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

WASHINGTON RESTAURANT ASSOCIATION, a Washington non-profit organization; NORTHWEST GROCERY ASSOCIATION, a non-profit organization; and COSTCO WHOLESALE CORPORATION, a Washington corporation; WASHINGTON LODGING ASSOCIATION, a Washington non-profit organization,

Appellants,

v.

WASHINGTON STATE LIQUOR AND CANNABIS BOARD,

Respondent.

RESPONSE BRIEF

ROBERT W. FERGUSON
Attorney General

MARY M. TENNYSON, WSBA No. 11197
Sr. Assistant Attorney General

R. JULY SIMPSON, WSBA No. 45869
Assistant Attorney General

Attorneys for Respondent

OD No. 91020

1125 Washington Street SE

PO Box 40110, Olympia, WA 98504

Phone: (360) 753-2702

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I. INTRODUCTION

Prior to Initiative 1183, the Washington State Liquor and Cannabis Board (Board) was the exclusive distributor and retailer of spirits. The Initiative created a new distributor license for spirits and allowed the distributors to differentiate in price so long as the prices were not discriminatory and did not otherwise violate federal laws or liquor laws.

The Board received a rulemaking petition filed by the Washington Liquor Store Association (WLSA), which asserted that distributors were charging small spirits retail stores almost twice as much as they were charging bars and restaurants for purchasing smaller volumes of liquor. The Board also discovered that some distributors were requiring bars and restaurants to purchase a certain percentage of their liquor used in well drinks and wines sold by the glass as a prerequisite to obtaining certain price discounts.

Over a three-year rulemaking process, the Board worked to adopt the “fair trade practice” rules. WAC 314-23-060 through -085, AR at 21–24. The Board received hundreds of pages of written comments and held seven rulemaking hearings. The rules evolved in response to the comments and to strike a balance between two starkly divided stakeholder groups: the off-premises retailers (including the WSLA) who wanted strict regulation; and the on-premises retailers (including the Appellants) who wanted no regulation at all. What resulted was a set of rules that leaves the statutory allowances of

price differentials in place and provides guidance to the industry about practices that violate the laws.

Appellants Washington Restaurant Association, the Northwest Grocery Association, Costco Wholesale Corporation, and Washington Lodging Association challenge the Board's rules because the Board did not wholly adopt their interpretation of the Initiative as eliminating the Board's authority to regulate any aspects of liquor sales. Opening Brief at 6, 30. To support their arguments that the Board exceeded its authority, Appellants misread the language of the rules and misconstrue how the rules work together. But the Initiative did not eliminate the Board's historically broad regulatory and rulemaking authority over the sale of liquor. The rules are within the Board's statutory authority and do not prohibit practices that the law allows. Nor are the rules arbitrary or capricious, when the Board considered a wide variety of comments from diametrically opposed points of view and adopted rules within the scope of the Board's regulatory authority. The Court should uphold the Board's rules.

II. COUNTERSTATEMENT OF THE ISSUES

1. Were the fair trade practice rules within the Board's broad authority to regulate liquor sales and consistent with the statutes prohibiting price discrimination?
2. Were the fair trade practice rules adopted with due regard to the attending circumstances when the Board received complaints about price discrimination, held seven rulemaking hearings, and responded to disparate industry comments as a whole?

III. STATEMENT OF THE CASE

A. The Board Has Had Broad Authority to Regulate the Sale of Liquor in Washington Since 1933

In 1933, Washington State adopted the Washington State Liquor Control Act to regulate intoxicating liquors. Laws of 1933, Ex. Sess., ch. 62; Title 66 RCW. The Act created the Washington State Liquor Control Board to regulate the distribution and sale of liquor. *Wash. Ass'n for Substance Abuse & Violence Prevention v. State*, 174 Wn.2d 642, 647, 278 P.3d 632 (2012) (“*WASAVP*”).¹ Prior to I-1183, the state was the exclusive distributor and retailer for spirits sold for off-premises consumption (i.e., private consumption rather than drinks at a restaurant or bar). *WASAVP*, 174 Wn.2d at 647, (citing former RCW 66.16.010 (2010)); *see also* former RCW 66.08.050 (2010). All retailers selling liquor on-premises (i.e., for consumption at restaurants and bars) had to purchase spirits from a designated state liquor store. *Id.*

For the distribution and sale of beer and wine, the legislature enacted a three-tier system, providing different regulations and licensing requirements for manufacturers, distributors, and retailers. *WASAVP*, 174

¹ The statute defines “liquor” as all forms of alcoholic beverages, including beer, wine, and spirits. RCW 66.04.010(25). “Spirits” is defined to include almost all distilled alcoholic beverages and some fortified wines, though spirits are sometimes referred to as “hard liquor.” RCW 66.04.010(42). Respondents will refer to “liquor” and “spirits” as specifically defined by the liquor statutes, in this brief.

Wn.2d at 647 (citing former RCW 66.28.280 (2009)). The three-tier system imposed limitations on the relationships between the three primary tiers: manufacturers, distributors, and retailers. The three-tier system required retailers to purchase beer and wine through distributors rather than directly from producers or importers, unless an exemption existed. RCW 66.28.280–.320.

The state—as the exclusive distributor and retailer of spirits—set uniform prices for spirits, and former RCW 66.28.170 flatly prohibited any form of price discrimination or differential pricing for beer and wine.

B. I-1183 “Privatized” the Sale of Spirits but Did Not Diminish the Board’s Role as Regulator or Licensor

Initiative 1183 was passed by the voters in 2011 and “privatized” the importation, distribution, and retail sale of spirits by ending the Board’s role as the exclusive distributor and retailer. The Initiative created new spirits distributor licenses and retail spirits licenses for private stores, and allowed those stores to sell wine and spirits to on-premises retailers. RCW 66.24.630 (retail-to-retail spirits sales); RCW 66.24.360 (retail-to-retail wine sales). I-1183 removed the state from the commercial sale of liquor to “allow the State to focus on the more appropriate government role of *enforcing liquor laws* and protecting the public health and safety

concerning all alcoholic beverages.” Laws of 2012, ch. 2, § 101(2)(b) (emphasis added); *WASAVP*, 174 Wn.2d at 646.

