule, the Board changed its position and effectively abandoned its earlier rationale. The Washington Supreme Court accepted the new approach, which should now govern here.

2. Parallel litigation over the “\$150 Million Rule”

To recap, I-1183 “created two fees designed to replace the revenue that the State lost when spirits distribution was privatized.” and these fees were codified at RCW 66.24.055(3). *Ass’n of Wash. Spirits & Wine Distribs.*, 182 Wn.2d at 348. Subsection (3)(a) creates the revenue-based license fee, collecting 10% (and later, 5%) of “all spirits sales by spirits distributor licensee[s].” *Id.* (alteration in original). Under Subsection (3)(c), if the 10% license fees did not generate \$150 million in the first

year, “the shortfall between the collected fees and \$150 million was to be equitably assessed against “all persons holding spirits distributor licenses.”” *Id.* At issue in the *Association* litigation was the Board’s \$150 Million Rule, WAC 314-23-025, which imposed Subsection (3)(c)’s shortfall for the \$150 million *only* on spirits distributor licensees, when, in apparent contradiction, the Board extended Subsection (3)(a)’s 10% license fee on spirits distributor licensees *and* others, such as distillers. *Id.*

By the time the matter came before the Supreme Court, the Board made “no serious attempts to distinguish its conflicting positions interpreting the language of the Subsection 3(a) percentage fee and the Subsection (3)(c) shortfall fee.” *Id.* at 354 (footnote omitted). Indeed, in its briefing, the Board, “contrary to its assertions” taken before the Superior Court in this matter, argued “that its broad regulatory authority to impose licensing fees justifies imposing a 10 percent fee on [distillers].” *Id.* at 354 n.4. The Supreme Court declined to rule upon the validity of the Board’s 10% Rule, finding that it was not properly before the Court, and decided that the “propriety of WAC 314-23-025 does not depend on the propriety of a separate regulation.” *Id.* at 355.

Squarely before the Court, however, was the argument that the Subsection (3)(c) shortfall fee was applicable to other licensees because of RCW 66.24.640’s language extending “applicable laws and rules”

applying to distributors to industry members acting as distributors. *Id.* at 354. And the Supreme Court roundly rejected this argument, holding that RCW 66.24.055(3)(c) unambiguously imposed liability only on “spirits distributor licensee[s],” and as a specific fee provision, it controlled over the general provisions included in RCW 66.24.640. *Id.* at 356-57. The Board’s rule, and its interpretation limiting RCW 66.24.640, was upheld. *Id.*

3. The “Sell-and-Deliver Rule”: WAC 314-23-020(2) & WAC 314-24-180(2)

The Board’s I-1183 implementing rules also required distributors to “sell and deliver” spirits and wine from the distributors’ licensed premises. WAC 314-23-020(2) (sell-and-deliver requirement for spirits distributors); WAC 314-24-180(2) (sell-and-deliver requirement for wine distributors). The origin of this requirement cannot be found in any part of the agency record: even a public record request and discovery into the origins of this rule could not unearth a single issue paper, internal memo, stakeholder comment, or other evidence of why the Board determined the Sell-and-Deliver Rule was necessary or appropriate. *See generally* CP 206-233 (discovery responses by Board members); CP 130 ¶ 7 (public records requests).

This new rule prohibits a business practice in which distributors sell and distribute product to retailers without ever storing the product at the distributors' warehouses. Some manufacturers and distributors are willing to cooperate in such an approach to provide modest cost savings to the retailer. Usually the manufacturer does not want to self-distribute but is willing to accept a hybrid approach in which the distributor handles sales but the product does not come to rest at the distributor's warehouse, going directly to the retailer (and therefore bypassing the need to pay for additional storage fees). The Board did not attempted to articulate a rationale for the rule, which is especially nonsensical under the new I-1183 regime that generally allows private sector innovation and efficiencies and specifically allows retailers to engage in central warehousing, which facilitates such an approach. Why make inventory come to rest in one distribution facility when it is immediately destined for another? No safety rationale was stated or is apparent.

The rule appeared late in the rulemaking effort, after missing from both the first and second emergency rules that served as the precursor drafts. *Compare* Appendix D (First Emergency Rules, LCB00000995-96, LCB000001410-21), *and id.* (Second Emergency Rules, LCB00000954-59), *with id.* (Draft Rules, LCB00001174). As its reason for adopting the rule, the Board stated only that "the board has the authority to adopt rules

governing the sale of liquor by licensees, including a clarification or further limitation on sales.” Appendix D (CES for first rules set, LCB00001037).

Not until the Board responded to Appellants’ opening brief below did the reason for the rule come to light: “Some stakeholders had engaged Board staff in conversations about practices in some industries where the product is purchased or ordered by a distributor, and purportedly shipped to the distributor’s location, but is never stored at the location, but simply redirected for delivery to the retailer.” CP 972 (Br. of Resp’ts at 22). Notably, there was no citation to the agency record for this explanation. *Id.* Nor is there any citation for the supposed justification of the rule: “This practice limits the ability of the Board to require record-keeping to assure proper tracking of product and payment of fees and taxes.” *Id.* The brief provided no explanation for this *ipse dixit*.

C. Procedural Background

Appellants sought judicial review of both sets of I-1183 implementing rules, bringing procedural, statutory, and constitutional challenges. Appendix B (CP 123 ¶ 25); *see also* CP 1-16 (Petition for Review for first set); CP 900-911 (Petition for Review for second set). Appellants also challenged nine specific rules for exceeding the Board’s statutory authority. Appendix B (CP 124-125 ¶¶ 27(a)-(e)) (listing rules

challenged from first set of rules); *id.* (CP 126 ¶¶ 28(a)-(b)) (listing rules challenged from second set).

