

No. 48807-8 II

COURT OF APPEALS, DIVISION II  
OF THE STATE OF WASHINGTON

WASHINGTON RESTAURANT ASSOCIATION; NORTHWEST  
GROCERY ASSOCIATION AND COSTCO WHOLESALE  
CORPORATION

Appellants

v.

WASHINGTON STATE LIQUOR AND CANNABIS BOARD, et al,

Respondents

and

ASSOCIATION OF WASHINGTON SPIRIT & WINE  
DISTRIBUTORS,

Intervenor-Respondent

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RESPONSE BRIEF OF INTERVENOR-RESPONDENT

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## I. INTRODUCTION

For years, Costco and the other Petitioners<sup>1</sup> supported attempts to modify the state's liquor regulation system through legislation and initiatives to the people. In the lead-up to the 2011 general election, Petitioners (principally Costco) spent some \$20 million to secure passage of I-1183 and privatize the distribution and sale of alcohol in Washington. Since adoption of the initiative, respondent Washington State Liquor and Cannabis Board (the "Board") has drafted dozens of rules necessary to effectively implement the initiative.

Now, rather than accept the logical consequences of the statutory language they drafted, Petitioners challenge several rules that implement I-1183. In doing so Petitioners cast themselves as hapless victims, asserting the Board has used its rule-making authority to purposefully undercut the changes wrought by I-1183, to the direct detriment of Petitioners. This is absurd. Some of the Board's rules indirectly benefit Petitioners, others indirectly benefit distillers, and still others indirectly benefit the spirits distributors. That is the inevitable result of the statutory scheme regulating alcohol distribution and sale, as amended by the Petitioner-drafted initiative, and the regulations necessary to implement it.

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<sup>1</sup> For the sake of simplicity, petitioners Washington Restaurant Association, Northwest Grocery Association; and Costco Wholesale will be referred to collectively as "Petitioners."

Petitioners' challenge to the rules reveals the "gotcha" game Petitioners played with the voters of this state. Having carefully crafted I-1183 to secure passage at the polls by purporting to deal with serious issues raised in opposition to earlier initiative and legislative efforts, Petitioners now seek to take advantage of the language they themselves authored, to distort the clear meaning of the initiative and to gain a competitive advantage.

Ultimately, what this appeal comes down to is the intent of the voters. All three of the rules at issue are consistent with Washington's statutory system for the regulation of alcohol, as amended by the initiative, and all three carry out the voters' intent.

It was the intent of the voters that the Board would retain the power to regulate liquor, in order to assure continued control over its distribution and sale, to combat counterfeit liquor and other health and safety issues, and to continue the effective collection of taxes – the "Sell-and-Deliver Rule," which requires distributors to sell and deliver product from their licensed premises, arose directly out of this intent.

It was the intent of the voters that the first party to distribute spirits would pay a "distributor" fee – the "10% Rule," which requires industry members operating as distributors to pay the distributor license fees, gives this intent regulatory effect.

And it was the intent of the voters to create a real and substantial limit on the amount of spirits Costco and other retailers could sell to restaurants – the “24-Liter Rule,” which limits the purchase of liquor by retail licensees to 24 liters per day, carries out this intent.

Thus, the Board has not purposefully undercut the changes imposed by I-1183 as Petitioners assert. Rather, in adopting these rules the Board has used its regulatory authority to effectuate the intent of the voters, as it is required to do. The rules Petitioners challenge are reasonably consistent with I-1183 and with the statutory scheme as a whole, and are necessary as “gap fillers” to effectively implement the initiative. Under the Administrative Procedures Act (“APA”) the burden is on Petitioners to show that the rules are not valid. It is a heavy burden, one Petitioners cannot meet.

## **II. ASSIGNMENTS OF ERROR**

This is the response of the Association of Washington Spirit & Wine Distributors (“AWSWD”) to Petitioners’ brief challenging the Superior Court decision to uphold WAC 314-23-030 and WAC 314-28-070(3) (the 10% Rule), and WAC 314-23-020 and WAC 314-24-180 (the Sell-and-Deliver rule). The Superior Court decided these issues correctly. CP 873-75.

In addition, AWSWD assigns error to the Superior Court's decision that the Board exceeded its authority in adding the "per day" language in WAC 314-02-103 and WAC 314-02-106 (the "24-Liter Rule"). CP 873.

### III. STATEMENT OF THE CASE

In November of 2011 the voters approved I-1183, thereby significantly changing 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, 635, 278 P.3d 632 (2012). As the Supreme Court has explained, "[t]he Initiative ended the State's exclusive rights to distribution and retail sales, allowing private distributors to become licensed to distribute spirits and permitting a limited number of retail stores to sell spirits." *Ass'n of Wash. Spirits & Wine Distributors v. Wash. State Liquor Control Bd.*, 182 Wn.2d 342, 348, 340 P.3d 849, 855-57 (2015).

However, in approving I-1183 the voters did not eradicate all restrictions on the sale of alcohol. Indeed, Costeo and the other Petitioners designed I-1183 to specifically "address ... concerns ... such as maintaining tax levels and revenue streams; ensuring adequate funding (and penalties) for licensing and enforcement missions of the Liquor Control Board and ... for related public health and safety efforts provided

by local governments'; and limiting the number and type of retail outlets that would sell spirits for off-premises consumption." *Wash. Ass'n for Substance Abuse*, 174 Wn.2d at 649 (quoting Decl. of John Sullivan, Associate General Counsel at Costco).

So while I-1183 proposed to "[g]et the state government out of the commercial business of distributing, selling, and promoting the sale of liquor," Laws of 2012, ch. 2, § 101(2)(b), it also promised to "continu[c] to strictly regulate the distribution and sale of liquor." *Id.* § 101(2)(a). To accomplish this, the Initiative maintained the Board's broad power regarding the following: "Regulating the sale of liquor kept by the holders of licenses which entitle the holder to purchase and keep liquor for sale"; "Prescribing the conditions, accommodations, and qualifications requisite for the obtaining of licenses to sell beer, wine, and spirits, and regulating the sale of beer, wine, and spirits thereunder"; and "Specifying and regulating ... the manner, method and means by which liquor may lawfully be conveyed or carried within the state."<sup>2</sup> RCW 66.08.030(6), (12), and (13).

