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ASSOCIATION OF WASHINGTON SPIRITS AND WINE DISTRIBUTORS

Appellants

v.

WASHINGTON STATE LIQUOR CONTROL BOARD

Respondent

and

WASHINGTON RESTAURANT ASSOCIATION, NORTHWEST GROCERY ASSOCIATION and COSTCO WHOLESALE CORPORATION

Intervenor-Respondent

OPENING BRIEF OF APPELLANT

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I. INTRODUCTION

Appellant Association of Washington Spirits & Wine Distributors ("AWSWD") respectfully submits that the Thurston County Superior Court erred in failing to invalidate a Washington State Liquor Control Board ("Board") regulation implementing Initiative 1183 ("I-1183"). The regulation at issue, WAC 314-23-025, exempts in-state distillers, out-of-state distillers, and spirits certificate of approval holders (hereafter, collectively "Distillers") acting as distributors from contributing to a $104 million distributor license fee shortfall. The superior court denied AWSWD's petition challenging the regulation, and AWSWD now appeals that decision.

In passing I-1183, Washington voters privatized the spirits distribution business. In the process, the Initiative effectively placed an initial value on that business of $150 million dollars. For the privilege of distributing spirits, distributor were required to pay a license fee equal to 10% of total spirits sales for the first 27 months[1] of licensure, and 5% thereafter. To guarantee the State received $150 million in what amounted to an up-front payment, I-1183 provided that, if the license fees paid by distributors did not equal $150 million by

[1] The Initiative as submitted to the public required payment of this fee for the first 24 months of licensure. In 2013 the legislature amended the law to require payment of 10% for the first 27 months of licensure. RCW 66.24.055(3)(a)(i), amended by 2013 2nd sp.s. c 12 § 1.

March 31, 2013, the shortfall would be equitably assessed against those who elected to participate in distributing spirits. The shortfall ended up being $104 million.

I-1183 permits Distillers to "act as distributors" of their own production by selling directly to retailers. Many chose to take advantage of the opportunity and sold directly to retailers. The Initiative also requires Distillers choosing to operate as distributors to comply with "all applicable laws and rules relating to distributors." RCW 66.24.640; RCW 66.28.330(4). Citing these statutory requirements, the Board adopted rules requiring persons acting as distributors to pay the 10% distributor license fee. WAC 314-23-030(3); WAC 314-28-070(3).

Then, ignoring the statutory requirement that any person operating as a distributor must comply with all applicable laws relating to distributors, and ignoring the fact that the law requiring distributors to contribute to the shortfall is necessarily an "applicable" law "relating to distributors," the Board adopted another rule, WAC 314-23-025, exempting Distillers acting as distributors from contributing to the shortfall. The Board based this rule on a false distinction between the terms "spirits distributor licensee[s]" and "persons holding spirits

distributor licenses," even though these terms are used synonymously in I-1183 and used by the Board interchangeably in WAC 314-23-025.

The trial court erroneously concluded that this interpretation of the statute was a defensible exercise of the Board's discretion. This Court should overrule the trial court and declare WAC 314-23-025 invalid because (1) the plain language of RCW 66.24.055(3), RCW 66.24.640, and RCW 66.28.330(4) imposes liability on those who operate as distributors for their ratable shares of the shortfall; (2) WAC 314-23-025 conflicts with provisions requiring those who operate as distributors to comply with all applicable laws relating to distributors; (3) the Board's justification for WAC 314-23-25 is based on a false distinction between synonymous and interchangeable terms; and (4) WAC 314-23-25 grants a privilege to one class of distributors at the expense of another class engaged in the same business in violation of the Washington Constitution.

II. FACTS

In the November 2011 General Election, Washington voters approved I-1183, which privatized the distribution and sale of spirits in Washington State and created a license for spirits distributors to sell spirits to retailers. In addition, I-1183 granted to Distillers the option of choosing to distribute their own production, and specified that anyone

making that choice would be subject to applicable spirits distributor rules in implementing the choice. This statutory scheme, and the Board's attempt to draft regulations to implement this scheme, is as follows:

A. The distributor license fee structure.

RCW 66.24.055(3) establishes the terms of the "license issuance fee" that must be paid for the privilege of distributing spirits in Washington State. This fee is made up of two components. The first component (subsection (3)(a)) comprises monthly payments, for the first 27 months of distribution, equal to 10% of the total revenue from spirits sales:

> (3)(a) As limited by (b)[2] of this subsection and subject to (c) of this subsection, each spirits distributor licensee must pay to the board, for deposit into the liquor revolving fund, a license issuance fee calculated as follows:
>
> (i) In each of the first twenty-seven months of licensure, ten percent of the total revenue from all the licensee's sales of spirits made during the month for which the fee is due, respectively ....

RCW 66.24.055(3)(a).

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[2] Subsection (3)(b) provides that the license issuance fee is calculated on sales of items which the licensee was the first spirits distributor in the state to have received. In other words, the 10% fee cannot be assessed more than once against any product. RCW 66.24.055(3)(b).

Subsection (3)(a) is subject to the second component of the license issuance fee, subsection (3)(c). This component ensured that the 10% fee provision would generate a minimum of $150 million dollars in the first year of privatization. It requires payment by distributors, on a pro rata basis, of the difference between the cumulative monthly 10% payments as of March 31, 2012, and $150 million:

> (c) By March 31, 2013, all persons holding spirits distributor licenses on or before March 31, 2013, must have paid collectively one hundred fifty million dollars or more in spirits distributor license fees. If the collective payment through March 31, 2013, totals less than one hundred fifty million dollars, the board must, according to rules adopted by the board for the purpose, collect by May 31, 2013, as additional spirits distributor license fees the difference between one hundred fifty million dollars and the actual receipts, allocated among persons holding spirits distributor licenses at any time on or before March 31, 2013, ratably according to their spirits sales made during calendar year 2012. Any amount by which such payments exceed one hundred fifty million dollars by March 31, 2013, must be credited to future license issuance fee obligations of spirits distributor licensees according to rules adopted by the board.

RCW 66.24.055(3)(c).

Read together, subsections (3)(a) and (3)(c) create the following fee structure: (1) Spirits distributors pay a fee on all spirits sales; (2) the fees in 2012 were required to total $150 million; (3) if the fees paid in 2012 did not generate that amount, the shortfall was to be

equitably assessed against spirits distributors; and (4) if the fees generated more than that amount, the excess was to be credited back to spirits distributors in the form of future license issuance fees.

In other words, spirits distributors were required to pay exactly $150 million in license issuance fees for the privilege of distributing spirits in 2012.[3] If they paid more than $150 million, they would get credited a proportionate amount of the overpayment to their future fee obligations. As it turned out, overpayment was not an issue. As of March 31, 2013, payments of the 10% distributor fee totaled only $46 million, leaving a shortfall of $104 million.

B. Other industry members may act as distributors but are subject to laws relating to distributors to the extent they do so.

Under two separate provisions of I-1183, the privilege of acting as a distributor and selling spirits to retailers is not limited to entities that actually acquire the specific "spirits distributor license" created by RCW 66.24.055(1).

First, RCW 66.24.640 authorizes "[a]ny distiller licensed under this title" to "act as a ... distributor to retailers selling for consumption on or off the licensed premises of spirits of its own production," and

[3] Licensed distributors also must pay a $1,320 annual renewal fee, assessed per each licensed distribution location, that is a separate and distinct obligation from the license issuance fees owed under RCW 66.24.055(3). RCW 66.24.055(4).

authorizes "any manufacturer, importer, or bottler of spirits holding a certificate of approval"[4] to "act as a distributor of spirits it is entitled to import into the state under such certificate." However, this statue also specifies that, to the extent a Distiller acts as a distributor under this section – i.e., distributes spirits to retailers – it "must comply with all the applicable laws and rules relating to distributors." (Emphasis added.)

Second, RCW 66.28.330(4) provides that "[a] distiller holding a license or certificate of compliance [sic] as a distiller under this title may act as a distributor in the state of spirits of its own production or of foreign produced spirits it is entitled to import." This statute also requires that a Distiller choosing to act as a distributor "must, to the extent consistent with the purposes of this act, comply with all provisions of and regulations under this title applicable to wholesale distributors selling spirits to retailers." (Emphasis added.)

In 2012, a significant number of Distillers elected to take advantage of this grant of authority and operate as distributors of their own production. They sold their spirits to both off-premises and on-premises retailers. Clerks Papers ("CP") at 18-22.

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[4] Out-of-state spirits producers and spirits importers may obtain a "certificate of approval" to distribute spirits to other distributors and to retailers in Washington State. *See* WAC 314-23-030.

C. RCW 66.24.640 and RCW 66.28.330(4) require everyone acting as distributors to pay the 10% license issuance fee.

On June 5, 2012, the Board adopted two regulations that appropriately required Distillers operating as distributors to pay the 10% spirits distributor license fee established by RCW 66.24.055(3)(a).

WAC 314-23-030(3) provides that "[t]he holder of a certificate of approval license that sells directly to licensed liquor retailers must ... [p]ay to the board a fee of ten percent of the total revenue from all sales of spirits to retail licensees ... during the first two years of licensure" and "five percent of the total revenue from all sales of spirits to retail licensees ... for the third year of licensure and every year thereafter." Likewise, WAC 314-28-070(3) states that "a distillery or craft distillery must pay ten percent of their gross spirits revenue to the board on sales to a licensee allowed to sell spirits for on- or off-premises consumption during the first two years of licensure and five percent of their gross spirits revenues to the board in year three and thereafter."

On June 21, 2012, the Washington Restaurant Association, Northwest Grocery Association, and Costco Wholesale Corporation ("Costco") (here Intervenor-Respondents) filed suit in Thurston County Superior Court, challenging the validity of these two rules, among

others. (Appendix A) Petition for Judicial Review and Declaratory Judgment, *Wash. Restaurant Ass'n v. Wash. State Liquor Control Bd.*, No. 12-2-013125 (June 21, 2012). The Board explicitly defended its rules on the grounds that RCW 66.24.640 requires Distillers operating as distributors to comply with all laws applicable to distributors, including RCW 66.24.055(3)(a), asserting that:

> Petitioners ignore RCW 66.24.640, which says that distillers and [certificate of approval] holders acting as distributors *must comply with all laws applicable to distributors*. That required the Board, and this court, to find that the distillers and [certificate of approval] holders who choose to distribute their products are subject to the 10% distributor fee.

Brief of Respondents at 21, *Wash. Restaurant Ass'n v. Wash. State Liquor Control Bd.*, No. 12-2-01312-5 (Mar. 1, 2013). (Appendix A) The superior court, Judge Erik Price presiding, agreed with the Board, reasoning that:

> Before the passage of I-1183, the law required that an "industry member" operating "as a distributor" be subject to the laws and rules applicable to distributors. Since this law, RCW 66.24.640, remains, the Board argues that harmonizing the assessment of fees required by I-1183 with RCW 66.24.640 requires that the 10% fee be assessed to [certificate of authority] holders when they "operate as distributors."
>
> The Court agrees with the Board that imposing the 10% fee on [certificate of authority] holders for their sale as distributors is reasonably consistent with the statutory scheme read as a whole and does not directly conflict with provisions of I-1183. Accordingly, imposing this fee is within the Board's authority.

Court's Opinion at 8, *Wash. Restaurant Ass'n*, No. 12-2-01312-5 (Apr. 29, 2013). (Appendix A) Meanwhile, the Board adopted a rule to implement RCW 66.24.055(3)(c), the provision requiring collection of $150 million in distributor fees and imposing liability for any shortfall. On October 15, 2012, the Board adopted WAC 314-23-025, which reaffirmed that Distillers acting as distributors would be required to pay the 10% spirits distributor license fee under subsection (3)(a), but also provided that their fees would not be counted toward the $150 million target set by subsection (3)(c), and that they would not be required to contribute to the shortfall if the fees collected by March 31, 2013, amounted to less than $150 million.

Earlier, in January 2012, the Washington Beer and Wine Distributors Association ("WBWDA") (Intervenor in Costco's challenge to the validity of the Board's rules requiring Distillers to comply with subsection (3)(a)) had asked the Board to interpret I-1183 consistently so that all persons required to pay the 10% distributor license fee under subsection (3)(a) would also be subject to subsection (3)(c). CP at 25. The Board responded that while subsection (3)(a) defines the circumstances when "spirits distributor licensees" must pay the 10% distributor fee, subsection (3)(c) "directs the Board to a more limited group of licensees to calculate whether they have collectively paid

$150 million." CP at 31. If a shortfall is found, the Board determined, the language directs the Board to collect the deficiency, "allocated among persons holding spirits distributor licenses ...." CP at 31. Somehow, the Board concluded that "persons holding spirits distributor licenses" is a smaller group than "spirits distributor licensees."

However, in actually drafting WAC 314-23-025, the Board ignored this perceived distinction and used the terms "persons holding a spirits distributor license" and "spirits distributor licensee" interchangeably, stating that:

> If the spirits distributor license fees collected by March 31, 2013, total less than one hundred fifty million dollars, the board is required to assess those persons holding a spirits distributor license on or before March 31, 2013, in order to collect a total of one hundred fifty million dollars. The board will calculate the additional amount owed by each spirits distributor licensee as follows: ....

WAC 314-23-025(1) (emphasis added).

WAC 314-23-025 took effect on November 15, 2012. As stated, as of March 31, 2013, payments of the 10% distributor fee totaled only $46 million, leaving a shortfall of $104 million. That shortfall was assessed against and paid by the "licensed" distributors only, as required by WAC 314-23-025's exemption for Distillers acting as distributors.

Correctly anticipating that there would be a significant shortfall, AWSWD challenged the validity of WAC 314-23-025 on January 8, 2013. The superior court recognized that "the language of [WAC] 314-23-030 seems completely at odds with what was adopted in [WAC] 314-23-025," and concluded that RCW 66.24.640 and RCW 66.28.330(4) are "unambiguous on their face." Verbatim Report of Proceedings ("VRP") at 31. Nevertheless, the trial court determined that it was within the Board's authority to enact WAC 314-23-025 as it did. AWSWD now appeals the superior court's decision.

III. ARGUMENT

A rule is invalid if it violates a constitutional provision, exceeds the statutory authority of the agency, or is arbitrary and capricious. RCW 34.05.570(2)(c). The Court of Appeals applies these standards directly to the agency record, sitting in the same position as the superior court. *Burnham v. Dep't of Soc. & Health Servs.*, 115 Wn. App. 435, 438 (1998). The Board's rule limiting liability for the shortfall to entities licensed as spirits distributors suffers from all three of the above-mentioned defects.

A. **The Board exceeded its statutory authority because the plain language of I-1183 requires anyone distributing spirits to retailers to pay their equitable share of the shortfall.**

Courts will not defer to an agency determination that conflicts with the statute. Rather, rules that conflict with the statute exceed the agency's authority and must be invalidated. *Waste Mgmt. of Seattle, Inc. v. Utils. & Transp. Comm'n*, 123 Wn.2d 621, 628 (1994); *H & H P'ship v. State*, 115 Wn. App. 164, 170 (2003). Courts also accord no deference to an agency's interpretation of an unambiguous statute. *Waste Mgmt.*, 123 Wn. App. at 627. In this case, the plain language of RCW 66.24.055(3), RCW 66.24.640, and RCW 66.28.330(4) requires Distillers to pay their pro rata share of the shortfall.

RCW 66.24.640 and RCW 66.28.330(4) authorize Distillers to operate as distributors but further require that, in doing so, Distillers must comply with the applicable statutes and regulations relating to distributors. There is no plausible argument that the shortfall provision, RCW 66.24.055(3), is not one of "<u>the applicable laws and rules relating to distributors</u>" referred to in RCW 66.24.640. Nor is there any plausible argument that it is not among the "<u>provisions of and regulations under this title applicable to wholesale distributors selling spirits to retailers</u>" referred to in RCW 66.28.330(4). The plain language of the three sections, when read together, permit no reading

of the statutory scheme other than a requirement that Distillers participate in the shortfall obligations in proportion to their direct sales to retailers.

This plain language understanding of the statutes is reinforced by consideration of the nature of the Distillers' license privileges. Under RCW 66.24.640 and RCW 66.28.330(4), Distillers are given the right to sell to retailers. This is clearly a privilege of their license, because unlicensed persons are not allowed to sell spirits to anyone under any circumstances. Therefore, Distillers are holders of licenses that permit the distribution of spirits. For all practical purposes, they are "persons holding spirits distributor licenses" within the meaning of the shortfall provision, RCW 66.24.055(3)(c).

This reading of the law is consistent with the Board's prior actions. Previously, the Board determined, and the Thurston County Superior Court affirmed, that "spirits distributor licensees" in RCW 66.24.055(3)(a) includes distillers selling their own production to retailers and persons selling to retailers pursuant to a certificate of authority, based on RCW 66.24.640. Therefore, to the extent they choose to exercise the privilege, and obtain the benefit, of selling directly to retailers they are required to pay the 10% spirits distributor fee. Logic, and the plain language of the statutes, requires that the

same analysis apply to subsection (3)(c) to require Distillers who chose to distribute spirits to pay their equitable share of the shortfall.

Because WAC 314-24-025 excludes direct-shipping Distillers from contributing to the shortfall, it conflicts with the plain language of RCW 66.24.055(3), RCW 66.24.640, and RCW 66.28.330(4) and therefore exceeds the Board's statutory authority.

