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COURT OF APPEALS,  
DIVISION II  
OF THE STATE OF WASHINGTON

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

*Appellants,*

v.

Washington State Liquor and Cannabis Board,

*Respondent.*

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**APPELLANTS' OPENING BRIEF**

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**TABLE OF CONTENTS**

I. INTRODUCTION ..... 1

II. IDENTITY OF THE PARTIES..... 2

III. ASSIGNMENTS OF ERROR ..... 3

IV. STATEMENT OF ISSUES ..... 4

V. STATEMENT OF THE CASE..... 4

    A. The Evolution of Washington’s Liquor Market..... 4

    B. The Board’s Rulemaking Process ..... 8

    C. The Impact of the Board’s Pricing Rules..... 12

    D. Procedural Background..... 12

VI. STANDARD OF REVIEW ..... 13

VII. ARGUMENT ..... 14

    A. The Pricing Rules Exceed the Board’s Statutory Authority ..... 14

        1. The statute allows myriad pricing practices based on individualized market factors..... 15

        2. The Board limited permissible pricing practices. .... 20

    B. The Board’s Justifications for Its Rulemaking Authority Fail..... 26

        1. RCW 66.28.170’s plain language is unambiguous and does not require interpretation. .... 27

        2. The Board’s authority to promulgate liquor regulations does not extend to controlling market pricing practices..... 29

    C. The Pricing Rules Are Arbitrary and Capricious..... 34

VIII. CONCLUSION..... 43

Appendix A: Initiative 1183’s Amendments to RCW 66.28.170

Appendix B: Overview of Pricing Rules

Appendix C: Text of Pricing Rules

## TABLE OF AUTHORITIES

### CASES

|  |            |
|--|------------|
| <i>Anderson, Leech &amp; Morse, Inc. v. Wash. State Liquor Control Bd.</i> ,<br>89 Wn.2d 688 (1978) .....            | 36         |
| <i>Ass’n of Wash. Spirits &amp; Wine Distribs. v. Wash. State Liquor Control Bd.</i> ,<br>182 Wn.2d 342 (2015) ..... | 13, 16, 17 |
| <i>Bostain v. Food Express, Inc.</i> ,<br>159 Wn.2d 700 (2007) .....   | 14, 25, 28 |
| <i>Children’s Hosp. &amp; Med. Ctr. v. Dep’t of Health</i> ,<br>95 Wn. App. 858 (1999) .....                         | 35         |
| <i>Costco Wholesale Corp. v. Maleng</i> ,<br>522 F.3d 874 (9th Cir. 2008) .....                                      | 5, 21      |
| <i>Dep’t of Ecology v. Campbell &amp; Gwinn, LLC</i> ,<br>146 Wn.2d 1 (2002) .....                                   | 15         |
| <i>Edelman v. State ex rel. Pub. Disclosure Comm’n</i> ,<br>152 Wn.2d 584 (2004) .....                               | 16, 25     |
| <i>H &amp; H P’ship v. State</i> ,<br>115 Wn. App. 164 (2003) .....  | 14         |
| <i>Puget Sound Harvesters Ass’n v. Dep’t of Fish &amp; Wildlife</i> ,<br>157 Wn. App. 935 (2010) .....               | 35, 36     |
| <i>Ravenscroft v. Wash. Water Power Co.</i> ,<br>136 Wn.2d 911 (1998) .....  | 27         |
| <i>Roe v. TeleTech Customer Care Mgmt.</i> ,<br>171 Wn.2d 736 (2011) .....   | 18         |
| <i>Seeber v. Pub. Disclosure Comm’n</i> ,<br>96 Wn.2d 135 (1981) .....   | 15         |

|  |           |
|--|-----------|
| <i>State v. Donaghe</i> ,<br>172 Wn.2d 253 (2011) .....  | 16, 29    |
| <i>State v. Watson</i> ,<br>146 Wn.2d 947 (2002) .....   | 15, 19    |
| <i>Stewart v. State, Dep't of Soc. &amp; Health Servs.</i> ,<br>162 Wn. App. 266 (2011) .....  | 13        |
| <i>Tapper v. State Emp't Sec. Dep't</i> ,<br>122 Wn.2d 397 (1993) .....  | 13        |
| <i>Tunstall ex rel. Tunstall v. Berguson</i> ,<br>141 Wn.2d 201 (2000) .....   | 34        |
| <i>W. Telepage, Inc. v. City of Tacoma Dep't of Fin.</i> ,<br>140 Wn.2d 599 (2000) .....   | 27        |
| <i>Wash. Ass'n for Substance Abuse &amp; Violence Prevention v. State</i> ,<br>174 Wn.2d 642 (2012) .....                                | 4, 30, 31 |
| <i>Wash. Fed'n of State Emps. v. State Pers. Bd.</i> ,<br>54 Wn. App. 305 (1989) .....   | 14        |
| <i>Wash. Indep. Tel. Ass'n v. Telecomms. Ratepayers Ass'n<br/>for Cost-Based &amp; Equitable Rates</i> ,<br>75 Wn. App. 356 (1994) ..... | 30, 34    |
| <i>Wash. Indep. Tel. Ass'n v. Wash. Utils. &amp; Transp. Comm'n</i> ,<br>148 Wn.2d 887 (2003) .....                                      | 34, 35    |
| <i>Wash. State Hosp. Ass'n v. Wash. State Dep't of Health</i> ,<br>183 Wn.2d 590 (2015) .....  | 3, 14     |
| <b>STATUTES</b>  |           |
| RCW 19.85 .....  | 10        |
| RCW 34.05 .....  | 13, 33    |
| RCW 34.05.325 .....  | 35        |

|                         |           |
|-------------------------|-----------|
| RCW 34.05.570 .....     | 3, 14, 34 |
| Title 66 RCW .....      | 5, 30     |
| RCW 66.08.030 .....     | passim    |
| Chapter 66.28 RCW ..... | 29        |
| RCW 66.28.170 .....     | passim    |
| RCW 66.28.180 .....     | 17        |

**REGULATIONS**

|                     |            |
|---------------------|------------|
| WAC 314-23-065..... | passim     |
| WAC 314-23-070..... | 20, 25     |
| WAC 314-23-080..... | 20, 21, 22 |
| WAC 314-23-085..... | passim     |

**OTHER AUTHORITIES**

|  |       |
|--|-------|
| James C. Copper & Joshua D. Wright, <i>Alcohol, Antitrust<br/>and the 21st Amendment: An Empirical Examination of<br/>Post and Hold Laws</i> , 32 Int’l Rev. L. & Econ. 379<br>(2012)..... | 21    |
| Wash. Sec’y of State, I-1183 Ballot Measure Summary .....  | 6, 18 |
| Wash. Sec’y of State, State of Wash. & Cowlitz County<br>Voters’ Pamphlet (2011).....  | 7     |
| Wash. State Liquor Control Bd., <i>Beer &amp; Wine Three-Tier<br/>System Review Task Force Report</i> (Nov. 21, 2006) .....  | 5     |

## I. INTRODUCTION

The People overwhelmingly voted to enact Initiative 1183 in 2011. They meant to overhaul “outdated, inefficient, and costly” regulations rooted in the Prohibition era. They explicitly changed Washington’s liquor laws to eliminate the requirement that all liquor must be offered and sold at the same price, regardless of location or market circumstance. As the Voter’s Pamphlet announced:

Initiative 1183 eliminates the requirement that distributors and manufacturers of wine sell at a uniform price, which would allow the sale of wine at different prices based on business reasons. Spirits could also be sold to different distributors and retailers at different prices.

To accomplish that goal, I-1183 revised the primary pricing statute, RCW 66.28.170, to allow price differentials for wine and spirits based on “competitive conditions, costs of servicing a purchaser’s account, efficiencies in handling goods, or other bona fide business factors.” The sole limitation was that price differentials could not be “unlawful under trade regulation laws applicable to goods of all kinds.” Liquor was no longer to be immune from market forces.

Notwithstanding the People’s unambiguously expressed judgment that bona fide business factors may support a price differential that is not otherwise unlawful, Respondent Washington State Liquor and Cannabis

Board (“the Board”) attempted to restore the old system by enacting rules that essentially require uniform pricing for all wine and spirits under the guise of regulating so-called “fair trade practices.” *See* WAC 314-23-065 through -085.<sup>1</sup>

These pricing rules eviscerate the People’s plain language and impose the Board’s own vision of a “fair” marketplace on Washington’s wine and spirits market. By proscribing practices that the statute permits, the Board exceeded the scope of its rulemaking authority. As corroborated by the Board’s haphazard deliberative process and the purposeless differentiation between wine and spirits, the pricing rules are also arbitrary and capricious. Under either rationale, the Court should invalidate the pricing rules and honor the People’s preference for typical competition in the spirits and wine industries.