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<sup>2</sup> In addition, and contrary to Petitioners' assertion, the Initiative did not abolish Washington's three-tier system. It converted the spirits retail tier from government owned and operated stores to privately owned and operated stores, and extended the three-tier system to spirits by creating spirits distributor licenses to permit private sector distribution. *See id.* § 102(d) (I-1183 will "allow a private distributor of alcohol to get a license to distribute liquor ... and create provisions to promote investments by private distributors")

Pursuant to its authority, and after a lengthy process, the Board adopted rules to implement I-1183. Petitioners challenged a number of these rules in Superior Court – particularly rules limiting the purchase of liquor by retail licensees to 24 liters per day (the “24-Liter Rule”), the rule requiring industry members operating as distributors to pay the distributor license fees (the “10% Rule”), and rules requiring distributors to sell and deliver product from their licensed premises (collectively the “Sell-and-Deliver Rule”).

The Superior Court held that the 10% Rule and Sell-and-Deliver Rule were reasonably consistent with the statutory scheme and valid exercises of the Board’s rulemaking authority. CP 846-47. The court also determined that the 24-Liter Rule “may be more consistent with the overall statutory scheme than I-1183’s original statutory language” but ultimately decided, based on *Dot Foods, Inc. v. Department of Revenue*, 166 Wn.2d 912, 215 P.3d 185 (2009), and *Edelman v State ex rel. Pub. Disclosure Comm’n*, 152 Wn.2d 584, 99 P.3d 386 (2004), that the Board exceeded its authority in enacting the 24-Liter Rule.

Petitioners appealed the Superior Court’s decision with regard to the 10% Rule and Sell-and-Deliver Rule, and AWSWD appealed the court’s decision regarding the 24-Liter Rule.

#### IV. STANDARD OF REVIEW

The Washington Administrative Procedure Act governs the standard of review of a challenge to an agency rule. Under RCW 34.05.570(2)(c), an agency rule may be invalidated only if it (1) violates constitutional provisions, (2) exceeds the agency's statutory rule-making authority, (3) is arbitrary and capricious in that it could not have been the product of a rational decision-maker, or (4) was adopted without complying with statutory rule-making procedures. Determining the extent of rule-making authority is a question of law. *Wash. Pub. Ports Ass'n v. Dep't of Revenue*, 148 Wn.2d 637, 645, 62 P.3d 462 (2003).

The Court "review[s] questions of statutory interpretation de novo." *State v. Veliz*, 176 Wn.2d 849, 853-54, 298 P.3d 75 (2013). In addition, the Court discerns legislative intent from the plain language enacted by the legislature, considering the text of the provision in question, the context of the statute in which the provision is found, related provisions, amendments to the provision, and the statutory scheme as a whole. *Dep't of Ecology v. Campbell & Gwinn, LLC*, 146 Wn.2d 1, 9-10, 43 P.3d 4 (2002).

If the statute is ambiguous, the Court must construe the statute so as to effectuate the legislative intent. In so doing, it avoids a literal

reading if it would result in unlikely, absurd or strained consequences. *State v. Elgin*, 118 Wn.2d 551, 555, 825 P.2d 314 (1992).

The purpose of an enactment should prevail over express but inept wording. *Id.*; *State ex rel. Royal v. Board of Yakima County Comm'rs*, 123 Wn.2d 451, 462, 869 P.2d 56 (1994). The court must give effect to legislative intent determined “within the context of the entire statute.” *Elgin*, 118 Wash.2d at 556; *State ex rel. Royal*, 123 Wn.2d at 459. The meaning of a particular word in a statute “is not gleaned from that word alone, because our purpose is to ascertain legislative intent of the statute as a whole.” *State v. Krall*, 125 Wn.2d 146, 148, 881 P.2d 1040 (1994).

## V. ARGUMENT

### A. The Sell-and-Deliver Rule is Valid.

Petitioners challenge the Sell-and-Deliver Rule, which imposes delivery restrictions on wine and spirits purchases by requiring distributors to “sell and deliver their product only from their licensed premises.” WAC 314-23-020 (applying to spirits distributors); WAC 314-24-180 (applying to wine distributors). This challenge fails.

#### I. The Board did not exceed its authority.

RCW 66.08.030 explicitly authorizes the Board to adopt rules regarding the sale of liquor by licensees and the manner in which liquor may be conveyed and carried within the state: “The power of the board to

make regulations under chapter 34.05 RCW extends to: ... (6) Regulating the sale of liquor kept by the holders of licenses which entitle the holder to purchase and keep liquor for sale [, and] ... (13) Specifying and regulating ... the manner, methods and means by which manufacturers must deliver liquor within the sates; and the time and periods when, and the manner, methods and means by which liquor may lawfully be conveyed or carried within the state.” RCW 66.08.030(6) and (13). The Board’s stated purpose of the Sell-and-Deliver Rule – i.e., assuring the Board’s ability to properly track spirits and wine products in Washington, CP 972 – fits neatly within the Board’s explicit authority under RCW 66.08.030.

Moreover, while I-1183 proposed to “[g]et the state government out of the commercial business of distributing, selling, and promoting the sale of liquor,” it directed the “[s]tate to focus on the more appropriate role of enforcing liquor laws and promoting the public health and safety concerning all alcoholic beverages.” Laws of 2012, ch. 2, § 101(2)(b). And while the Initiative amended the policy reasons behind the State’s regulation of alcohol by removing the goals of “orderly marketing of alcohol and encouraging moderation in consumption of alcohol,” it left intact the State’s goal of promoting the “efficient collection of taxes...” *Wash. Ass’n for Substance Abuse*, 174 Wn.2d at 651 (citing Laws of 2012, ch. 2, §124).