However, I-1183 did not disturb the three-tier system, which remains part of state law. *See also Ass’n of Wash. Spirits v. WSLCB*, 182 Wn.2d 342, 347, 340 P.3d 849 (2015). Rather than disturbing the three-tier system, I-1183 expanded it to include spirits. Laws of 2012, ch. 2, § 124, codified at RCW 66.28.280.

I-1183 also did not disturb the provision in RCW 66.08.010 requiring the entirety of Title 66 RCW to “be deemed an exercise of the police power of the state, for the protection of the welfare, health, peace, morals, and safety of the people of the state, and all its provisions shall be liberally construed for the accomplishment of that purpose.”

Finally, I-1183 amended the total prohibition on price discrimination found in former RCW 68.28.170. Laws of 2012, ch. 2, §119, codified at RCW 66.28.170. The prohibition on price discrimination was expanded to include spirits, in addition to beer and wine. It also allowed, for the first time, price differentials in certain circumstances:

It is unlawful for a manufacturer of spirits, wine, or malt beverages holding a certificate of approval 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.

Laws of 2012, ch. 2, §119 (Amendments to RCW 66.28.170 underlined).

C. Retailers Complain the Newly Licensed Distributors Are Discriminating in Price and Violating Liquor Laws

In December 2012, the Board received a Petition for Rulemaking from the Washington Liquor Store Association. AR 31. The Petition followed an Industry Advisory the Board issued one month earlier in response to complaints that distributors were requiring bars and restaurants to purchase liquor in the form of “family plans,” where bars and restaurants had to agree to purchase a certain percentage of the spirits used in well drinks and wines sold by the glass before receiving volume discounts. AR 1629.

The rulemaking petition stated distributors were “openly engaged in discriminatory pricing against small, independent spirits retailers” because “most distributors maintain different sets of wholesale prices” for off-premises retailers, on-premises retailers and big box retailers. AR 33, 34. Specifically, distributors were charging off-premises retailers “significantly higher prices” than restaurants and bars despite the off-premises retailers buying in “much larger quantities.” AR 34.

The Petition asked the Board to adopt rules to clarify the new provision in RCW 66.28.170 allowing for “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.” AR 32. The Petition pointed out that while RCW 66.28.170 allows some price differentials, it prohibits price discrimination. AR 33-34. Price discrimination had been prohibited in Washington for nearly a century. Thus, the Petition alleged, the circumstances in which price differentials were allowed were unclear, leading to arbitrary and discriminatory pricing. AR 33.

D. The Board Conducts a Thorough Rulemaking Process Driven by Stakeholder Comments

In March 2013, the Board filed a CR 101 for new rules to clarify RCW 66.28.170, called “the fair trade practice rules.” AR 46, 51. The Board informed stakeholders of the rulemaking and invited comments. AR 50. In September 2013, the Board held a work session with representatives from all types of licensees in the liquor industry. AR 95–102.

The work session addressed four concerns. First, that distributors were unlawfully pressuring retailers to purchase a percentage of the spirits used in well drinks and wine for sale by the glass from the distributor before a volume discount is offered. WSLCB staff believed this practice violated

the undue influence statute prohibiting the business practice that requires certain purchases as a prerequisite for purchase of other items under RCW 66.28.285(6)(c), RCW 66.28.305 and .310, and results in the business purchasing less of a competing distributor's product. (AR 96-99). Second, "channel pricing," which means charging a different price to a restaurant or bar versus a spirits retail store, which staff believed was unlawful price discrimination under RCW 66.28.170. *Id.* Third, discounts based on purchases made over a period of time, which staff believed was a violation of the prohibition on giving a money advance ("money's worth") for liquor in violation of RCW 66.28.305, WAC 314-12-140, and WAC 314-13-015. *Id.* And fourth, discounts based on one delivery site versus multiple delivery sites, which staff believed violated the requirement that deliveries be made to the licensed premises or to a central warehouse as contemplated in I-1183. *Id.*; Laws of 2012, ch. 2, § 101(2)(o), § 103(3)(d), codified as RCW 66.24.630.

In response to the comments received at these initial meetings, the Board filed its first CR 102 in November 2013 with its initial draft of proposed rules. AR 187-191. These rules defined "volume discounts," "bona fide business practices," "marketplace," "undue influence," and explained what is and is not allowed as a volume discount. AR 188-191. In this version, "channel pricing" was listed as a practice not allowed as a

volume discount (charging one channel of sale a different price than another, here, bars and restaurants versus spirits retail stores.) *Id.*

In response to the first draft of rules, the Board received many comments and held the first two—of an eventual seven total—rulemaking hearings. AR 235 (April 24, 2014 Rulemaking Hearing), AR 483 (May 14, 2014 Rulemaking Hearing).

The Board considered the comments and testimony received at these first two hearings and revised the rules in June 2014 with a Supplemental CR 102. AR 515-519. The primary change in this version of the rules was to allow “channel pricing” in response to numerous comments that on-premises and off-premises retailers serve different roles in the market and are not in competition with one another. AR 206 (Washington Wine Institute), 241 (Vinum Wine Importing), AR 253 (Young’s Market), AR 270 (Washington Restaurant Association).

After filing the second draft of rules, the Board prepared and filed the Small Business Economic Impact Statement. AR 1602 (June 4, 2014). The Board also held three more rulemaking hearings. AR 576–643 (July 9, 2014), 743–750 (July 15, 2014), 803–830 (December 17, 2014). The Board continued to receive written comments in addition to the testimony at the rulemaking hearings. The Board considered the comments and testimony and responded by filing a second Supplemental CR 102 in December 2014.

AR 836–840. This third draft of the rules responded to comments that the Board’s use of “family plan” in the second draft was incorrect, and the new draft clarified that it was prohibiting the required purchase of a percentage of back-bar items in order to obtain a discount. AR 585–86, 650–51, 833–35.

The Board held a sixth rulemaking hearing in February 2015. AR 911–954 (February 11, 2015). The comments at this hearing specifically concerned the definition of channel pricing with comments that, because both spirits retail stores and bars and restaurants purchased for the purposes of reselling, it is not a bona fide business reason to charge different prices. AR 917.