B. The Board exceeded its authority because it failed to harmonize RCW 66.24.055, RCW 66.24.640, and RCW 66.28.330(4).

Courts, in reading and analyzing statutes, are guided by two venerable rules of construction. First, in interpreting a statute it is the duty of the court to ascertain and give effect to the intent and purpose of the legislature – or in this case the voters – as expressed in the act. The act must be construed as a whole, and effect should be given to all the language used. All of the provisions of the act must be considered in their relation to each other, and, if possible, harmonized to insure proper construction of each provision. *Burlington Northern, Inc. v. Johnston*, 89 Wn.2d 321, 326 (1977). Second, it is the duty of the court to reconcile apparently conflicting statutes and to give effect to each of them, if this can be achieved without distortion of the language used. *State v. Fagalde*, 85 Wn.2d 730, 736 (1975).

The Board exceeded its authority in adopting WAC 314-23-24 because it failed to harmonize RCW 66.24.055, RCW 66.24.640, and RCW 66.28.330(4). Rather, the board interpreted these statutes selectively and inconsistently, resulting in an absurd reading of the statutes.

As stated, RCW 66.24.640 permits any licensed distiller to "act as a ... distributor ... of spirits of its own production," and authorizes any certificate of approval holder to "act as a distributor of spirits it is entitled to import into the state under such certificate." But, to the extent a distiller or certificate of approval holder acts as a distributor and sells spirits to retailers, it "must comply with the applicable laws and rules relating to distributors ...." Similarly, RCW 66.28.330(4) provides that a distiller holding a license or certificate of approval "may act as a distributor in the state of spirits of its own production or of foreign produced spirits it is entitled to import," but requires that such an entity electing to act as a distributor must "comply with all provisions of and regulations under this title applicable to wholesale distributors selling spirits to retailers."

An unreasonably-strict reading of RCW 66.24.640 and RCW 66.28.330(4) would result in Distillers being subject to all obligations relating to licensed spirits distributors, including the

obligation to apply for a spirits distributor license and the obligation to pay an annual spirits distributor license fee (in addition to a distillery license annual fee or certificate of approval annual fee). Such an interpretation of the law would make little or no sense. As with nearly all statutory schemes, the Board has some discretion to reasonably interpret the various provisions of I-1183 and to draft appropriate implementing regulations. However, the Board exceeded its discretion, resulting in an absurd reading of the statutes, when it excused Distillers from liability for any part of the shortfall.

The Board determined that Distillers who act as distributors are subject to the basic distributor fee requirement, RCW 66.24.055(3)(a), because it is an "applicable law" "relating to distributors." *See* CP at 25-33. This is a reasonable and appropriate reading of the statutes. RCW 66.24.640 relates to distillers and other industry members selling spirits to retailers, and subsection (3)(a) directly relates to fees paid for the privilege of selling spirits to retailers. Thus, subsection (3)(a) is clearly an "applicable" law "relating to distributors" for purposes of RCW 66.24.640's compliance requirements.

The Board then determined, however, that Distillers are not subject to the shortfall provisions of subsection (3)(c) because that supposedly <u>is not</u> an "applicable" law "relating to distributors." CP at

25-33. This makes no sense and is an unreasonable exercise of the Board's discretion.

First, like subsection (3)(a), subsection (3)(c) clearly is an "applicable" law within the meanings of RCW 66.24.640 and RCW 66.28.330(4). Both of these sections of the Initiative relate to Distillers selling spirits to retailers – i.e., that is the action that triggers application of both statutes. Subsection (3)(c) relates to the collective payment of fees paid for the privilege of selling spirits to retailers. Accordingly, it is a law relating to distributors that is directly "applicable" for purposes of the compliance requirements in both RCW 66.24.640 and RCW 6 6.28.330(4). Moreover, the fees assessed under both subsection (3)(a) and subsection (3)(c) are assessed on the basis of sales volume. That is unquestionably a provision "applicable to wholesale distributors selling spirits to retailers" within the meaning of RCW 66.28.330(4).

Second, the supposed distinction between "spirits distributor licensees" and "persons holding spirits distributor licenses" – which is the basis for the Board applying RCW 66.24.640 to subsection (3)(a) but not to subsection (3)(c) – is unreasoned. It is self-evident that the two phrases are identical in meaning, because each is a definition of the other. In addition, they are used synonymously within the statute

itself: While the "additional spirits distributor license fees" are to be "allocated among persons holding spirits distributor licenses," "[a]ny amount by which such payment exceeds one hundred fifty million dollars by March 31, 2013, must be credited to ... spirits distributor licensees." RCW 66.24.055(3)(c) (emphasis added). Finally, as noted above, the Board used the terms interchangeably in its own regulation excluding distillers and others from contributing to the shortfall. WAC 314-23-025. There is simply no justification, statutory or otherwise, for interpreting the two sections differently. The Board's conclusion that the phrase "spirits distributor licensees" includes distillers choosing to self-distribute in the context of one subsection of RCW 66.24.055(3), but the identical term "persons holding spirits distributor licenses" in another subsection of RCW 66.24.055(3) does not include them, creates an absurd result. Washington courts read statutes to avoid such absurd results. *Double D Hop Ranch v. Sanchez*, 133 Wn.2d 793, 799 (1997).

Third, the two provisions of RCW 66.24.055(3) at issue here create one license issuance fee. Subsection (3)(a) levies a fee equal to 10% of a licensee's revenue from the sale of spirits to retailers, payable monthly as sales are made. Subsection (3)(c), which assesses additional payments determined "ratably according to their spirits

sales" in 2012 and payable on May 31, 2013, merely guarantees that the fees for the first year of privatization will total $150 million. In other words, the statute created a single distributor license fee for that first year but left the amount of that fee payable by any one entity to be determined when the respective volumes of sales to retailers became known. In adopting WAC 314-23-025, the Board unilaterally exempted direct-shipping Distillers from one part of that fee, but not the other, contrary to the overall statutory scheme.

In sum, the Board harmonized all pertinent parts of I-1183 when it enacted WAC 314-23-030 and WAC 312.28.070(3). It correctly concluded that RCW 66.24.640 and RCW 66.28.330(4) require persons acting as distributors to comply with all applicable laws relating to distributors; that RCW 66.24.055(3)(a) is an applicable law that directly relates to distributors; and that Distillers operating as distributors must therefore comply with it and pay 10% of their "distributor" sales in fees. In contrast, the Board made no effort to harmonize these same provisions when it enacted WAC 314-23-025. Instead, it chose to read RCW 66.24.055(3)(c) in a vacuum, ignoring all other sections of I-1183. By exempting Distillers who operate as distributors from contributing to the shortfall, the Board effectively rewrote RCW 66.24.640 and RCW 66.28.330(4), limiting the

obligation of self-distributing Distillers to compliance with some but not all of the applicable laws governing distributors. An agency cannot modify or amend a statute by regulation, *Bird-Johnson Corp. v. Dana Corp.*, 119 Wn.2d 423, 428 (1992), yet that is precisely what the Board did when adopting WAC 314-23-025. In doing so, the Board exceeded its statutory authority.

C. The Board's adoption of WAC 314-23-025 is arbitrary and capricious.

The Board's selective and inconsistent interpretation of these three statutory provisions underscores the arbitrary nature of the Board's adoption of WAC 314-23-025. Agency action is arbitrary and capricious if it is willful and unreasoning and taken without regard to the attending facts or circumstances. *D. W. Close Co., Inc. v. Wash. State Dep't of Labor & Indus.*, 143 Wn. App. 118, 130 (2008).

The Board's adoption of WAC 314-23-025 was both willful and unreasoned. The Board knew or should have known that the rules it was adopting for dealing with distribution fees were logically inconsistent. When it enacted WAC 314-23-030, for example, the Board determined that RCW 66.24.640 required industry members acting as distributors to comply with the requirements imposed on "spirits distributor licensee[s]" under RCW 66.24.055(3)(a). Yet when

the Board enacted WAC 314-23-025 it concluded that industry members acting as distributors were not required to comply with the requirements imposed on "persons holding spirits distributor licenses" by RCW 66.24.055(3)(c).

The only way for the Board to reconcile WAC 314-23-030 with WAC 314-23-025 is for it to maintain that "spirits distributor licensees" has a different meaning in subsection (3)(a) than it has in subsection (3)(c), but there is no basis for that position in the statute. The fact that RCW 66.24.055(3)(c) dictates that if the fees paid by "persons holding spirits distributor licenses" exceed $150 million the excess will be refunded as credit to "spirits distributor licensees" confirms that the two terms have the same meaning. Otherwise, one would have to conclude that Distillers whose fees were not considered in determining whether $150 million had been collected would be entitled to receive a "refund" of an excess they did not contribute to in the first place. That absurd result inexorably follows from the Board's attempt to distinguish the two terms.

Exempting Distillers from contributing their ratable shares of the shortfall is contrary to the mandate of RCW 66.24.640 and RCW 66.28.330(4), is inconsistent with the Board's requirement that Distillers pay distributor license fees under RCW 66.24.055(3)(a), and

is not grounded in logic. This is not a situation in which the Board considered the attending circumstances and reached a conclusion about which reasonable minds could differ. Instead, the Board purposefully interpreted the statues selectively and inconsistently in an effort to maximize revenues. The Board acted willfully and unreasonably in adopting WAC 314-23-025 and its action is therefore arbitrary and capricious.

D. WAC 314-23-025 violates article I, section 12 of the Washington Constitution.

The arbitrary nature of WAC 314-23-025 has constitutional ramifications. Article I, section 12 of the Washington Constitution provides that "[n]o law shall be passed granting to any citizen, class of citizens, or corporation other than municipal, privileges or immunities which upon the same terms shall not equally belong to all citizens, or corporations." WASH. CONST. art. I, § 12. By exempting industry members who act as distributors from RCW 66.24.055(3)(c), WAC 314-23-025 violates this provision.

The Washington Supreme Court long viewed article I, section 12 as "substantially identical" to the Equal Protection Clause of the Fourteenth Amendment. *Am. Network, Inc. v. Wash. Utils. & Transp. Comm'n*, 113 Wn.2d 59, 77 (1989). In 2004, however, the court held

that article I, section 12 required an independent analysis. *Grant Cnty. Fire Prot. Dist. No. 5 v. City of Moses Lake*, 150 Wn.2d 791, 811 (2004). In doing so, the court was guided by the substantial body of law on Washington's privileges and immunities clause that it had developed during the early 20th Century. *See id.* at 809 n.12 (citing *State v. Robinson Co.*, 84 Wash. 246, 249-50 (1915) (invalidating statute that exempted cereal and flour mills from act imposing onerous conditions on similar businesses); *In re Camp*, 38 Wash. 393, 397 (1905) (holding that city ordinance prohibiting fruit and vegetable peddling within city, but exempting farmers, violated article I, section 12); *City of Seattle v. Dencker*, 58 Wash. 501, 504 (1910) (invalidating ordinance that imposed a license fee on businesses employing vending machines, but not on those that sold identical goods by other means).

For a violation of article I, section 12 to occur, a law must confer a privilege or immunity upon a citizen, class of citizens, or corporation. *Grant Cnty.* 150 Wn.2d at 812. The Washington Supreme Court has said that "the terms 'privileges and immunities' 'pertain alone to those fundamental rights which belong to the citizens of the state by reason of such citizenship,'" including the right to "'carry on business therein.'" *Id.* (quoting *State v. Vance*, 29 Wash. 435, 458

(1902)). "[A] 'privilege' normally relates to an exemption from a regulatory law that has the effect of benefitting certain businesses at the expense of others." *Am. Legion Post #149 v. Wash. State Dep't of Health*, 164 Wn.2d 570, 607 (2008). The exclusion of industry members who act as a distributor under WAC 314-23-025 fits that description, benefitting those businesses at the expense of others engaged in the distribution of spirits.

One of the early cases cited by the Washington Supreme Court in *Grant County Fire Protection District No. 5 v. City of Moses Lake* is particularly apt. In *Dencker, supra*, the court considered a challenge by a cigar company to a Seattle ordinance that imposed a license fee on businesses selling goods by vending machine, but excluding businesses selling the same goods by other means. Observing that the ordinance was strictly a revenue measure, and thus did not involve the police power, the Court proceeded to test the ordinance against "certain fundamental principles," namely, that while a "tax may be imposed in the form of a license fee" for the purpose of raising revenue, and the "state may tax all or any occupations or businesses carried on within its boundaries, imposing the burden on some and passing by others," the determination must not be made "arbitrarily or

fraudulently," and "the decision exercised by the law-making power must be natural and reasonable." *Dencker*, 58 Wash. at 504-05.

The Court held that, "[t]ested by these principles," the ordinance could not be sustained. *Id.* Reciting the Supreme Court of Minnesota's admonition that "'[t]he classification must be based on some reason suggested by a difference in the situation and circumstances of the subjects treated, and no arbitrary distinction between different kinds or classes of businesses can be sustained,'" the Court added, "A much worse discrimination would be a discrimination between citizens of the <u>same class</u> engaged in the <u>same business</u>, where there is no reason suggested by a difference in the situation and circumstances or the subjects treated." *Id.* at 507-08 (quoting *State ex rel. McCue v. Sheriff of Ramsey Cnty.*, 48 Minn. 236, 239, 51 N.W. 112 (1892)) (emphasis added).

I-1183 created a spirits distributor license, but authorized other industry members to "act as a distributor." RCW 66.24.640. In other words, it enabled these members to engage in the same business as licensed distributors. Their participation in this business, however, was properly conditioned on their compliance with all applicable rules relating to distributors. RCW 66.28.330(4); RCW 66.24.640. Despite this, WAC 314-23-025 immunizes these competitors from the millions

of dollars in fees that spirits distributor licensees have been required to pay for the privilege of distributing spirits. Such protectionism is precisely the sort of "discrimination between citizens of the same class engaged in the same business" condemned in *Dencker*.

Indeed, the Board justified its interpretation of the shortfall provision as a method of generating revenue for the State, and not on any principled interpretation of the statute as a whole. Whatever distinctions exist between distributors and other industry members "operating as distributors" do not offer a reasonable basis for imposing a heavy tax burden on one while exempting the other. Under *Dencker*, such an arbitrary classification fails.

Any argument that Distillers operating as distributors do not operate "similar or identical" businesses places form over substance, because, to the extent a Distiller operates as a distributor and sells spirits to retailers, it operates <u>exactly the same</u> business as distributors. Industry members operating as distributors sell the same product (spirits) to the same parties (retailers) in the same location (in-state) as do distributors. The fees imposed by RCW 66.24.055(3) are directly proportionate to those sales. There is simply no rational basis for treating industry members differently than distributors when they elect to act as distributors.

In addition, any argument that reading RCW 66.24.640 and RCW 66.28.330(4) literally would lead to inequitable results, with a windfall going to "large," dominant distributors at the expense of "small," craft distillers must fail. RCW 66.24.055(3)(c) expressly limits the amount a Distiller acting as a distributor must pay to its ratable share. Thus, if a craft distiller sold its product directly to retailers in amounts equal to .001% of all spirits distributed in 2012, it is responsible for .001% of the shortfall. This result is no less equitable – and no less in line with the purpose of opening up the spirits market to fair competition – than is permitting all Distillers, whether small, medium, or large, to engage in the same business as distributors without obtaining a distributors license and without contributing their share of the license fees. I-1183 already accounts for market participation and, thus, any difference in volume is an improper basis for a discriminatory classification.

IV. CONCLUSION

The record shows the Board considered RCW 66.24.055(3)(c) in a vacuum, ignoring all other provisions of I-1183. Read together, as they must be, the three pertinent statutory provisions (RCW 66.24.055(3), RCW 66.24.640, and RCW 66.28.330(4)) are unambiguous and provide that anyone who elects to distribute spirits

for their own benefit is subject to RCW 66.24.055(3)(a) and (3)(c). This is the clear intent of the voters in passing I-1183. The Board's conclusion to the contrary conflicts with the clear language of the statutes and fails to harmonize all the pertinent provisions. The arguments purporting to support the Board's conclusion are not grounded in the language of the initiative. Because WAC 314-23-025 conflicts with I-1183's statutory scheme regarding spirits distributor license fees, exceeds the Board's authority and creates an arbitrary and capricious distinction among entities performing identical functions, the Court should reverse the superior court and declare the regulation invalid.

Dated this 3rd day of March, 2014.

Respectfully submitted,

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By _____

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CERTIFICATE OF SERVICE

I, Gina A. Mitchell, declare that on March 3, 2014, I caused the following pleadings:

1. Appellant's Opening Brief

together with this Declaration of Service, to be served on counsel for all parties as follows:

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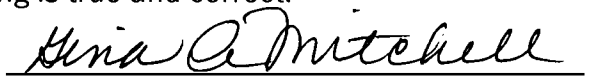
I declare under the penalty of perjury of the laws of the State of Washington that the foregoing is true and correct.



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APPENDIX A

Petition for Judicial Review and Declaratory Judgment, *Wash. Restaurant Ass'n v. Wash. State Liquor Control Bd.*, Thurston County Superior Court Case No. 12-01312-5 (June. 21, 2013); Brief of Respondents, *Wash. Restaurant Ass'n v. Wash. State Liquor Control Bd.*, Thurston County Superior Court Case No. 12-01312-5 (Mar. 1, 2013); Court's Opinion, *Wash. Restaurant Ass'n v. Wash. State Liquor Control Bd.*, Thurston County Superior Court Case No. 12—01312-5 (Apr. 29, 2013).

The briefing and court's opinion in *Wash. Restaurant Ass'n v. Wash. State Liquor Control Bd.* was brought to the attention of the trial court in this case, CP 50, 170, and was considered by Judge Schaller in making her ruling, RP 26-27, 29. Appellants ask the Court to take judicial notice of the case and Judge Price's ruling in the case. The Petition for Judicial Review and Declaratory Judgment, Brief of Respondent, and Judge Price's Opinion in *Wash. Restaurant Ass'n v. Wash. State*

Liquor Control Bd. are attached for the Court's convenient reference.