The Sell-and-Deliver Rule falls squarely within both the “public health and safety” and the “efficient collection of taxes” functions of the Board’s rule-making authority. It permits the Board to accurately track shipments of spirits into the state, which facilitates the accurate collection of taxes at both the distribution level and the retail level. Without the rule, it would be relatively easy for an unscrupulous supplier to deliver more product to a retailer than was invoiced through a distributor, which would open the door to the provision of free product to retailers in violation of the tied-house laws. RCW 66.28.285-320. That, in turn, would make it relatively easy for an unscrupulous retailer to sell the “extra” liquor without collecting or paying taxes on those sales. The Sell-and-Deliver Rule makes the sale of black market, gray market or adulterated liquor far more difficult, because it gives suppliers and distributors direct control over the products entering the state. The rule also helps preserve a legitimate competitive market, because without it fly-by-night or out-of-state distributors would be able to undercut the competitive position of legitimate, in-state distributors, and small distillers who do not have the capacity to make large sales direct to retailers would be at a severe competitive disadvantage to their larger competitors.

The Board clearly did not exceed its statutory authority in promulgating the Sell-and-Deliver Rule. RCW 66.08.030 authorizes the

Board to create such a rule and the rule support's the Board's policy mandate. Effectively tracking spirits and wine products allows the State to confirm the amounts and types of spirits being distributed, contributing to both public health and safety and efficient taxation.

II. The Sell-and-Deliver Rule is not arbitrary and capricious.

A rule is arbitrary or capricious only if it is willful, unreasoning, and taken without regard to the attending facts or circumstances – i.e., it could not have been the product of a rational decision-maker. *Wash. Indep. Tel. Ass'n v. Wash. Utils. & Transp. Comm'n*, 148 Wn.2d 887, 905, 64 P.3d 606 (2003); *D.W. Close Co. v. Dep't of Labor & Indus.*, 143 Wn. App. 118, 130, 177 P.3d 143 (2008). “[W]here there is room for two opinions, an action taken after due consideration is not arbitrary and capricious even though a reviewing court may believe it to be erroneous.” *Rios v. Dep't of Labor & Indus.*, 145 Wn.2d 483, 501, 39 P.3d 961 (2002) (quoting *Hillis v. Dep't of Ecology*, 131 Wn.2d 373, 383, 932 P.2d 139 (1997)). The scope of review under an arbitrary and capricious standard is narrow, and the party asserting it carries a “heavy burden.” *King County Pub. Hosp. Dist. No. 2 v. Dep't of Health*, 167 Wn. App. 740, 749, 275 P.3d 1141 (2012).

Petitioners assert incorrectly that the Board has failed to articulate any explanation of the Sell-and-Deliver Rule, that no justification for it

exists, and thus the Board's rule is arbitrary and capricious under RCW 34.05.570(2).<sup>3</sup> Petitioners have not met their burden here.

Petitioners cite *Puget Sound Harvesters Ass'n v Dep't of Fish & Wildlife*, 157 Wn. App. 935, 951 (2010), for the proposition that agency action is arbitrary where the agency does not provide a rational explanation for its decision in its concise explanatory statement ("CES"). However, that case is inapposite. In *Puget Sound Harvesters Ass'n*, the Washington Department of Fish and Wildlife ("WDFW") was mandated with fairly allocating the opportunity to catch salmon between gear types (gillnetters and purse seiners). It promulgated a rule that allocated the opportunity based solely on time on the water. *Id.* It did not consider the efficiency of the gear that would be used, even though it had considerable information about how much fish each type of gear could catch. *Id.* The rule resulted in a disproportionate allocation in favor of purse seiners. The Court of Appeals determined that "it was not rational for the WDFW to ignore the considerable information that it does have to estimate likely harvests" and that the WDFW could not provide a rational basis for favoring one gear type over the other. *Id.* Therefore, the court

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<sup>3</sup> RCW 34.05.570(2) explains that "[i]n a proceeding involving review of a rule, the court shall declare the rule invalid only if it finds that: The rule violates constitutional provisions; the rule exceeds the statutory authority of the agency, the rule was adopted without compliance with statutory rule-making procedures; or the rule is arbitrary and capricious."

determined, WDFW acted arbitrarily and capriciously in adopting the rule.  
*Id* at 951.

Unlike in *Puget Sound Harvesters Ass'n*, where the agency adopted a rule that was in conflict with its mandate and could not provide a rational basis for departing from its mandate, here the Board adopted a rule that is consistent with its mandates of public safety and efficient collection of taxes and has articulated a rational basis for doing so – to assure the Board’s ability to properly track spirits and wine product.

The fact that the Board did not articulate its basis specifically in the CES is immaterial. As the Supreme Court has recognized:

The Model [Administrative Procedures] Act wisely included a provision that limited justification of rules on judicial review to reasons contained in the agency’s concise general statement. The purpose of such a restriction is to ensure that reasons and justifications were part of the agency deliberative process and not the post hoc rationalizations of agency lawyers or judges....

... Unfortunately, such a provision was not proposed for inclusion in the new Act [the Washington APA]. It is to be hoped that the legislature will correct this oversight at an early date....

In fact, the APA specifically provides that the trial court is permitted to take additional evidence where needed to “decide disputed issues regarding ... [u]nlawfulness of procedure or of decision-making process.” RCW 34.05.562(1)(b).

*Aviation West Corp v. Washington State Dept. of Labor and Industries*,  
138 Wn.2d 413, 418-19, 980 P.2d 701 (1999) (citing William R.