In May of 2013, the Superior Court invalidated all of the rules because the Board failed to satisfy its statutory obligation to consider the rules' impact on Washington's small businesses. CP 790 (May 2013 Order at 3 ¶ 6). With one exception, the court allowed the rules to remain in effect during a remand for the Board to prepare a Small Business Economic Impact Statement ("SBEIS"), as required by RCW 19.85.011. *Id.* The exception is that the court invalidated the so-called "24 Liter Rule" on the merits. CP 789 (*Id.* at 2 ¶ 1).

Nearly a year later, the Board adopted an SBEIS, Declaration of Ulrike B. Connelly, Exs. A & B ("Connelly Decl."), but took no action to reconsider, revise, or re-promulgate the rules based on the analysis performed in the SBEIS. Nor did the Board promptly return to the Superior Court to validate its action. While Appellants do not concede that the Board's SBEIS process satisfied the reasoned consideration contemplated by the lower court and RCW 19.85, in March of 2016, the parties agreed that the Board's reconsideration of the challenged rules had concluded, and a final Superior Court issue was ordered. CP 851 (March 2016 Order at 2 ¶ 5); *see also* CP 852 (the May 2013 Order "shall remain in effect" except as otherwise superseded by Final Order). The Board has

not challenged the lower court's determination regarding the initial procedural deficiency or the ruling that the 24 Liter Rule exceeded the Board's authority because it contradicted the plain language of I-1183.

IV. STATEMENT OF ISSUES

(1) May the Board impose I-1183's distributor license fee on distillers when I-1183 explicitly applies the fee only on distributors? No. The Board's 10% Rule, WAC 314-23-030(3)(b), is invalid.

(2) May the Board promulgate a rule without any basis or explanation? No. The Board's Sell-and-Deliver Rule, WAC 314-23-020(2) and WAC 314-24-180(2), is invalid.

V. ASSIGNMENT OF ERROR

This is a challenge to the validity of rules pursuant to Washington's Administrative Procedure Act, RCW 34.05.570(2). Because the appellate court "sits in the same position as the superior court," it applies the standards of the APA directly to the record before the agency during the rulemaking rather than assessing the validity of the Superior Court's decisions. *State Hosp. Ass'n v. Dep't of Health*, 183 Wn.2d 590, 595 (2015). To the extent still warranted, Petitioners assign error to the following decisions of the Superior Court:

1. The Superior Court erred in deciding WAC 314-23-030, imposing the 10% distributor's license fee (the 10% Rule), is within the

Board's authority and reasonably consistent with the statutory scheme enacted by I-1183. *See* CP 864 (May 2013 Order at ¶ 2); CP 873-74 (Court's Opinion at 7-8).

2. The Superior Court erred in deciding WAC 314-23-020 and WAC 314-24-180 (the Sell-and-Deliver Rule provisions) are valid exercises of the Board's authority. *See* CP 864 (May 2013 Order at ¶ 3); CP 874-75 (Court's Opinion at 8-9).

3. The Superior Court erred in denying Petitioners' challenge to the rules as being arbitrary and capricious. *See* CP 864 (May 2013 Order at 3).

VI. STANDARD OF REVIEW

The APA governs. RCW 34.05 et seq. The challenged rules are invalid on two grounds: (1) the rules exceed the agency's statutory rulemaking authority, and (2) the rules are arbitrary and capricious. RCW 34.05.570(2)(c).

Determining the extent of rulemaking authority is a question of law. *Ass'n of Wash. Spirits & Wine Distribs.*, 182 Wn.2d at 350 (citing *Wash. Pub. Ports Ass'n v. Dep't of Revenue*, 148 Wn.2d 637, 645 (2003)). Similarly, appellate review of whether agency action is arbitrary and capricious is de novo. *Stewart v. Dep't of Soc. & Health Servs.*, 162 Wn.

App. 266, 273 (2011) (citing *Wash. Indep. Tel. Ass'n v. Wash. Utils. & Transp. Comm'n.*, 149 Wn.2d 17, 24 (2003)).

Nor does this Court owe any deference to the Board's interpretation of the statute at issue here. "We do not require agency expertise in construing an unambiguous statute, and we do not defer to an agency determination that conflicts with the statute." *Id.* at 355 (citing *Waste Mgmt. of Seattle, Inc. v. Utils. & Transp. Comm'n.*, 123 Wn.2d 621, 628, 869 P.2d 1034 (1994)). RCW 66.24.055 is unambiguous. *Ass'n of Wash. Spirits & Wine Distribs.*, 182 Wn.2d at 351.

VII. ARGUMENT

A. The 10% Rule Is Invalid and Unenforceable.

The Board's 10% Rule is invalid for three independent reasons. First, the Washington Supreme Court has held the Board's sole stated justification for the 10% Rule to be legally invalid in related litigation, and this Court should reject the effort by the Board's attorneys to fashion a new reason for upholding the rule. Second, the Board lacks authority to contradict the Initiative or to impose license fees untethered from the needs to protect public safety or to cover administrative costs. Finally, the Board's decision-making process was arbitrary and capricious in failing to consider the impact or need for the 10% license fee and in contradicting the Board's approach to the \$150 Million Rule.