The WLSA testified that distributors were charging off-premises retailers nearly double what they charged bars and restaurants. AR 919–20. Additionally, owners of retail stores testified that they are limited in their choice of distribution due to exclusive agreements the two main distributors have with the manufacturers of the major brands. AR 922–23. The retail store owners testified that because of this virtual monopoly, where a distributor is the sole source of a particular product, distributors engage in behavior indicative of undue influence. AR 924.

In contrast, wineries and wine institutes testified in support of channel pricing because sales at bars and restaurants serve an important

marketing purpose in the very competitive Washington wine market. AR 928–29, 940–41. Specifically, a representative from Anthony’s testified that it was important to allow channel pricing for wine because wines are offered in tasting flights, allowing customers to try wines they would not normally purchase by the bottle. AR 933.

The Board also heard testimony about the role of spirits sales at restaurants and bars. Specifically, restaurants that specialize in specific spirits cannot hold large volumes of liquor at their store, but their restaurants serve as a place where bartenders and customers can come to taste and try new spirits products. AR 930.

In short, the testimony was contradictory and deeply split between off-premises and on-premises retailers. The Washington Restaurant Association (one of the Appellants) testified in favor of allowing any and all differential pricing for wine and spirits. AR 942–944. By contrast, the Washington Liquor Store Association testified against allowing any kind of differential pricing at all. AR 945–947. Both sides claimed their positions were supported by statute and the intent of I-1183. AR 942–947.

In response to the comments, the Board revised the rules to ensure compliance with the laws, striking a balance between the competing claims and needs of on-premises retailers and off-premises retailers. The Board issued a third Supplemental CR 102 with revised proposed rules. AR 1434–

1438. In response to the on-premises retailer's articulated business needs, the rules allowed channel pricing for wines but limited channel pricing for spirits to a reasonable time period to allow a bar or restaurant to introduce and market a new product. AR 1437–1438, 1379.²

The Board held a seventh rulemaking hearing to gather comments on these new rules in August 2015. AR 1516–1529.³ In September 2015 the Board filed its Concise Explanatory Statement (CR 103) and filed the final version of the rules. AR 1579.

E. The Challenged Rules

Among the challenged fair trade practice rules is a definition of “unfair trade practice,” which is defined the same as the statutory definition of “undue influence” in RCW 66.28.285(6). WAC 314-23-065. Included in that definition is “discriminatory pricing where the product is not offered to retailers in the same local market at the same price.” WAC 314-23-065(1)(j). Another rule defined “local market” as businesses in the same

² The revised rules also responded to the comments from restaurants and grocery stores to allow volume discounts when the order is delivered to multiple locations owned by the same licensed entity. AR 933, 927, 1438. The discount for delivery to multiple locations was later repealed. AR 2301–2303.

³ From the time the Board first proposed rulemaking to the time the rules were adopted, the composition of the Board changed so that only one member who was part of the initial rulemaking remained on the Board to vote on the final rules. The Board members who approved Advisory 2012-02 were Sharon Foster, Chris Marr, and Ruthann Kurose; the Board members who approved the adoption of the rules challenged in this case were Jane Rushford, Ruthann Kurose, and Russ Hauge. Compare, e.g., AR at 42 (March 13, 2013) with AR at 906 and AR at 1426 (July 15, 2015) and AR at 1570 (September 9, 2015).

geographic area in which distribution services are provided, but defines on-premises and off-premises retailers as separate markets. WAC 314-23-070. Another rule clarifies when “differential pricing” beyond these situations is allowed. WAC 314-23-080(2). This rule allows differential pricing for wines and for spirits when a new product is introduced. *Id.* “Volume discounts” are required to be based solely on the volume of spirits and wine purchased. Discounts are also required to be based on single shipments, rather than by volume over time. WAC 314-23-080(1). Finally, volume discounts can only be based on delivery to a single location, rather than on combined orders delivered to multiple licensed sites. WAC 314-23-085(3).

F. Procedural History

The Appellants, Washington Restaurant Association, Northwest Grocery Association, Costco, and the Washington Lodging Association, filed a Petition for Review and Declaratory Relief in Thurston County Superior Court arguing the rules were beyond the Board’s authority, arbitrary and capricious, and failed to substantially comply with the APA rulemaking requirements because the Small Business Economic Impact Statement (SBEIS) was alleged to be inadequate. AR 649–670.⁴

⁴ Appellants now abandon the argument that the SBEIS was inadequate and, instead, argue that the SBEIS evidences the rules are arbitrary and capricious. Appellants’ Opening Br. 40-41.

The Board filed a 2,257 page Certified Agency Record which primarily consisted of the comments and transcripts of the seven rulemaking hearings. AR 1–2257. Both parties stipulated to supplement the agency record and more documents were added to the record. AR 2280–2303. Appellants additionally, without seeking to supplement the agency record or request permission to add additional evidence, as required by RCW 34.05.562, filed two declarations with their superior court Opening Brief. CP 5–31 (Declaration of Julia Gorton); CP 146–632 (Declaration of Ulrike Connelly). Because Appellants did not follow the procedures to supplement the agency record, the superior court struck exhibits B–F from the Connelly declaration and limited the consideration of the Gorton declaration to the issue of standing. AR 642 (Superior Court Order). Thus, these documents are not part of the record. *See* Appellants’ Opening Br. 5, 12, 43 (citing Connelly and Gorton Declarations).

After briefing and oral argument, the superior court held that the fair trade practices rules were valid. CP 641–43. Specifically, the superior court held that the Board had the authority to adopt the rules, that the rules did not contradict RCW 66.28.170, and that the rules were not arbitrary or capricious. *Id.* The superior court also held that the only entity against which relief is available under the APA is the agency and dismissed the individual board members as parties. *Id.* Neither the superior court’s letter ruling nor

the stipulated Order presented to the Court addressed the issue of whether the Board's SBEIS failed comply with the APA rulemaking provisions. CP 641-48. The Appellants appealed to this Court. On appeal, Appellants abandon the argument that the rulemaking process failed to comply with the APA. Appellants' Opening Br. 3, 4.

IV. STANDARD OF REVIEW

The Court reviews the validity of agency rules under RCW 34.05.570(2)(c). Under that provision, a rule may be invalidated only if it 1) violates constitutional provisions; 2) exceeds the agency's statutory authority; 3) was adopted without complying with statutory rule-making procedures; or 4) is arbitrary and capricious in that it could not have been the product of a rational decision maker. *Ass'n of Wash. Spirits v. WSLCB*, 182 Wn.2d at 350. Appellants do not allege a constitutional violation nor do they clearly articulate a failure to comply with statutory rule-making procedures.