Andersen, THE 1988 WASHINGTON ADMINISTRATIVE PROCEDURE ACT – AN INTRODUCTION, 64 Wash. L. Rev. 781, 803–04 (1989) (footnotes omitted). The Board provided a rational basis for the rule and Petitioners have not shown why the basis is invalid.<sup>4</sup>

Ultimately, the burden is on Petitioners to show the Board lacked the authority to promulgate the Sell-and-Deliver Rule and that the rule is arbitrary and capricious. They cannot do so. Accordingly, the Court should uphold the rule.

**B. The 24-liter Rule Is Valid.**

I-1183 permits spirits retail licensees to sell spirits to on-premises retailers (restaurants and bars), but with the limitation that “no single sale may exceed twenty-four liters.” RCW 66.24.630(1). The same limit applies to sales of wine by grocery store licensees to on-premises retailers. RCW 66.24.360(2). The logical reading of these two provisions is that a retail licensee may not purchase more than 24 liters of liquor at a time. Unfortunately, I-1183 fails to specify how much time must pass between one 24-liter sale and the next, so the Board stepped in to “fill the gap.”

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<sup>4</sup> Petitioners also appear to challenge the Sell-and-Deliver Rule by challenging the sufficiency of the Board’s concise explanatory statement (“CES”) for the Rule. Br. of Appellants at 40-41. Petitioners challenged the Board’s CESs as being insufficient at the Superior Court. The court rejected this argument, ruling that the CESs “are sufficient to meet the minimum requirements of the law.” CP 843. Petitioners did not assign error to this decision, Br. of Appellants at 17-18, and should be precluded from challenging the Sell-and-Deliver Rule based on the sufficiency of the CESs.

*See Wash. Pub. Ports Ass'n v. Dep't of Revenue*, 148 Wn.2d 637, 646 (2003).

WAC 314-02-103(2) and WAC 314-02-106(1)(c) provide that no single sale may exceed 24 liters, and that such sales “are limited to one per day.” This is consistent with the only plausible reading of the statute, which unquestionably purports to limit the volume of liquor sold. Therefore the rules should be upheld.

I. Without a temporal limitation, the 24-liter provision is utterly pointless.

There are sound public policy reasons for limiting who can hold which kind of license, and for determining what kinds of conduct will or will not be permitted to a particular class of licensee. The Board must act from the assumption that each provision reflects a policy choice and strive to make that provision effective. Here, the Board correctly assumed that there are sound public policy reasons for inclusion of the 24-liter limit on retail-to-retail sales, and acted to effectuate those policy reasons by making the limitation meaningful.

If the statute were interpreted to allow unlimited sales, as Petitioners want, the volume of liquor that could be purchased at any given time would also be unlimited. In that case, the provision would serve no purpose, except to compel retail licensees purchasing more than

24 liters of liquor to swipe their credit cards multiple times upon reaching the checkout counter. Courts, however, will “avoid a literal reading if it would result in unlikely, absurd or strained consequences.” *Whatcom Cnty. v. City of Bellingham*, 128 Wn.2d 537, 546 (1996) (citing *State v. Elgin*, 118 Wn.2d 551, 555 (1992)).

The Washington Supreme Court’s decision in *Whatcom County* is instructive. There, the court considered a statute providing that if a city “repealed in its entirety that portion of its municipal code defining crimes,” but continued to hear traffic cases in municipal court, the city must enter into an agreement with the county to pay the costs “associated with prosecution, adjudication, and sentencing in criminal cases filed in district court as a result of the repeal.” *Id.* at 544-45 (emphasis added). Although the City of Bellingham had closed its jail and by ordinance repealed most of its criminal code, “a few crimes remained” on the books (e.g., shoplifting, littering, possession of marijuana). *Id.* at 541. Noting that the purpose of the underlying statute was to prevent a city from keeping profitable traffic business while “dumping the loss end” (jury trials in criminal cases) on the county, the trial court rejected the city’s argument that it did not have to pay the county because it had not repealed its criminal code “in its entirety.” The court declared, “[T]here should not be a triumph here of form over substance and that is what it would be,

an escape through a loophole that makes no sense at all.” *Id.* at 543. The Washington Supreme Court affirmed, observing that “[w]e have never blindly applied a statute without considering the context of the statute’s language or the legislative purpose.” *Id.* at 548.

Costco’s interpretation of the 24-liter rule is the perfect illustration of the Supreme Court’s warning about the blind application of a statute. Like the law at issue in *Whatcom County*, the 24-liter rule “requires construction.” Only one interpretation, the one adopted by the Board, gives effect to the statute’s purpose. Accordingly, the Court should defer to the agency charged with enforcement of the statute and uphold the validity of WAC 314-02-103(2) and WAC 314-02-106(1)(c). *Bostain v. Food Express, Inc.*, 159 Wn.2d 700, 716, 153 P.3d 846 (2007).

The Superior Court below conceded “that the 24 liter limitation makes much more sense with a ‘per day’ limitation” and “agree[d] that the 24 liter rules with a ‘per day’ restriction may actually be more consistent with the overall statutory scheme than 1-1183’s original statutory language. Without question, the 24 liter rules would be more meaningful with the inclusion of ‘per day’ restriction.” CP 825-26. However, the court determined, relying on *Dot Foods, Inc. v. Department of Revenue*, 166 Wn.2d 912, 215 P.3d 185 (2009), that the Board exceeded its

authority in promulgating WAC 314-02-103(2) and WAC 314-02-106(1)(c). This is incorrect.