1. The Board's justification for the 10% Rule fails because I-1183 imposes it only on spirits distributor licensees.

In imposing the 10% Rule, the Board misread I-1183. The Board improperly imposed distributor license fees on distillers who are not licensed as distributors, contrary to the plain language of I-1183, which imposes the 10% license fee only on spirits distributors.

a. RCW 66.24.055(3)(a) applies only to spirits distributor licensees.

In exchange for the opportunity to replace the state in distributing spirits “purchased from manufacturers, distillers, or suppliers,” I-1183 imposed on “each spirits distributor licensee” a license fee based on the volume of resales to retail licensees. RCW 66.24.055(1), (3)(a). RCW 66.24.055 is unambiguous. *Ass'n of Wash. Spirits & Wine Distribs.*, 182 Wn.2d at 351. Subsection (3)(a) plainly limits what type of licensee owes the 10% license fee, using precise language: “distributor license” and “distributor licensee.” RCW 66.24.055(3)(a). The Initiative does not use the broader term “distributor” in this subsection, and its purpose section clearly articulates on whom this license fee should be imposed: the Initiative would “[r]equire private *distributors* (who get licenses to distribute liquor) to pay ten percent of their gross spirits revenues to the state.” Laws of 2012, ch. 2, § 101(2)(c) (emphasis added).

In short, RCW 66.24.055 is unambiguous and “precisely defines the fees attendant to obtaining” a spirits distributor license. *Ass’n of Wash Spirits & Wine Distribs.*, 182 Wn.2d at 351. It does not apply to distillers. The Board has previously agreed with such a reading, stating before the Washington Supreme Court that “persons holding a distillers license or certification of approval are not licensed under RCW 66.24.055, and their license fees—including the extra fee prescribed for undertaking the limited distribution of their products to licensed spirits retailers—do not depend on the language of RCW 66.24.055(3)(a).” Appendix E-62 (*Association Board’s Resp. Br.* at 18).

b. The Supreme Court’s decision controls the question of whether RCW 66.24.640 operates to extend Subsection (3)(a)’s fee to distillers.

Before the Superior Court, the Board “asserted that ‘distillers or certificate of approval holders acting as distributors *must comply with all laws applicable to distributors*’ as justification for its successful argument that ‘distillers and certificate of approval holders who choose to distribute their products are subject to the 10% distributor fee.’” *Ass’n of Wash. Spirits & Wine Distribs.*, 182 Wn.2d at 354 (citation omitted). When confronted with the inconsistency in its position between the \$150 Million Rule and the 10% Rule, however, the “Board ma[d]e[] no serious attempts to distinguish its conflicting positions,” and indeed argued—

successfully—that the specific fee provision under Subsection (3)(c) trumped the general provisions set out in RCW 66.24.640.⁹ *Id.*: see also Appendix E-62-63 (*Association* Board’s Resp. Br. at 18-19) (arguing that RCW 64.24.640 “does not subject a licensed distiller to fees assessed against holders of a spirits distributor license” because a specific fee provision trumps over general provision).

Presumably, the Board will now abandon the argument that RCW 66.24.640 requires the extension of the Subsection (3)(a) revenue-based license fee to industry members operating as distributors. The Supreme Court’s reasoning in *Association of Washington Spirits & Wine Distributors* controls, and the same basis for rejecting such an argument in the context of the Subsection (3)(c) shortfall provision dictates rejection in the context of the Subsection (3)(a) revenue-based license fee.

In the litigation regarding Subsection (3)(c), the Supreme Court held that it is a “specific fee provision[]” that applies only to “persons holding spirits distributor licenses,” not to distillers. *Ass’n of Wash. Spirits & Wine Distribs.*, 182 Wn.2d at 356. In contrast, RCW 66.24.640

⁹ The Association also relied on a related provision, RCW 66.28.330(4), which contained similar language extending “provisions of and regulations under this title applicable to wholesale distributors” to spirits retailers. *See id.* at 356-57 (quoting RCW 66.28.330(4)). It is inapplicable here to spirits distributors; to the extent any relevance remains, the arguments are the same for both this statutory provision and RCW 66.24.640.

is a general provision that does not “address[] the licensing fee structure or impose[] additional licensing fees” for distillers. *Id.* at 357.

The same reasoning applies here to limit the plain language of Subsection (3)(a) and imposes the 10% license fee on only spirits distributor licensees. Indeed, the Initiative used virtually the same language in both subsections (emphasis added):

Subsection (3)(a): “[E]ach spirits distributor licensee must pay to the board . . . a license issuance fee calculated as follows . . . ten percent of the total revenue from all the licensee’s sales of spirits made during the month for which the fee is due”

Subsection (3)(c): “[A]ll persons holding spirits distributor licenses . . . must have paid collectively one hundred fifty million dollars or more in spirits distributor license fees. If the collective payment . . . totals less than one hundred fifty million dollars, the board must . . . collect . . . as additional spirits distributor license fees the difference between one hundred fifty million dollars and the actual receipts, allocated among persons holding spirits distributor licenses”

There is no meaningful difference between “persons holding spirits distributor licenses” and “each spirits distributor licensee.” While the Board originally, when promulgating the \$150 Million Rule, attempted to draw a distinction between the language of Subsections (3)(a) and (3)(c), CP 255-56, the Board again made no serious attempts on insisting there

was such a difference on appeal. *See* Appendix E-64 (*Association Board's* Resp. Br. at 20) (brief does not argue that the difference between the phrase "spirits distributor licensee" and "person holding a spirits distributor license" is meaningful).