## **II. IDENTITY OF THE PARTIES**

Appellants are three trade organizations—the Washington Restaurant Association, the Northwest Grocery Organization, and the Washington Lodging Association—and Costco Wholesale Corporation.

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<sup>1</sup> For ease of reference, this brief will refer to these rules by omitting reference to Title 314, Chapter 23, and indicating only a rule’s section number. For instance, WAC 314-23-065 will be referred to as “Rule -065.” Appendix C includes a copy of the rules.

Appellants' members and customers are currently forced to pay higher prices and curtail their business based on the challenged rules.

Respondent, the Board, promulgated the rules at issue.

### III. ASSIGNMENTS OF ERROR

This is a challenge to the validity of agency rules brought under Washington's Administrative Procedure Act ("APA"), RCW 34.05.570(2). Because this 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. *Wash. State Hosp. Ass'n v. Wash. State Dep't of Health*, 183 Wn.2d 590, 595 (2015). Assignments of error are not strictly necessary.

Nevertheless, Appellants assign error to the Superior Court's failure to rule that:

1. The challenged rules conflict with RCW 66.28.170 and exceed the Board's statutory rulemaking authority under RCW 34.05.570(2), *see* CP 642 (Order at 2, ¶ 2); and
2. The challenged rules are arbitrary and capricious under RCW 34.05.570(2)(c), *see id.* (Order at 2, ¶ 3).

#### **IV. STATEMENT OF ISSUES**

(1) May the Board limit pricing practices allowed by RCW 66.28.170?

No. Agency regulations may not amend or narrow the law. That core principle is critically important where the law was the informed choice of the People. The Board exceeded its authority in enacting the challenged pricing rules.

(2) May the Board impose pricing rules without a basis in evidence and untethered to its delegated authority?

No. The pricing rules are arbitrary and capricious.

#### **V. STATEMENT OF THE CASE**

The parties agree on the facts of this case. At issue is whether the Board's pricing rules are an appropriate exercise of its statutory authority and the result of a reasoned process. Both are legal questions. The below overview of Washington's liquor market—and the State's evolving regulation of it—provides context for these legal issues.

##### **A. The Evolution of Washington's Liquor Market**

*The old system.* After the repeal of Prohibition in 1933, Washington chose to be a “control” state, in which all sales of spirits were exclusively routed through a State-owned distribution center and sold only in State liquor stores. *See Wash. Ass'n for Substance Abuse & Violence*

*Prevention v. State*, 174 Wn.2d 642, 647-50 (2012) (hereinafter “WASAVP”) (setting out history of Washington’s liquor laws, now RCW Title 66). The State controlled competition and limited the marketplace for liquor. See Wash. State Liquor Control Bd., *Beer & Wine Three-Tier System Review Task Force Report* at 7-14 (Nov. 21, 2006), [http://leg.wa.gov/jointcommittees/archive/scbw/documents/6-10-2008\\_lcb.pdf](http://leg.wa.gov/jointcommittees/archive/scbw/documents/6-10-2008_lcb.pdf).<sup>2</sup> The State used pricing regulation, including requirements for uniform pricing and prohibitions on volume discounts, to restrain marketplace competition and “[e]nsure a level playing field.” *Id.* at 12-14 (listing regulations used to control pricing). Every bottle had to be sold at the same price, whether it was delivered or picked up in Seattle or Spokane.

“[O]ver the years, the state’s environment . . . changed,” as did social norms and values, and “new businesses . . . emerged that old rules did not envision.” *Id.* at 8-9. But neither the Legislature nor the Board engaged in comprehensive reform—despite a court throwing out some of the pricing regulations for violating federal antitrust laws. See *Costco Wholesale Corp. v. Maleng*, 522 F.3d 874, 895 (9th Cir. 2008) (holding

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<sup>2</sup> A copy of this document is at CP 185-214. The cited section spans CP 197-204.

the Board's regulations requiring the posting and holding of prices violated federal antitrust law).

*The new system.* In November 2011, Washington voters resoundingly approved Initiative 1183, which removed the State government from the business of distributing, selling, and promoting the sale of liquor and redirected the State's focus to "the more appropriate government role of enforcing liquor laws and protecting public health and safety concerning all alcoholic beverages." Laws of 2012, ch. 2 (hereinafter "I-1183"), § 101(2)(b).<sup>3</sup> I-1183 didn't just eliminate the Board as merchant. It caused a sea change in the way Washington regulates and controls the sale of liquor. It ended the preference for a level playing field over competition, removing "state government regulations that arbitrarily restrict the wholesale distribution and pricing of wine" because such regulations are "outdated, inefficient, and costly to local taxpayers, consumers, distributors, and retailers." *Id.* § 101(1).

That included the dated and arbitrary requirement for uniform pricing. The ballot made clear that I-1183 would "allow non-uniform wholesale pricing for wine and spirits." Wash. Sec'y of State, I-1183 Ballot Measure Summary (2011),

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<sup>3</sup> A copy of I-1183 is at CP 150-83.

<https://www.sos.wa.gov/elections/initiatives/people.aspx?y=2011>

(hereinafter “I-1183 Ballot Measure Summary”).<sup>4</sup> The Voter’s Pamphlet was equally explicit:

Initiative 1183 *eliminates* the requirement that distributors and manufacturers of wine sell at a uniform price, which would allow the sale of wine at different prices based on business reasons. Spirits could also be sold to different distributors and retailers at different prices.

Wash. Sec’y of State, State of Wash. & Cowlitz County Voters’ Pamphlet at 20 (2011),<sup>5</sup> <https://wei.sos.wa.gov/county/cowlitz/en/Documents/Local%20Voters%20Pamphlets/2011%20General%20Combined%20Pamphlet.pdf> (hereinafter, “2011 Voter’s Pamphlet”) (emphasis added); *see also id.* at 25 (“1183 eliminates outdated regulations that currently restrict price competition . . .”).

The People legalized price differentials for sales of spirits—i.e., hard alcohol—and wine so long as that price differential is (1) “based upon competitive conditions, costs of servicing a purchaser’s account, efficiencies in handling goods, or other bona fide business factors,” and (2) “not unlawful under trade regulation laws applicable to goods of all kinds.” RCW 66.28.170; *see also* App. A (showing the pre-2011 language

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<sup>4</sup> A copy of this document is at CP 217.

<sup>5</sup> Relevant excerpts from this document are at CP 219-28.

of RCW 66.28.170 and I-1183's amendments). These changes created new options and paved the way for suppliers and retailers to negotiate a variety of pricing practices encouraged by market factors and competition.

The People's dramatic change to Washington's liquor market had an immediate and wide-ranging impact. Within a year, all 160 State liquor stores had closed and most auctioned off; the new spirits distributors were enjoying \$450 million in business; and Washington's businesses had begun forging new and innovative methods to compete and address retailer and consumer needs. While many businesses flourished, some did not. Particularly hard hit were Washington's former State liquor stores, which were inefficient and had lost the State monopoly driving business to their doors. And although the distributors benefited from the new spirits business, they were unhappy that the new landscape was not "level" but required them to compete more freely for sales of both spirits and wine to retailers.

#### **B. The Board's Rulemaking Process**

In March 2013, spurred by complaints from former State liquor stores about their difficulties competing once I-1183 removed their favored status, the Board announced rulemaking was necessary "to fully clarify" RCW 66.28.170. AR 51 (Notice); AR 47 (CR-101). The Board dubbed this an attempt to impose "fair trade practices" on the liquor

market in the State. AR 46 (entitled “Rule Making on Fair Trade Practices”). Appellants and many of their members submitted comments opposing such a rulemaking attempt, including multiple legal memoranda summarizing the Board’s lack of authority to regulate spirits pricing and stressing that rules to “clarify” a statute that was clear on its face were unnecessary and inappropriate. AR 56-70, 1072-74, 1076-79 (legal memoranda summarizing state of law); *see also* AR 970-1115, 1547-48 (Appellant WRA’s comments); AR 72-75, 119-21, 242-46 (Appellant NWGA’s comments).