*Dot Foods* is a much different case and is not applicable. While the Supreme Court in *Dot Foods* warned agencies against importing additional language into a statute that the legislature chose not to use, the facts that gave rise to this warning in *Dot Foods* are dissimilar to the facts in this case. That case involved a challenge to the Department of Revenue's interpretation of a statute that provided a Business and Occupation ("B & O") tax exemption for certain out-of-state sellers. When the Department amended the rules that implemented the statute, it revised its interpretation of the qualifications needed for the exemption. *Dot foods, Inc.*, 166 Wn.2d at 915-16. This revision changed the Department's prior interpretation. *Id.*

Under the new interpretation the petitioner no longer qualified for the exemption and filed suit. *Id.* at 916. The trial court granted summary judgment in favor of the Department and the Court of Appeals affirmed. The Supreme Court reversed, holding that "[w]hile we give great deference to how an agency interprets an ambiguous statute within its area of special expertise, 'such deference is not afforded when the statute in question is unambiguous.'" *Id.* at 921 (quoting *Densley v. Dep't of Ret. Sys.*, 162 Wn.2d 210, 221, 173 P.3d 885 (2007)).

But unlike in this case, in *Dot Foods* the statute was truly unambiguous – the language provided: “This [tax] shall not apply to any person in respect to gross income derived from the business of making sales at wholesale or retail....” A subsection of the statute clarified that sales in this state had to be made “*exclusively*” to or through a direct seller’s representative to qualify for the exemption. *Id.* at 920 (discussing RCW 82.04.423(1)). The Department contended that “*exclusively*” – in addition to modifying to whom sales must be made – also modified the type of purchases that a seller’s representative must make (i.e., consumer versus non-consumer) in order for the out-of-state direct seller to qualify for the tax-exempt statute. *Id.* “To achieve such an interpretation,” the Court determined, “we would have to import additional language into the statute that the legislature did not use.” *Id.*

In contrast, considering the purpose behind the limitation at issue in the 24-liter rule, the statute in this case, RCW 66.24.630(1), is ambiguous, and the ambiguity lies in the word “sale.” According to Costco and the Petitioners, a retail licensee might purchase, say, 72 liters of liquor at a time, so long as the licensee paid separately for every 24 liters. However, it is not clear whether “sale” as used in this provision describes each separate payment or the entire “exchange.” If the latter, the sale would obviously exceed the 24-liter limit. Substituting “transaction”

for “sale” does not solve anything. As the Washington Supreme Court has observed, “The meaning of a word in a statute ‘is not gleaned from that word alone, because our purpose is to ascertain legislative intent of the statute as a whole.’”<sup>5</sup> *Whatcom Cnty.*, 128 Wn.2d at 546 (quoting *State v. Krall*, 125 Wn.2d 146, 148, 881 P.2d 1040 (1994)).

If the goal of the Initiative drafters was to permit restaurants to purchase unlimited volumes of alcohol from Costco and others, one must conclude that Petitioners tried to sneak a “gotcha” provision past the public with the 24-liter limit. In short, it appears from Costco’s position since the adoption of the 24-Liter Rule that Costco intentionally drafted

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<sup>5</sup> Another difference between *Dot Foods* and these circumstances is that in *Dot Foods* the Department for years interpreted the statute one way and then, out of the blue, revised the rules to interpret the statute in an entirely different way:

Before the 1999 revision ... the Department interpreted the statute to permit an out-of-state seller, like Dot, to claim 100 percent exempt status from the B & O tax even though some of its sales consisted of non-consumer products. This had been the case for companies in a similar situation to Dot apparently since 1984, just after the statute was enacted. The wording of the statute has not changed since its enactment; only the Department’s interpretation and application of the statute has changed. Considering the foregoing, we reject the Department’s interpretation. To do otherwise would add words to and rewrite an unambiguous statute.

*Dot Foods*, 166 Wn.2d at 921. The Court also determined that the great judicial deference it would normally give the Department to how an agency interprets an ambiguous statute within its area of special expertise was not warranted given the Department’s flip-flopping interpretations: “The Department’s argument for deference is a difficult one to accept, considering the Department’s history interpreting the exemption. Initially, and shortly after the statutory enactment, the Department adopted an interpretation which is at odds with its current interpretation.” *Id.*

In this case, the Board did not change its position with regard to its interpretation of RCW 66.24.630(1). Rather, faced with clear voter intent to create a quantitative and real restriction on sales of spirits and wine, and faced with a failure on the part of I-1183 to specify how much time must pass between one 24-liter sale and the next, the Board stepped in to fill the gap. Deference should be afforded to the Board under these circumstances.

the provision to be palatable to the public but ambiguous enough for Petitioners to subvert the limitation following passage of the Initiative. Indeed, at the public hearing to discuss the 24-Liter Rule, Costco, through its attorney, asserted that, even though the substantive, 24-liter limitation was sold to the public as part of I-1183, it was in fact illusory:

[Board Member]: And can you tell me why there's a, that you put a 24 liter limit in there?

[Costco Attorney]: Because the distributors wanted a fig leaf limitation on sales for resale.

[Board Member]: What do you mean by that?

[Costco Attorney]: Something that was there so that they could say that they got something to have a limitation on sales for resale, but everyone recognized that in the absence of a temporal requirement, it would not have a meaningful restriction on sales for resale.

CP 543.

This is nonsensical and certainly not what voters intended. An initiative susceptible to reasonable alternative interpretations is to be construed to effectuate the voter's intent. *Department of Rev v. Hoppe*, 82 Wn.2d 549, 552, 512 P.2d 1094 (1973). In determining voter intent, courts look to the language of the initiative as the "average informed lay voter would read it." *In re Estate of Hitchman*, 100 Wn.2d 464, 467, 670

P.2d 655 (1983). An average informed lay voter reading the language of the initiative would have believed that it created a substantive limitation, not an illusory “fig leaf limitation.” Costco’s interpretation amounts to a backdoor attempt by Costco to obtain the ability to distribute an unlimited quantity of liquor to retailers without obtaining a distributor’s license. The Board, rather than condoning such a subterfuge, adopted a rule that made the limitation approved by the people reasonable instead of illusory.