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☐ Hearing is set

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Time: _____
Judge/Calendar: _____

SUPERIOR COURT OF THE STATE OF WASHINGTON
FOR THURSTON COUNTY

WASHINGTON RESTAURANT ASSOCIATION, a Washington non-profit organization; NORTHWEST GROCERY ASSOCIATION, a non-profit organization; and COSTCO WHOLESALE CORPORATION, a Washington corporation; Petitioners, v. WASHINGTON STATE LIQUOR CONTROL BOARD, a state agency; CHRIS MARR, SHARON FOSTER, and RUTHANN KUROSE, in their official capacities as members of the Washington State Liquor Control Board; Respondents.	No. 12 2 01312 5 **PETITION FOR JUDICIAL REVIEW AND DECLARATORY JUDGMENT**

I. INTRODUCTION

1. Nearly 60 percent of Washington voters enacted Initiative 1183, fundamentally altering state liquor laws to "modernize both wholesale distribution and retail

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ORIGINAL

sales of liquor and remove outdated restrictions on the wholesale distribution of wine." Laws of 2012, ch. 2, § 1 (I-1183, § 101(1)). The Initiative ended state liquor stores; removed many barriers to competition among private licensees, particularly distributors; and adjusted the rulemaking authority of Respondent Liquor Control Board, directing its focus to controlling abuse of liquor rather than adjusting the field of competition among licensees. The primary financial opponents of the Initiative were large out-of-state distributors, but the Board did not favor the Initiative and had opposed prior attempts at privatization and increased competition. The Board now seeks to circumvent the Initiative through rules that still "arbitrarily restrict the wholesale distribution and pricing of wine" and spirits, *id.*, undermining the Initiative, and protecting those distributors from competition. The Board's actions are increasing prices paid by consumers—yet the Board blames voters for prices not being lower. The Board has ignored the costs of its actions, and the challenged rules are outside of its authority, arbitrary and capricious, and contrary to I-1183 and requirements of the United States and Washington Constitutions.

2. Petitioners challenge both the manner in which the Board adopted the rules and the substance of six rules. By failing to properly evaluate the impact on small businesses, such as thousands of restaurants, the Board disregarded its statutory duty to stakeholders and the public. Beyond that procedural failure, the Board refuses to acknowledge the purpose of the Initiative and its circumscription of the Board's regulatory authority. Acting under pressure from distributors, the Board belatedly introduced a daily limit on the amount of wine or spirits that a retailer may sell to another retailer, although the Initiative imposes only a single-sale limit and there are no health or safety implications warranting additional these limitations. The Board's rule restricts competition, to the private

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benefit of distributors, and hampers the business options available to local businesses that sell liquor for consumption on their premises, such as restaurants, bars, and nightclubs.

3. Similarly, the Board has imposed a geographic limitation on a type of licensee, a "certificate holder," that wishes to import and sell spirits, refusing this business opportunity to foreign entities. The Initiative does not impose this limitation, and its text and purpose make clear that it did not intend to handicap foreign spirits suppliers, whose products are very popular in Washington. Indeed, representatives from the Association of Canadian Distillers and the Scotch Whiskey Association commented on this exclusion of foreign distillers and the conflict with international trade agreements, but the Board did not respond to these concerns.

4. Furthermore, the regulations addressing the rights of spirits importers and out-of-state certificate holders arbitrarily deny these licensees the right to sell and ship directly to retailers (pursuant to a direct shipping endorsement) despite the fact that I-1183 specifically confers this privilege. The Board is also imposing the ten percent license fees applicable to distributors to these certificate holders, again contrary to the text and purpose of the Initiative, and this action drives up prices for the consumer.

5. Finally, the Board, without reason or explanation, limited the locations from which spirits distributors may sell and deliver product, again without basis in the text or purpose of the Initiative.

6. The Board does not even contend, much less rely upon evidence, that the regulations promote public health and safety, or otherwise protect communities from abuse of liquor. Instead, the Board explicitly acknowledges that its purpose is to manipulate the marketplace to favor the financial interests of distributors, at the expense of Petitioners and consumers. Such actions exceed the Board's statutory authority, and the process constitutes

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arbitrary and capricious rulemaking. The regulations independently violate the State and the United States Constitutions by, among other things, discriminating against foreign and out-of-state businesses.

II. PARTIES

7. Petitioner Washington Restaurant Association ("WRA") is a non-profit trade association that represents over 5,000 restaurants and other hospitality businesses in the state. It is located at 510 Plum St. S.E., Suite 200, Olympia, Washington 98501.

8. Petitioner Northwest Grocery Association ("NGA") is a non-profit trade association that represents grocery retailers and other grocery industry interests in Washington, Oregon, and Idaho. Its headquarters are located at 8565 SW Salish Lane, Suite 100, Wilsonville, Oregon, and it maintains an office in Olympia, Washington, with a mailing address of P.O. Box 1414, Olympia, Washington 98507.

9. Petitioner Costco Wholesale Corporation is a Washington corporation doing business in Washington. Its principal place of business is located at 999 Lake Drive, Issaquah, Washington 98027.

10. Petitioners and members of NGA and WRA are substantially prejudiced by the challenged rules, and such prejudice will be substantially eliminated by judgment in Petitioners' favor. Petitioner and their members have interests among those that the agency was required to consider.

11. Respondent Board has its headquarters at 3000 Pacific Avenue S.E., Olympia, Washington 98501. Its mailing address is P.O. Box 43080, Olympia, Washington 98504. The Board is an agency of the State of Washington, RCW 66.08.020, and promulgated the emergency and permanent rules that purport to implement Initiative 1183 and that are challenged in this action.

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12. Respondents Marr, Foster, and Kurose are members of the Board. They enacted the rules challenged in this action, and the action is brought against them in their official capacities.

III. JURISDICTION AND VENUE

13. The Court has jurisdiction under RCW 34.05.570. Venue is proper under RCW 34.05.570(2)(b).

IV. BACKGROUND

Initiative 1183

14. Some of the Initiative's primary components include:

a) Removing the State from the liquor business;

b) Creating licenses for private entities to sell and distribute spirits;

c) Imposing a new license fee based on sales, to replace the State's markup on liquor and continue a significant revenue stream to the State;

d) Removing uniform pricing requirements on the sale of spirits and wine;

e) Allowing "off-premises" retailers of wine and spirits (such as Costco Wholesale and members of Petitioner NGA) to make wholesale sales to "on-premises" retailers (such as members of WRA), just as they do with any other product; and

f) Ending prior prohibitions on other efficient business practices, such as central warehousing.

15. The Initiative also removed some of the Board's powers, eliminating, for example, RCW 66.08.030(1), which used to furnish the Board with authority to fill in gaps

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in liquor legislation and has historically served as the basis for the Board's independent regulatory power.

The Board's Rulemaking Process

16. I-1183 requires the Board to promulgate rules to implement certain of its provisions. This action challenges five of the emergency and parallel permanent rules that the Board adopted under I-1183 (collectively, the "I-1183 rules"). The emergency I-1183 rules are in effect now, and the permanent I-1183 rules become effective on July 6, 2012.

17. By I-1183's effective date, December 8, 2011, the Board had adopted emergency rules and had issued pre-proposal notices to stakeholders of permanent rulemaking. WSR 11-24-101. The emergency rules expired April 8, 2012. Although the Board identified all of the rules as implementing I-1183, not all of them were in response to provisions of the new law, as shown below, and there was no emergency as to the challenged rules.

18. On February 20, 2012, the Board circulated a revised set of emergency rules. One revision, which had been sought by distributors, imposed a daily volume limit (24 liters per customer) on wholesale sales by off-premises retailers. The Initiative imposed no such limit and authorized no such rulemaking. Instead, it imposed a limit (also 24 liters) on single sales. Thus, the new rules prohibited single sales allowed by the Initiative if such sales would bring the daily total to greater than 24 liters—or if a customer wished to make more than a single purchase in a day, regardless of the quantity purchased.

19. On February 22, the Board heard testimony on the proposed per-day limit. The testimony identified the negative impact the new limitation would have on small businesses, such as restaurants, bars, and nightclubs, and on competition, and addressed the intent of the Initiative's drafters. Although licensees had operated under the Initiative's per-

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single sale limit on wine for over three months, and former contract stores were exempted from the new rule, the testimony identified no problems related to abuse of alcohol. The only identified negative consequence of the Initiative's limit was that distributors faced somewhat greater competition from off-premises retailers. Petitioners' representatives and members of NGA and WRA testified at this hearing. Costco Wholesale also submitted a transcript and recording of this meeting to the Board as part of its written comments on the final proposed rules.

20. On March 14, the Board filed proposed permanent rules to implement I-1183 based largely on the existing emergency rules. WSR 12-07-040. The Board proposed 16 new rules "needed to implement new laws created by the initiative" and six amendments to current rules "needed to clarify new license types created by the initiative." *Id.* The Board filed a new CR-102 for the same permanent rules, updated to reflect allegedly minor revisions, on April 18. WSR 12-09-088. One of these revisions, added without comment or explanation, included an entirely new subsection with a restriction on delivery locations for spirits distributors.

21. On April 4, four days before the existing emergency rules were to expire, the Board adopted new emergency rules, pending its adoption of permanent rules. WSR 12-08-067. The Board did not explain why it had revised the original emergency rules; did not identify any problems that had arisen under the prior emergency rules; and did not respond to the comments submitted on these rules. It did change its basis for claiming an emergency that allows such expedited rulemaking, although neither circumstances nor rules changed substantially. The new emergency rules will expire on August 8.

22. As required by law, the Board held a public hearing to accept testimony regarding the proposed permanent I-1183 rules on May 24. Petitioners' representatives and

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numerous members of WRA and NGA attended the hearing, testified, and submitted written comments. During the meeting, Board members specifically made reference to testimony given at the February 22 meeting. The Board's Rules Coordinator also accepted almost 300 written comments.

23. Only three business days later, on May 30, the Board officially adopted the permanent I-1183 rules without a single change. On June 5, the agency filed a CR-103 with the Code Reviser, including the statutorily required Concise Explanatory Statement that summarized some of the comments submitted to the Board and offered the Board's explanation of why it chose to adopt the rules as proposed. WSR 12-12-065; Ex. A.

24. The permanent I-1183 rules go into effect on July 6, replacing the emergency rules.

Impact of the Challenged Rules

25. Petitioners challenge the following permanent rules and, to the extent necessary, their emergency counterparts:

a) WAC 314-02-103(2), which adds a daily 24-liter limit on wine sales to retailers by off-premises retailers other than former contract stores and limits such sales to one per day, regardless of quantity purchased, and subsection (4), which lists the permissible delivery locations for wine retailers;

b) WAC 314-02-106(1)(c), which adds a daily 24-liter limit on spirits sales to retailers by off-premises retailers other than former contract stores and limits such sales to one per day, regardless of quantity purchased;

c) WAC 314-23-020(2), which imposes a restriction on the delivery locations for spirits distributors;

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d) WAC 314-23-001, which prohibits spirits being sold below acquisition cost;

e) WAC 314-23-030, which sets out regulations regarding spirits certificate of approval holders, a new category of licensees created under the Initiative; and

f) WAC 314-23-050, which sets out regulations regarding spirits importers, also a new license created by I-1183.

26. Petitioners and members of NGA and WRA opposed the challenged rules and are substantially prejudiced by the denial of business opportunities in both selling and purchasing product, increased cost of product, greater inconvenience, and unnecessary administrative and compliance costs. Consumer members and customers of Petitioners are encountering unnecessarily increased prices and fewer product choices as a result of the challenged rules.

27. Petitioner WRA represents thousands of businesses throughout the State, many of which are licensed to sell spirits, and/or beer and wine for on-premises consumption. The challenged rules limit the ability of these member restaurants, bars, nightclubs, and other hospitality licensees to procure their wine and spirits at lower prices and with greater convenience by denying them the benefits of the competition by off-premises retailers and foreign producers that the Initiative envisioned. WRA members are often located very close to members of NGA, and it can be very convenient to be able to acquire some needed wine or spirits from an NGA member even if the WRA member has to make more than one purchase during a day. This is especially true in the less populated areas of our state.

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28. Petitioner NGA represents grocery retailers, such as Safeway, Fred Meyer, and QFC, that sell beer, wine, and now spirits pursuant to Board licenses. NGA member stores engage in sales for resale by on-premises licensees and seek to purchase directly from licensed manufacturers regardless of whether they are foreign or domestic.

29. Petitioner Costco Wholesale operates membership warehouses offering consumer and business members low prices on a limited selection of products. A significant part of its business is wholesale sales to business members for resale to consumers. To keep its prices low, Costco often buys large amounts directly from manufacturers located in the United States and abroad, with deliveries to its cross-docking facilities for distribution to the membership warehouses. Many manufacturers, wherever located, do not need the services of distributors to serve Costco. Pursuant to Board licenses, Costco Wholesale sells liquor in Washington. Its liquor customers include individuals and licensed on-premises retailers, and it purchases wine and spirits from various sources, including distributors, distilleries and wineries (both in- and out-of-state), wine and spirits importers, and certificate of approval holders.

FIRST CAUSE OF ACTION

VIOLATION OF STATUTORY REQUIREMENTS FOR RULEMAKING

30. Petitioners reallege and incorporate by reference, as if fully set forth in this paragraph, the allegations in paragraphs 1 through 29 above.

31. The permanent I-1183 rules were adopted without substantially complying with the statutory requirements imposed by the Administrative Procedures Act, codified at RCW 34.05 et seq., requiring their invalidation. Such violations include a failure to prepare and consider a Small Business Economic Impact Report, required by RCW 19.85.030, and a

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failure to consider all of the comments submitted to the Board regarding the I-1183 rules, including all testimony given during the February 22 meeting.

32. The Board also failed to substantially comply with the Administrative Procedures Act when promulgating the emergency rules adopted in April, as it failed to give a reasoned explanation for why such emergency rules were needed. What little explanation was offered contradicted the reasons given just a few months before, despite the fact that the rules were mainly repetitive of the prior rule set.

33. Petitioners request the Court to declare all of these permanent rules and the emergency rules invalid and unenforceable.

SECOND CAUSE OF ACTION

ACTION BEYOND AND CONTRARY TO STATUTORY AUTHORITY

34. Petitioners reallege and incorporate by reference, as if fully set forth in this paragraph, the allegations in paragraphs 1 through 33 above.

35. The Board promulgated rules where the Initiative did not contemplate the authority for rules, and these rules contradict the statutory purpose:

a) In WAC 314-02-103(2) and 314-02-106(1)(c), the Board exceeded the scope of its specified rulemaking authority by adding an additional limitation and thus prohibits sales that were made legal by I-1183 (sales of 24 liters or less, regardless of daily total, and multiple sales in a day totaling less than 24 liters), and it did so on a rationale in excess of its authority under I-1183—to alter competition as such and not as needed to control abuse.

b) In WAC 314-23-020(2), the Board exceeded its authority under I-1183 and relied exclusively on some general separate authority to

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create, contrary to the purpose of I-1183, a new limitation on the physical locations from which spirits distributors may ship their product. This rule is not needed to implement the Initiative, as evidenced by the fact that it appeared in neither set of emergency rules nor in the first version of the proposed permanent rules.

c) There are three separate instances in WAC 314-23-030 in which the Board exceeded its statutory authority:

i. In WAC 314-23-030(1), the Board exceeded its authority by imposing geographic limitations on spirits certificate of approval holders even though such limitations and obligations are not found in the Initiative and contrary to its purpose. Such certificates are denied entirely to spirits manufacturers located outside of the United States.

ii. WAC 314-23-030(2) discriminates against the out-of-state spirits manufacturers because it fails to grant them the ability to obtain a direct shipping endorsement, which would allow them to sell directly to retailers—a right that their in-state counterparts enjoy. The Initiative specifically contemplated that both Washington and non-Washington certificate holders would enjoy this right. Moreover, the statute could not have granted the Board authority to discriminate against interstate and foreign commerce under federal and international law.

iii. WAC 314-23-030(3)(b) & (c) impose the ten percent license fee based on sales imposed on distributors on spirits certificate

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holders, contrary to the plain text of the Initiative. The Board exceeded its authority in extending the license fees to this license group.

d) In WAC 314-23-050, the Board exceeded its authority by eliminating a spirits importers' right to sell directly to retailers, pursuant to a direct shipping endorsement, contrary to clear statutory language that grants a spirits importer this right.

e) In WAC 314-02-103(4) and 314-23-001, the Board omitted rights granted by the statute without any authority to limit those rights.

36. Petitioners request the Court to declare these challenged sections of the permanent rules and their identical emergency counterparts invalid and unenforceable.

THIRD CAUSE OF ACTION

ARBITRARY AND CAPRICIOUS RULEMAKING

37. Petitioners reallege and incorporate by reference, as if fully set forth in this paragraph, the allegations in paragraphs 1 through 36 above.

38. The Board, in promulgating the I-1183 rules, acted in an arbitrary and capricious manner. It purported to implement I-1183 but ignored the plain language and intent and purposes of I-1183, and it acted to fulfill some concept of economic fairness that is contrary to the Initiative's provisions and its changes to state policy.

39. Petitioners request the Court to declare these permanent rules invalid and unenforceable.

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FOURTH CAUSE OF ACTION

VIOLATION OF SUPREMACY CLAUSE

40. Petitioners reallege and incorporate by reference, as if fully set forth in this paragraph, the allegations in paragraphs 1 through 39 above.