The Board did not draft its rules pursuant to I-1183’s directly applicable pricing section, but in its face, relying on a rationale of prohibiting “undue influence.” AR 169-70. Even under that rubric, the Board never studied how undue influence was arising, nor did it ever expressly conclude that the practices banned by the proposed rules could cause “undue influence.” The Board has also raised the specter of a public safety rationale, but no stakeholder ever identified—much less proffered evidence of—detrimental impacts on public safety or undue influence unrelated to channel pricing. The Board did not investigate any allegations of unfair pricing, perform any economic studies, or consult an expert in pricing practices, fair market economics, or the impact of pricing on public safety. The Board did assess the rules’ impact on Washington’s

small businesses, as required by Chapter 19.85 RCW. That Small Business Economic Impact Study (“SBEIS”) suggested no threat of undue influence. AR 11-14.

The Board’s initial draft rules essentially banned *all* pricing differentials and carved out narrow exceptions, primarily by allowing only volume discounts. AR 169-71 (draft rules). Stakeholders coalesced around one main form of price differentiation: channel pricing. *See* AR 170-71 (draft rules). This common practice typically refers to tailoring pricing based on the type of retailer purchasing the product. *See* AR 1107; *see also* AR 1103-11 (economic expert’s summary of channel pricing). After I-1183, manufacturers and distributors offered different pricing to two market channels: off-premises retailers (e.g., liquor stores or grocery stores) and on-premises retailers (e.g., restaurants and bars).

Acquiescing to the liquor store stakeholders that had requested the rulemaking, *see, e.g.*, AR 46 (liquor store comments), the Board explicitly prohibited such channel pricing in the first draft rules, *see* AR 1382 (timeline of draft rules and position on channel pricing). Outrage followed. *E.g.*, AR 1733 (summary of testimony); AR 1023-35 (Appellants’ comments opposing prohibition on channel pricing); AR 133-35, 253 (comments by distributors); AR 366 (comments by wineries); AR 218-19 (comments by national spirits association). The

Board reversed course. The next draft rules allowed channel pricing.

AR 1382.

More comments followed. But notably the Board did not study the extent of any alleged undue influence, the impact on public safety, or whether the existing pricing practices complied with existing antitrust restrictions or any other limitations applicable to goods generally. The last draft of the pricing rules scaled back channel pricing, allowing it for wine, but allowing it for spirits only for the first six months on “new products.”

AR 1410-15.

In short, the Board whipped from position to position in an attempt to forge a compromise between divergent interest groups. It contravened the direct command of RCW 66.28.170 and I-1183 because of the supposed indirect effects in other areas of applying the letter of directly applicable law. And yet it never bothered to determine whether such indirect effects were real or significant.

On September 9, 2015, the Board adopted the pricing rules, AR 1570-71, with an effective date of October 22, 2015, AR 1574-78 (final rules filed with code reviser). The day before the pricing rules went into effect, however, the Board stayed the enforcement of the last sentence of Rule -085(3) and then removed it. WSR 16-19-105. That rule now

prohibits volume discounts based on a delivery to multiple locations owned by one entity. Rule -085.

**C. The Impact of the Board’s Pricing Rules**

The Board’s interference with generally lawful trade practices rewards those who benefited under the old system (primarily former State stores and distributors) at the expense of consumers and Appellants. Appellants are prejudiced by higher cost of product, restriction of legitimate business practices, and increased regulatory burden. *E.g.*, CP 7 (Gorton Decl. ¶¶ 5-6). The public and customers of Appellants’ members suffer unnecessarily increased prices and fewer product choices as a result of the pricing rules. *Id.* Indeed, in the wake of the enacted rules, prices have gone up substantially. CP 7-8, 10-12 (Gorton Decl. ¶ 7, Ex. A (spreadsheet showing comparison of pricing offered prior to and after rule adoption)). Appellants’ members suffer from significant economic losses based on the unlawful restrictions on their ability to negotiate pricing. CP 7 (Gorton Decl. ¶ 6).

**D. Procedural Background**

Appellants sought judicial review of the pricing rules immediately after they went into effect. CP 649-70 (Petition for Review). In June 2017, the Superior Court rejected Appellants’ challenge, holding that (1) the Board did not exceed its authority in promulgating the pricing

rules, and (2) the pricing rules are not arbitrary and capricious. CP 644-48 (Letter Ruling); CP 641-43 (order dismissing petition for review). The Superior Court also rejected the Board's challenge to Appellants' standing, granted in part and denied in part the Board's request to strike certain evidence, and dismissed several individual Board members as improper parties. CP 641-43 (order dismissing petition for review). The Board has not appealed any portion of the Superior Court's rulings.

This appeal requests that the Court uphold the plain language of RCW 66.28.170 and stop the Board's pricing rules from impeding legitimate, competitive pricing practices. CP 638-40 (Notice of Appeal).

## **VI. STANDARD OF REVIEW**

The APA governs this case. *See* Chapter 34.05 RCW. "In reviewing administrative action, th[e] court sits in the same position as the superior court, applying the standards of the [APA] directly to the record before the agency." *Tapper v. State Emp't Sec. Dep't*, 122 Wn.2d 397, 402 (1993). The Court reviews challenges to an agency's rulemaking authority de novo. *Ass'n of Wash. Spirits & Wine Distribs. v. Wash. State Liquor Control Bd.*, 182 Wn.2d 342, 350 (2015). Review of arbitrary and capricious challenges is also de novo. *Stewart v. State, Dep't of Soc. & Health Servs.*, 162 Wn. App. 266, 273 (2011).

## VII. ARGUMENT

The APA invalidates rules that (1) “exceed[] the statutory authority of the agency” or (2) are “arbitrary and capricious.” RCW 34.05.570(2)(c); *Wash. State Hosp. Ass’n*, 183 Wn.2d at 595. Either basis suffices to invalidate the pricing rules, and both apply here.

### A. The Pricing Rules Exceed the Board’s Statutory Authority

The Board lacks the authority to “amend or change legislative enactments.” *Wash. State Hosp. Ass’n*, 183 Wn.2d at 595. “[R]ules that are inconsistent with the statutes they implement are invalid.” *Bostain v. Food Express, Inc.*, 159 Wn.2d 700, 715 (2007) (invalidating inconsistent agency rule); see *Wash. Fed’n of State Emps. v. State Pers. Bd.*, 54 Wn. App. 305, 308 (1989) (“Agencies do not have the power to make rules which amend or change legislative enactments.”). Any agency rule that “conflicts with a statute is beyond an agency’s authority and invalidation of the rule is proper.” *H & H P’ship v. State*, 115 Wn. App. 164, 170 (2003). There is no exception for situations where the agency believes that applying a directly applicable statute as written would indirectly conflict with other statutory objectives.

Here, the Board has stripped Washington businesses of rights granted by RCW 66.28.170. The statute permits “[p]rice differentials for sales of spirits or wine based upon competitive conditions, costs of

servicing a purchaser’s account, efficiencies in handling goods, or other bona fide business factors.” But with the challenged rules, the Board categorically prohibits market practices that the factors listed in RCW 66.28.170 support in most, if not all, individualized circumstances. Below, Subsection (1) establishes the scope of the statute, and Subsection (2) explains how the Board’s rules interrelate to impermissibly prohibit pricing practices allowed by the plain language of the statute.

**1. The statute allows myriad pricing practices based on individualized market factors.**

RCW 66.28.170 governs pricing practices for liquor in Washington. The Court’s primary objective in interpreting a statute is to “ascertain and give effect to the intent and purpose of the Legislature”—or the People. *State v. Watson*, 146 Wn.2d 947, 954 (2002); *see Seeber v. Pub. Disclosure Comm’n*, 96 Wn.2d 135, 139 (1981) (clarifying that the same canons of statutory construction that apply to legislation apply to initiatives). The start, and often the end, is the plain language: “if the statute’s meaning is plain on its face, then the court must give effect to that plain meaning as an expression of legislative intent.” *Dep’t of Ecology v. Campbell & Gwinn, LLC*, 146 Wn.2d 1, 9-10 (2002). Plain meaning can be determined by the statute’s text and by reference to “the context of the statute in which that provision is found, related provisions,

and the statutory scheme as a whole.” *State v. Donaghe*, 172 Wn.2d 253, 262 (2011). Courts interpret statutes with no deference due to an agency’s interpretation of an unambiguous statute, even when such an interpretation is promulgated in an agency rule. *Ass’n of Wash. Spirits*, 182 Wn.2d at 355 (extending no deference to Board); *Edelman v. State ex rel. Pub. Disclosure Comm’n*, 152 Wn.2d 584, 590 (2004) (according agency rule no deference “where no ambiguity exists”).