Costco itself has admitted that the purpose was to impose a “quantitative restriction” on sales of spirits and wine, CP 76, yet its current position utterly defeats that goal. “The purpose of an enactment should prevail over express but inept wording.” *Elgin*, 118 Wn.2d at 555; *State ex rel. Royal v. Bd. of Yakima Cnty Comm’rs*, 123 Wn.2d 451, 462, 869 P.2d 56 (1994). The only way to interpret the Initiative’s “inept wording” so as to give effect to its manifest purpose is to read the provision as prohibiting the purchase of more than 24 liters of liquor at a time.

Petitioners may rely on *Edelman v. Public Disclosure Commission*, 152 Wn.2d 584, 99 P.3d 386 (2004), as they did below, to argue that the Board acted impermissibly by adding the per day rule to the 24-liter limitation. This argument and reliance are misplaced. This case and *Edelman* both involve situations where an initiative imposed a limit, but from there the facts go in exact opposite directions. In both cases it was

apparent from the language of the initiative that a meaningful limitation had been intended. However, in *Edelman* the agency adopted a rule that undermined a limitation adopted by the people; in this case the Board adopted a rule that gives meaning to a limitation adopted by the people. The Public Disclosure Commission (“PDC”) rule in *Edelman* was invalid because it ignored the context in which the limit appeared and the obvious intent of the public. Here, the Board adopted a rule that makes sense in context and implements the intentions of the voters. In *Edelman* the PDC added a prerequisite to the limitation, where no such prerequisite could be found in the statute. Here, the Board added meaning to the limitation expressed in the statute, without which the statutory language is illusory. The Court should uphold the validity of WAC 314-02-103(2) and WAC 314-02-106(1)(c).

II. The Board has the authority to regulate the volume of liquor sold by licensees.

Petitioners claim that “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 policy.” Br. of Appellants at 33-34. But RCW 66.08.030 enumerates 20 discrete subjects for the Board to address through the adoption of rules, and specifically provides that “[t]he power of the board

to make regulations under chapter 34.05 RCW extends to ... (6) [r]egulating the sale of liquor kept by the holders of licenses which entitle the holder to purchase and keep liquor for sale.” This power easily embraces the 24-liter-per-day limitation on “the sale of liquor” by “holders of licenses” contained in WAC 314-02-102 and WAC 314-02-106. Thus, the plain text of RCW 66.08.030(6) extends the “power of the board” to precisely the sort of “regulations” of the “sale of liquor” that WAC 314-02-102 and WAC 314-02-106 represent.

III. The Board retains the power to fill gaps in statutes that it implements.

The Washington State Liquor Control Act formerly empowered the Board not only to “carry[] into effect the provisions of this title, “but also to “supply[] any deficiency therein” by adopting “regulations not inconsistent with the spirit of this title as are deemed necessary or advisable.” Laws of 1933, Ex. Sess., ch. 62, § 79(1) (former RCW 66.08.030(1)). Although I-1183 revoked this authority, Laws of 2012, ch. 2, § 204, it did not leave the Board powerless to restrict retail-to-retail sales. Not only does the Board retain the express authority to “regulate the sale of liquor,” like any agency it has the power to issue rules “to ‘fill in the gaps’ in legislation if such rules are ““necessary to the effectuation of a

general statutory scheme.” *Wash. Pub. Ports Ass’n*, 148 Wn.2d at 646 (citations omitted). The Initiative left these powers untouched.

The power to “supply[] any deficiency” in the Act, which I-1183 rescinded, involved more than mere “gap-filling,” as Petitioners put it. It authorized the Board, in the absence of a specific statute in Title 66, to adopt rules “not inconsistent with the spirit of this title,” which had “the same force and effect as if incorporated in this title.” Laws of 1933, Ex. Sess., ch. 62, § 79(1). In other words, it empowered the Board to go beyond the implementation of a specific statutory provision. In *State v Gregory*, 191 Wash. 70 (1937), the court upheld a rule prohibiting the sale of liquor “from midnight Saturday of each week to 6 o’clock on the following Monday morning,” even though the statute only prohibited the sale of liquor “on Sunday.” Similarly, in *Anderson, Leech & Morse, Inc. v. Liquor Control Bd.*, 89 Wn.2d 688, 690, 694 (1978), the Court affirmed a regulation prohibiting “suggestive, lewd and/or obscene” conduct on licensed premises, particularly topless table dancing, as “within the statutory authority of the Board.” The Court noted that the Board had “very broad” power to “supply[] any deficiency” with “such regulations not inconsistent with the spirit of this title as are deemed necessary or advisable.”

The repeal of such sweeping power in no way diminishes the Board's authority to limit retail-to-retail sales to "one per day." WAC 314-02-103(2); WAC 314-02-106(1)(c). Unlike the regulations at issue in *Gregory* and *Anderson*, the per-day limitation implements specific statutory provisions; namely, RCW 66.24.630(1) and RCW 66.24.360(2). Indeed, without the per-day limitation, the 24-liter rule is meaningless. In promulgating these rules the Board merely filled in the gaps in I-1183 and gave effect to the Initiative's 24-liter rule. *See Wash. Pub. Ports Ass'n*, 148 Wn.2d at 646.

**C. The 10% Rule is Valid.**

Petitioners' challenge to the 10% Rule also fails on multiple grounds. Contrary to Petitioners' assertion, the Supreme Court's ruling in the *Association of Washington Spirits & Wine Distributors v. Washington State Liquor Control Board* case does not control. The mere fact that the Board's interpretation of RCW 66.24.055(3)(c) was deemed valid in that case does not mean the Board's interpretation of RCW 66.24.055(3)(a) is invalid. In fact, both interpretations should be deemed valid under the APA standard of review. Beyond that, the Supreme Court in *Association of Washington Spirits & Wine Distributors* made clear that, for multiple reasons, its holding is not determinative of whether the Board's interpretation of RCW 66.24.055(3)(a) is valid. The 10% rule is

consistent with the statutory scheme and the Board acted within its rule-making authority in adopting it.