41. WAC 314-23-030(1), by discriminating against foreign spirits certificate of approval holders, violates the Supremacy Clause of the United States Constitution, which reserves to the federal government the right to determine foreign policy. Articles 301, 1201, and 1210 of NAFTA and similar provisions of other international trade agreements by the United States prohibit such discrimination in goods and self-distribution services.

42. Petitioners request the Court to declare this section of the rule and its identical emergency counterpart invalid and unenforceable.

FIFTH CAUSE OF ACTION

VIOLATION OF COMMERCE CLAUSE

43. Petitioners reallege and incorporate by reference, as if fully set forth in this paragraph, the allegations in paragraphs 1 through 42 above.

44. WAC 314-23-030(2) violates the Commerce Clause of the United States Constitution because it discriminates intentionally and without basis between Washington licensees and out-of-state spirits certificate holders. While in-state spirits licensees have the right to sell directly to retailers (pursuant to proper Board licensure), the same privilege is prohibited to spirits certificate holders located out of state.

45. Petitioners request the Court to declare this section of the rule and its identical emergency counterpart invalid and unenforceable.

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SIXTH CAUSE OF ACTION

VIOLATIONS OF STATE CONSTITUTION

46. Petitioners reallege and incorporate by reference, as if fully set forth in this paragraph, the allegations in paragraphs 1 through 45 above.

47. The challenged rules violate Article I, Section 12, and Article XII, Section 22, of the Washington Constitution by granting special privileges and immunities and by limiting competition in and regulating the transportation of products, and by doing so for private financial interests.

48. To the extent the Board relies on some general authority delegated by the Legislature, the rules also violate Article II, Section 1(c), of the Washington Constitution by amending an Initiative enacted by the People within two years of its adoption.

49. Petitioners request the Court to declare these rules and their identical emergency counterparts invalid and unenforceable.

V. PRAYER FOR RELIEF

Accordingly, Petitioners respectfully request that the Court:

50. Enter judgment in Petitioners' favor on its Petition for Review;

51. Grant attorneys' fees, costs, and such further relief as deemed just and proper by the Court.

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DATED: June 21, 2012

PERKINS COIE LLP

By: _____

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EXHIBIT

A

RULE-MAKING ORDER

CR-103P (May 2009)
(Implements RCW 34.05.360)

Agency: Washington State Liquor Control Board

Permanent Rule Only

Effective date of rule:
Permanent Rules
☒ 31 days after filing.
☐ Other (specify) _____ **(If less than 31 days after filing, a specific finding under RCW 34.05.380(3) is required and should be stated below)**

Any other findings required by other provisions of law as precondition to adoption or effectiveness of rule?
☐ Yes ☒ No If Yes, explain:

Purpose: New permanent rules are needed to implement Initiative 1183 that passed on November 8, 2011. Parts of the initiative became effective on December 8, 2011. New license types were created and the state of Washington changed from a controlled liquor system to a privatized liquor system. Emergency rules were adopted on December 7, 2011, and on April 4, 2012, to clarify the language in the new laws created in Initiative 1183. Permanent rules are needed to replace the emergency rules and further clarify the new laws.

Citation of existing rules affected by this order:
Repealed:
Amended: 314-28-010, 314-28-050, 314-28-060, 314-28-070, 314-28-080, 314-28-090

Statutory authority for adoption: RCW 66.08.030, RCW 66.24.055, RCW 66.24.160, RCW 66.24.630, RCW 66.24.640

Other authority :

PERMANENT RULE (Including Expedited Rule Making)
Adopted under notice filed as WSR 12-09-088 on April 18, 2012 (date).
Describe any changes other than editing from proposed to adopted version: None

If a preliminary cost-benefit analysis was prepared under RCW 34.05.328, a final cost-benefit analysis is available by contacting:

Name:
Address:

phone ( ) _____
fax ( ) _____
e-mail _____

Date adopted:
May 30, 2012

NAME (TYPE OR PRINT)
Sharon Foster

SIGNATURE
Sharon Foster

TITLE
Chairman

CODE REVISER USE ONLY

OFFICE OF THE CODE REVISER
STATE OF WASHINGTON
FILED

DATE: June 05, 2012
TIME: 12:49 PM

WSR 12-12-065

(COMPLETE REVERSE SIDE)

Note: If any category is left blank, it will be calculated as zero. No descriptive text.

Count by whole WAC sections only, from the WAC number through the history note. A section may be counted in more than one category.

The number of sections adopted in order to comply with:

Federal statute:	New	____	Amended	____	Repealed	____
Federal rules or standards:	New	____	Amended	____	Repealed	____
Recently enacted state statutes:	New	16	Amended	6	Repealed	0

The number of sections adopted at the request of a nongovernmental entity:

New	____	Amended	____	Repealed	____

The number of sections adopted in the agency's own initiative:

New	16	Amended	6	Repealed	0

The number of sections adopted in order to clarify, streamline, or reform agency procedures:

New	16	Amended	6	Repealed	0

The number of sections adopted using:

Negotiated rule making:	New	____	Amended	____	Repealed	____
Pilot rule making:	New	____	Amended	____	Repealed	____
Other alternative rule making:	New	____	Amended	____	Repealed	____

NEW SECTION

WAC 314-02-103 What is a wine retailer reseller endorsement? (1) A wine retailer reseller endorsement is issued to the holder of a grocery store liquor license to allow the sale of wine at retail to on-premises liquor licensees.

(2) No single sale to an on-premises liquor licensee may exceed twenty-four liters. Single sales to an on-premises licensee are limited to one per day.

(3) A grocery store licensee with a wine retailer reseller endorsement may accept delivery at its licensed premises or at one or more warehouse facilities registered with the board.

(4) The holder of a wine retailer reseller endorsement may also deliver wine to its own licensed premises from the registered warehouse; may deliver wine to on-premises licensees, or to other warehouse facilities registered with the board. A grocery store licensee wishing to obtain a wine retailer reseller endorsement that permits sales to another retailer must possess and submit a copy of their federal basic permit to purchase wine at wholesale for resale under the Federal Alcohol Administration Act. A federal basic permit is required for each location from which the grocery store licensee holding a wine retailer reseller endorsement plans to sell wine to another retailer.

(5) The annual fee for the wine retailer reseller endorsement is one hundred sixty-six dollars.

NEW SECTION

WAC 314-02-104 Central warehousing. (1) Each retail liquor licensee having a warehouse facility where they intend to receive wine and/or spirits must register their warehouse facility with the board and include the following information:

(a) Documentation that shows the licensee has a right to the warehouse property;

(b) If a warehouse facility is to be shared by more than one licensee, each licensee must demonstrate to the board that a recordkeeping system is utilized that will account for all wine and/or spirits entering and leaving the warehouse for each license holder. The system must also account for product loss;

(c) Licensees in a shared warehouse may consolidate their commitment for the amount of product they plan to order, but their orders must be placed separately and paid for by each licensee; and

(d) Alternatively, if the warehouse does not have a

recordkeeping system that provides the required information, wine and/or spirits for each licensee in a shared warehouse must be separated by a physical barrier. Where physical separation is utilized, a sketch of the interior of the warehouse facility must be submitted indicating the designated area the licensee will be storing product. (Example: If ABC Grocery and My Grocery, each licensed to a different ownership entity, both lease space in a warehouse facility, the wine and/or spirits must be in separate areas separated by a physical barrier.)

(2) Upon the request of the board, the licensee must provide any of the required records for review. Retail liquor licensees must keep the following records for three years:

(a) Purchase invoices and supporting documents for wine and/or spirits purchased;

(b) Invoices showing incoming and outgoing wine and/or spirits (product transfers);

(c) Documentation of the recordkeeping system in a shared warehouse as referenced in subsection (1)(b) of this section; and

(d) A copy of records for liquor stored in the shared warehouse.

(3) Each licensee must allow the board access to the warehouse for audit and review of records.

(4) If the wine and/or spirits for each licensee in a shared warehouse is not kept separate, and a violation is found, each licensee that has registered the warehouse with the board may be held accountable for the violation.

NEW SECTION

WAC 314-02-106 What is a spirits retailer license? (1) A spirits retailer licensee may not sell spirits under this license until June 1, 2012. A spirits retailer is a retail license. The holder of a spirits retailer license is allowed to:

(a) Sell spirits in original containers to consumers for off-premises consumption;

(b) Sell spirits in original containers to permit holders (see chapter 66.20 RCW);

(c) Sell spirits in original containers to on-premises liquor retailers, for resale at their licensed premises, although no single sale may exceed twenty-four liters, and single sales to an on-premises licensee are limited to one per day; and

(d) Export spirits in original containers.

(2) A spirits retailer licensee that intends to sell to another retailer must possess a basic permit under the Federal Alcohol Administration Act. This permit must provide for purchasing distilled spirits for resale at wholesale. A copy of the federal basic permit must be submitted to the board. A federal basic permit is required for each location from which the spirits retailer licensee plans to sell to another retailer.

(3) A sale by a spirits retailer licensee is a retail sale only if not for resale to an on-premises spirits retailer. On-premises retail licensees that purchase spirits from a spirits retail licensee must abide by RCW 66.24.630.

(4) A spirits retail licensee must pay to the board seventeen percent of all spirits sales. The first payment is due to the board October 1, 2012, for sales from June 1, 2012, to June 30, 2012 (see WAC 314-02-109 for quarterly reporting requirements).

Reporting of spirits sales and payment of fees must be submitted on forms provided by the board.

(5) The annual fee for a spirits retail license is one hundred sixty-six dollars.

NEW SECTION

WAC 314-02-107 What are the requirements for a spirits retail license? (1) The requirements for a spirits retail license are as follows:

(a) Submit a signed acknowledgment form indicating the square footage of the premises. The premises must be at least ten thousand square feet of fully enclosed retail space within a single structure, including store rooms and other interior areas. This does not include any area encumbered by a lease or rental agreement (floor plans one-eighth inch to one foot scale may be required by the board); and

(b) Submit a signed acknowledgment form indicating the licensee has a security plan which addresses:

(i) Inventory management;

(ii) Employee training and supervision; and

(iii) Physical security of spirits product with respect to preventing sales to underage or apparently intoxicated persons and theft of product.

(2) A grocery store licensee or a specialty shop licensee may add a spirits retail liquor license to their current license if they meet the requirements for the spirits retail license.

(3) The board may not deny a spirits retail license to qualified applicants where the premises is less than ten thousand square feet if:

(a) The application is for a former contract liquor store location;

(b) The application is for the holder of a former state liquor store operating rights sold at auction; or

(c) There is no spirits retail license holder in the trade area that the applicant proposes to serve; and

(i) The applicant meets the operational requirements in WAC 314-02-107 (1)(b); and

(ii) If a current liquor licensee, has not committed more than one public safety violation within the last three years.

NEW SECTION

WAC 314-02-109 What are the quarterly reporting and payment requirements for a spirits retailer license? (1) A **spirits retailer** must submit quarterly reports and payments to the board.

The required reports must be:

(a) On a form furnished by the board;

(b) Filed every quarter, including quarters with no activity or payment due;

(c) Submitted, with payment due, to the board on or before the twenty-fifth day following the tax quarter (e.g., Quarter 1 (Jan., Feb., Mar.) report is due April 25th). When the twenty-fifth day of the month falls on a Saturday, Sunday, or a legal holiday, the filing must be postmarked by the U.S. postal service no later than the next postal business day; and

(d) Filed separately for each liquor license held.

(2) **What if a spirits retailer licensee fails to report or pay, or reports or pays late?** If a spirits retailer licensee does not submit its quarterly reports and payment to the board as required in subsection (1) of this section, the licensee is subject to penalties.

A penalty of two percent per month will be assessed on any payments postmarked after the twenty-fifth day quarterly report is due. When the twenty-fifth day of the month falls on a Saturday, Sunday, or a legal holiday, the filing must be postmarked by the U.S. postal service no later than the next postal business day.

Chapter 314-23 WAC

SPIRITS DISTRIBUTORS, SPIRITS CERTIFICATE OF APPROVAL LICENSES, AND SPIRITS IMPORTERS

NEW SECTION

WAC 314-23-001 What does a spirits distributor license allow? (1) A spirits distributor licensee may not commence sales until March 1, 2012. A spirits distributor licensee is allowed to:

(a) Sell spirits purchased from manufacturers, distillers, importers, or spirits certificate of approval holders;

(b) Sell spirits to any liquor licensee allowed to sell spirits;

(c) Sell spirits to other spirits distributors; and

(d) Export spirits from the state of Washington.

(2) The price of spirits sold to retailers may not be below acquisition cost.

NEW SECTION

WAC 314-23-005 What are the fees for a spirits distributor license? (1) The holder of a spirits distributor license must pay to the board a monthly license fee as follows:

(a) Ten percent of the total revenue from all sales of spirits to retail licensees made during the month for which the fee is due for the first two years of licensure; and

(b) Five percent of the total revenue from all sales of spirits to retail licensees made during the month for which the fee is due for the third year of licensure and every year thereafter.

(c) The license fee is only calculated on sales of items which the licensee was the first spirits distributor in the state to have received:

(i) In the case of spirits manufactured in the state, from the distiller; or

(ii) In the case of spirits manufactured outside the state, from a spirits certificate of approval holder.

(d) Reporting of sales and payment must be submitted on forms provided by the board.

(2) The annual fee for a spirits distributor license is one thousand three hundred twenty dollars.

NEW SECTION

WAC 314-23-020 What are the requirements for a spirits distributor license? (1) In addition to any application requirements in chapter 314-07 WAC, applicants applying for a spirits distributor license must submit:

(a) A copy of all permits required by the federal government;

(b) Documentation showing the applicant has the right to the property;

(c) An acknowledgment form certifying the applicant has a security plan which addresses:

(i) Inventory management; and

(ii) Physical security of spirits product with respect to preventing theft.

(2) Spirits distributors must sell and deliver product from their licensed premises.

NEW SECTION

WAC 314-23-021 What are the monthly reporting and payment requirements for a spirits distributor license? (1) A **spirits distributor** must submit monthly reports and payments to the board.

(2) The required monthly reports must be:

(a) On a form furnished by the board;

(b) Filed every month, including months with no activity or payment due;

(c) Submitted, with payment due, to the board on or before the twentieth day of each month, for the previous month. (For example, a report listing transactions for the month of January is due by February 20th.) When the twentieth day of the month falls on a Saturday, Sunday, or a legal holiday, the filing must be postmarked by the U.S. Postal Service no later than the next postal business day; and

(d) Filed separately for each liquor license held.

NEW SECTION

WAC 314-23-022 What if a distributor licensee fails to report or pay, or reports or pays late? (1) If a spirits distributor licensee does not submit its monthly reports and payment to the board as required in WAC 314-23-021(1), the licensee is subject to penalties.

(2) A penalty of two percent per month will be assessed on any payments postmarked after the twentieth day of the month following the month of sale. When the twentieth day of the month falls on a Saturday, Sunday, or a legal holiday, the filing must be postmarked by the U.S. Postal Service no later than the next postal business day.

NEW SECTION

WAC 314-23-030 What does a spirits certificate of approval license allow? (1) A spirits certificate of approval licensee may not commence sales until March 1, 2012. A spirits certificate of approval license may be issued to spirits manufacturers located outside of the state of Washington but within the United States.

(2) A holder of a spirits certificate of approval may act as a distributor of spirits they are entitled to import into the state by selling directly to distributors or importers licensed in Washington state. The fee for a certificate of approval is two hundred dollars per year.

(3) A certificate of approval holder must obtain an endorsement to the certificate of approval that allows the shipment of spirits the holder is entitled to import into the state directly to licensed liquor retailers. The fee for this endorsement is one hundred dollars per year and is in addition to the fee for the certificate of approval license. The holder of a certificate of approval license that sells directly to licensed liquor retailers must:

(a) Report to the board monthly, on forms provided by the board, the amount of all sales of spirits to licensed retailers.

(b) Pay to the board a fee of ten percent of the total revenue from all sales of spirits to retail licensees made during the month for which the fee is due for the first two years of licensure.

(c) Pay to the board five percent of the total revenue from all sales of spirits to retail licensees made during the month for which the fee is due for the third year of licensure and every year thereafter.

(4) An authorized representative out-of-state spirits importer or brand owner for spirits produced in the United States but outside of Washington state may obtain an authorized representative certificate of approval license which allows the holder to ship spirits to spirits distributors, or spirits importers located in

Washington state. The fee for an authorized representative certificate of approval for spirits is two hundred dollars per year.

(5) An authorized representative out-of-state spirits importer or brand owner for spirits produced outside of the United States may ship spirits to licensed spirits distributors, or spirits importers located in Washington state. The fee for an authorized representative certificate of approval for foreign spirits is two hundred dollars per year.

NEW SECTION

WAC 314-23-040 What are the requirements for a certificate of approval license? The following documents are required to obtain a certificate of approval license:

(1) Copies of all permits required by the federal government;

(2) Copies of all state licenses and permits required by the state in which your operation is located; and

(3) Licensing documents as determined by the board.

NEW SECTION

WAC 314-23-041 What are the monthly reporting and payment requirements for a spirits certificate of approval licensee? (1) A spirits certificate of approval licensee must submit monthly reports and payments to the board.

(2) The required monthly reports must be:

(a) On a form furnished by the board;

(b) Filed every month, including months with no activity or payment due;

(c) Submitted, with payment due, to the board on or before the twentieth day of each month, for the previous month. (For example, a report listing transactions for the month of January is due by February 20th.) When the twentieth day of the month falls on a Saturday, Sunday, or a legal holiday, the filing must be postmarked by the U.S. Postal Service no later than the next postal business day; and

(d) Filed separately for each liquor license held.