RCW 66.28.170 allows many pricing practices for spirits and wine in Washington, based on individual circumstances of a manufacturer. The statute consists of two parts. Although the People left in place a prohibition of price discrimination for wine, spirits, and beer, they explicitly limited such prohibition for business reasons. RCW 66.28.170. I-1183 added exceptions for wine and spirits (but not malt beverages): “Price differentials for sales of spirits or wine based upon competitive conditions, costs of servicing a purchaser’s account, efficiencies in handling goods, or other bona fide business factors, to the extent the differentials are not unlawful under trade regulation laws applicable to goods of all kinds, do not violate this section.” RCW 66.28.170.

In short, following the passage of I-1183, the statute permits price differentials in the sale of wine and spirits when the price differential is (1) supported by a bona fide business factor, and (2) not unlawful under

generally applicable trade regulation laws. *Id.* Such bona fide business factors include, but are not limited to: “competitive conditions,” “costs of servicing a purchaser’s account,” and “efficiencies in handling goods.” *Id.*

Related provisions in I-1183 show that the plain language harmonizes with the overall statutory scheme. *See Ass’n of Wash. Spirits*, 182 Wn.2d at 350 (looking to statutory scheme as part of the plain meaning analysis). *First*, the Initiative revised RCW 66.28.180, which had previously prohibited all quantity discounts, and left this prohibition intact only for beer. I-1183 § 121(1)(d). *Second*, the Initiative added a new subsection to RCW 66.28.180 to allow sales of wine “at a discounted price” if permissible under “applicable trade regulation laws,” including “good faith meeting of a competitor’s lawful price and absence of harm to competition.” *Id.* § 121(4). *Third*, Section 120(5) of I-1183 used the same language to permit spirits sales at discounted prices. Reading I-1183 as a whole supports the conclusion that RCW 66.28.170 means exactly what its plain language says: price differentials generally, not just those based on volume, are allowed as long as they are supported by a bona fide business practice and not contrary to general trade regulations.

Although unnecessary because the statute is unambiguous, the People’s intent regarding pricing practices, clear from both I-1183 and the voting materials, underscores the plain meaning of RCW 66.28.170. *See*

*Roe v. TeleTech Customer Care Mgmt.*, 171 Wn.2d 736, 746-47 (2011) (in assessing an initiative, “the court may look to extrinsic evidence of the voters’ intent such as statements in the voters’ pamphlet”). The Initiative’s purpose included removing uniform pricing regulations for wine. I-1183 § 101(1) (intent to remove “outdated, inefficient, and costly” regulations restricting wholesale pricing of wine); *id.* § 101(2)(n) (intent to “[u]pdate the current law on wine distribution to allow wine distributors and wineries to give volume discounts”). Its summary, provided on every ballot, read: “This measure would . . . allow non-uniform wholesale pricing for wine and spirits.” I-1183 Ballot Measure Summary. The Voter’s Pamphlet was equally explicit:

Initiative 1183 eliminates the requirement that distributors and manufacturers of wine sell at a uniform price, which would allow the sale of wine at different prices based on business reasons. Spirits could also be sold to different distributors and retailers at different prices.

2011 Voter’s Pamphlet at 20; *see also id.* at 25 (“1183 eliminates outdated regulations that currently restrict price competition . . .”). In sum, the intent of RCW 66.28.170 is to allow the sale of wine and spirits at varying prices, so long as there exists a bona fide business reason lawful “under trade regulation laws applicable to goods of all kinds.”

By explicitly linking wine and spirits pricing practices to those allowed for “goods of all kinds,” RCW 66.28.170, the People also chose to treat alcohol more like other goods in this regard. But the Board flatly rejected the People’s choice, stating in the rules’ Concise Explanatory Statement (“CES”): “Alcohol cannot be marketed and regulated as other goods. Alcohol privatization did not change the fact that alcohol is different from other products and should be regulated accordingly.” AR 1581. Whether or not the Board is right that it knows better than the People—it cited to no evidence to support its claims—it lacks authority to impose its preference. The People meant what they said and allowed price differentials “not unlawful under trade regulation laws applicable to goods of all kinds.”

So instead of allowing price differentials “based upon competitive conditions, costs of servicing a purchaser’s account, efficiencies in handling goods, or other bona fide business factors,” RCW 66.28.170, the Board’s final rules “allow[] differential pricing other than by volume” only “under specific circumstances,” AR 1581. But an unambiguous statute is not subject to construction, and neither an agency nor a court may add language to an unambiguous statute “even if [it] believe[s] the Legislature intended something else but did not adequately express it.” *Watson*, 146 Wn.2d at 955. Each of the Board’s rules contravenes the

rights granted by RCW 66.28.170 because each rule imposes a blanket prohibition where individualized business factors may well support a price differential.

**2. The Board limited permissible pricing practices.**

The five pricing rules challenged here function together to set up a framework in which a select few pricing practices are allowed—and all others are prohibited. *See* App. B (summary chart of challenged rules); App. C (text of rules).

Rule -065(1)(j) provides the first commandment for pricing practices under the Board’s regime: “The exercise of undue influence is . . . prohibited,” and that includes practices in which a “product is not offered to all retailers in the local market at the same price.” Rule -065(2), (1)(j). Restated, the Board prohibits any pricing differentials offered within the same local market. A “local market” is defined vaguely as a geographic area “such as [a] town, city, county or other recognized geographic area.” Rule -070.

The remaining rules then establish limited exceptions, far narrower and different than those specified by statute. Some channel pricing—differential pricing for off-premises and on-premises retailers—is allowed for wine, even within the same local market. Rule -080(2)(b). But for spirits, permission for differential pricing is limited to “new” spirits

products (defined as products that have not previously been offered for sale before by the retailer) and capped at six months. Rule -080(2)(a).

Together, Rules -080(1), -085(2) and -085(3) limit volume discounts to pricing differentials based on the volume of product ordered by a single retailer, in a single transaction, and delivered to a single location.

Each of the practices prohibited by the pricing rules could be, and generally is, supported by bona fide business factors and therefore permissible under RCW 66.28.170. But the rules essentially return Washington to uniform pricing, specifically rejected by I-1183, and they protect distributors from most common forms of business competition.<sup>6</sup>

Under Rules -065 and -070, an upscale wine and whiskey bar in Olympia could not negotiate different prices than the local restaurant in Yelm, regardless of a bona fide business reason. Similarly, a specialty liquor store and a grocery store in the same county could not negotiate

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<sup>6</sup> The requirement to offer all wine and spirits to retailers at the same price would also signal a return to the era of post-and-hold regulations, in which suppliers had to publish their prices and hold them for a period of time. The Ninth Circuit invalidated Washington's post-and-hold regulations under federal antitrust laws. *Costco*, 522 F.3d at 895. Such regulations have also been empirically studied and found to promote collusion between distributors to raise prices, to the detriment of the consumer and state (through the loss of tax revenue), without any attendant gains in public welfare goals related to reduced alcohol consumption, as measured by decreases in underage drinking and drunk driving incidents. James C. Copper & Joshua D. Wright, *Alcohol, Antitrust and the 21st Amendment: An Empirical Examination of Post and Hold Laws*, 32 Int'l Rev. L. & Econ. 379 (2012).

prices by pointing to their particular circumstances. But many conceivable bona fide business factors besides sheer volume would enable one entity to negotiate a better price than another: one store might be closer to the distributor's office and therefore cheaper to supply ("efficiencies in handling goods"), or a specialty bar might offer an atmosphere more in line with the producer's product, and therefore offer a better marketing opportunity, than the dive bar down the street ("competitive conditions"). RCW 66.28.170; *see* AR 1105-06 (Expert Report at 3-4) (discussing various value-adds by retailers that might warrant differential pricing).

Similarly, competitive conditions such as exposure and marketing may warrant differentiating spirits prices between on-premises and off-premises retailers, but Rule -080(2)(a) prohibits such differentiation after a product has spent at least six months on the market.

The following practices, all presented to the Board, exemplify practices prohibited by the sweeping pricing rules despite being supported by bona fide business conditions and not otherwise illegal—hence allowed by RCW 66.28.170.