Moreover, Petitioners cannot meet their burden of showing that the Board's action in enacting the 10% Rule was willful and unreasoning and taken without regard to the attending facts and circumstances. Again, "where there is room for two opinions, an action taken after due consideration is not arbitrary and capricious even though a reviewing court may believe it to be erroneous." *Wash. Indep. Tel. Ass'n v. Wash. Utils. & Transp. Comm'n*, 148 Wn.2d 887, 905-06, 64 P.3d 606 (2003).

Most importantly, the 10% Rule effectuates the intent of the voters in passing I-1183 – i.e., that the first party that "distributes" spirits (whether they hold a spirits distributor license, a retail license, or a distillers/certificate of approval license) is subject to a fee for being the first "distributor" of that product.

I. *The Association of Washington Spirits & Wine Distributors v. Washington State Liquor Control Board* case does not control.

Contrary to Petitioners' contention, the *Association of Washington Spirits & Wine Distributors* case does not control on this issue.

First, it simply does not follow from the fact that the Supreme Court upheld WAC 314-23-030 (restricting payment of the shortfall fee to "persons holding spirits distributor licenses"), that WAC 314-23-030

(requiring distillers and certificate of approval holders to pay the 10% distributor fee when they act as distributors) is arbitrary and capricious. WAC 314-23-030 is subject to de novo review under the arbitrary and capricious standard. It is arbitrary and capricious only if it is willful, unreasoning, and taken without regard to the attending facts or circumstances. That is not the case.

Second, the Washington State Supreme Court in *Association of Washington Spirits & Wine Distributors* expressly stopped short of making any ruling regarding the Board's interpretation of RCW 66.24.055(3)(a), stating the following:

In reaching this conclusion, we do not opine on the Board's interpretation of the subsection (3)(a) percentage fee, as it is not properly before this court. The subsection (3)(a) percentage fee uses different language than the subsection (3)(c) shortfall fee and is related to the requirements of subsection (3)(b).

*Ass'n of Wash. Spirits & Wine Distributors v. Wash. State Liquor Control Bd.*, 182 Wn. 2d 342, 355-58, 340 P.3d 849, 855-57 (2015). Thus, the Court provided two reasons why its decision would not control this issue, beyond the fact that the issue was not before the Court in that case.

a. *The subsections use different language for a reason*

In *Association of Washington Spirits & Wine Distributors*, The Supreme Court considered AWSWD's argument that the language of the shortfall provision of the initiative (RCW 66.24.055(3)(c)) should be

interpreted as having the same meaning as the language of the general distributor fee statute (RCW 66.24.055(3)(a)). The Supreme Court rejected that argument, holding that the differences in these two sections are material to proper implementation of the statutory scheme. Subsection (3)(a) states that “each spirits distributor licensee must pay to the board, for deposit into the liquor revolving fund, a license issuance fee” of 10% for the first 27 months of distributing, and 5% thereafter. However, Subsection (3)(c) states that “[b]y March 31, 2013, all persons holding spirits distributor licenses on or before March 31, 2013, must have paid collectively one hundred fifty million dollars or more in spirits distributor license fees.” As the Supreme Court in *Association of Washington Spirits & Wine Distributors* stated,

Different statutory language should not be read to mean the same thing: “[w]hen the legislature uses different words in the same statute, we presume the legislature intends those words to have different meanings.”

*Ass’n of Wash. Spirits & Wine Distributors*, 182 Wn.2d at 354 (quoting *In re Pers. Restraint of Dalluge*, 162 Wn.2d 814, 820, 177 P.3d 675 (2008)).

The Supreme Court in *Association of Washington Spirits & Wine Distributors* determined that the phrase “persons holding distributor licenses” is unambiguous and means just that: persons holding distributor

licenses. *Id.* at 355-56. And the Court’s holding was based on this language in Subsection (3)(c) of RCW 66.24.055:

We hold that subsection (3)(c) is specifically applicable to “persons holding spirits distributor licenses” and that the general provisions of RCW 66.24.640 and RCW 66.28.330(4) do not render the subsection (3)(c) shortfall fee applicable to distillers distributing their own spirits.

*Id.* at 357-58. The Court then indicated that its ruling would not have affected the validity of the 10% Rule, even if that issue was before the court, in part because Subsection 3(a) uses different language than Subsection (3)(c). *Id.* at 357 n.5. In short, the Court indicated that the phrases “spirits distributor licensee” and “persons holding spirits distributor licenses” could reasonably be interpreted as intended to have different meanings.

The purpose for using the language “persons holding spirits distributor licenses” as opposed to “spirits distributor licensee” in Subsection (3)(c) likely was to decouple persons that actually hold spirits distributor licenses from the broader group of licensees that are authorized by the Board to distribute spirits under the Initiative. Stated differently, it was to limit those responsible for payment of the \$150 million to persons actually holding distributor licenses.<sup>6</sup>

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<sup>6</sup> While AWSWD argued against this interpretation at the Supreme Court in *Association of Washington Spirits & Wine Distributors*, the Supreme Court disagreed with AWSWD

Such decoupling was reasonable and necessary as it was clearly the intent of the voters that licensees other than “persons holding spirits distributor licenses” would be subject to “distributor fees” when they act as the first party to touch/distribute spirits. For example, under Subsection (3)(d), a “retail licensee selling for resale must pay a distributor license fee under the terms and conditions of [Subsection (3)(a)] on resales of spirits the licensee has purchased on which no other distributor license fee has been paid.” RCW 66.24.055(3)(d). That spirits retail licensees are specifically made subject to RCW 66.24.055(3)(a)’s distributor fees under the statute when they are the first to touch/distribute spirits is not surprising. While distillers and certificate of approval holders are made subject to RCW 66.24.055(3)(a) through RCW 66.24.640 and RCW 66.28.330(4) when they are the first to distribute spirits, no separate statute makes retailers subject to Subsection (3)(a); thus, RCW 66.24.055(3)(d) did so explicitly.