NEW SECTION

WAC 314-23-042 What if a certificate of approval licensee fails to report or pay, or reports or pays late? (1) If a spirits certificate of approval licensee does not submit its monthly reports and payment to the board as required by this subsection (1), the licensee is subject to penalties.

(2) A penalty of two percent per month will be assessed on any payments postmarked after the twentieth day of the month following the month of sale. When the twentieth day of the month falls on a Saturday, Sunday, or a legal holiday, the filing must be postmarked by the U.S. Postal Service no later than the next postal business day.

NEW SECTION

WAC 314-23-050 What does a spirits importer license allow? (1) A spirits importer license is issued to an in-state spirits importer. A spirits importer is allowed to:

(a) Import spirits into the state of Washington;

(b) Store spirits in the state of Washington;

(c) Sell spirits to spirits distributors; and

(d) Export spirits in original containers.

(2) An out-of-state spirits importer is required to obtain an authorized representative certificate of approval license as referenced in WAC 314-23-030.

AMENDATORY SECTION (Amending WSR 10-19-066, filed 9/15/10, effective 10/16/10)

WAC 314-28-010 Records. (1) All distilleries licensed under RCW 66.24.140 and 66.24.145, including craft, fruit, and laboratory distillers must:

(a) ((~~Must~~)) Keep records ((~~concerning~~)) regarding any spirits, whether produced or purchased, for three years after each sale. A distiller ((~~may be~~)) is required to report on forms approved by the board;

(b) ((~~Must,~~)) In the case of spirits exported or sold, preserve all bills of lading and other evidence of shipment; ((~~and~~))

(c) ((~~Must~~)) Submit duplicate copies of transcripts, notices, or other data that ((~~are~~)) is required by the federal government to the board if requested, within thirty days of the notice of such request. A distiller shall also furnish copies of the bills of lading, covering all shipments of the products of the licensee, to the board within thirty days of notice of such request;

(d) Preserve all sales records to spirits retail licensees, sales to spirits distributors, and exports from the state; and

(e) Submit copies of its monthly records to the board upon request.

(2) In addition to the above, a craft distiller must:

(a) Preserve all sales records((~~, in the case~~)) of retail sales to consumers; and

(b) Submit ((~~duplicate copies of~~)) its monthly ((~~returns~~)) records to the board upon request.

NEW SECTION

WAC 314-28-030 Changes to the distiller and craft distiller license. (1) Beginning March 1, 2012, all distilleries licensed under RCW 66.24.140 and 66.24.145 may sell spirits of their own production directly to a licensed spirits distributor in the state of Washington and to a licensed spirits retailer in the state of Washington.

(2) Beginning June 1, 2012, a distiller may sell spirits of its own production to a customer for off-premises consumption, provided that the sale occurs when the customer is physically present at the licensed premises.

AMENDATORY SECTION (Amending WSR 10-19-066, filed 9/15/10, effective 10/16/10)

WAC 314-28-050 What does a craft distillery license allow? (1) A craft distillery license allows a licensee to:

(a) Produce sixty thousand proof gallons or less of spirits per calendar year. A "proof gallon" is one liquid gallon of spirits that is fifty percent alcohol at sixty degrees Fahrenheit;

(b) Sell spirits of its own production directly to a customer for off-premises consumption, provided that the sale occurs when the customer is physically present on the licensed premises. A licensee may sell no more than two liters per customer per day. A craft distiller may not sell liquor products of someone else's production;

(c) ((~~Sell spirits of its own production to the board provided that the product is "listed" by the board, or is special ordered by an individual Washington state liquor store~~)) For sales on or after March 1, 2012, sell spirits of its own production to a licensed spirits distributor;

(d) For sales on or after March 1, 2012, sell spirits of its own production to a licensed spirits retailer in the state of Washington;

((~~(d)~~)) (e) Sell to out-of-state entities;

((~~(e)~~)) (f) Provide, free of charge, samples of spirits of its own production to persons on the distillery premises. Each sample must be one-half ounce or less, with no more than two ounces of samples provided per person per day. Samples must be unaltered, and anyone involved in the serving of such samples must have a valid Class 12 alcohol server permit. Samples must be in compliance with RCW 66.28.040;

((~~(f)~~)) (g) Provide, free of charge, samples of spirits of its own production to retailers. Samples must be unaltered, and in compliance with RCW 66.28.040, 66.24.310 and WAC 314-64-08001. Samples are considered sales and are subject to taxes;

((~~(g)~~)) (h) Contract ((~~produced~~)) produce spirits for holders of a distiller or manufacturer license.

(2) A craft distillery licensee may not sell directly to in-state retailers or in-state distributors until March 1, 2012.

AMENDATORY SECTION (Amending WSR 10-19-066, filed 9/15/10, effective 10/16/10)

WAC 314-28-060 What are the general requirements for a craft distillery license? Per RCW 66.24.140 and 66.24.145, a craft distillery licensee is required to:

(1) Submit copies of all permits required by the federal government;

(2) Submit other licensing documents as determined by the

board;

(3) Ensure a minimum of fifty percent of all raw materials (including any neutral grain spirits and the raw materials that go into making mash, wort or wash) used in the production of the spirits product are grown in the state of Washington. Water is not considered a raw material grown in the state of Washington((~~;~~

~~(4) Purchase any spirits sold at the distillery premises for off-premises consumption from the board, at the price set by the board;~~

~~(5) Purchase any spirits used for sampling at the distillery premises from the board; and~~

~~(6) Purchase any spirits used for samples provided to retailers from the board~~)).

AMENDATORY SECTION (Amending WSR 10-19-066, filed 9/15/10, effective 10/16/10)

WAC 314-28-070 What are the monthly reporting and payment requirements for a distillery and craft distillery license? (1) A distiller or craft distiller must submit monthly reports and payments to the board.

The required monthly reports must be:

(a) On a form furnished by the board ((~~or in a format approved by the board~~));

(b) Filed every month, including months with no activity or payment due;

(c) Submitted, with payment due, to the board on or before the twentieth day of each month, for the previous month. (For example, a report listing transactions for the month of January is due by February 20th.) When the twentieth day of the month falls on a Saturday, Sunday, or a legal holiday, the filing must be postmarked by the U.S. postal service no later than the next postal business day; and

(d) Filed separately for each liquor license held.

(2) For reporting purposes, production is the distillation of spirits from mash, wort, wash or any other distilling material. After the production process is completed, a production gauge shall be made to establish the quantity and proof of the spirits produced. The designation as to the kind of spirits shall also be made at the time of the production gauge. A record of the production gauge shall be maintained by the distiller. The completion of the production process is when the product is packaged for distribution. Production quantities are reportable within thirty days of the completion of the production process.

(3) ((~~Payments to the board. A distillery must pay the difference between the cost of the alcohol purchased by the board and the sale of alcohol at the established retail price, less the established commission rate during the preceding calendar month,~~

~~including samples at no charge.~~)) On sales on or after March 1, 2012, a distillery or craft distillery must pay ten percent of their gross spirits revenue to the board on sales to a licensee allowed to sell spirits for on- or off-premises consumption during the first two years of licensure and five percent of their gross spirits revenues to the board in year three and thereafter.

(a) ((~~Any on-premises sale or sample provided to a customer is considered a sale reportable to the board.~~)) On sales after June 1, 2012, a distillery or craft distillery must pay seventeen percent of their gross spirits revenue to the board on sales to customers for off-premises consumption.

(b) ((~~Samples provided to retailers are considered sales reportable to the board.~~

~~(c)~~)) Payments must be submitted, with monthly reports, to the board on or before the twentieth day of each month, for the previous month. (For example, payment for a report listing transactions for the month of January is due by February 20th.) When the twentieth day of the month falls on a Saturday, Sunday, or a legal holiday, payment must be postmarked by the U.S. postal service no later than the next postal business day.

AMENDATORY SECTION (Amending WSR 09-02-011, filed 12/29/08, effective 1/29/09)

WAC 314-28-080 What if a distillery or craft distillery licensee fails to report or pay, or reports or pays late? If a distillery or craft distiller ((~~fails to~~)) does not submit its monthly reports ((~~or~~)) and payment to the board((~~, or submits late, then~~)) as required in WAC 314-28-070(1), the licensee is subject to penalties ((~~and surety bonds~~)).

((~~(1)~~)) Penalties. A penalty of two percent per month will be assessed on any payments postmarked after the twentieth day of the month following the month of sale. When the twentieth day of the month falls on a Saturday, Sunday, or a legal holiday, the filing must be postmarked by the U.S. postal service no later than the next postal business day.

((~~(2) Surety bonds. A "surety bond" is a type of insurance policy that guarantees payment to the state, and is executed by a surety company authorized to do business in the state of Washington. Surety bond requirements are as follows:~~

~~(a) Must be on a surety bond form and in an amount acceptable to the board;~~

~~(b) Payable to the "Washington state liquor control board"; and~~

~~(c) Conditioned that the licensee will pay the taxes and penalties levied by RCW 66.20.040 and by all applicable WACs.~~

~~(3) The board may require a craft distillery to obtain a surety bond or assignment of savings account, within twenty-one~~

~~days after a notification by mail, if any of the following occur:~~

~~(a) A report or payment is missing more than thirty days past the required filing date, for two or more consecutive months;~~

~~(b) A report or payment is missing more than thirty days past the required filing date, for two or more times within a two-year period; or~~

~~(c) Return of payment for nonsufficient funds.~~

~~(4) As an option to obtaining a surety bond, a licensee may create an assignment of savings account for the board in the same amount as required for a surety bond. Requests for this option must be submitted in writing to the board's financial division.~~

~~(5) The amount of a surety bond or savings account required by this chapter must be either three thousand dollars, or the total of the highest four months' worth of liability for the previous twelve month period, whichever is greater. The licensee must maintain the bond for at least two years.~~

~~(6) Surety bond and savings account amounts may be reviewed annually and compared to the last twelve months' tax liability of the licensee. If the current bond or savings account amount does not meet the requirements outlined in this section, the licensee will be required to increase the bond amount or amount on deposit within twenty one days.~~

~~(7) If a licensee holds a surety bond or savings account, the board will immediately start the process to collect overdue payments from the surety company or assigned account. If the exact amount of payment due is not known because of missing reports, the board will estimate the payment due based on previous production, receipts, and/or sales.~~))

AMENDATORY SECTION (Amending WSR 10-19-066, filed 9/15/10, effective 10/16/10)

WAC 314-28-090 Distilleries or craft distilleries((~~--Selling in state, retail pricing and product listing~~))--Selling out-of-state((~~--Special orders~~)). ((~~(1) What steps must a craft distillery licensee take to sell a spirits product in the state of Washington?~~

~~(a) There are two ways to sell a spirits product at a state liquor store:~~

~~(i) Through the special order process; and~~

~~(ii) Through product listing.~~

~~(b) If a craft distillery licensee wants the board to regularly stock its product on the shelf at a state liquor store, a licensee must request the board to list its product. If the board agrees to list the product, a licensee must then sell its product to the board and transport its product to the board's distribution center.~~

~~(c) Before a craft distillery licensee may sell its product to~~

~~a customer (twenty-one years old or older) at its distillery premises, a licensee must:~~

~~(i) Obtain a retail price from the board;~~

~~(ii) Sell its product to the board; and~~

~~(iii) Purchase its product back from the board. Product that a licensee produces and sells at its distillery premises is not transported to the board's distribution center.~~

~~(d) *Listing a product.* A craft distillery licensee must submit a formal request to the board to have the board regularly stock its product at a state liquor store. The board's purchasing division administers the listing process.~~

~~(i) A licensee must submit the following documents and information: A completed standard price quotation form, a listing request profile, bottle dimensions, an electronic color photograph of the product, a copy of the federal certificate of label approval, and a signed "tied house" statement.~~

~~(ii) The purchasing division shall apply the same consideration to all listing requests.~~

~~(iii) A craft distillery licensee is not required to submit a formal request for product listing if a licensee sells its product in-state only by special order (see chapter 314-74 WAC).~~

~~(e) *Obtaining a retail price.* A craft distillery licensee must submit a pricing quote to the board forty-five days prior to the first day of the effective pricing month. A pricing quote submittal includes a completed standard price quotation form, and the product's federal certificate of label approval. The board will then set the retail price.~~

~~(i) Pricing may not be changed within a calendar month.~~

~~(ii) A craft distillery licensee is required to sell to its on-premises customers at the same retail price as set by the board. If and when the board offers a temporary price reduction for a period of time, a licensee may also sell its product at the reduced price, but only during that same period of time.~~

~~(2)~~)) **What are the requirements for a craft distillery licensee to sell its spirits product outside the state of Washington?**

((~~(a)~~)) (1) A distillery or craft distillery licensee shall include, in its monthly report to the board, information on the product it produces in-state and sells out-of-state. Information includes, but is not limited to, the amount of proof gallons sold, and for a craft distillery, the composition of raw materials used in production of the product.

((~~(b)~~)) (2) Product produced in-state and sold out-of-state counts toward a craft distillery licensee's sixty thousand proof gallons per calendar year production limit (see WAC 314-28-050).

((~~(c)~~)) (3) Product produced in-state and sold out-of-state is subject to the fifty percent Washington grown raw materials requirement for a craft distillery.

((~~(d) Product sold out-of-state is not subject to retail pricing by the board.~~

~~(e)~~)) (4) A distillery or craft distillery licensee is not subject to Washington state liquor taxes on any product the

licensee sells out-of-state.

Washington State
Liquor Control Board

Notice of Permanent Rules to Implement I-1183 – Explanatory Statement

This explanatory statement concerns the **Washington State Liquor Control Board's adoption of rules to implement Initiative 1183.**

The Administrative Procedure Act (RCW 34.05.325(6)) requires agencies to complete a concise explanatory statement before filing adopted rules with the Office of the Code Reviser. This statement must be provided to anyone who gave comment about the proposed rule making.

Once persons who gave comment during this rule making have had a chance to receive this document, the Liquor Control Board will file the amended rules with the Office of the Code Reviser. These rule changes will become effective 31 days after filing (approximately July 6, 2012).

The Liquor Control Board appreciates your involvement in this rule making process. If you have any questions, please contact Karen McCall, Rules Coordinator, at (360) 664-1631 or e-mail at rules@liq.wa.gov.

What are the agency's reasons for adopting these rules?

Initiative 1183 was passed by the voters on November 8, 2011. New license types were created and additional privileges are allowed for current license types. Rules are needed to implement and clarify changes made by Initiative 1183.

Summary of all public comments received on this rule proposal.

The Liquor Control Board received eighteen comments on the proposed permanent rules at the public hearing on May 24, 2012, and received two hundred ninety-four written comments during the comment period that ended May 30, 2012.

Comments from Public Hearing:

WAC 314-02-106 (4): The following people commented on the 17% license issuance fee that spirits retail licensees must pay on all spirits sales. The commenters stated that former contract liquor stores and successful bidders of former state liquor stores should not be required to pay the 17% license issuance fee on retail-to-retail sales. There was also comment that no spirits retailer licensee should pay 17% license issuance fees on retail-to-retail sales.

- Rob Kauffman – CLS owner and member of the Lincoln County Board of Commissioners.
- Trent House – Representing former CLS, Clear View Spirits & Wine.
- Jerry McAlpine – CLS owner.
- Anthony Thieland – successful bidder of former state liquor store.
- Ian Murphy – Small restaurant owner.
- Katherine Degorty – CLS in Port Hadlock.
- Julia Clark – Washington Restaurant Association.
- Natalie Murphy – CLS in Greenacres.
- Julian Mark – CLS 147, Lake Chelan.
- Mike Thieland – successful bidder of former state liquor store.
- Bonnie Ralston – CLS owner
- Jeannie Weston – CLS 639.

LCB response: The language in RCW 66.24.630 (4) states, "Each spirits retail licensee must pay to the board, for deposit into the liquor revolving fund, a license issuance fee equivalent to seventeen percent of all spirits sales revenues under the license, exclusive of taxes collected by the licensee and of sales of items on which a license fee payable under this section has otherwise been incurred. The board must establish rules setting forth the timing of such payments and reporting of sales dollar volume by the licensee, with payments required quarterly in arrears. The first payment is due October 1, 2012. The language does not include any basis for the board to exempt any retail-to-retail-sales from the 17% license issuance fee required by the law.

WAC 314-02-103 (2) and WAC 314-02-106 (1) (c): The following people commented on the 24 liter limit per sale per on-premises licensee per day rules for wine and spirits. Numerous written comments were also received on this rule.

- Lynne Omlie – DISCUS. Supported the per day limit.
- Andy Thieland – Successful bidder of former state liquor store. Opposes the per day limit.
- Holly Chisa – NWGA – Opposes the per day limit.

- Julia Clark – WRA. Opposes the per day limit.
- Bruce Beckett – WRA. Opposes the per day limit.
- John Guadnola – WBWWA – Supports the per day limit.