**Promotional efforts and branding benefits support a price differential.** Rumba Rhum & Food is a Seattle-based bar featuring only one kind of liquor: rum. AR 1055 (comment letter). Based on its

business model, Rumba offers suppliers the value of having their product promoted by knowledgeable staff and being offered in a setting designed to highlight rum, increasing the exposure of this liquor to customers. *Id.*; accord AR 1105-06 (expert opinion regarding value added by specialty restaurants); AR 1536 (spirits association noting difference in value offered by a sports bar versus a sushi bar); AR 100-01 (additional restauranters commenting on value uniquely added by their businesses); AR 253 (distributor noting value added to product branding by trained restaurant staff). Rumba, however, does not buy and sell in sufficient volume to qualify for a typical volume discount. AR 1055. Under the Board's rules (specifically, Rules -065 and -070), Rumba may not negotiate with suppliers for a lower price than the sports bar next door or the sushi bar across the street because it is in the same local market.

**Multi-location efficiencies support a price differential.** Azteca is a family-owned restaurant chain that coordinates the volume generated by all of its restaurants to negotiate lower prices for goods it needs for its business, from chickens to avocados. AR 276-77. Its suppliers negotiate discounts based on this volume, and they undoubtedly consider efficiencies from Azteca's companywide order notwithstanding the multiple delivery locations. Those negotiations are based not only on the volume Azteca orders, but on other factors, such as the kind of customer

the restaurants target and Azteca's ability to cross-sell similar items. *Id.* (The Court can take judicial notice that a margarita pairs well with chips and salsa.) Yet under the Board's pricing rules (specifically, Rule -085(2) and (3)), Azteca cannot rely on these bona fide business factors to negotiate for lower pricing or combine its volume for any level of discount on purchases of wine and spirits across delivery locations.

**Multi-day orders support a price differential.** The Hotel Murano in Tacoma hosts multiple events each day. AR 196-97. Events scheduled for the same day are often reserved at different times, but supplies are still needed (and delivered) at the same time. *Id.* Yet the Board's rules (specifically, Rule -085(1)) prohibit the hotel from watching for opportunities to combine subsequent orders, placed on different days but for delivery on the same day and time, to count toward a volume discount. Yet there are efficiencies in handling goods realized by delivering multiple orders at the same time, and a reduction of costs to service the Hotel's account. Both are bona fide business factors under RCW 66.28.170.

The Board failed to consider whether practices like the above were supported by "competitive conditions, costs of servicing a purchaser's account, efficiencies in handling goods, or other bona fide business conditions." RCW 66.28.170. Instead, it declared all such practices

prohibited regardless of the applicability of those factors. It lacks the authority to do so when RCW 66.28.170 expressly permits any “[p]rice differential” supported by bona fide business reasons. *Accord Bostain*, 159 Wn.2d at 716 (rejecting agency rules that interpreted Washington’s overtime law more narrowly than the plain language of the statute); *Edelman*, 152 Wn.2d at 591 (rejecting “gap-filling” rules when plain language of statute did not permit exemption created by agency). Any of these explicit business factors can support a price differential between retailers in the same “local market,” as defined in Rule -070, but Rule -065(1)(j) categorically prohibits such price differentiation. *See* AR 1105-07 (Expert Report at 3-5) (explaining the menu of considerations that might warrant differential pricing).

In sum, the pricing rules flout the statutory language that grants the right to differentiate prices when selling spirits and wine, so long as those prices are based on bona fide business conditions and not otherwise prohibited by law. The contrast is obvious if you put the statute’s broad language next to the Board’s narrow prohibition on pricing practices:

| <b>RCW 66.28.170</b>   | <b>Rule -065</b>   |
|--|--|
| “Price differentials for sales of spirits or wine based upon competitive conditions, costs of servicing a purchaser’s account, efficiencies in handling goods, or other bona fide business factors, to the extent the differentials are not unlawful under trade regulation laws applicable to goods of all kinds, do not violate this section.” | Any practice in which “product is not offered to all retailers in the local market at the same price . . . is prohibited.” |

RCW 66.28.170 permits pricing differentials unless they are prohibited by applicable antitrust or general trade regulation laws; the Board starts from a position of prohibiting all price differentials and carves out a few limited exceptions that are far narrower than and not tied to the statute. The Board’s approach imposes a blind, industrywide standard whereas the statute contemplates a system based on individualized, market-driven conditions that would justify price differentials.

**B. The Board’s Justifications for Its Rulemaking Authority Fail**

During the rulemaking and the proceedings before the Superior Court, the Board justified its authority to enact more detailed pricing rules (despite the plain language of RCW 66.28.170) based on two arguments. *First*, the Board claimed it has the authority to “interpret” the statute and provide clarification. As discussed already, RCW 66.28.170 is not ambiguous, and the Board’s “interpretation” strips away rights granted by

I-1183. *Second*, the Board clung to its authority to regulate the sale of liquor. This authority, narrowed by I-1183, does not trump the specific statutory directive allowing *any* price differential based on a bona fide business condition. Neither argument overcomes the plain language of the statute.

**1. RCW 66.28.170’s plain language is unambiguous and does not require interpretation.**

The Board has argued that its rulemaking clarifies an alleged ambiguity in RCW 66.28.170. This argument relies on the assertion that the statute’s permissive catchall—“other bona fide business factors”—did not specify what practices are permissible. That is, of course, exactly what you would expect from a catchall, and it can hardly excuse eviscerating what was specified and thereby writing the catchall out of the statute completely.

Statutory language is only ambiguous if it is susceptible to two or more reasonable interpretations. *W. Telepage, Inc. v. City of Tacoma Dep’t of Fin.*, 140 Wn.2d 599, 608 (2000). “The fact that a word is not defined in a statute does not mean the statute is ambiguous.” *Ravenscroft v. Wash. Water Power Co.*, 136 Wn.2d 911, 920 (1998). The catchall for other “bona fide business factors” is broad, but not ambiguous.<sup>7</sup> Broad

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<sup>7</sup> No deference is due to the agency in interpreting general trade regulation rules, even if some ambiguity existed. “[D]eference is accorded an agency’s interpretation only if . . .

does not mean limitless; the catchall is bound by the requirement that the business factor be “bona fide.” In other words, the catchall refers to good faith, genuine considerations that—like the enumerated examples preceding it—are rooted in the economics of the competitive marketplace and exemplified with respect to the broad array of products other than liquor.

Before the Superior Court, the Board relied on an alleged ambiguity as a justification for the Board’s rulemaking exercise. But neither there nor during the multi-year rulemaking process did the Board suggest two competing reasonable interpretations of the catchall such that the statute must be considered ambiguous. Below, the Board argued in its briefing that RCW 66.28.170 was ambiguous, but it did not suggest alternative reasonable interpretations of the catchall. CP 691-92. By oral argument, the Board’s “thinking ha[d] evolved a little bit since writing the brief,” and it essentially abandoned the argument that the statute was ambiguous. RP at 25:11-14, 33:4:5-6. Instead, the Board focused on the need to “interpret” RCW 66.28.170 in light of the entire statutory

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the particular agency is charged with the administration and enforcement of the statute” and “the statute falls within the agency’s special expertise.” *Bostain*, 159 Wn.2d at 716. The Board lacks specialized expertise in antitrust or general pricing regulation principles, and it nowhere contends—and could not honestly contend—that general trade regulation laws are as narrow as its rules.

scheme—analysis a court does to determine the statute’s plain meaning.<sup>8</sup> *Donaghe*, 172 Wn.2d at 262 (the “statutory scheme as a whole” is relevant to determining the plain meaning of statutory text).

The plain meaning of RCW 66.28.170 is consistent with the greater context of I-1183 and Chapter 66.28 RCW. *See supra* § VII.A.1. (discussing how statutory scheme as a whole supports plain reading of RCW 66.28.170). The plain language makes clear that it was not intended to be an exclusive list of what practices are allowed. Instead, it is meant to be broad enough to cover the myriad commercial practices that may arise in Washington’s vibrant and growing wine and spirits markets, just as such practices had arisen with respect to other products. The Board’s so-called “interpretation” rewrites RCW 66.28.170. But the Board lacks the authority to overrule the People’s legislation.