The Supreme Court's reasoning in *Association of Washington Spirits & Wine Distributors* controls here. Just like Subsection (3)(c), Subsection (3)(a) is a specific fee provision that trumps over the general application of RCW 66.24.640. *See Waste Mgmt. of Seattle*, 123 Wn.2d at 629-30 (a specific statute supersedes a general one). Given that Subsection (3)(a) chose specifically not to impose the 10% spirits distributor license fee on any other entities, the general provision in RCW 66.24.640 cannot trump the People's choice and apply the 10% license fee to distillers distributing their own spirits. *Accord Ass'n of Wash. Spirits & Wine Distribs*, 182 Wn.2d at 358.

c. With the Board's reasoning invalidated, the 10% Rule must be invalidated.

This Court must review the validity of a challenged administrative rule based on the reasons relied on by the agency in the course of rulemaking. RCW 34.05.570(1)(b) ("The validity of agency action shall be determined in accordance with the standards of review provided in this section, as applied to the agency action *at the time it was taken.*")

(emphasis added); *Wash. Indep. Tel. Ass'n v. Wash. Utils. & Transp. Comm'n*, 148 Wn.2d 887, 906 (2003) (finding “the validity of a rule is determined as of the time the agency took the action adopting the rule”).

Courts cannot “substitute their or counsel’s discretion for that of the [agency].” *Lightfoot v. MacDonald*, 86 Wn.2d 331, 336-37 (1976) (discussing federal agencies and citing *SEC v. Chenery Corp.*, 318 U.S. 80, 88 (1943)).¹⁰ Therefore “agency action cannot be sustained on post hoc rationalizations supplied during judicial review.” *Somer*, 28 Wn. App. at 272.

Here, the Board based the 10% Rule solely on its interpretation of RCW 66.24.640. Appendix D (CES for first rules set, LCB00001035) (“Based on the language of the new law [RCW 66.24.640], a distillery or spirits certificate of approval licensee is required to pay the 10% on sales to retailers.”); CP 971 (Br. of Resp’ts at 21). But as discussed above, the Board’s stated reason for promulgating the 10% Rule fails given the Washington Supreme Court’s holding in *Association of Washington Spirits & Wine Distributors*, 182 Wn.2d at 354 (finding such a reading of

¹⁰ Federal law is persuasive authority on this issue. *Somer v. Woodhouse*, 28 Wn. App. 262, 272 (1981) (when “no Washington authority adequately addresses the question,” the court will “look to federal law for guidance”). Known as the *Chenery* doctrine, a federal court will not uphold an agency rule on a basis other than the one provided by the agency in its original decision. *Chenery*, 318 U.S. at 87 (“The grounds upon which an administrative order must be judged are those upon which the record discloses that its action was based.”)

RCW 66.24.640 to have “little appeal”).¹¹ In sum, the Board’s only rationale has been invalidated—and the 10% Rule must necessarily be invalidated as well.

This Court should reject any attempt by the Board now to justify the 10% Rule under a basis different from the one considered by the Board. During the litigation over the \$150 Million Rule, the Board “acknowledge[ed] that the purpose behind the broad reading of the Subsection (3)(a) percentage fee was to maximize the State’s revenue.” *Ass’n of Wash. Spirits & Distribs.*, 182 Wn.2d at 354-55. Additionally, the Board argued, “contrary to its assertions” in this case to the lower court, “that its broad regulatory authority to impose licensing fees justifies imposing a 10 percent fee on certificate of approval holders [i.e. distillers].” *Id.* at 354 n.4; *see also* Appendix E-60 (*Association Board’s* Resp. Br. at 16) (arguing the “broad and specific powers” of the Board “authorize the Board to impose an additional fee on distillers”).

¹¹ The Superior Court did not have before it the need to resolve the conflict between the 10% Rule and the \$150 Million Rule, and at the time it ruled on the issues before this Court now, Judge Price did not have the benefit of the Supreme Court’s decision. Indeed, the lower court’s memorandum opinion shows that the court also misunderstood the origin of RCW 66.24.640. CP 785 (Ct.’s Op. at 8) (“Since this law, RCW 66.24.640, remains . . . [t]he Court agrees with the Board that imposing the 10% fee on COA holders for their sales as distributors is reasonably consistent with the statutory scheme read as a whole and does not directly conflict with provisions of I-1183.”). Yet RCW 66.24.640 was a new statutory provision implemented by I-1183. *See* Laws of 2012, ch. 2, § 206

But neither maximizing state revenue nor imposing a licensing fee based on the Board's independent authority were reasons articulated by the Board at the time the 10% Rule was adopted, and those reasons cannot now justify judicial approval of the rule. Not only did the public not receive an opportunity to comment on such rationalizations and submit evidence that may well have shown the fallacy of the Board's assumption that the imposition of this fee "maximized" revenue, the Board had no opportunity to exercise what judgment and discretion it does have to consider the amount of an additional license fee. Last but not least, the Board did not perform the required small business impact analysis on whether this 10% license fee disproportionately hurt the distillers—many of whom are in fact, small businesses. *See* CP 790 (May 2013 Order at 3 ¶ 6) (invalidating all rules for failure to conduct any SBEIS); Connelly Decl., Ex. B (no discussion of the 10% Rule's impact in the SBEIS finally adopted by the Board).

Even were this Court to now consider these new rationalizations, however, the conclusion remains the same: the 10% Rule is invalid because the Board has no authority to impose it.

2. The Board Has No Authority to Impose the 10% License Fee on Distillers.

I-1183 does not authorize the imposition of the 10% fee on distillers. And the Board has no authority to impose it on distillers when the People made the choice *not* to impose it on these entities. Nor is there an implied authority for the Board to act when no nexus exists between this license fee and any administrative function or public safety.

a. The Board has no authority to impose a revenue-based license fee when I-1183 chose not to impose it.