LCB response: The emergency rules adopted by the board simply repeated the language of the initiative that included the 24 liter limitation. In response to the emergency rules, the board received comments that suggested the rule should be more specific, such as limiting the retail-to-retail sales to one every twenty-four hours, or other limitation, such as requiring each sale to be completed and the product removed from the store before another transaction could be made.
The board set this matter for a work session at the February 22, 2012, board meeting and received numerous comments. Some of the comments asserted that the board has no authority to impose a limitation and that the "twenty-four liters per sale" language is clear.
Testimony at the board work session certainly supports the view that a limitation of some kind was intended, and that the inclusion of a limit on the amount of spirits and wine that may be sold in a retail-to-retail transaction was intended to be a meaningful limitation. Although I-1183 amends the powers of the Liquor Control Board, the board clearly has authority to do rulemaking that affects how licensees may sell liquor:

RCW 66.08.030 *"The power of the board to make regulations under chapter 34.05 RCW extends to:*

- *(6) Regulating the sale of liquor kept by the holders of licenses which entitle the holder to purchase and keep liquor for sale;*
- *(12) 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;*

Together these sections referenced above clearly show that the board has the authority to adopt rules governing the sale of liquor by licensees, including a clarification or further limitation on sales.

WAC 314-23-030. The following people commented on the restriction that an authorized representative US spirits COA and an authorized representative foreign spirits COA are not allowed to sell directly to a sprits retail licensee in Washington State.

- Lynne Omlie – DISCUS. Opposes the rule that does not allow authorized representative spirits COAs from selling directly to Washington retailers.
- C.J.Healy – Spirits Canada. Opposes the rule that does not allow authorized representative spirits COAs from selling directly to Washington retailers. This

rule may be inconsistent with Washington State's international trade obligations under NAFTA.

LCB response: RCW 66.24.640 (section 206 of the initiative), states in part, "The board must by rule provide for issuance of certificates of approval to spirits suppliers." Rules were created for three types of spirits COA licenses based on the language in the new law. These new COA licenses are consistent with the authority provided to beer and wine COA licenses. Only an actual spirits manufacturer licensed as a Spirits COA with a direct sale to retail endorsement is allowed to sell directly to spirits retailers in the State of Washington.

WAC 314-02-106 (3). One person commented on the requirement in RCW 66.24.630 (2) that on-premises spirits licensees that purchase spirits from a spirits retail licensee are required to submit a quarterly report should include providing the report to all spirits suppliers, not just distributors and distillers acting as a distiller:

The board must establish by rule an obligation of on-sale spirits retailers to:

(a) Maintain a schedule by stock-keeping unit of all their purchases of spirits from spirits retail licensees, indicating the identity of the seller and the quantities purchased; and

(b) Provide, not more frequently than quarterly, a report for each scheduled item containing the identity of the purchasing on-premise licensee and the quantities of that scheduled item purchased since any preceding report to:

(i) A distributor authorized by the distiller to distribute a scheduled item in the on-sale licensee's geographic area; or

(ii) A distiller acting as distributor of the scheduled item in the area.

- Lynne Omilie – DISCUS.

LCB response. The law is clear and requires no language to clarify.

General comment. We thought the initiative was intended to create a competitive marketplace. My prices for product are going up, not down.

- Max Mesmer – Alderbrook resort.

LCB response. The initiative did create a competitive marketplace. Retailers are allowed to purchase spirits and wine directly from manufacturers, distributors, and off-

premises retailers holding the required licenses or endorsements. Uniform prices were repealed and quantity discounts are allowed for spirits and wine.

Written comments.

Additional written comments address several proposed rules. They are addressed individually below:

Wine retailer reseller endorsement. WAC 314-02-103 (2): No single sale to an on-premises liquor licensee may exceed twenty-four liters. Single sales to an on-premises licensee are limited to one per day.

Spirits retailer license. WAC 314-02-106 (1)(c): Sell spirits in original containers to on-premises liquor retailers, for resale at their licensed premises, although no single sale may exceed twenty-four liters, and single sales to an on-premises licensee are limited to one per day.

- Numerous comments were received opposing the per day limit on retail-to-retail sales of wine and spirits.

LCB response: The emergency rules adopted by the board simply repeated the language of the initiative that included the 24 liter limitation. In response to the emergency rules, the board received comments that suggested the rule should be more specific, such as limiting the retail-to-retail sales to one every twenty-four hours, or other limitation, such as requiring each sale to be completed and the product removed from the store before another transaction could be made.
The board set this matter for a work session at the February 22, 2012, board meeting and received numerous comments. Some of the comments asserted that the board has no authority to impose a limitation and that the "twenty-four liters per sale" language is clear.
Testimony at the board work session certainly supports the view that a limitation of some kind was intended, and that the inclusion of a limit on the amount of spirits and wine that may be sold in a retail-to-retail transaction was intended to be a meaningful limitation. Although I-1183 amends the powers of the Liquor Control Board, the board clearly has authority to do rulemaking that affects how licensees may sell liquor:

RCW 66.08.030 *"The power of the board to make regulations under chapter 34.05 RCW extends to:*

- *(6) Regulating the sale of liquor kept by the holders of licenses which entitle the holder to purchase and keep liquor for sale;*
- *(12) 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;*

Together these sections referenced above clearly show that the board has the authority to adopt rules governing the sale of liquor by licensees, including a clarification or further limitation on sales.

WAC 314-02-106 (4): A spirits retail licensee must pay to the board seventeen percent of all spirits sales.

- Numerous comments were received that former contract liquor stores and successful bidders of former state liquor stores should not be required to pay the 17% license issuance fee on retail-to-retail sales. There were also comments that no spirits retailer licensee should pay 17% license issuance fees on retail-to-retail sales. There was also a comment that the word "sales" should be changed to the word "revenues" as used in the initiative.

LCB response: The language in RCW 66.24.630 (4) states, "Each spirits retail licensee must pay to the board, for deposit into the liquor revolving fund, a license issuance fee equivalent to seventeen percent of all spirits sales revenues under the license, exclusive of taxes collected by the licensee and of sales of items on which a license fee payable under this section has otherwise been incurred. The board must establish rules setting forth the timing of such payments and reporting of sales dollar volume by the licensee, with payments required quarterly in arrears. The first payment is due October 1, 2012." The language does not include any basis for the board to exempt retail-to-retail-sales from the 17% license issuance fee required by the law. The board feels the use of the word "sales" is appropriate.

WAC 314-23-001 (2) The price of spirits sold to retailers may not be below acquisition cost.

- Comment was received that the rule does not include the exception in RCW 66.24.330 (1) that states: No price for spirits sold in the state by a distributor or other licensee acting as a distributor pursuant to this title may be below acquisition cost unless the item sold below acquisition cost has been stocked by the seller for a period of at least six months. The seller may not restock the item

for a period of one year following the first effective date of such below cost price.

LCB response: The exception in RCW 66.24.330 is clear and does not require a rule to clarify. There are numerous exceptions in law that do not have clarification in rule. The rule does not forbid what the statute allows..

WAC 314-23-030. What does a spirits certificate of approval license allow?

- Several comments were received that manufacturers located outside of the US should not be excluded from obtaining a Spirits COA license. All persons holding a Spirits COA license should be allowed to obtain a direct shipment endorsement and sell directly to a retailer located in Washington state.

LCB response: RCW 66.24.640 states, "Any distiller licensed under this title may act as a retailer and/or distributor to retailers selling for consumption on or off the licensed premises of spirits of its own production, and any manufacturer, importer, or bottler of spirits holding a certificate of approval may act as a distributor of spirits it is entitled to import into the state under such certificate. The board must by rule provide for issuance of certificates of approval to spirits suppliers."
The language of the new law required the board to create "certificates" (plural) of approval for spirits. Since the board was directed to create certificates, to be consistent, the board created the same certificates for spirits that are currently in law for wineries and breweries.

WAC 314-23-030 (3)(b) Pay to the board a fee of ten percent of the total revenue from all sales of spirits to retail licensees made during the month for which the fee is due for the first two years of licensure.

- Comments were received that distillers and spirits COA holders selling direct to retailers should not be required to pay the board 10% of the total revenue from all sales of spirits to retail licensees.

LCB response: RCW 66.24.640 states, "An industry member operating as a distributor and/or retailer under this section must comply with the applicable laws and rules relating to distributors and/or retailers." Based on the language of the new law, a distillery or spirits COA is required to pay the 10% fee on sales to retailers. A distillery is also required to pay the 17% fee on sales to retailers. ESB 6635, passed in the 2012 legislative session, exempted craft distilleries from paying the 17% fee on retail sales.

WAC 314-23-050. What does a spirits importer license allow?

- Comments were received that a spirits importer license should allow direct sales to retailers if they hold a direct shipment endorsement.

LCB response. The initiative did not change what a spirits importer was allowed to do prior to the initiative in RCW 66.24.160. The law states, "A spirits importer's license may be issued to any qualified person, firm or corporation, entitling the holder thereof to import into the state any liquor other than beer or wine; to store the same within the state, and to sell and export the same from the state." There is no allowance to sell to retailers.

WAC 314-02-103 (4) The holder of a wine retailer reseller endorsement may also deliver wine to its own licensed premises from the registered warehouse; may deliver wine to on-premises licensees, or to other warehouse facilities registered with the board.

- Comments were received that the rule does not include the provision in the law, RCW 66.24.360 (8), which allows delivery of wine to "lawful purchasers outside the state".

LCB response: The law is clear and does not require a rule to clarify.

WAC 314-02-104 (c). Licensees in a shared warehouse may consolidate their commitment for the amount of product they plan to order, but their orders must be placed separately and paid for by each licensee.

- Comments were received stating the only limitations imposed on members of the the group are the limitations applicable individually and registration. The efficiency of consolidated warehousing logically extends to consolidated ordering and payment.

LCB response: There is no liquor license for a "cooperation, association, or comparable group of retailers". The initiative did not create such a license either, thus a cooperative or association may not purchase liquor on behalf of the members. An entity must hold a liquor license to purchase alcohol for resale. The board worked with stakeholders to create a solution that would work for all licensees interested in central warehousing.

WAC 314-23-020 (2). Spirits distributors must sell and deliver product from their licensed premises.

- Comments were received that the initiative does not direct the board to promulgate rules in this area, and there is no statutory authority for this limitation.

LCB response: ***RCW 66.08.030*** *"The power of the board to make regulations under chapter 34.05 RCW extends to:*

- *(6) Regulating the sale of liquor kept by the holders of licenses which entitle the holder to purchase and keep liquor for sale;*
- *(12) 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;*

Together these sections referenced above clearly show that the board has the authority to adopt rules governing the sale of liquor by licensees, including a clarification or further limitation on sales.

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☐ EXPEDITE
☐ No Hearing Set
☑ Hearing is Set:
Date: 4/4/2013
Time: 9:00 AM
The Honorable Erik D. Price

STATE OF WASHINGTON
THURSTON COUNTY SUPERIOR COURT

WASHINGTON RESTAURANT ASSOCIATION, a Washington non-profit organization; NORTHWEST GROCERY ASSOCIATION, a non-profit organization; and COSTCO WHOLESALE CORPORATION, a Washington corporation, Petitioners, v. WASHINGTON STATE LIQUOR CONTROL BOARD, a state agency; CHRIS MARR, SHARON FOSTER, and RUTHANN KUROSE, in their official capacities as members of the Washington State Liquor Control Board, Respondents, and WASHINGTON BEER & WINE DISTRIBUTORS ASSOCIATION, Intervenors.	NO. 12-2-01312-5 BRIEF OF RESPONDENTS WASHINGTON STATE LIQUOR CONTROL BOARD, CHRIS MARR, SHARON FOSTER AND RUTHANN KUROSE, MEMBERS

I. INTRODUCTION

This is a proceeding brought under Ch. 34.05 RCW, challenging rules adopted by the Liquor Control Board (Board) to implement Initiative 1183 (I-1183).[1] I-1183 was approved by

[1] The Washington State Liquor Control Board will be referred to in this brief as the "Board". Initiative 1183 will be referred to as "I-1183." The Certified Rulemaking File, as supplemented by agreement of the parties, will be referred to using the LCB000 or LCB2000 series of numbers for the documents included in the record as certified by the Board, and as "Supp" followed by the appropriate page numbers for the documents added by supplementing the record, or as LCB5000, as appropriate.

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Washington voters in November 2011. Initiative 1183 required the Board to adopt rules to create new types of licenses and application forms, act on applications for the new licenses quickly, and to close all state-run liquor stores no later than May 31, 2012.[2] Respondents Board and the Board members submit this brief in Response to the Opening Brief of Petitioners. In addition to the argument and authority in this Brief, Respondents adopt and incorporate the arguments and authorities in Respondent-Intervenors' Response Brief.

Petitioners, led by Costco, who drafted and funded the campaign in favor of I-1183, sought to create a marketplace advantage for itself for sales of spirits and wine, but failed to write many aspects of the new law to actually accomplish their goal. Petitioners now chafe at their inability to completely control the actions of the Liquor Control Board, despite their extensive lobbying of the Board members during the rulemaking process.[3] Petitioners challenge the rules adopted by the Board based on their "intent" in the drafting of the language of the Initiative, ignoring the actual language and how it must be construed in conjunction with the rest of Title 66 RCW. They seize on occasional suggestions from other stakeholders about the Board's proposed rule language to accuse the Board of bias in favor of those other stakeholders, despite clear evidence that the Board's rules impose regulatory restrictions on many types of licensees. The Board was handed an incredibly complex series of tasks to complete in the six months after the law took effect, and worked hard to complete

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[2] The document in the record at LCB00001814-1817 lists tasks the Board needed to accomplish in order to implement I-1183, as well as the "key dates" on which the law authorized or required certain actions or authorities to take effect.

[3] For example, the certified record at CR LCB00001372-1379 shows that Board member Marr engaged in an email dialogue with Julia Clark and Bruce Beckett, on or about March 1, 2012. LCB00001789 references a contact between Pat Kohler, the Board's Administrative Director, and Greg Hanon, Costco's lobbyist, that Ms. Kohler's email references she shared with the Board members at the EMT meeting. Ms. Clark provided another "followup" email on March 8, LCB00002363-66. Representatives of Petitioners, in particular, took advantage of the willingness of the Board, and Board staff, to engage in a dialogue about the proposed rules. Julia Clark and Bruce Beckett, representing Petitioner Washington Restaurant Association, and Greg Hanon, Costco's lobbyist, engaged in lengthy email discussions about the proposed rules, and, in particular, the proposed 24 liter limit. See LCB00000168-173; LCB00000174-176.

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all the required tasks efficiently and fairly. The Board's statement on the day after the election, expressing disappointment with the results,[4] does not demonstrate any bias on the part of the Board, but is simply an expression of genuine human emotion at the prospect of having to terminate the employment of over 900 employees, many of whom had worked for the Board their entire career. Petitioners have failed to show any bias or prejudice on the part of the Board. The challenges should be rejected, and the case dismissed.

II. FACTS

The Parties have filed a Joint Statement of Facts as directed by the court. In addition to the stipulated facts, other uncontroverted facts can be gleaned from the certified record. Attached as Exhibit A to the Declaration of Mary M. Tennyson (Tennyson Decl.) is a timeline of events related to the Board's implementation of I-1183, including a listing of the numerous opportunities for public comment and input on the Board's proposed rules. Petitioners attempt to paint the Board as acting precipitously to adopt the first set of permanent rules to implement I-1183, yet Costco itself requested an extension of the deadline for comments on the rules adopted on June 5, 2012, waiting until May 24 to submit its lengthy comments.[5] Representatives of Petitioners themselves met with the Board members in the supposed "closed door" meetings.[6] Throughout their Opening Brief, Petitioners sprinkle references to the Board's supposed concerns about the impact of the rules on certain industry members as "valued stakeholders" or the "rights" or "privileges" but these comments do not show that the

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[4] *See* Connelly Decl. Ex. D.

[5] The Board received very few comments after the May 24 hearing; May 23 was the original deadline for comments on the rules adopted on June 5, 2012. *See* LCB00000602-952 (Costco comments); LCB00001777-8;

[6] Julia Clark and Bruce Beckett represent the Washington Restaurant Association. Ms. Clark sent emails to the Board on December 2 and 7, 2011, (See LCB00002619-2624). The Board met with Ms. Clark and Mr. Beckett and Costco's lobbyist, Greg Hanon, on February 28, 2012 during the Board Caucus meeting time. LCBS000010-16. Board Caucus meetings and Executive Management Team (EMT) meetings are open to the public, although most members of the public attend only the more formal weekly Board meetings held on Wednesday mornings. Exhibit B to the Tennyson Decl. is a copy of the Board's published schedule of public meetings for 2011 and 2012. LCB00000099, a January 11, 2012 email from Greg Hanon references his meeting with Board staff.

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Board was biased in favor of, or against, any business or group of licensees[7]. The Board followed rulemaking procedures, and exceeded the notice requirements, providing advance email copies of draft rules prior to the official publication, even though not required by statute.

Under Ch. 34.05 RCW, agencies that adopt rules must first file a "Preproposal Statement of Inquiry" on Code Reviser form CR 101, to solicit comments from the public on the general topic that the rules will address. After a period of 30 days, the agency may file a CR 102, which includes the proposed rule language. The CR 102 notice informs stakeholders and members of the public of the deadline for submitting written comments on the proposed rule language, how they may submit comments, the date of a hearing or hearings to take in-person public testimony, and the date the agency intends to adopt the rule. The actual adoption of the rule is filed on form CR 103. Each of these documents is filed for publication in the Washington State Register (WSR) and the Board's rulemaking coordinator also emails the documents to all persons requesting notice of rulemaking. The WSR is published periodically, so the "filed" date shown on a WSR notice is normally some period of days before the official publication date. Exhibit A to Tennyson Decl. lists the notices and dates.