**2. The Board’s authority to promulgate liquor regulations does not extend to controlling market pricing practices.**

During the rulemaking and before the Superior Court, the Board also argued that it had authority to enact these fair trade rules and control pricing for wine and spirits. But as already discussed, the Board lacks the authority to amend legislation through its rulemaking. RCW 66.28.170 allows what the rules prohibit. But even if one sets aside the plain

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<sup>8</sup> The Superior Court found the catchall to be “amorphous,” but not ambiguous so as to require construction. CP 647 (Letter Ruling at 4).

language of that statute, the Board lacks the general or specific authority to regulate “fair trade” practices and control liquor pricing.

An agency’s authority is “limited to that which is expressly granted by statute or necessarily implied therein.” *Wash. Indep. Tel. Ass’n v. Telecomms. Ratepayers Ass’n for Cost-Based & Equitable Rates*, 75 Wn. App. 356, 363 (1994). Here, RCW Title 66 has not granted the Board general or specific authority to regulate fair trade practices and control pricing for wine and spirits.

**a. The Board no longer has gap-filling authority to generally enact rules to interpret law.**

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 title.” Laws of 1933, ch. 62, § 79(1) (former RCW 66.08.030(1)). Even putting aside the clear spirit of I-1183, it eliminated that authority.

The Initiative signaled a shift not just in economic policy but also in social policy. *WASAVP*, 174 Wn.2d at 651. It struck both the “orderly marketing of alcohol” and “encouraging moderation in consumption of alcohol” as policy goals for the State. *Id.* Today, the State’s goals are “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 presciently reduced the Board’s authority to undercut the Initiative through expansive regulatory authority. I-1183 removed the Board’s historically broad, general rulemaking authority, striking the following language from RCW 66.08.030:

For the purpose 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.

I-1183 § 204 (strikeout omitted). Voters explicitly intended to remove the Board’s power to regulate prices: “Initiative 1183 . . . alters the Liquor Control Board’s power and duties. It eliminates the Board’s power to . . . set the prices of spirits.” 2011 Voter’s Pamphlet at 20.

In sum, the People terminated the State’s “outdated, costly and inefficient” regulation of wine pricing, removed the Board’s authority to control spirits pricing, and declined to build in uniform pricing requirements for the new, private spirits scheme.

The Board also lacks authority to make contrary rules under the guise of “fairness.” (The Board refers to the challenged rules as “fair

trade” rules.) The voluminous agency record reveals no analysis of how the restricted pricing practices could cause, or the pricing rules could prevent, abusive consumption or other threats to public safety. *See, e.g.*, AR 1580-87 (CES). Instead, the Board pursued the now-rejected policy goal of creating an orderly market by policing “fair” trade practices via State regulation. As articulated by the Board, the goal for the pricing rules was to “strike a legitimate balance in the liquor marketplace and appropriately prohibit unfair trade practices.” AR 14 (Proposed Rules). The State Attorney General enforces the extensive State and federal legislation that already exists to police fair competition, and it is neither the Board’s purpose nor within its historical expertise to enter that fray.<sup>9</sup>

**b. The Board’s permission to regulate the sale of liquor does not include controlling the market.**

Lacking any general authority to enact these fair trade rules, the Board’s express grant of authority is limited to the enumerated powers in RCW 66.08.030. The Board has claimed that its specifically enumerated power under Subsection (12) allows it to control the wine and spirits markets by proscribing pricing practices because it was a function of

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<sup>9</sup> As a UW pricing expert, Professor Schulman, noted, “[t]here is not only no need to pass the proposed rules, doing so will have a negative, anti-competitive impact on the spirits and wine marketplace in Washington.” AR 1111 (Expert Report at 9). Appellant WRA retained Professor Schulman to analyze the proposed rules and liquor market practices when it became clear that the Board would not engage in any rigorous analysis or engage its own expert.

“regulating the sale of beer, wine, and spirits.”<sup>10</sup> See AR 1580-81 (CES); CP 689-90 (Board’s Response Brief at 16-17). Not so. Neither the Legislature nor the People have delegated authority to maintain fair competition laws to the “Liquor and Cannabis” Control Board, and such an authority cannot be implied by the exhaustive list of 21 specific tasks delegated to the Board under RCW 66.08.030.<sup>11</sup> See RCW 66.08.030.

The specific authority to “regulate[] the sale of beer, wines, and spirits” under RCW 66.08.030(12) does not allow the Board to mandate “fair trade” practices and limit pricing practices for wine and spirits. The Board’s authority extends to regulating the circumstances surrounding the act of where and when liquor can be sold, such as where the act occurs (at licensed properties), how the act is transacted (cash, credit, or EFT), or what times of the day the act may occur. It cannot reasonably be stretched to cover the sweeping economic interest regulation the Board enacted with

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<sup>10</sup> This subsection allows the Board to enact regulations for “prescribing the conditions, accommodations, and qualifications requisite for the obtaining of licenses to sell beer, wines, and spirits, and regulating the sale of beer, wines, and spirits thereunder.” RCW 66.08.030(12).

<sup>11</sup> Notably, only a year after I-1183 removed the Board’s gap-filling authority, the People did not similarly limit its authority with respect to regulation of marijuana. Initiative 502 granted the Board the authority to adopt rules generally and, “*without limiting the generality of*” this grant, lists specific areas over which the Board has authority. Laws of 2013, ch. 3, § 9 (emphasis added). RCW 66.08.030 lacks any such qualification and any catchall. Its statement that “[t]he power of the board to make regulations under chapter 34.05 RCW extends to” the 21 topics suggests that it does not extend beyond them. RCW 66.08.030. Such a construction is further supported by I-1183’s revocation of the gap-filling authority.

its “fair trade” pricing rules.<sup>12</sup> That is especially true here, where the Board acknowledges that the rules do not promote public welfare or safety and are not tethered to enforcing undue influence. *See* CP 688 (Board’s Response Brief at 15). Nor may an agency ignore a specific statutory directive on a topic merely because the topic is within its general authority. To the contrary, an agency rule that is contrary to statute must be declared invalid despite any apparent practical necessity or appropriateness. *Wash. Indep. Tel. Ass’n*, 75 Wn. App. at 363.

**C. The Pricing Rules Are Arbitrary and Capricious**

Even assuming the statute and the People had not been clear in their intent to remove pricing restrictions specific to wine and spirits, and even assuming the Board could regulate “fair trade practices,” the rules are arbitrary and capricious and must be invalidated under RCW 34.05.570(2)(c).

“[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 reasons for adopting the rule.” *Wash. Indep. Tel. Ass’n v. Wash. Utils. & Transp. Comm’n*, 148 Wn.2d 887, 906 (2003). While

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<sup>12</sup> To the extent any conflict exists between RCW 66.08.030(12) and RCW 66.28.170, “courts generally give preference to the more specific and more recently enacted statute” to resolve such conflicts. *Tunstall ex rel. Tunstall v. Berguson*, 141 Wn.2d 201, 211 (2000). RCW 66.28.170 is the more recent and specific enactment.

deferential, Washington courts hold agencies accountable for promulgating rules that reflect a rational connection to the facts and circumstances of the problem the agency is attempting to solve—and will reverse such agency regulations despite lengthy, well-intentioned, complicated rulemaking. *See Puget Sound Harvesters Ass’n v. Dep’t of Fish & Wildlife*, 157 Wn. App. 935 (2010); *Children’s Hosp. & Med. Ctr. v. Dep’t of Health*, 95 Wn. App. 858 (1999).

Here, there is no question the Board considered a plethora of material. Over the course of four years, the Board held multiple meetings and hearings and revised its proposed rules multiple times, creating hundreds of pages of paper. But volume alone cannot substitute for rational analysis, and receiving information is not the same as deliberating on it. The arbitrary nature of this rulemaking is apparent for three reasons: (1) the Board failed to explain its reasoning to support the rules; (2) the rules draw arbitrary boundaries around permissible behavior; and (3) the Board ignored the evidence before it to arbitrarily reward some stakeholders and deny appropriate market opportunities to others.