A person seeking to overturn an agency rule bears "a heavy burden," given that agency rules are presumed to be valid. *Superior Asphalt & Concrete v. Dep't of Labor & Indus.*, 84 Wn. App. 401, 929 P.2d 1120 (1996) (the burden of proving a regulation invalid is met only if one shows that the regulation is in conflict with the intent and purpose of State law or exceeds an agency's authority; as long as the regulation is reasonably

consistent with the statute being implemented, it will be upheld); *see also Kaiser Aluminum & Chem. Corp. v. Pollution Control Hearings Bd.*, 33 Wn. App. 352, 654 P.2d 723 (1982).

A. Agency Rules Are Presumed Valid and Will Be Upheld if Reasonably Consistent with the Statutes They Implement

Agency rules are presumed valid and are upheld if they are reasonably consistent with the statute they implement. *Wash. Pub. Ports Ass'n v. Dep't of Revenue*, 148 Wn.2d 637, 646, 62 P.3d 462 (2003); *Hi-Starr, Inc. v. Liquor Control Bd.*, 106 Wn.2d 455, 459, 722 P.2d 808 (1986) (upholding WSLCB rules imposing food/liquor ratio on sales by restaurants selling spirits). Rules will not be invalidated except when “compelling reasons are presented sufficient to show the scheme is in conflict with the intent and purpose of the legislation.” *Anderson, Leech & Morse v. Wash. State Liquor Control Bd.*, 89 Wn.2d 688, 695, 575 P.2d 221 (1978) (quoting *Weyerhaeuser Co. v. Dep't of Ecology*, 86 Wn.2d 310, 317, 545 P.2d 5 (1976)). A rule is valid if it is promulgated pursuant to properly delegated authority. *State v. Brown*, 142 Wn.2d 57, 62, 11 P.3d 818 (2000). The burden is on the Appellants to present compelling reasons why the rule conflicts with the statutes it implements. RCW 34.05.570(1)(a).

Questions of statutory interpretation are reviewed de novo. *Ass'n of Wash. Spirits v. WSLCB*, 182 Wn.2d at 350. “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 . . . and the statutory scheme as a whole.” *Id.* (citing *Dep’t of Ecology v. Campbell & Gwinn, LLC*, 146 Wn.2d 1, 9–10, 43 P.3d 4 (2002)). With *de novo* review, the Court need not rely on the Board's reasons for adopting the rule, so long as the rule is reasonably consistent with the statute it implements. *H & HP’ship v. State*, 115 Wn. App. 164, 170, 62 P.3d 510 (2003) (anyone attacking the validity of an administrative rule must show “compelling reasons” why the rule conflicts with the legislation's intent and purpose).

B. Agency Rules Are Not Arbitrary and Capricious When They Are Adopted After Due Consideration and Where There Is Room for Two Opinions

A rule is arbitrary and capricious only if it is “willful, unreasoning, and taken without regard to the attending facts or circumstances.” *Association of Washington Spirits & Wine Distributors v. WSLCB*, 182 Wn.2d 342, 358, 340 P.2d 849 (2015). “[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.” *Id.* (quoting *Rios v. Dep’t of Labor & Indus.*, 145 Wn.2d 483, 501, 39 P.3d 961 (2002)).

The arbitrary and capricious standard is very narrow and highly deferential, and the party asserting it carries a “heavy burden.” *King Cty. Pub. Hosp. Dist. No. 2 v. Dep’t of Health*, 167 Wn. App. 740, 749, 275 P.3d 1141 (2012). Even if the majority of testimony and comments received during the rulemaking process opposed the adoption of a rule, if there is room for “a contrary opinion,” the rule should be upheld. *Hi-Starr*, 106 Wn.2d at 465.

V. ARGUMENT

The Court should uphold the fair trade practice rules. Although I-1183 changed the liquor statutes, it did not repeal the statutes granting the Board broad authority to regulate the sales of liquor. Because the Board has the authority to regulate the sales of liquor, the rules properly clarified an ambiguous area of the law: what differential pricing is non-discriminatory. Furthermore, the Board was neither arbitrary nor capricious in its adoption of the rules because the process was well-reasoned and—as evidenced by the sharply contrasting stakeholder comments—there is room for two opinions on the adopted rules. Though the Appellants wished the Board had written the rules to align with their views, the Board properly adopted rules that were in due regard to *all* the comments it received.

A. The Board Properly Exercised Its Broad Regulatory Authority Over the Sale of Liquor to Adopt the Fair Trade Practice Rules

1. I-1183 did not repeal the Board's authority to regulate the sales of liquor.

I-1183 ended the Board's monopoly over the commercial distribution and retail sale of spirits, but it did not diminish the Board's statutory authority to regulate liquor sales or undue influence, including discriminatory pricing, in liquor sales.

The general authority of the Board to regulate the sale of liquor is found in RCW 66.08.030, which provides: "The power of the board to make regulations under chapter 34.05 RCW extends to . . . [p]rescribing 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) (emphasis added). This authority was not limited by I-1183; rather, it was expanded to include the regulation of sales of spirits. *Id.*; *see also*, Laws of 2012, ch. 2, § 204.

The Board further has specific statutory authority to adopt rules regulating the relationships between manufacturers, distributors and retailers, including the purchase of liquor. RCW 66.28.320; *See generally*, Laws of 2009, ch. 506. Although I-1183 adopted a finding that the "total prohibition" on ownership between the three tiers was unduly restrictive and "historical restrictions on financial incentives and business relationships"

were too strict, it found RCW 66.28.285–.320 to be appropriate provisions to protect the public interest for all varieties of liquor. RCW 66.28.280. Among those “appropriate provisions” is the mandate that the Board “adopt rules as are deemed necessary to carry out the purposes and provisions of this chapter.” RCW 66.28.320.