Petitioners accuse the Board of "complaining" about I-1183 (Opening Brief at p. 6, line 41) but even the reference they provide fails to prove the point. Contrary to Petitioner's assertions, I-1183 was not a "complete rejection" of the historical model of control over liquor

[7] Petitioners also assert that the Board members deliberated in secret on the challenged rules. The only support for this statement is one email exchange, on a topic unrelated to the challenged rules, in which two Board members' personal email addresses appear. *Opening Brief p. 9, l. 46-47.* Notably, the email in question was also sent to the Board email address for one of the Board members. The email provides no support for this specious assertion, apparently made to undermine the credibility of the Board members, or to show bias against Petitioners. Not all discussions in Board meetings are tape recorded, and fewer are transcribed. Simply because Petitioners found no tangible record of Board deliberations that meet their expectations does not mean the Board deliberated in secret. The record contains many emails in which the Board members engaged in a dialogue with representatives of Petitioners, which refutes their assertion that the Board members denied them access, in favor of meetings with distributors.

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sales. I-1183 did provide exceptions to certain aspects of the "tied house" laws, but kept many of the restrictions of activities between the manufacturing, wholesale distribution, and retail tiers intact.[8]

III. ARGUMENT

A. Standard of Review of Agency Rules and Statutory Construction

1. A party challenging rules adopted by an agency bears the burden of demonstrating the rules are invalid.

Where the legislature gives specific rulemaking power to an agency, the rules are presumed valid. *Anderson, Leech and Morse, Inc. v. WSLCB*, 89 Wn.2d 688, 695, 575 P.2d 221 (1978), citing to *Weyerhaeuser Co. v. Dept. of Ecology*, 86 Wn.2d 310, 545 P.2d 5 (1976); *Lindsay v. Seattle*, 86 Wn.2d 698, 548 P.2d 320 (1976). The person claiming a rule is invalid has the burden of proof, and the rules only need to be reasonably consistent with the statutes they implement. Parties should not ask the court to substitute its judgment for that of the agency acting within its statutory powers. *Anderson*, supra, at 695, citing to *Weyerhaeuser, supra,* 86 Wn.2d at 317. RCW 34.05.570(1) provides:

RCW 34.05.570--Judicial review.

> (1) Generally. Except to the extent that this chapter or another statute provides otherwise:
> (a) The burden of demonstrating the invalidity of agency action is on the party asserting invalidity;
> (b) The validity of agency action shall be determined in accordance with the standards of review provided in this section, as applied to the agency action at the time it was taken;
> (c) The court shall make a separate and distinct ruling on each material issue on which the court's decision is based; and

[8] The statement made by Rick Garza, Deputy Director of the Board, referenced at page 6, line 9-10 of the Opening Brief, is not an acknowledgement that the three-tier system no longer exists, as Petitioner represents. LCBS00052 is notes of a discussion in an EMT meeting, where the topic was whether and how to modify the Liquor Control Board's Mission and Vision statements, with the elimination of the Board's role as the sole seller of packaged spirits in Washington. Mr. Garza's statement was actually phrased as a question, not a statement of fact. The line starts out "Is that an old term . . ." but does not end with a question mark in the draft meeting notes. *See* ER-50(LCBS000052). This certainly is not an admission of the Board, or interpretation of a statute, that has any bearing on the interpretation of the law in this case.

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> (d) *The court shall grant relief only if it determines that a person seeking judicial relief has been substantially prejudiced by the action complained of.*

(*emphasis added).* RCW 34.05.570(2)(c) sets the standard for review of the validity of a rule, and provides:

> (c) In a proceeding involving review of a rule, the court shall declare the rule invalid only if it finds that: The rule violates constitutional provisions; the rule exceeds the statutory authority of the agency; the rule was adopted without compliance with statutory rule-making procedures; or the rule is arbitrary and capricious.

Petitioners have not shown that they have been substantially prejudiced by the Board's alleged violation of rulemaking procedures or the substance of the Board's rules, as required by RCW 34.05.570(1)(d). In addition, Petitioners have failed to prove that the rules violate constitutional provisions, exceed the Board's statutory authority, or are arbitrary or capricious. Thus, the court should not grant the requested relief.

2. Liquor Control Board's Interpretation of the Liquor Laws is entitled to deference.

Petitioner cites *Washington Public Ports Association v Department of Revenue,* 148 Wn.2d 637, 645, 62 P. 2d 462 (2003) for the proposition that court should give the agency's interpretation of the statutes no deference, because the construction and meaning of a statute is a question of law. However, the Court in that case also stated that if, after a "plain meaning" analysis of a statute (which includes both the ordinary meaning of words and the legislative purposes and closely related statutes) the statute still remains susceptible to more than one reasonable meaning, the court will find the statute to be ambiguous and resort to aids to statutory construction. *WPPA,* 148 Wn.2d at 645-646.

The Board has not acted outside its authority by interpreting I-1183 to conform with provisions of preexisting laws regulating the sale of liquor that I-1183 did not amend. As the court in *WPPA* found, although agencies cannot adopt rules that amend or change legislative enactments, agencies *can* "fill in the gaps" in legislation, and the court will defer to the

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agency's judgment. In finding the agency in that case did not exceed its statutory authority nor violate the state constitution, the Court stated: "We presume that administrative rules adopted pursuant to a legislative grant of authority are valid, and we will uphold such rules if they are reasonably consistent with the controlling statute." The Court held that the agency did not exceed its statutory authority nor violate the state constitution. *WPPA*, 148 Wn.2d at 646.

In reviewing a challenge to the interpretation or application of a statute, the court looks first to the plain language of the statute. If the language of a statute is not ambiguous, there is no need for judicial interpretation. *State v. Alvarez*, 128 Wn.2d 1, 11, 904 P.2d 754 (1995); *Maxwell v. Dep't of Labor & Indus.*, 25 Wn. App. 202, 208-209, 607 P.2d 310 (1980). However, a statute is ambiguous if it can reasonably be interpreted in more than one way. *Vashon Island v. Boundary Review Bd.*, 127 Wn.2d 759, 771, 903 P.2d 953 (1995); *In re Sehome Park Care Center*, 127 Wn.2d 774, 778, 903 P.2d 443 (1995); *State v. Hofer*, 86 Wn. App. 497, 942 P.2d 979 (1997). A court should avoid a literal reading of a statute if the literal meaning "would result in unlikely, absurd, or strained consequences." *Tenino Aerie v. Grand Aerie*, 148 Wn.2d 224, 239, 59 P.3d 655 (2002).

3. Courts defer to an agency's construction of a statute where the agency has expertise in construing the laws it administers.

Deference to an agency's construction of a statute it is charged with administering is appropriate where an administrative agency's construction of statute is within its field of expertise. *Thurston County v. Cooper Point Ass'n*, 148 Wn.2d 1, 15 (2002). In this case, the Liquor Control Board has been administering Title 66 RCW, as frequently amended over the years, since 1934. One area of the liquor laws that is unique is referred to as the "tied-house" laws. The regulation of liquor, since the repeal of Prohibition, is delegated to the states through the 21st Amendment to the US Constitution. The majority of states have maintained a system

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of control over manufacturers, distributors, and retailers of liquor that prevents one person or legal entity from controlling both the supply and retail sale of liquor, to prohibit undue influence between the tiers (supplier over retailer, or retailer over supplier). While the "tied-house" laws in Washington have been modified or loosened over the years, they are by no means non-existent. These laws are codified in RCW 66.28.285 through RCW 66.28.320, and the actions of those who obtain the newly created licenses must be consistent with those laws.[9]

Although agency interpretation is entitled to considerable deference, the court is the final authority on statutory construction and interpretation. *Moses v. Social & Health Servs.*, 90 Wn.2d 271, 275 , 581 P.2d 152 (1978); *Walthew v. Dep't of Revenue*, 103 Wn.2d 183, 186, 691 P.2d 559 (1984). In construing a statute, the court looks first to the plain meaning of the words of the statute. *Enterprise Leasing, Inc. v. City of Tacoma*, 139 Wn.2d 546, 552, 988 P.2d 961 (1999). Words in a statute are given their ordinary meaning, but courts avoid strained or absurd constructions. A court will not depart from the usual meaning of words in a statute absent ambiguity or a statutory definition. *Pope & Talbot v. Dept. of Revenue*, 90 Wn.2d 191, 194, 580 P.2d 262 (1978). Another basic rule of statutory construction is that, whenever possible, statutes should be construed so that no portion is superfluous; all words must be given effect, if possible. *Gross v. Lynwood*, 90 Wn.2d 395, 398, 583 P.2d 1197 (1978).

B. The Board's Rulemaking Powers Are Broad, And Are Not Limited Strictly To Public Safety Purposes

Petitioners repeatedly claim that after the passage of I-1183 the Liquor Control Board is limited to adopting rules that are designed to protect the public health and safety, and has no other regulatory powers. No such limitation exists in law. As noted by the Court in *Anderson,*

[9] §124 of I-1183 includes a recognition that RCW 66.28.285 through .320 "are appropriate for all varieties of liquor . . ."

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supra, the powers of the Liquor Control Board are very broad. RCW 66.08.010, cited by the *Anderson* court provides:

> "(t)his entire title shall 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."

Anderson, 89 Wn.2d at 694-5. RCW 66.08.010 remains unchanged. As long ago as 1937, our Supreme Court examined the scope of the Board's regulatory powers under Title 66 RCW, and specifically referenced the language now codified in RCW 66.08.030(6) and (12) (as amended by I-1183).[10] *In State ex rel Thornbury v, Gregory*, 191 Wash. 70, 70 P.2d 788 (1937), the court then went on to say:

> The regulation and control of the liquor traffic is manifestly a problem of the greatest difficulty and importance, involving an immense amount of detail, and including many matters which, if successful operation and control is to be established and maintained, must be left to some regulatory body other than the State Legislature.

Thornbury, 191 Wash. at 74. In that case, the Court upheld the Board's rules regulating the hours of sale of liquor, over a challenge that there was no authority for the Board to impose such limits. The "purpose" statement in §101 of I-1183 does not strip the Board of its authority to regulate the sale of liquor by licensees, and the Board is not otherwise limited to regulating *only* actions of licensees that implicate public safety.

Having set up the straw man that Liquor Control Board is limited to only addressing public safety concerns in its rulemaking and administration of Title 66 RCW, Petitioners challenge many of the rules on the basis that not every single challenged rule directly serves a clear public safety purpose. Petitioners repeatedly cite to §101 of Initiative 1183 (I-1183) to support their contention that I-1183 limits the Liquor Control Board to adopting rules that enhance public safety. However, the Board's rulemaking authority is clearly not so limited. Section 101 of I-1183 is not a grant or limitation on the Board's substantive authority, but only

[10] The latter subsection now references spirits as well as wine and beer.

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provides an overview of the intent of the drafters in proposing the law. It is a recitation of what the Initiative purports to do, not a substantive enactment or repeal of authority and duties. §101 is not codified in any section of the Revised Code of Washington, but rather is relegated to a "Finding" inserted following RCW 66.24.620 in the codified laws.

In addition, §101(a) states that the Board should continue "to strictly regulate the distribution and sale of liquor." If Petitioners intended to limit the Board's "regulatory functions" to adopting only rules that address public safety concerns, they should have clearly provided for that in the law they wrote.

1. The Liquor Control Board has broad specific rulemaking authority under Title 66 RCW, as amended by I-1183.

As noted above, the Board retains broad rulemaking authority, and broad responsibility for regulating the conduct of liquor licensees. Section 204 of I-1183 revised RCW 66.08.030, which codifies the Board's specifically delegated rulemaking powers, re-enacting numerous sections of the Board's rulemaking powers that direct the Board to regulate licensees and how those licensees buy and sell liquor.

RCW 66.08.030 includes twenty subsections. A simple review of this statute, attached as Appendix 1 for ease of reference, reveals the fallacy of Petitioners assertions. For example, RCW 66.08.030(6) empowers the Board to adopt rules "Regulating the sale of liquor kept by the holders of licenses which entitle the holder to purchase and keep liquor for sale;" RCW 66.08.030(12) provides that the Board may adopt rules "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." In addition, RCW 66.08.030 directs the Board to adopt rules on reporting requirements (for collection of taxes and fees) and do not serve only a public safety purpose. Thus, under RCW 66.08.030, the

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Board clearly has the authority to adopt rules governing the sale of liquor by licensees, including a clarification or further limitation on sales.

The Board is given rulemaking responsibility in other sections of I-1183 as well. For example, §103(2) requires the Board to adopt rules to implement the requirement that an "on-sale" spirits retailer (restaurants and other licensees that serve liquor for consumption on the licensed premises) maintain a schedule of their purchases of spirits from spirits retail licensees, and provide quarterly reports to the distributor in the on-premises licensee's geographic area, or to report directly to the distiller. Petitioners claim that this authority is only ministerial in nature. However, imposing a record-keeping requirement indicates an awareness that direct retail-to-retail sales are an exception to the three tier system of sales codified in Ch. 66.28 RCW, and that the 24-liter limit on retail-to retail sales means something.

2. Rules of statutory construction direct the court to construe all parts of statutes to have meaning (24-liter) and to read the language of statutes in context with other parts of the laws on the same subject.

a. The Board properly clarified the language restricting retail-to retail sales of wine and spirits to one sale per day.

In general, if the language of a statute is clear, the court gives effect to its plain meaning without resort to rules of statutory construction. *Murphy v. Dep't of Licensing*, 23 Wn. App. 620, 623, 625 P.2d 732 (1981). However, the meaning of the language in RCW 66.24.360 and RCW 66.24.630 that allows a spirits retail licenses to engage in a "single sale" of no more than twenty-four liters of wine or spirits to a restaurant or bar is far from clear. The fact that an interpretation has been made by at least one retailer, to the effect that they can engage in sequential transactions and sell an unlimited quantity of wine or spirits to another retail licensee so long as payment is tendered after each twenty-four liters is rung up, shows

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that there is ambiguity in the statutory language, and resort to rules of statutory construction is appropriate.

The legislative history of the statute may also be considered. *In re Sehome Park Care Center*, 127 Wn.2d 774, 778, 903 P.2d 443 (1995). Whenever possible, a statute should be construed so that no portion is superfluous. *Gross v. Lynwood*, 90 Wn.2d 395, 398, 583 P.2d 1197 (1978).

Testimony the Board heard on February 22 certainly supports the view that a limitation of some kind on retail-to retail sales was intended. Representatives of Petitioners argued to the Board that the limit has no meaning in practice.[11] Rules of statutory construction support the conclusion that the limit on the amount of spirits and wine that may be sold in a retail-to retail transaction has some meaning, and was not simply a sham or surplus language. If the 24 liter per sale limitation really means nothing in practice but "friction" then why provide an exception from the limitation for former contract liquor store managers? Why require the restaurant to keep records of those purchases and report those purchases to the distributors (not to the Board)? To ask these questions is to answer them: if the limit of twenty-four liters per sale means nothing but "friction", permitting the sale of more than twenty-four liters in an unbroken series of transactions would, essentially, read the limitation out of the law. The limitation must have been intended to be meaningful, and the Board acted appropriately in adopting the rules limiting sales to one per day.

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[11] In fact, if Mr. Sullivan, Costco's Associate General Counsel, is to be believed, the words were intended to impose no real restriction. During the February 22, 2012 work session when the proposed emergency rule was first discussed, Board member Marr asked John Sullivan, Costco's associate general counsel and one of the drafters of I-1183, what the purpose of the 24-liter limit was. Mr. Sullivan replied that it was to add "friction". LCB00001717-1720, transcript of February 22, 2012 work session. Board chair Sharon Foster then asked why there was a 24-liter limit on retail-to retail sales in the initiative. Mr. Sullivan replied: "Because the distributors wanted a fig leaf limitation on sale for resale." When asked to explain what that meant, Mr. Sullivan stated that although the words in the initiative would appear to provide a real limitation on the sale of spirits and wine from a spirits retail licensee to restaurants and bars, that the drafters really intended the words would provide no meaningful restriction on sales for resale. *See* LCB00001720.

3. Deference to agency with expertise in the area; Court should not substitute its judgment for that of the agency.

The court reviews agency rulemaking to determine whether the rules as adopted are arbitrary and capricious, without substituting its judgment for that of the agency that is delegated the policymaking authority. *Deaconess Hospital v. Washington State Highway Commission*, 66 Wn.2d 378, 405 P.2d 54 (1965). "If the administrative agency has acted honestly, with due deliberation, within the scope of and to carry out its statutory and constitutional functions, and been neither arbitrary, nor capricious, nor unreasonable, there is nothing left for the courts to review."

Deaconess, 66 Wn.2d at 406. This deferential standard of review is rooted in the separation of powers, and respect for the other branches of government. "A different conclusion would place the judiciary in the untenable position of substituting its judgment for that of the administrative agency contrary to a number of decisions on this particular point." *Id.* (*citations omitted*).

As the Supreme Court held in *WITA v. WUTC*, 148 Wn.2d 887, 64 P.3d 606 (2003):

> "...the more familiar formulation of the test for determining whether actions are arbitrary and capricious, i.e., agency action is arbitrary and capricious if it is willful and unreasoning and taken without regard to the attending facts or circumstances. Rios v. Dep't of Labor & Indus., 145 Wn.2d 483, 501, 39 P.3d 961 (2002); *see* Hillis, 131 Wn.2d at 383, 932 P.2d 139 (in connection with agency action alleged to be arbitrary and capricious). " '[W]here there is room for two opinions, an action taken after due consideration is not arbitrary and capricious even though a reviewing court may believe it to be erroneous.' " Rios, 145 Wn.2d at 501, 39 P.3d 961 (quoting Hillis, 131 Wn.2d at 383, 932 P.2d 139). This examination of agency action is consistent with the APA's requirement that "[i]n reviewing matters within agency discretion, the court shall limit its function to assuring that the agency has exercised its discretion in accordance with law, and shall not itself undertake to exercise the discretion that the legislature has placed in the agency." RCW 34.05.574(1).