The Board lacks the authority to modify or amend I-1183 by rulemaking. “An administrative agency cannot modify or amend a statute by regulation. Indeed, a rule that conflicts with a statute is beyond an agency’s authority and invalidation of the rule is proper.” *H & HP’ship v. State*, 115 Wn. App. 164, 170 (2003) (footnotes omitted). Here, the Board’s imposition of the 10% license fee on distillers effectively amends I-1183, which intentionally did not impose that fee on anyone other than spirits distributors. *See* Laws of 2012, ch. 2, § 101(2)(c) (purpose of 1183 was to “require private *distributors* who get licenses *to distribute* liquor to pay ten percent of their gross spirits revenues to the state”) (emphasis added). If a statute “specifically designates” its legislative objects, courts presume that “all things or classes of things omitted from it were intentionally omitted.” *Landmark Dev., Inc v City of Roy*, 138 Wn.2d

561, 571 (1999) (upholding the legislative choice to apply an offset to the calculation of water connection charges on three of four types of municipal corporations by refusing to extend such an offset to the fourth) (citation omitted); *State ex rel. Port of Seattle v. Dep't of Pub. Serv.*, 1 Wn.2d 102, 112-13 (1939) (“Where a statute enumerates the persons or things to be affected by its provisions, there is an implied exclusion of others, and the natural inference follows that it is not intended to be general.”) (citation omitted).

The Washington Supreme Court has invalidated rules in analogous circumstances. In *Edelman v. State ex rel. Public Disclosure Commission*, the agency defended a rule by claiming it was addressing a “gap” in the law concerning the extent of campaign contribution limits as applied to affiliated entities and whether there existed an exemption if a parent organization did not participate in the campaign. 152 Wn.2d 584, 587-88 (2004). But the Court found the statute’s plain language did address the topic of whether there should be such an exemption—and addressed it by *not including* the exemption created by the agency’s rule, despite having included other exemptions. *Id.* at 590. The agency’s rule was therefore invalid because it “amend[ed] or change[d] a legislative enactment.” *Id.* at 591.

Other portions of the law demonstrate that the People knew both how to impose a fee on entities other than spirits distributor licensees and how to extend fees to those “acting as distributors.” *See United Parcel Serv., Inc. v. Dep’t of Rev.*, 102 Wn.2d 355, 362 (1984) (finding “where the Legislature uses certain statutory language in one instance, and different language in another, there is a difference in legislative intent”). RCW 66.24.055(3)(d) extends the 10% license fee to entities not holding a distributor license in a single, narrow instance: on a “retail licensee selling for resale” when no “other distributor license fee has been paid.” And the Initiative also knew how to sweep non-distributor licensee types into its net, extending certain spirits taxes on “other licensees acting as a spirits distributor” in addition to spirits distributors. *E.g.*, Laws of 2012, ch. 2, § 106(2) (imposing a tax on spirits) (codified at RCW 82.08.150(2)).

Similarly, RCW 66.24.055 specifically addresses how, when, and who owes the 10% distributor license fee: it chose not to impose it on any other entities. The Board’s decision to unilaterally extend the license fees to a different group of licensees disturbs the careful choices made by the People in setting up the new private spirits market for Washington and therefore exceeds its authority.

Here, the Board may not extend liability for the 10% license fee to entities not specified by the Initiative. *See Dep’t of Rev. v. Bi-Mor, Inc.*,

171 Wn. App. 197, 206 (2012) (holding that the agency rule “created more tax liability than the legislature authorized” under the unambiguous statute, rendering the rule “void as a matter of law”), *review denied*, 177 Wn.2d 1002 (2013). To do so would allow the agency to contradict the careful choices made by the People in enacting I-1183.

Notably, the Board embraced this same principle of statutory construction during the \$150 Million Rule, and the reasoning it presented to the Supreme Court applies with equal force here. In its Response Brief, the Board argued that “neither the Board in its rulemaking nor the Court in deciding this case may add language to an unambiguous statute.”

Appendix E-67 (*Association Board’s Resp. Br.* at 23 (citing to *City of Seattle v Fuller*, 177 Wn.2d 263, 287 (2013))). The Board (successfully) insisted it would be unlawful to add language to RCW 66.24.055(3)(c) that extended the liability for the \$150 million shortfall fee to any entity other than “persons holding spirits distributor licenses.” *Id*

The same statutory interpretation and deference to the unambiguous language of RCW 66.24.055 governs here: the Board cannot, by rule, amend the statute to extend the 10% license fee imposed by RCW 66.24.055(3)(a) to any entity other than a spirits distributor licensee. *See Fuller*, 177 Wn.2d at 269 (stating “[t]he court must not add words where the legislature has chosen not to include them”). Regardless

of the Board's authority to impose license fees, discussed in detail below, an agency always lacks authority to contradict or amend a statute. *See H & H P'ship v. State*, 115 Wn. App. at 170 .

b. The Board does not have authority to impose significant new license fees untethered to its regulatory function or public safety.

Even assuming the People had not been clear in their choice to impose the 10% license fee on only those who inherited the nearly half-a-billion dollar distribution business from the state, the Board has no authority to independently impose a license fee intended solely to raise revenue for the state. The Board's position, taken not in rulemaking but in the related \$150 Million Rule litigation, was that the Board's "broad regulatory authority" allowed it to impose a "10 percent fee on certificate of approval holders." *Ass'n of Wash. Spirits & Wine Distribs.*, 182 Wn.2d at 354 n.4; *see also* Appendix E-60 (*Association Board's Resp. Br.* at 16). No such broad authority exists in the wake of I-1183.