Even parts of Title 66 RCW adopted by I-1183 show an ongoing legislative intent to regulate the pricing of spirits sold by licensees. RCW 66.28.330 proscribes sales of spirits for less than the distributor’s acquisition cost unless the product has been stocked for more than six months, and cannot restock that product for one year following a sale below cost. Subsection (5) allows the defense of “good faith meeting of a competitor’s lawful price, and absence of harm to competition” as factors to be considered in the event of a charge of price discrimination. The Board, as the regulator of liquor licensees, is charged with monitoring sales practices as well as other aspects of the liquor laws in RCW Title 66. *See, e.g.,* RCW 66.08.030(6), (7), (13).

Further, the statutory language of the statutes providing the Board rulemaking authority is clear and plain on its face: the Board has the power to regulate the sales of liquor by licensees, including sales between the three tiers of licensees. RCW 66.08.030(12); RCW 66.28.320. When a statute’s meaning is plain on its face, courts “give effect to that plain meaning as an

expression of legislative intent.” *O.S.T. ex rel. G.T. v. BlueShield*, 181 Wn.2d 691, 696–97, 335 P.3d 416 (2014).⁵ Thus “[p]lain language that is not ambiguous does not require construction.” *State v. Evans*, 177 Wn.2d 186, 192, 298 P.3d 724 (2013).

2. Because the Board has the authority to regulate the sale of liquor, it properly exercised its authority to define undefined terms in RCW 66.28.170.

Chapter 66.28 RCW (“Miscellaneous Regulatory Provisions”), imposes limitations on actions and arrangements between the three tiers in the liquor industry (manufacturer, distributor, and retailer tiers). For example, RCW 66.28.305 prohibits an industry member from advancing, and retailers from receiving, “money or moneys’ worth under an agreement written or unwritten or by means of any other business practice or arrangement.” RCW 66.28.285 defines an exercise of “undue influence” to include: “Discriminatory pricing practices as prohibited by law or other practices that are discriminatory in that product is not offered to all retailers in the local market on the same terms.” RCW 66.28.285(6)(j). RCW 66.28.285(6) also describes numerous other business practices that constitute “undue influence” when imposed by a manufacturer or distributor on a retailer. These practices, that may be common in other industries, such

⁵ The canons of statutory construction apply equally to initiatives. *Utter v. Bldg. Indus. Ass’n of Wash.*, 182 Wn.2d 398, 410 n.3, 341 P.3d 953, 959 (2015).

as requiring purchases of some items as a prerequisite for purchase of others, RCW 66.28.285(6)(c), or a requirement that a retailer purchase a specific or minimum quantity or type of product from an industry member, RCW 66.28.285(6)(d), have long been proscribed in the liquor industry. Furthermore, the Board also has the authority to determine whether “undue influence” has occurred and, if so, to require violating transactions to be rescinded or undone. RCW 66.28.300. Thus, the Board has the specific statutory authority to adopt the fair trade practice rules, which regulate how liquor may be sold by the manufacturer/distributor tiers to retailers.

The Board has been charged with administering and interpreting the liquor laws since the Board was created in 1933. The fair trade practice rules clarify and interpret ambiguous statutory language in the context of a larger statutory scheme. The rules clarify which price differentials are allowed as “competitive conditions, costs of servicing a purchaser's account, efficiencies in handling goods, or other bona fide business factors” and which are prohibited discriminatory practices. RCW 66.28.170. An agency's definition of an undefined statutory term should be given great weight where that agency has the duty to administer the statutory provisions. *Phillips v. City of Seattle*, 111 Wn.2d 903, 908, 766 P.2d 1099 (1989).

In *Ass'n of Wash. Spirits v. WSLCB*, 182 Wn.2d 342, 340 P.2d 849 (2015), the Supreme Court reviewed several rules the Board adopted interpreting I-1183. The Court stated that in interpreting a statute, including an initiative, the text must be considered in the context of the statute in which the provision is found, with related provisions, amendments to the provisions, and the statutory scheme as a whole. *Id.*, 182 Wn.2d at 346.

Here, the Board implemented ambiguous statutory terms that were subject to differing interpretations. RCW 66.28.170 must be read together with the other statutes in Title 66 RCW, including RCW 66.28.190 (distributors can sell retailers non-liquor items on credit, but cannot sell liquor on credit), RCW 66.28.270 (defining conditions of cash, credit, debit cards and EFTs between licensees), RCW 66.28.305 (no industry member may advance, no retailer can receive, money or money's worth), RCW 66.28.310 (limiting promotional items and services provided to industry members). The statutes must be read together to determine what practices are allowed and which are prohibited.

The practices of distributors prior to rulemaking, the rulemaking petition, and the sharply divided comments received during rulemaking all show that there is room for two opinions on the meaning of allowable "price differentials" and "other bona fide business practices" in RCW 66.28.170. Specifically, various commenters argued that the phrase "bona fide business

factors” should be limited to factors similar to those specifically set out in the second sentence of RCW 66.28.170: “competitive conditions, costs of servicing a purchaser’s account” and “efficiencies in handling goods.” Others, including Appellants, argue that “other bona fide business factors” means anything and makes the first sentence prohibiting discriminatory pricing meaningless.

Under RCW 66.28.285(6)(j), “discriminatory pricing practices as prohibited by law or other practices that are discriminatory in that product is not offered to all retailers in the same market on the same terms” is undue influence. The rules were designed to explain what practices extend beyond permissible “price differential(s)” based on “bona fide business factors” in a way that preserves the three-tier system, and harmonizes with the laws regulating practices between the tiers. While commenters variously advocated for and against allowing channel pricing, the Board needed to address the prohibition against discriminatory pricing practices in RCW 66.28.285(6)(j) “Discriminatory pricing practices as prohibited by law or other practices that are discriminatory in that product is not offered to all retailers in the local market on the same terms” to harmonize that with RCW 66.28.170.

WAC 314-23-070 defines “local market” as used in RCW 66.28.285(6)(j), allowing on- and off-premises retailers that are in close

geographic proximity to be considered different markets for purposes of differential pricing under RCW 66.28.170. If the rule did not define local market to address the “channel pricing” question, the prohibition in RCW 66.28.285(6)(j) would continue to raise interpretation questions.

WAC 314-23-075 describes discounts which are prohibited in RCW 66.28.285(6)(b)–(e), including requiring a retailer to purchase less of one product than another product, requiring a retailer to purchase one product as a prerequisite to purchasing other items, and requiring a retailer to take a certain product type. This rule harmonizes the language of RCW 66.28.170 and RCW 66.28.285, as price differentials offered on those terms would be “undue influence” under the latter statute.