The basis for the Court’s review is the agency’s record and explanation. *Wash. Indep. Tel. Ass’n*, 148 Wn.2d at 906. An agency must explain its rulemaking in the form of the legislatively mandated CES. *See* RCW 34.05.325(6)(a)(iii) (requiring the agency to summarize all the

comments received and to indicate “how the final rule reflects agency consideration of the comments, or why it fails to do so”); *Anderson, Leech & Morse, Inc. v. Wash. State Liquor Control Bd.*, 89 Wn.2d 688, 693 (1978) (explaining that the purpose of a CES is “to assure the agency actually considered all arguments made” and to “facilitate court review”); *Puget Sound Harvesters Ass’n*, 157 Wn. App. at 951 (finding agency acted arbitrarily by “cursorily . . . considering the facts and circumstances surrounding its actions” and because its CES “[did] not provide a rational explanation” for its decision). By requiring an agency to prepare a CES, the APA ensures that the agency actually *considers* public comments by explaining why it did, or did not, find them persuasive, and thus provides for meaningful judicial review of the agency’s reasoning. The public’s role is rendered meaningless if the agency formally accepts comments, but ignores them. Requiring the agency to produce a discussion—that is, the CES—ensures that the “public respect[s] the process whereby administrative rules are adopted, whether or not they agree with the result.” Laws of 1995, ch. 403, § 1(2)(d) (Regulatory Fairness Act). To that end, “the bases for agency action must be legitimate and clearly articulated.” *Id.*

Here, after three years, four drafts, and hundreds of comments, the Board’s CES does nothing more than summarize comments received and

explain what the Board did. There is no “why.” The closest the Board comes to engaging critiques and explaining its actions is the conclusory assertion that the final rules “strike[] a legitimate balance in the liquor marketplace and appropriately prohibit unfair trade practices.” AR 14. Review of the record fails to reveal evidence sufficient to support this decision.

First, the Board provided no explanation as to how the limited form of channel pricing it allowed was more bona fide or less threatening to public safety or less likely to result in “undue influence” than the channel pricing it prohibited. Nor was there any explanation as to why the channel pricing allowed between off-premises retailers and on-premises retailers should be limited in the case of spirits to the first six months of a new product. The record’s answer to any basic question probing the reasoning behind the Board’s channeling rules is silence. *See* AR 1479-83 (distributors discussing lack of basis to distinguish between spirits and wine); AR 1531-34 (spirits association, same comments). The CES merely states that the Board initially intended to prohibit all channel pricing, but allowed some in the final rules. AR 1585. But explaining that some channel pricing is permitted falls short of explaining why the Board chose the limits it did, and how it justified treating wine and spirits sales differently. The absence of any explanation by itself suffices to render the

channel pricing rules arbitrary; this conclusion is further supported by the lack of any explanation in the record.

The Board drew other arbitrary limits around what pricing practices would be allowed. As discussed above, the challenged rules prohibit various practices that can be, and often are, supported by bona fide business factors and permissible under general antitrust rules and regulations applicable to other goods. *See* RCW 66.28.170. Instead of investigating whether certain practices are supported by legitimate factors, or analyzing why the testimony offered by stakeholders describing various business practices does not demonstrate bona fide conditions, the Board simply prohibited the vast majority of price differentials, carving out narrow exceptions for some volume discounts and channel pricing practices. To support the rules, the Board tendered only its belief (unsupported by analysis of market conditions) that there was an imbalance in the marketplace and “confusion” about what prices were allowed. AR 11, 14. But without tethering its decision to public safety, the rules are simply arbitrary expressions of where Board members felt an “appropriate balance” was struck.

Finally, the rules are arbitrary and capricious because the Board disregarded the facts and evidence before it. Before the Board were hundreds of comments that pricing differentials were beneficial and

satisfied the statutory standards. While most comments centered on permitting channel pricing between on-premises and off-premises licenses, many also discussed the value added by other rules, such as negotiated discounts for reasons other than volume or the manner of calculating such volume. *See, e.g.*, AR 279 (ability to negotiate pricing discount for value added by restaurant for featuring a certain product); AR 286-87 (pricing discount for value added by allowing for delivery on one day, even though orders placed over multiple days). To be sure, the Board could not reconcile every position presented. But it owed the People more than lip service, and there is no logical path from the comments and data received to the final rules the Board implemented.

The Board did not retain an expert to study the state of the wine and spirits markets to assess the extent and nature of “price discrimination,” nor did it ever comment on the expert opinion provided by Professor Schulman, who summarized the factors influencing pricing decisions for suppliers, retailers, and customers. AR 1103-11. After personally talking to a number of liquor market participants and reviewing the Board’s rules, Professor Schulman’s professional opinion was that “the kinds of pricing differentials being offered to market participants in Washington’s wine and spirits industry are based on legitimate competitive market considerations that take into account the cost for the

supplier to service an account and the value added by a retailer's Service Outputs." AR 1111. Comments from numerous individual businesses supported his opinion. *See, e.g., supra* § VII.A.2. (discussing examples of bona fide business practice prohibited by rules).

The single, cursory analysis performed by the Board did not support the rules. Its SBEIS showed the challenged rules would have a largely detrimental impact on Washington's small businesses. Instead of hiring a professional to conduct the required SBEIS or otherwise rigorously analyzing how the proposed pricing rules would affect Washington's small businesses, the Board chose to send a seven-question survey to those entities that had opted into rulemaking notices.<sup>13</sup> AR 11. The Board shrugged off criticism of the survey and prepared the SBEIS based on responses from only 100 small businesses.<sup>14</sup> AR 11. The anemic results still revealed the following:

- 87% of respondents "stated their business would lose sales or revenue." AR 13. For 39%, the losses would exceed \$15,000.<sup>15</sup> *Id.*
- 64% of respondents noted additional professional services would be required to abide by the rules. AR 12.

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<sup>13</sup> Appellant WRA, noting the small distribution list, more widely distributed the survey by sending it to its members. AR 1604; AR 11-12.

<sup>14</sup> Appellant WRA alone has over 5,800 members, the majority of which qualify as small businesses. CP 6 (Gorton Decl. ¶ 3).

<sup>15</sup> For context, the average net income for a restaurant in Seattle is around only four percent of its total revenue before taxes. CP 6 (Gorton Decl. ¶ 3).

- 73% noted there would be additional costs for record keeping, labor and administrative costs, and 65% estimated those costs to range from \$5,000 to over \$15,000. AR 12-13.<sup>16</sup>
- 60% noted no jobs would be created. AR 13.

Beyond the survey results, dozens of businesses stated to the Board that the pricing rules would harm their businesses. *See, e.g.*, AR 256-74 (comments from Appellant WRA noting negative impact of proposed rules on bars and restaurants); AR 72-75, 119-21, 242-46 (comments from Appellant NWGA regarding negative impact on grocery stores); AR 811 (comments from distributors noting impact of channel pricing rules would fall most heavily on restaurants and bars).

The Board dismissed the survey evidence it had gathered, noting that the petition for rulemaking had been submitted by a small business. AR 14. The Board never even acknowledged Professor Schulman's analysis or Appellants' submissions documenting how various practices are supported by valid business considerations. Instead of considering these issues, the Board merely restated its non-substantive conclusion that it "believe[d] the rules are necessary to interpret the law to define the limits on business practices in the liquor industry." AR 14. Pronouncing that rules are believed to be needed, however, is not the same as

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<sup>16</sup> The Board preposterously claimed in response that "the proposed rules do not add any reporting or recordkeeping requirements." AR 12.

explaining how the regulations meet substantive statutory standards or are appropriate despite their impact on small businesses, or how alternatives to minimize that impact would be insufficient to meet the statutory goals.

What the Board did say effectively admits that its objective was to impose its vision of economic fairness, artificially boosting some businesses at the expense of others. Wineries benefit more than spirits suppliers based on the channeling limits drawn by the Board; on-premises retailers face significant economic harm with the curtailment of their ability to negotiate pricing; and distributors benefit from a State-sponsored requirement to raise prices.

The most recent chapter in the drama of these pricing rules is the most telling of all. Based on one meeting with distributors, the Board suddenly reversed course and removed a sentence from Rule -085(3) that would have permitted volume discounts based on deliveries to multiple locations owned by one licensee. AR 2300 (meeting log); AR 2292 (email by distributor thanking Board for its prompt willingness to change course). Despite multiple requests to the Board and multiple public record requests, the Board has failed to disclose what justified the reversal. AR 2257 (stating the rule as promulgated would be “unnecessarily challenging to the distribution tier”); AR 2301 (stating only that the pricing exemption would “require [distributors] to completely change the way they do

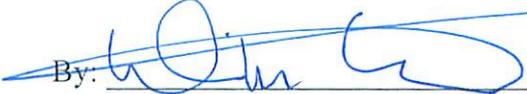
business”); CP 147 (Connelly Decl. ¶ 7 & Ex. F (submission of two public records requests failed to reveal any evidence submitted to Board)). Appellant WRA and its members submitted comments documenting the difficulties their industry faced by the removal of this rule and have been met, again, with silence. CP 8 (Gorton Decl. ¶ 9 & Ex. C (comment letters expressing difficulties and negative impact of removing Rule -085(3))); CP 147 (Connelly Decl. ¶ 6 & Ex. E (same)). The decision to reward one set of stakeholders’ business practices at the expense of others without explanation is the very definition of arbitrary and capricious behavior.