Historically, the Board had been empowered to enact rules to "supply[] any deficiency" in the state's liquor laws with "regulations not inconsistent with the spirit of this act." Laws of 1933, ch. 62, § 79(1) (former RCW 66.08.030(1)). Washington courts repeatedly relied on this general gap-filling authority to uphold Board rules. *E.g., Anderson, Leech & Morse, Inc. v. Liquor Control Bd* , 89 Wn.2d 688, 693 (1978)

(restrictions on topless dancing on licensed premises): *State ex rel. Thornbury v. Gregory*, 191 Wn. 70 (1937) (ban on Sunday sales).

I-1183, however, signaled a shift not just in economic policy but also in social policy. “I-1183 also amended the policy reasons behind the State’s regulation of alcohol.” *WASAFP*, 174 Wn.2d at 638. The Initiative removed half of the policy goals for the state: namely, the “orderly marketing of alcohol and encouraging moderation in consumption of alcohol.” *Id* The only two goals remaining today include “protecting the public interest and advancing public safety by preventing the use and consumption of alcohol by minors and other abusive consumption, and promoting the efficient collection of taxes by the state.” *Id*

With this policy shift, the People also reduced the Board’s authority to regulate the liquor market. I-1183 removed the Board’s historically broad, general rulemaking authority, striking the following language from RCW 66.08.030:

For the purposes of carrying into effect the provisions of this title according to their true intent or of supplying any deficiency therein, the board may make such regulations not inconsistent with the spirit of this title as are deemed necessary or advisable.

Laws of 2012, ch.2, § 204. Thus I-1183 removed the Board's long-standing gap-filling authority to "fill in" RCW Title 66 with rules and limited the Board to governing the administrative aspects of liquor sales and focus on public safety.¹² In other words, while public safety was a major source of rulemaking power prior to I-1183, *Anderson*, 89 Wn.2d at 695, after I-1183, it is the Board's *exclusive* purpose beyond enforcing the laws as written, *WASAFP*, 174 Wn.2d at 657. *Accord* Laws of 2012, ch. 2, § 101(2)(b) (Board should focus on the "more appropriate government role of enforcing liquor laws and protecting public health and safety concerning all alcoholic beverages").

Finally, if the People had intended to grant the Board generalized powers in addition to specific, enumerated ones, it would have done so explicitly. *See* Laws of 2013, ch. 3, § 9 (Initiative 502, which delegated authority to license marijuana producers, distributors and retailers to the Board, specifically granted the Board the authority to adopt rules generally and, "without limiting the generality of" the grant of general authority, then lists specific areas over which the Board has authority). Yet after excising the general powers language from RCW 66.08.030, all that

¹² The Board has failed to recognize the removal of this gap-filling authority. *See* Appendix D (February 28, 2012 Board Caucus, LCBS000015) (Then-Agency Director Kohler stating that they have "gap-filling" authority post-I-1183: "It is the Board's job to, when there is a lack of clarity, to define that by rule"); Appendix E-60 (*Association* Board's Resp. Br. at 15) (citing exclusively to pre-Initiative cases, and one which relies specifically on the "gap-filling" authority removed by the initiative)

remains for the Board is a list of enumerated powers. And those enumerated powers are circumscribed by the Board's delegated purpose: to administer licenses for the sale of liquor and focus on public safety.

The Board's specific grant of authority to "prescrib[e] the fees payable in respect of permits and licenses issued under this title for which no fees are prescribed in this title," RCW 66.08.030(4), must therefore be read narrowly to accord with the scope of the Board's authority to impose any rules. *Wash. Indep. Tel. Ass'n*, 148 Wn.2d at 363 (agency authority is limited to that which is expressly granted by statute or necessarily implied therein").

The Board readily admits that it did not consider how any of its rules, including the 10% Rule, impacted public safety during the rulemaking process. Appendix B (CP 122 ¶ 20). Nor does the 10% Rule cover necessary administrative expenses or defray the cost of some new regulation; as the Board admitted in the *Association of Washington Spirits & Wine Distributors* litigation, the 10% Rule was a means to "maximize the State's revenue." 182 Wn.2d at 355. But decisions about new sources of revenue for the state, as opposed to collecting expressly authorized fees, have not been delegated to the Board. What would stop the Board from declaring a 10% license fee for every caterer that applies for an event

liquor license, or a 20% license fee based on all sales by sports venue liquor licensees?

3. The Board's 10% Rule Is Arbitrary and Capricious.

A third, independent reason to invalidate the 10% Rule is that the Board's rulemaking process here was arbitrary and capricious. It was based on an erroneous and inconsistent interpretation of the statute, and the Board failed to undertake the necessary consideration of the impact of the rules.

"[W]hen a rule is challenged as arbitrary and capricious, the reviewing court must consider the relevant portions of the rule-making file and the agency's explanations for adopting the rule." *Wash. Indep. Tel. Ass'n v. Wash. Utils. & Transp. Comm'n*, 148 Wn.2d 887, 906 (2003). While this Court should not replace its reasoned process with that of the agency, action that is "willful and unreasoning and taken without regard to the attending facts or circumstances" must be invalidated. *Id.* One example of such an unreasoning approach is an agency's adoption of inconsistent positions. *See generally Port of Seattle v. Pollution Control Hearings Bd.*, 151 Wn.2d 568, 634 (2004) (applying RCW 34.05.570(3) and stating APA provides relief when an agency's order is "inconsistent with an agency rule" without explanation); *see also* RCW 34.05.570(3)(h) (allowing relief from agency action when the order is "inconsistent with a

rule of the agency unless the agency explains the inconsistency by stating facts and reasons to demonstrate a rational basis for inconsistency”).