WAC 314-23-080 addresses when volume discounts are appropriate; it does not prohibit all other forms of volume discounts. Subsection (1) permits volume discounts when the discount is “based solely on the volume” of liquor purchased. For example, under the rule, it would be impermissible to charge one price to Safeway for delivery of 100 cases of a particular product, but to charge the liquor store across the street a different price for delivery of same amount. The subsection further provides that “the limitations on interactions between the levels of licenses remain, including the prohibition on undue influence and sales below cost of acquisition.” Subsection (2) describes circumstances when differential

pricing between on- and off-premises retailers permitted. However, this subsection does not say differential pricing is allowed “only” under the listed exceptions; thus it is not an exclusive list.

Finally, the Board adopted WAC 314-23-085 to clarify that aggregation of purchases over time are not a proper basis for a discount. WAC 314-23-085(2). This rule is consistent with the prohibition in RCW 68.28.305, on an exchange of “money or money’s worth under an agreement written or unwritten or by means of and other business practice or arrangement.” If an industry member offers a discount based on the volume of product purchased over a period of time, as opposed to a single delivery, the discount is not calculated until the end of the purchase period. This business practice either constitutes an extension of credit by the seller to the buyer, or a rebate of funds previously paid, both of which have monetary value and are prohibited by RCW 66.28.305. The practice of a discount for purchases made over time can also influence the purchaser’s buying practices, contrary to RCW 66.28.285(6). The rule does allow multiple orders delivered to the same location in the same delivery to be aggregated to qualify for a quantity discount, a practice that I-1183 allowed for the first time. RCW 66.24.630(3), RCW 66.28.340, WAC 314-23-

085(3).⁶ WAC 314-23-085 does not prohibit all volume discounts, but clarifies that any discounts on purchases over time violate RCW 66.28.190 (industry member may not sell liquor on credit).

Thus, contrary to Appellants arguments, the rules do not declare all differential pricing practices unlawful. Appellants' Opening Br. 2, 20. In fact, the plain language of the rules does not prohibit all pricing differentials. Rather, it states certain differentials are specifically allowed, and prohibits certain specific discounts. If the price difference is based only on volume, the rules allow different pricing between on- and off-premises purchasers for wine, and for spirits to introduce products. WAC 314-23-080. Specifically, WAC 314-23-080 clarifies what is allowed but does not state the rule is a limited list. In contrast, WAC 314-23-085 provides an illustrative list of the type of practices not allowed, but states it is not an inclusive list. Thus it is clear that the rules still allow for a case-by-case determination of whether a discounted price is appropriate under bona fide business factors. The Court should affirm the fair trade practice rules.

3. I-1183 did not limit the Board's rulemaking authority

Appellants appear to argue that repeal of some rulemaking authority in the liquor laws is an implicit repeal of all the Board's rulemaking

⁶ WAC 314-23-085 was later amended by the Board, and now reads as included in the Appendix to Appellant's Opening Brief. See also, AR 2301-2303.

authority. *Id.* Specifically, Appellants argue that removal of prefatory language from RCW 66.08.030⁷ removed the Board’s “broad, general rulemaking authority,” including the authority to control the price of spirits. Appellants’ Opening Br. 29-32. This argument fails because I-1183 did not repeal the remaining statutes granting the Board rulemaking authority over the sale of liquor, over discriminatory pricing, and to regulate the three-tiers of the liquor industry.

Implicit repeals occur when a later statute not specifically repealing a statute is wholly or partially incompatible with an earlier statute. *O.S.T. ex rel. G.T. v. BlueShield*, 181 Wn.2d at 701–02. However, implicit repeals are highly disfavored and only found where the two statutes are unable to stand side by side. *Id.*, *See also Gilbert v. Sacred Heart Med. Ctr.*, 127 Wn. 2d 370, 375, 900 P.2d 552 (1995) (“Where an amendment may be harmonized with the existing provisions and purposes of a statutory scheme, there is no implicit repeal.”)

The change in I-1183 to the prefatory language in RCW 66.08.030 did not implicitly repeal the more specific rulemaking provisions remaining

⁷ I-1183, §204 omitted the following prefatory language from RCW 66.08.030:

For the purpose of carrying into effect the provisions of this title according to their 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.

in RCW 66.08.030, including the authority to regulate sales of liquor. The initiative also left intact the more specific rulemaking authority in RCW 66.28.320 to implement RCW 66.28.280–320. Laws of 2009, ch. 506. Thus, there is no obvious intention to supersede the Board’s rulemaking authority nor are the prior law and I-1183 repugnant to one another and irreconcilable. Rather, the fact that the more specific rulemaking authority in both RCW 66.08.030 and RCW 66.28.320 was not repealed shows that the voters intended to keep this authority intact.

Here, each of the fair trade practice rules fall within the authority of the Board to regulate the distribution and sale of liquor and enforce the liquor laws as found in RCW 66.08.030(12) or RCW 66.28.320. Specifically, WAC 314-23-065 defines “unfair trade practice” to be exactly the same as an undue influence in RCW 66.28.285(6)(a)–(j). It is absurd to argue that the Board lacks authority to adopt as a rule that is already found in statutes governing liquor licensees. *See* RCW 66.28.320. Similarly, the definition of “local market” in WAC 314-23-070 defines a term found in RCW 66.28.285(j): “Discriminatory pricing practices as prohibited by law or other practices that are discriminatory in that product is not offered to all retailers in the local market on the same terms.” WAC 314-23-075; WAC 314-23-080; WAC 314-23-085.

Furthermore, the Board's rulemaking authority is supported by the stated purpose of I-1183. The intent of the Initiative includes Board regulation of liquor sales and enforcement of the liquor laws. Subsection (2) of §101 of I-1183 reads, in relevant part:

(2) This initiative will:

(a) Privatize and modernize wholesale distribution and retail sales of liquor in Washington state in a manner that will reduce state government costs and provide increased funding for state and local government services, *while continuing to strictly regulate the distribution and sale of liquor*;

(b) Get the state government out of the commercial business of distributing, selling, and promoting the sale of liquor, allowing the state to focus on the more appropriate government role of *enforcing liquor laws* and protecting public health and safety concerning all alcoholic beverages;

Initiative 1183, § 101(2) (emphasis added). Appellants fail to show there is an ambiguity in the laws requiring the Board to regulate the distribution and sale of liquor, *id.*, RCW 66.08.030, RCW 66.28.320, but instead rely on voter pamphlet materials to argue the intent of the initiative. Appellants' Opening Br. 1. This reference to extrinsic aids of construction is inappropriate. *State, Dep't of Ecology v. Campbell & Gwinn, L.L.C.*, 146 Wn.2d 1, 12, 43 P.3d 4 (2002) (it is appropriate to resort to extrinsic aids including legislative history only if the statute is ambiguous).