### **VIII. CONCLUSION**

The Board exceeded its authority in promulgating the pricing rules and acted in an arbitrary and capricious manner. On either ground, the APA requires invalidation of Rules -065 through -085.

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## APPENDIX A

*Before I-1183 passed, RCW 66.28.170 read, in its entirety:*

It is unlawful for a manufacturer of wine or malt beverages holding a certificate of approval issued under RCW 66.24.270 or 66.24.206 or the manufacturer's authorized representative, a brewery, or a domestic winery to discriminate in price in selling to any purchaser for resale in the state of Washington.

*Initiative 1183 (Laws of 2012, ch. 2, §119) made the following changes:*

It is unlawful for a manufacturer of spirits, wine, or malt beverages holding a certificate of approval ~~issued under RCW 66.24.270 or 66.24.206~~ or the manufacturer's authorized representative, a distillery, brewery, or a domestic winery to discriminate in price in selling to any purchaser for resale in the state of Washington. Price differentials for sales of spirits or wine based upon competitive conditions, costs of servicing a purchaser's account, efficiencies in handling goods, or other bona fide business factors, to the extent the differentials are not unlawful under trade regulation laws applicable to goods of all kinds, do not violate this section.

**APPENDIX B**

The chart below summarizes how the Board’s challenged pricing rules work together. (Appendix C sets out the text of all of the challenged rules.)

| <b>Rule</b>      | <b>Relevant Language</b>  | <b>Effect</b>  |
|------------------|---|--|
| 314-23-065(1)(j) | “‘Unfair trade practice’ means . . . discriminatory pricing practices as prohibited by law or other practices that are discriminatory in that the product is not offered to all retailers in the local market at the same price.”   | Rule requires that <b>all</b> liquor (beer, wine, and spirits) must be offered to all retailers in the same local market at the same price.  |
| 314-23-070       | “Local market is limited to businesses in geographic recognized market areas such as town, city, county or other recognized geographic area in which distribution services are provided. For the purposes of differential pricing, sales to on-premises retailers and off-premises retailers constitute separate markets.”  | Although -070 appears to allow all differential pricing for off-premises and on-premises retailers, this limited exception is further narrowed by -080(2), which clarifies such pricing differentials are permissible for only wine and, for spirits, are limited to only the first six months and only for a “new product.” |
| 314-23-080(2)    | “Differential pricing between on premises licensed retailers and off-premises licensed retailers is allowed under the following exceptions:<br>(a) For spirits: A new product to the market may be sold to on-premises retailers at an ‘introductory price’ for a maximum of six months. After the six-month introductory period the price for on-premises and off-premises retailers must be the same price for the same |  |

| Rule          | Relevant Language   | Effect  |
|---------------|---|---|
|               | <p>volume purchased . . . .</p> <p>(b) For wine: Wine may be sold to on-premises retailers and off-premises retailers at different prices.”</p>   |   |
| 314-23-080(1) | “[Volume] discounts must be based solely on the volume of the spirits and/or wine that is purchased by a retailer from a distributor or other licensed suppliers.”  | Together, rules limit pricing differentials to volume of product ordered in a single transaction and distributed to a single delivery location. |
| 314-23-085(2) | “The following types of discounts are not allowed . . . (2) <b>Discounts on purchases over time.</b> Prices must be based on the spirits or wine delivered in a single shipment.”   |   |
| 314-23-085(3) | “(3) <b>Discounts on a combined order that is delivered to multiple licensed sites.</b> Volume discounts may only be provided based on combined orders by one or more licensees to the ‘central warehouse’ or a single location to which the order is delivered.” |   |

## APPENDIX C

### WAC 314-23-065

#### **What are “unfair trade practices”?**

(1) “Unfair trade practice” means one retailer or industry member directly or indirectly influencing the purchasing, marketing, or sales decisions of another retailer or industry member by any agreement written or unwritten or any other business practices or arrangements such as, but not limited to, the following:

- (a) Any form of coercion between industry members and retailers or between retailers and industry members through acts or threats of physical or economic harm, including threat of loss of supply or threat of curtailment of purchase;
- (b) A retailer on an involuntary basis purchasing less than it would have of another industry member’s product;
- (c) Purchases made by a retailer or industry member as a prerequisite for purchase of other items;
- (d) A retailer purchasing a specific or minimum quantity or type of a product or products from an industry member;
- (e) An industry member requiring a retailer to take and dispose of a certain product type or quota of the industry member’s products;
- (f) A retailer having a continuing obligation to purchase or otherwise promote or display an industry member’s product;

(g) An industry member having a continuing obligation to sell a product to a retailer;

(h) A retailer having a commitment not to terminate its relationship with an industry member with respect to purchase of the industry member's products or an industry member having a commitment not to terminate its relationship with a retailer with respect to the sale of a particular product or products;

(i) An industry member being involved in the day-to-day operations of a retailer or a retailer being involved in the day-to-day operations of an industry member in a manner that violates the provisions of this subsection;

(j) Discriminatory pricing practices as prohibited by law or other practices that are discriminatory in that the product is not offered to all retailers in the local market at the same price.

(2) The exercise of undue influence is an unfair trade practice and is prohibited.

### **WAC 314-23-070**

#### **What is "local market"?**

Local market is limited to businesses in geographic recognized market areas such as town, city, county or other recognized geographic area in which distribution services are provided. For the purposes of differential pricing, sales to on-premises retailers and off-premises retailers constitute separate markets.

### **WAC 314-23-075**

**Are licensed distributors or other suppliers of spirits and wine allowed to provide discounts to on-premises or off-premises retail licensees based on a commitment from the retailer to purchase a particular percentage of the spirits back-bar, well-drinks, wine by the glass, or any combination of these?**

(1) It is unlawful for a distributor or other supplier of spirits or wine to offer a lower price to an on-premises or off-premises retailer if the retailer is required to purchase a specific portion of some or all of its wine or spirits from that distributor or supplier in order to qualify for the lower price. Such requirements include, but are not necessarily limited to, agreeing to devote certain percentage of the spirits back-bar, well-drinks, wine by the glass, or any combination of these or other types of purchases to products sold by that distributor or supplier.

(2) Such exclusive discounts are prohibited under RCW 66.28.170 and federal law 27 C.F.R. 6.72.

### **WAC 314-23-080**

**Are licensed distributors or other licensed suppliers of spirits and wine allowed to provide volume discounts to on-premises or off-premises retail licensees?**

(1) Yes, distributors or other licensed suppliers are allowed to provide volume discounts to licensed on-premises and off-premises retailers. The discounts must be based solely on the volume of the spirits and/or wine that is purchased by a retailer from a distributor or other licensed suppliers. However, the limitations on interactions between the levels of licenses remain, including the prohibition on undue influence and sales below cost of acquisition.

(2) Differential pricing between on-premises licensed retailers and off-premises licensed retailers is allowed under the following exceptions:

(a) For spirits: A new product to the market may be sold to on-premises retailers at an “introductory price” for a maximum of six months. After the six-month introductory period the price for on-premises and off-premises retailers must be the same price for the same volume purchased.

(i) “New product” means the product has not previously been offered for sale to retailers.

(ii) “Introductory price” means the price of the spirits product when it first becomes available for purchase.

(b) For wine: Wine may be sold to on-premises retailers and off-premises retailers at different prices.

### **WAC 314-23-085**

#### **What type of discounts are not allowed?**

The following types of discounts are not allowed. Please note that this list is representative and not inclusive of all practices that are not allowed:

(1) **Volume discounts that violate local, state, or federal laws.**

(2) **Discounts on purchases over time.** Prices must be based on the spirits or wine delivered in a single shipment.

**(3) Discounts on a combined order that is delivered to multiple licensed sites.** Volume discounts may only be provided based on combined orders by one or more licensees to the “central warehouse” or a single location to which the order is delivered.

**PERKINS COIE LLP**

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