Importantly, nowhere in RCW 66.24.055 are distillers/certificate of approval holders exempt from paying the distributor fee when they distribute spirits. The statutes allow certain licensees (not just distributor licensees) to distribute spirits under certain circumstances. But in all

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on this issue. Thus, AWSWD’s current analysis is based on its interpretation of the Supreme Court’s holding in that case.

cases, the distribution is taxed based on the amount of spirits distributed. The Board's enactment of WAC 314-23-030 is reasonably consistent with the statutory scheme and effectuates voter intent.

b. Subsection (3)(b) supports the Board's interpretation.

Subsection (3)(b), which the Court in *Association of Washington Spirits & Wine Distributors* cited as another reason its holding did not affect the 10% Rule, is further evidence that the voters intended that the first to distribute must pay the "distributor" fee.

Subsection (3)(b) states that the fee required under Subsection (3)(a) "is calculated only on sales of items which the licensee was the first spirits distributor in the state to have received: (i) [i]n the case of spirits manufactured in the state, from the distiller; or (ii) [i]n the case of spirits manufactured outside the state, from an authorized out-of-state supplier." When a distiller distributes its own spirits (as opposed to distilling spirits), it is not acting as a distiller; it is acting as a distributor. Indeed, RCW 66.24.640, the statute that permits distillers to direct-distribute, specifically states that "[a]ny distiller licensed under this title may act as a ... distributor to retailers" but that "[a]n industry member operating as a distributor ... must comply with the applicable laws and rules relating to distributors...." To the extent that a distiller is acting/operating as a

distributor, it by definition is the first “distributor” in the state to have received spirits from the distiller. It therefore is subject to Subsection (3)(a). Again, there is nothing in Subsection (3)(b), or in RCW 66.24.055 generally, that exempts a distiller or certificate of approval holder from paying “distributor” fees when it acts as a distributor.

II. The Board was neither arbitrary nor capricious in enacting the 10% Rule.

I-1183 created a license for spirits distributors to sell spirits to retailers, but permits other industry members to “act as a distributor.” RCW 66.24.640 provides that “[a]ny distiller licensed under this title may act as a retailer and/or distributor to retailers selling for consumption on or off the licensed premises of spirits of its own production,” and further that “any manufacturer, importer, or bottler of spirits holding a certificate of approval may act as a distributor of spirits it is entitled to import into the state under such certificate.” This section also requires “[a]n industry member operating as a distributor and/or retailer” to “comply with the applicable laws and rules relating to distributors and/or retailers.” *Id.* (emphasis added).<sup>7</sup>

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<sup>7</sup> There is one exception, namely that “an industry member operating as a distributor under this section may maintain a warehouse off the distillery premises for the distribution of spirits of its own production to spirits retailers within the state, if the warehouse is within the United States and has been approved by the Board.” *Id.* However, the existence of this express exception indicates that no other exemptions were intended or implied.

Similarly, RCW 66.28.330(4) provides that “[a] distiller holding a license or certificate of compliance as a distiller under this title may act as a distributor in the state of spirits of its own production or of foreign produced spirits it is entitled to import,” but such distillers “must, to the extent consistent with the purposes of this act, comply with all provisions of and regulations under this title applicable to wholesale distributors selling spirits to retailers.” *Id.* (emphasis added). There are no enumerated exceptions to this requirement.

In enacting the 10% Rule the Board reasoned that one provision “applicable to” and “relating to distributors” is RCW 66.24.055(3)(a), which requires a spirits distributor licensee to pay a license issuance fee equal to ten percent of the licensee’s total revenue from the sale of spirits. Accordingly, the Board adopted the 10% Rule (WAC 314-23-030 and WAC 314-28-070(3)), specifying that any licensed distiller or certificate-of-approval holder choosing to act as a distributor by selling spirits directly to retailers must pay the spirits distributor license fees imposed by RCW 66.24.055(3)(a). WAC 314-23-030 and WAC 314-28-070(3) simply implement the plain text of those two statutory provisions by requiring industry members who choose to engage in the business of distributing spirits to comply with the laws applicable to spirits distributors.

“‘[W]here there is room for two opinions, an action taken after due consideration is not arbitrary and capricious even though a reviewing court may believe it to be erroneous.’” *Wash. Indep. Tel. Ass’n*, 148 Wn.2d at 905-06. And, as Petitioners recognize, “‘the validity of a rule is determined as of the time the agency took the action adopting the rule.’” Br. of Petitioners at 24 (quoting *Wash. Indep. Tel. Ass’n*, 148 Wn.2d at 906). The Board enacted WAC 314-23-030 and WAC 314-28-070(3) after taking due consideration of the entire statutory scheme of I-1183, as it was required to do. There is no indication that the Board disregarded pertinent information when it enacted WAC 314-23-030 and WAC 314-28-070(3). Rather, the Board’s action was reasoned and based on all relevant information. Clearly, it is not the case that the 10% Rule “could not have been the product of a rational decision-maker.” *Id.* As such, it is valid under an APA standard of review.

## CONCLUSION

The Liquor and Cannabis Board adopted the three rules at issue on this appeal in a considered, legitimate attempt to implement the language of I-1183 and the will of the people. Petitioners have challenged all three rules, arguing in essence that the clear language of the initiative – and thus the clear intent of the voters – should be ignored and the Court should

impose the alcohol regulatory system they want. There is no basis in law or logic for reaching the conclusions Petitioners are clamoring for.

This Court should affirm the trial court's determination that the 10% Rule and the Sell-and-Deliver Rule are valid and enforceable. This Court should also reverse the trial court's determination that the 24-Liter Rule is invalid, and reinstate that rule.

RESPECTFULLY SUBMITTED this 22<sup>nd</sup> day of August, 2016.

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CERTIFICATE OF SERVICE

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- 1. Response Brief of Intervenor-Respondent

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

Gina A Mitchell

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