Appellants rely on the voter pamphlet to argue that the intent of the initiative was to allow spirits to "be sold to different distributors and different retailers at different prices." Appellants' Opening Br. 1 (quoting

Voter's Pamphlet). But this ignores the language of the initiative within the broader setting of the liquor laws and, more specifically, the laws the initiative did not amend or repeal. It also ignores the plain and unambiguous statutory language that provides the Board broad authority to adopt rules to regulate the sale of liquor. RCW 66.08.030(12); RCW 66.28.320. When a statute's meaning is plain on its face, courts "give effect to that plain meaning as an expression of legislative intent." *O.S.T. ex rel. G.T. v. BlueShield*, 181 Wn.2d 691, 696–97, 335 P.3d 416 (2014). Therefore, Appellants incorrectly rely on extrinsic sources such as voter pamphlets and general claims of policy shifts to construe an unambiguous statute. Appellants' Opening Br. 31.

Because the fair trade practice rules are within the Board's statutory authority to promulgate rules regulating the sale of liquor and interactions between the wholesalers and retailers as found in RCW 66.08.030(12) and RCW 66.28.320, and they are consistent with the specific statutes they implement, the Court should uphold the rules as a valid exercise of the Board's authority.

B. The Fair Trade Practice Rules Were Adopted After Due Consideration and Thus Are Neither Arbitrary Nor Capricious

The fair trade practice rules are neither arbitrary nor capricious because they were adopted by the Board with due consideration to the facts

and circumstances of the competing opinions of the off-premises and on-premises retailers. *Ass'n of Wash. Spirits v. WSLCB*, 182 Wn.2d at 358 (A rule is arbitrary and capricious only if it is “willful, unreasoning, and taken without regard to the attending facts or circumstances.” “[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.”). Appellants’ disagreement with the rules is not enough to meet their heavy burden of establishing that the Board’s rules were arbitrary or capricious.

- 1. The rules are not arbitrary or capricious because the Board adopted them with due regard to the many, and often competing, comments from stakeholders.**

The Board engaged in an extensive, well-reasoned process to develop the fair trade practice rules over a three-year period listening to, and responding to, stakeholder comments. The Board held multiple meetings and hearings in an effort to understand stakeholder concerns. During the rulemaking process, the Board held two work sessions with all liquor licensees, AR 124, 2171, and a total of seven different rulemaking hearings to discuss and hear comments on various drafts of the rules. See Section III. D., *supra*. Based on the comments received at the rulemaking hearings and in writing, the Board filed three Supplemental CR 102s with changes reflecting stakeholder comments. AR 187–191, 831–840, 1434–

1438. After the third Supplemental CR 102 and a sixth rulemaking hearing, the Board filed a CR 103 with the statutorily required Concise Explanatory Statement (CES) and adopted the challenged rules in September 2015. This CES summarizes the Board's responses to conflicting stakeholder comments and provides a summary of the Board's reasoning and rationale for adopting the fair trade practice rules. Because the rules were reached through a process of reason and with due consideration, they are not arbitrary and capricious. RCW 34.05.570(2)(c).

2. Appellants' contrary opinion about the language of the rules does not mean the rules are arbitrary or capricious.

Appellants argue the Board's adoption of the rules was arbitrary and capricious because: (1) the Board did not explain its reasoning to support the rules, (2) the Board drew arbitrary limits around permissible behavior, and (3) the Board ignored some "evidence before it to arbitrarily reward some stakeholders and deny appropriate market opportunities to others." Appellants' Opening Br. 35.

Appellants' disagreement with the rules does not mean they have met their heavy burden of establishing that the Board's rules were arbitrary or capricious. *King Cty Public Hosp. Dist. No. 2 v. Dep't of Health*, 167 Wn. App. 740, 749, 275 P.3d 1141 (2012) (The arbitrary and capricious standard is very narrow and highly deferential, and the party asserting it

carries a “heavy burden.”); *Hi-Starr*, 106 Wn.2d at 465 (even if the majority of testimony and comments received during the rulemaking process opposed the adoption of a rule, if there is room for “a contrary opinion,” the rule should be upheld.)

Contrary to the Appellants’ first argument,⁸ the Board adequately explained its reasoning for adopting the rules. The Board’s CES provides a summary of the Board’s reasoning and rationale for how it reached the decision to adopt these rules and contains a summary of the comments received and the Board’s response to those comments. AR 1579–1590 (Concise Explanatory Statement). In the CES, the Board explained that the rules were adopted in response to a petition for rulemaking that was filed because small liquor stores were being charged more per bottle for larger quantity purchases than bars and restaurants were charged for smaller quantity purchases. AR 1580. Additionally, the Board explained that it had the authority to regulate this area under RCW 66.08.030(12), which specifically gives the Board regulatory authority over the sales of beer, wines, and spirits. AR 1581. Furthermore, the Board Chair discussed the Board’s reasoning at Board meetings, explaining that the Board tried its best

⁸ Opening Brief at 35.

to be fair when considering competing interests and spent considerable time considering the issues. AR 2280–81.

Appellants next argue the rules draw arbitrary boundaries around permissible behavior.⁹ Just because Appellants disagree with the Board's actions does not demonstrate the rules are arbitrary. Here, the bona fide business factor for differential pricing articulated by many stakeholders was that bars and restaurants serve to introduce new products to consumers who may then purchase a whole bottle at a retail store if they like it. *See, e.g.*, AR at 123, 388, 408, 457, 700, 730, 776, 928, 933, 1282, 1799.