Accord Rochester-Genessee Reg'l Transp. Auth v Hynes-Cherin, 531 F. Supp. 2d 494, 506-07 (W.D.N.Y. 2008) (in finding agency action arbitrary and capricious, stating “that, despite the narrow scope of court review . . . any agency’s unexplained departure from prior agency determinations is inherently arbitrary and capricious”) (citations and quotations omitted); *see also Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 981 (2005) (“Unexplained inconsistency is, at most, a reason for holding an interpretation to be an arbitrary and capricious change from agency practice under the Administrative Procedure Act.”) (citations omitted).

As already discussed, the Board’s only reason for the 10% Rule, and the only one that appears in the agency record, is its interpretation of RCW 66.24.640’s reach. The Board’s interpretation of RCW 66.24.640 as applied to the 10% Rule is inconsistent with its interpretation proffered to support its \$150 Million Rule. *See Ass’n of Wash. Spirits & Wine Distribs.*, 182 Wn.2d at 354 (discussing Board’s “conflicting positions”). That is arbitrary and capricious, and the Washington Supreme Court has determined which approach is correct.

Finally, the 10% Rule cannot have been the result of a reasoned process with “regard to the attending facts or circumstances.” *Id.* at 358. If the Board ever engaged in a reasoned process regarding the need and impact of the 10% Rule on distillers, the agency record does not reflect it. Indeed, in promulgating the rule initially, the Board failed to so much as engage in any small business economic impact analysis; its court-ordered foray into such analysis shows that the 10% Rule was not separately considered or analyzed. *See Connelly Decl., Ex. B.*

In fact, what little consideration was given to the 1-1183 rules as a whole reveal that the Board concerned itself with structuring the new liquor marketplace to ensure some kind of economic “fairness.” For example, Respondent Marr explained that his interest was to establish a “level playing field” and that the amount of competition the Initiative expressly allowed to off-premises retailers against distributors was “unfair.” CP 215 (Marr Interrogatory Responses at 10). In fact, he went so far as to claim that the Board had a duty to act to protect the financial interests of distributors: “[W]holesalers should rely on the expectation that the [Board] will act to insure that those not licensed to act as distributors (except under those exceptions allowed under the initiative) are prevented from doing so.” CP 214 (*Id.* at 9); Appendix D (February 28, 2012 Board Caucus, LCBS000015) (noting “[t]here is an unevenness in terms of harm

that will be done,” referring to the economic consequences of the 1183 rules).

Similarly, the Board’s discussions about which businesses can do what, and how large their profit margins should be, illustrate how far the Board drifted from its statutory purpose. Appendix D (February 22, 2012 Board Meeting Transcript, LCB00000648-76); *id.* (May 24, 2012 Rules Hearing Transcript, LCB00001743-76). The economic structure of the marketplace is no longer within the Board’s purview—if it ever was a legitimate concern.

The Board had no authority to enact the 10% Rule, or alternatively, either its basis for so enacting the rule has been invalidated or its action was arbitrary and capricious. The rule must be invalidated.

B. The Sell-and-Deliver Rule Is Invalid.

The second issue concerns the Board’s Sell-and-Deliver Rule, which imposes new delivery restrictions on distributors, requiring them to “sell and deliver” spirits and wine from the distributor’s licensed premises. WAC 314-23-020(2) (sell-and-deliver requirement for spirits distributors); WAC 314-24-180(2) (sell-and-deliver requirement for wine distributors). This new rule prohibits a business practice in which distributors sell and distribute product to retailers without ever storing the product at their

warehouses. Some wineries and distillers cooperate in such an approach to provide modest savings to the retailer.

The Board has never seriously contended that I-1183 necessitates the Sell-and-Deliver Rule. *See, e.g.*, RP at 82; CP at 971 (Br. of Resp'ts at 21); *see also* Section III.C., *supra*. The Initiative invites private sector efficiency and innovation. *See, e.g.*, Laws of 2012, ch. 2 § 101 (purpose). It does not direct the Board to promulgate such a rule, nor does any particular provision invite such rulemaking. The Board has failed to articulate any explanation for the Sell-and-Deliver Rule, and no justification or reasoning for it exists in the record, rendering the agency's rule arbitrary and capricious under RCW 34.05.570(2).

When an agency proffers no explanation of the reasons for a rule, the court has no choice but to find the agency acted in an arbitrary and capricious manner. *Puget Sound Harvesters Ass'n v. Dep't of Fish & Wildlife*, 157 Wn. App. 935, 951 (2010) (finding agency acted arbitrarily because the CES "[did] not provide a rational explanation" for its decision); *see also Low Income Hous. Inst. v. City of Lakewood*, 119 Wn. App. 110, 119 (2003) (applying RCW 34.05.570(3) and finding "where, as

here, the Board presents no basis for its decision, we cannot review its analysis”).¹³

The only discussion in the CES for the Sell-and-Deliver Rule recites RCW 66.08.030(6) and (12) and then states: “Together these sections referenced above clearly show that the board has the authority to adopt rules governing the sale of liquor by licensees, including clarification or further limitation on sales.” Appendix D (CES for first rules set, LCB00001031) (discussing WAC 314-23-020(2)). This is an explanation of the Board’s alleged authority, not of the reason for exercising authority in a particular way. The CES for the second set of rules, which included the wine Sell-and-Deliver Rule, does not include *any* relevant discussion. *Id.* (CES for second rules set, LCB20000398-99) (covering WAC 314-24-180(2)).