Although there was testimony from bars and restaurants that they had higher overhead and costs for creating drinks, no evidence was ever provided explaining what business reason justified *distributors* selling a single bottle of liquor at much lower price than was charged to a retail liquor store who bought ten cases of that product, particularly given the lower taxes that bars and restaurants pay for spirits they purchase. Because of the different ways in which retail stores and restaurants can market wines and spirits, the Board did conclude that pricing differences for an introductory period would not be discriminatory for spirits. Similarly, testimony about how wineries use restaurants to introduce their wines, which can change

⁹ Opening brief at 35.

with each new bottling year, persuaded the Board that differential pricing of bottled wine for restaurants and other retailers was not discriminatory pricing. There was also never evidence provided to the Board for why limiting channel pricing would result in a rise in cost to restaurants, as opposed to distributors lowering the price at which they sold that same product to retail liquor stores who purchase at a much higher volume.

Turning to the Appellants third argument,¹⁰ the rules are not “arbitrary” or “capricious” merely because the Board did not rely exclusively on the information provided by the Appellants and did not reject all the positions of the off-premises stakeholders in favor of the positions provided by the Appellants. Specifically, as described above, the Board thoughtfully exercised its discretion in an effort to respond to the polarized needs and positions of its stakeholders. Contrary to Petitioners’ assertions, the Board’s authority, and its rulemaking power, is not strictly limited to rules which address risks to public safety.¹¹

The Board recognized that the law prohibits price discrimination but that differential pricing is allowed if there is a bona fide business factor supporting the differential pricing. Nothing in Title 66 requires the Board to tether its regulation of the sale of liquor solely to public safety. Given the

¹⁰ Opening Brief at 35.

¹¹ Opening Brief at 37.

widely varying views of what RCW 66.28.170 allows, and the business practices stakeholders complained to the Board about, the statute required interpretation and guidance from the Board.

Nor was the Board required to conduct economic studies or to engage experts to determine the state of the markets to determine the extent and nature of price discrimination. Appellants' Opening Br. 39. The Board provided all the proper notices, took comments, and considered them. The Board held hearings; its staff presented issue papers for the Board's consideration, and prepared concise explanatory statements for the rules. The Board made its decisions about how to implement I-1183 in a way that responded to specific concerns. The Board received many comments on some of the rules, and many of the comments contradicted each other. This is not a situation such as in *Ocosta School Dist. No. 172 v. Brouillet*, 38 Wn. App 785, 791, 689 P.2d 1382 (1984), where the Superintendent of Public Instruction did not even allow comments to be made before the rule was adopted. Here, the Board provided proper notice of its rulemaking, held numerous hearings, then made its decisions about how to implement I-1183 based on the comments and its interpretation of the various parts of Title 66 RCW that addressed the issues raised in the rulemaking. *Hi-Starr v. WSLCB*, 106 Wn.2d at 458.

C. The Board Substantially Complied with the APA Provisions to Adopt the Fair Trade Practice Rules

If Appellants intended to raise the Board's alleged failure to comply with rulemaking procedures, they have not included this in the statement of issues in their Opening Brief, and thus have abandoned this as an issue on review. Appellants do not make a substantial compliance challenge to the rules but seem to argue that the Board's Concise Explanatory Statement (CES) was insufficient. Appellants' Opening Br. 36. The standard to challenge a CES is whether the agency was in "substantial compliance" with the requirements of the APA. RCW 34.05.375; *Anderson, Leech & Morse, Inc. v. Liquor Control Bd.*, 89 Wn.2d 688, 693, 575 P.2d 221 (1978).

The APA requires an agency undertaking rulemaking to provide a statement "summarizing all comments received regarding the proposed rules, and responding to the comments by category or subject matter, indicating how the final rule reflects agency consideration of the comments, or why it fails to do so." RCW 34.05.325(6)(a)(ii). The Board substantially complied with this requirement, and all of the APA rulemaking provisions in this case, as shown by the Administrative Record.

In the CES, the Board explained the general nature of the comments received at each of the seven rulemaking hearings and responded to the substance of the comments. AR 1580-87. There is no requirement that the

Board separately address each and every comment in the CES or provide a detailed rationale for why the Board found some comments more persuasive than others. *Anderson, Leech and Morse, supra*, at 693. Nor does *Puget Sound Harvesters Ass'n v. Dep't of Fish and Wildlife*, 157 Wn. App. 935, 951, 239 P.3d 1140, 1148 (2010), support Appellants' argument. Appellants' Opening Br. 36. In that case, the court held the CES did "not provide a rational explanation" for its decision, but it was because the court disagreed with the agency's assertion that it could not accurately predict fishing catch outcomes. *Puget Sound Harvesters*, 157 Wn. App. at 947-48. The court's review of the data in the CES showed the agency *could* predict catch outcomes, thus the agency's explanation was not rational. *Id.*, 157 Wn. App. at 949-950.

The Court should affirm the rules because the Board substantially complied with the APA requirement to promulgate a CES.

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VI. CONCLUSION

This Court should affirm the Board's fair trade practices rules. The Board had the authority to adopt the rules and Appellants have failed to meet their burden that the rules are arbitrary or capricious. The Court should deny the requested relief, and affirm the rules as adopted.

RESPECTFULLY SUBMITTED this 25th day of April, 2018.

ROBERT W. FERGUSON
Attorney General



MARY M. TENNYSON, WSBA No. 11197
Sr. Assistant Attorney General
R. JULY SIMPSON, WSBA No. 45869
Assistant Attorney General
Attorneys for Respondent
OID No.91020
1125 Washington Street SE
PO Box 40110, Olympia, WA 98504
(360) 753-2702; (360) 534-4850
MaryT@atg.wa.gov; RJulyS@atg.wa.gov

PROOF OF SERVICE

I, Dianne S. Erwin, certify that I sent a copy of this document, **Response Brief**, for service on all parties or their counsel of record on the date below and as follows to:

Sent via e-mail per agreed electronic service to:

David J. Burman
Ulrike B. Connelly
Perkins Coie LLP
1201 Third Ave., Ste. 4900
Seattle, WA 98101-3099
UConnelly@perkinscoie.com
DBurman@perkinscoie.com
Jstarr@perkinscoie.com

Electronically Filed with:
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I declare under penalty of perjury under the laws of the state of Washington that the foregoing is true and correct.

DATED this 25 day of April 2018.



DIANNE S. ERWIN, Legal Assistant

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