The record is as devoid of reasoning as the Board’s CESs. The Board has admitted that public safety was not a consideration for this (or any other) rule. Appendix B (CP 122 ¶ 20) (“[T]he agency record does not include, and the Board did not otherwise consider, any specific information regarding the anticipated effect of the proposed rules at issue

¹³ See also *Nat. Res. Def. Council v. EPA*, 658 F.3d 200, 216 (2d Cir. 2011) (failure to provide explanation was arbitrary and capricious); *Nat. Res. Def. Council v. EPA*, 571 F.3d 1245, 1267 (D.C. Cir. 2009) (stating that “to ensure that an agency’s decision has not been arbitrary, we require the agency to have identified and explained the reasoned basis for its decision”) (citation omitted).

on public safety.”). The record is also silent on how the Board members reached their final decisions on any of the contested rules. *See* Appendix D (May 24, 2012 Board Caucus, LCBS000022-24) (setting out entire discussion of the first rule set). The Board points to no studies, reports, articles, or commentary. There are no emails between agency staff or the members engaging in debate over the specifics of the rules. There is no evidence even of an attempt by the Board to gather relevant information. The meeting notes of internal agency discussions show that the Board did not stop to consider why favoring one approach to a proposed rule over another would promote the agency’s objectives. The record contains no comments, discussion, or other analysis of these new delivery restrictions.¹⁴ Finally, the Board’s do-over attempt to analyze the rules’ impact on small businesses, as required by the lower court, also fails to include any discussion on the Sell-and-Deliver Rule. Connelly Decl., Ex. B.¹⁵

¹⁴ Indeed, the sole mention of the Sell-and-Deliver Rule during the entire rulemaking record appears to be the Rules Coordinator’s announcement during a public hearing that this rule was added from the emergency rules and described the rule, but not its purpose or what need it would address. *See id.* (May 24, 2012 Board Hearing Transcript, LCB00001745).

¹⁵ Indeed, the Board’s SBEIS was designed to meet at most the letter of the Superior Court’s remand. The effort consisted, in its entirety, of a surveymonkey.com link sent to the Board’s listserv and left open for less than a month. *See* Connelly Decl., Ex. B at 1. The survey posed seven generic questions about the impact of all 37 disparate rules lumped together. The Board then shrugged off the overwhelmingly negative response to its survey by stating the complaints were due to I-1183, not the rules adopted by the Board. *Id.* at 4.

Despite Appellants' public records requests seeking everything related to I-1183 implementing rules and discovery, the Board disclosed only in the briefing before the Superior Court that "some stakeholders" had raised the delivery issue, apparently in unrecorded ex parte contacts, and that the new delivery requirements somehow further "proper record-keeping to assure proper tracking of product." CP 971 (Br. of Resp'ts at 21). No explanation is provided as to why the Board's ability to directly require record-keeping or assess taxes is in any way compromised by such details as how the product is physically shipped. And whether the connection is real was never tested by discussion and reasoning on the public record or in the CESs.

Notably, the Board has never identified any part of the agency record that supports either the origin story or demonstrated the existence of a concrete administrative issue with tracking product between licensees. At the hearing, the Board's attorney claimed only that "[i]f there is, you know, nothing in the record about that [sell-and-deliver] rule and its purpose, there certainly also wasn't testimony about as to why it is a bad problem." RP at 84. But the APA does not require an agency to engage in a reasoned, public process to promulgate rules only when the public complains.

The Board's explanations for the Sell-and-Deliver Rule do not allow the public or this Court to understand why it chose to exercise its asserted powers as it did. That, by itself, makes the action arbitrary and capricious. "When an agency makes rules without considering their effect on agency goals, it acts arbitrarily and capriciously, without regard to the attending facts or circumstances." *Puget Sound Harvesters*, 157 Wn. App. at 950 (reversing agency rules). The Sell-and-Deliver Rule is invalid.

VIII. CONCLUSION

The Board exceeded its authority in promulgating the 10% Rule and the Sell-and-Deliver Rule, or alternatively, exercised its authority in an arbitrary and capricious manner. Under either basis, the fair application of the APA requires the invalidation of both rules.

RESPECTFULLY SUBMITTED this 22nd day of June, 2016.

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**COURT OF APPEALS,
DIVISION II
OF THE STATE OF WASHINGTON**

Washington Restaurant Association, a Washington non-profit organization;
Northwest Grocery Association, a non-profit organization;
and Costco Wholesale Corporation, a Washington corporation,

Appellants,

v.

Washington State Liquor and Cannabis Board, a state agency;
Chris Marr, Sharon Foster, and Ruthann Kurose, in their official
capacities as members of the Washington State Liquor and Cannabis
Board,

Respondents,

and

Association of Washington Spirit & Wine Distributors,

Intervenor-Respondent.

CERTIFICATE OF SERVICE

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CERTIFICATE OF SERVICE

STATE OF WASHINGTON

On June 22, 2016, I caused to be served upon the below named _____
DEPUTY
counsel of record, at the address stated below, via the method of service
indicated, a true and correct copy of the foregoing documents.'

- Brief of Appellants with Appendices

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**I certify under penalty of perjury under
the laws of the State of Washington that
the foregoing is true and correct.**

EXECUTED at Seattle, Washington, on June 22, 2016.



June Starr, Legal Secretary