WITA v. WUTC, 148 Wn.2d 887, 904.

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C. The Board's Rules Appropriately Implement The Law, Creating New Licenses And Regulating The Actions Of Licensees Thereunder

1. The Board's rules clarifying the "24 liters per sale" limit contained in RCW 66.24.360(wine) and RCW 66.24.630(spirits) give meaning to all parts of the law.

In adopting WAC 314-02-103 and 314-02-106, the Board sought to administer the law so that all words in the law are given effect. A statute is ambiguous if "susceptible to two or more reasonable interpretations," but "a statute is not ambiguous merely because different interpretations are conceivable." *State v. Hahn,* 83 Wn. App. 825, 831, 924 P.2d 392 (1996). Petitioners cite *Tesoro Refining and Marketing Co. v. Dep't. of Revenue*, 164 Wn.2d 310, 190 P.3d 28 (2008) which allows the use of legislative history to construe an ambiguous statute. In this case, because the law was enacted via the Initiative process, we do not have aids such as testimony in legislative hearings, bill reports, etc., to aid us in interpreting I-1183.[12] As directed by the *Tesoro* court, the Board also considered "...the subject, nature, and purpose of the statute as well as the consequences of adopting one interpretation over another." *Id.,* 164 Wn.2d at 146. Petitioners assert that we should listen to them, because they drafted the language, but our court has generally rejected relying on the views of the legislative sponsor as a definitive aid to construction. *Tekoa Construction v. Seattle*, 56 Wn. App. 28, 36, 781 P.2d 1324 (1989).

RCW 66.24.630, enacted in §103(1) of I-1183, reads:

> (1) There is a spirits retail license to: Sell spirits in original containers to consumers for consumption off the licensed premises and to permit holders; sell spirits in original containers to retailers licensed to sell spirits for consumption on the premises, for resale at their licensed premises according to the terms of their licenses, *although no single sale may exceed twenty-four liters, unless the sale is by a licensee that was a contract liquor store manager of a contract liquor store at the location of its spirits retail licensed premises from which it makes such sales;* and export spirits.

[12] The Voter's Pamphlet for I-1183, as obtained from the Secretary of State's website, is attached to the Tennyson Decl. as Exhibit C. It sheds no light on this question.

(emphasis added). The same "twenty-four liters" language is included in RCW 66.24.360, for wine sales. From testimony and comments the Board received, the language italicized in the above quote is certainly susceptible to more than one interpretation, and its purpose is also unclear. Why impose any limitation on retail-to-retail sales, if none was intended? Why expressly permit former contract liquor store managers to sell unlimited quantities of spirits to a restaurant retailer, if all spirits retail licensees are implicitly permitted to sell unlimited quantities?[13] Some may believe the exception for former contract stores was a way to help those retailers retain the retail customers they served when they sold liquor under contract with the Board. If that was the purpose, however, why not provide the same exception for sales by those who purchased the right at auction to operate the former state stores?

As worded, the exception raises other questions, such as: Can the former contract liquor store manager continue to sell unlimited quantities of spirits to a restaurant if the contract store manager moves its store to another location? What if the contract liquor store manager sells the business to another person—does the exception still apply? This exception supports the Board's "per day" limitation on sales by other licensed retailers, because, if the intent of the law was that there was no limitation in practice, the exception would not be necessary.

The recordkeeping requirement that Petitioner NW Grocers objected to[14] is required by the language of the statute, which the Board's rules only implement. If the intent was to allow spirits retail licensees to act as distributors by selling unlimited quantities of spirits restaurants, why include the "twenty-four liter per sale" limit at all?

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[13] Some commenters suggested the exception for contract liquor stores was to allow restaurants in more remote locations, where many former contract liquor stores are located, better access to spirits and wine, because distributors are less likely to serve remote locations. This exception, if that is the reason for it, serves the purpose of encouraging competition that some of the restaurant commenters assert is the reason for the allowing the sale of limited quantities from one retailer to another. The exception, not the limitation, serves that purpose.

[14] LCB00001713-1714, testimony of Holly Chisa. §103(2), codified at RCW 66.24.630(2)(a) and (b) requires the purchasing restaurant to keep records of its purchases of spirits from spirits retail licensees, and to report those purchases *to the distributor* who has the right to distribute that product or to the distiller acting as a distributor, not to the Board.

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Petitioner WRA would have us believe that they wanted the ability to buy unlimited quantities of spirits and wine from a retailer, despite the likelihood that the price would be more than when purchasing from a distributor,[15] in order to put competitive pressure on distributors. Costco's attorney would have us believe the 24-liter limit is essentially meaningless in application, except to cause a bit of "friction" by requiring numerous "transactions" of 24 liters or less be rung up and paid for before removing a larger quantity of spirits from the stores.[16] It may make sense to allow a restaurant to pick up a small quantity of spirits[17] to meet an unexpected demand, particularly if the demand occurs after hours when they are unable to schedule a delivery from the distributor. That would not, however, justify the purchase of unlimited quantities of spirits or wine. The statutory language is clearly subject to more than one interpretation. The Board's rules provide a legitimate clarification, and are not an improper amendment of the law nor in excess of its delegated authority.

2. The Board's rules give effect to all the words in the statute.

Courts construe statutes so no language is surplusage. After I-1183 took effect, the three-tier system remains in place.[18] The language of Sections 103(1) and 104(2) provides an exception to the prohibition in the "tied house" provisions of law that prohibit retail to retail sales. *See* RCW 66.28.070, as revised by §118 of I-1183. As an exception, courts generally

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[15] Retailers must pay the state a 17% fee on all sales, thus if the restaurant or bar purchases spirits and pays a price that includes the 10% distributor fee, and the retailer also collects its 17% spirits retailer license fee from the purchaser, the price will normally be higher than if the restaurant purchases spirits from a distributor. §105(3)(d) requires the retail licensee selling for resale to pay the 10% distributor fee if the retail licensee has procured the spirits without any prior distributor fee being paid on the product, thus demonstrating the intent of the drafters that all product sold in the state will be subject to payment of the distributor license fee. *See also* RCW 66.28.340(3), from I-1183 §120, which makes it clear that spirits retail licensees must comply with the laws and rules applicable to distributors when they sell spirits to retailers.

[16] Costco's interpretation of the 24-liter limit was brought to the Board's attention when a stakeholder sent the Board a copy of a letter Costco had sent to its restaurant customer regarding wine sales, in which Costco notified the restaurants that, although each sale was limited to twenty-four liters, there was no limit on the number of transactions. See LCB00001234.

[17] 24 liters is 24 bottles of 1 liter size spirits, or 32 bottles 750 ml size bottles.

[18] LCB00002287 is a summary of the three-tier changes that the Board posted on its website.

read exceptions narrowly, rather than expansively. The Board's rules do not contradict the retail-to-retail language of I-1183, but give it meaning. In adopting WAC 314-02-103(2) and WAC 314-02-106(1)(c), the Board did not ignore testimony objecting to limiting the "single sale" to one per day; rather, it weighed the language of the statute, the other laws it administers, and testimony from all who provided it. The Board heard comments in the February 22, 2012 work session, and asked thoughtful questions.[19] On April 4, 2012, the Board adopted the emergency rules that included the "24 liters per sale, one sale per day" that Petitioners object to. The record of the April 4 Board meeting, at LCB00000985-988, LCB00000991-992, shows the Board received, and considered, comments made at, and after, the February 22, 2012 work session, prior to adopting the rules on April 4, 2012.

D. The Board's Rules Defining the Authority of "Certificate of Approval" licenses are Reasonable and Within its Authority

1. The Board followed the legislative structure for Certificates of Approval for wine sales, adopted in 2006, in crafting the COA rules.

I-1183 directed the Board to "by rule provide for issuance of certificates of approval to spirits suppliers."[20] RCW 66.24.640, I-1183 §206. Petitioners challenge the Board's adoption of WAC 314-23-030 and WAC 314-30-010. In determining how to "provide for" certificates of approval the Board naturally looked to the statutes it had recently implemented, that "provide for" certificates of approval for wine and beer manufacturers, importers, and distributors. LCB00001035. In 2004, the Legislature adopted SSB 6655, which created the Authorized Representative US Wine Certificate of Approval license, the Authorized Representative Foreign Wine Certificate of Approval license, and corresponding COAs for

[19] The references in Pet. Opening Brief at p. 7-8, rather than showing the Board was biased in favor of distributors, show the Board members were seeking testimony from all present, in order to determine an appropriate response.

[20] Many of the materials refer to "Certificates of Approval" holders as "COAs". There are several types of COA licenses, with different privileges and endorsements available, depending on the particular type of COA the person or business holds.

beer (US and Foreign Authorized Rep COA). These licenses enabled marketing agents for wineries and breweries outside of Washington but within the US to obtain a COA to sell wine or beer to distributors or importers in Washington, but do not allow the COA to sell to retailers or consumers. In 2006, the state Legislature adopted 2SSB 6823, which created an endorsement for the Wine COA and Beer COA to allow direct shipment of US-produced beer and wine directly to retailers in Washington.

The Certificate of Approval license for wine is codified in RCW 66.24.206,[21] with the Board's rules adopted as WAC 314-24-117. RCW 66.24.206 requires a winery outside the state of Washington, but within the United States, to hold a certificate of approval to allow sales and shipment of the winery's own wine to licensed Washington wine distributors, importers or retailers. RCW 66.24.206(1)(a). If the winery that holds a certificate of approval also obtains a "direct shipment endorsement", it may act as a distributor of its own production—in other words, it can sell the wine *it produces* directly to licensed retailers in Washington. RCW 66.24.206(1)(b) requires an "authorized representative" to hold a certificate of approval to represent a US winery in sales in Washington. The "COA authorized representative" may sell and ship US-made wine that it does not produce, but is made in the United States, to a Washington licensed wine distributor or importer, but may not sell or ship that product to a licensed Washington wine retailer.

Similarly, RCW 66.24.206(1)(c) requires an "authorized representative" of foreign-produced wine to hold a certificate of approval to sell and ship the foreign-produced wine to licensed Washington wine distributors or importers (COA authorized representative-foreign), but not to retailers. Again, RCW 66.24.206 only allows the winery that produces wine outside the state of Washington to sell and ship *its own* wine directly to retailers; if the representative

[21] Copy attached as Appendix 2.

does not produce the wine it sells, the sale and shipment must be to a Washington licensed distributor or importer.

The reason for requiring each of these entities obtain the certificate of approval is made clear in RCW 66.24.206(2) and (4); the applicant for a certificate of approval must agree in writing to furnish reports to the Board, and is deemed to have consented to the jurisdiction of Washington for enforcement purposes, in order that the state may collect taxes and enforce its tax laws on these licensees. Following the adoption of the 2006 changes, the Board adopted rules to implement the new law, WAC 314-24-231 (Wine shipper permit or COA with direct sales endorsement), WAC 314-24-050; 314-24-150 (Out of state wineries must maintain records). The rules adopted by the Board to create Certificates of Approval for spirits, which Petitioners challenge, follow the same structure set out by RCW 66.24.206 for wine, for whom holders of spirits certificates of approval can sell spirits to. LCB00001035, CES.

RCW 66.24.640, which allows a distiller to act as a retailer or distributor of its own production, also allows a manufacturer, importer of bottler of spirits *holding a certificate of approval* to distribute products it is entitled to import *under such certificate*. This statute does not define the parameters of what the importer may do under the COA license. If the importer obtains both the importer's license and the COA (which only costs $200 and requires the importer to have authority from the brand owner to import) then it can sell directly to retailers. The Board has not improperly limited the actions of importers. The Board is given authority to set the parameters of the Certificate of Approval and if the drafters did not want Board to have ability to define those parameters, they could have clearly defined that authority in the initiative.[22] The Board made rational, logical, choices in defining the authority of COAs,

[22] Petitioner quotes the Board on page ER 168 (LCB00001032) "[T]he board created the same certificates for spirits that are currently in law for wineries and breweries." *OB p 25, line 9-11.* This reference actually appears in the record at LCB00001035, not LCB 00001032.

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consistent with structure of COA authority the legislature created for COAs selling wine and beer.

2. The Board has accepted a Petition for Rulemaking that may make this moot.

On July 2, 2012, the Board received a Petition for Rulemaking signed by various parties, representing foreign distillers and manufacturers and some from within the U.S., but outside the state of Washington. On August 29, 2012, the petition was presented to the Board, which granted the Petition and began the rulemaking process. A copy of the Petition is attached to the Tennyson Decl. as Exhibit D; the memo from the Board's Rules Coordinator, describing the proposed changes to the rules and the text of the proposed rules, are attached as Exhibit E. A Notice of Rule Change prepared by the Board in 2006, as filed with the Code Reviser, describing the history of the statutes governing Certificates of Approval in the beer and wine industry, The Board has drafted proposed rules, which are scheduled for adoption on March 6, 2013. Tennyson Decl. Exhibit F. If adopted as scheduled, the rules will resolve the concerns Petitioners have raised in this proceeding.

3. The Board properly requires all persons acting as distributors to pay the 10% distributor license fee on sales of product for which no prior distributor license fee has been paid.

Petitioner argues that the distributor license fee should not be levied against distillers or others acting as distributors by selling direct to retailers because the statute does not expressly include them. Petitioner cites to *United Parcel Service, Inc., v. DOR,* 102 Wn.2d 355, 687 P.2d 186 (1984). *Opening Brief p. 23, lines 5-19.* In that case, the Department of Revenue's application of a use tax to UPS vehicles was because the language defining the tax for motor vehicle carriers (exemption only applied to vehicles that crossed state lines for a majority of their business) differed from the language used in statutes exempting activities of other types of carriers. The Court found that DOR did not act in an arbitrary and capricious

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manner, in applying the "line crossing" test to the UPS vehicles to determine whether they were eligible for the exemption. *UPS v. DOR,* 102 Wn.2d at 365.

More importantly, Petitioners ignore RCW 66.24.640, which says that distillers or COA holders acting as distributors *must comply with all laws applicable to distributors*. That required the Board, and this court, to find that the distillers and COA holders who choose to distribute their products are subject to the 10% distributor fee.[23]

4. The Board is not required to repeat all parts of the statute in a rule; the statutory language will control.

Petitioners state that the Board ignored their request to change the spirits pricing rule, WAC 314-23-001, regarding sales below cost not being allowed when the statute, RCW 66.28.330(1) allows an exception. *Opening Brief, p. 28, line 1-17.* RCW 66.28.330 states that no sales of spirits may be made by a distributor or a person acting as distributor, for less than the cost of acquisition, and provides a limited exception for closeout of product that has been stocked for more than six months, which may not be restocked for a period of one year after setting a below-cost price. Petitioners object to the Board's failure to include the limited statutory exception in the rule.[24] Because the statute controls, if the Board received a complaint of an illegal sale for less than the seller's cost of acquiring the product, the Board would investigate, and if the exception applied, could not find the seller in violation of the statute. The rule does not negate the statutory exception.

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[23] A careful review of the Fiscal Impact Statement prepared by the Office of Financial Management, and published in the Voter's Pamphlet for the 2011 election, also reveals that OFM assumed all spirits sold in the state would be subject to payment of both the 17% spirits retail license fee, and the 10% distributor license fee. Costco participated in discussions with OFM and provided input to OFM on its assumptions. *See* LCB00002260-65.

[24] Petitioner cites to ER 171 (LCB00001035) but misstates what the Board said in the CES. The Board's response states: "**LCB response:** The exception in RCW 66.24.330 is clear and does not require a rule to clarify. There are numerous exceptions in law that do not have clarification in rule. The rule does not forbid what the statute allows."

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5. WAC 314-02-103(4) is appropriate.

Petitioners complain that the Board erred in not including delivery to "lawful purchasers outside the state" as a location where holders of a wine retailer reseller endorsement may deliver wine, in WAC 314-02-103(4), challenging the rule as arbitrary and in excess of the Board's authority, because the Board left out part of the statute when it drafted the WAC. *Opening Brief p. 28, line 19-39.* Petitioner cites to ¶26(d) of the Joint Statement of Facts, which does not exist, but ¶27(d)(ii) does reference WAC 314-02-103(3). Here, the proper record reference is to LCB00001036 (ER 172); the Board's response to the comment in the CES is that the statute does not require clarification. Petitioner is, essentially, asking the court to add to the rule, rather than defer to the judgment of the agency about the need for a rule to clarify the law.

6. The Board acted within its authority in requiring distributors to deliver product from their license locations.

Petitioners challenge WAC 314-23-020 (spirits distributors) and WAC 314-24-180(2) (wine distributors), which require distributors to sell and deliver product only from their licensed premises. The comments in the rulemaking process were that the Board is not directed to adopt rules on this subject. The LCB response to this comment on the proposed rule, found at LCB00001037, cites to RCW 66.08.030, which clearly authorizes the Board to adopt rules regarding the sale of liquor by licensees. Some stakeholders had engaged Board staff in conversations about practices in some industries where the product is purchased or ordered by a distributor, and purportedly shipped to the distributor's location, but is never stored at the location, but simply redirected for delivery to the retailer. This practice limits the ability of the Board to require record-keeping to assure proper tracking of product and payment of fees and taxes.

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E. The Board Substantially Complied With Statutory Rulemaking Requirements

1. The rules implement a statute that provides new business opportunities for many small businesses, with an overall positive impact on businesses in the state.

The Board's rules do not impose costs on businesses in excess of those imposed by the law the rules implement. The Board did not conduct a specific study of the impacts of its proposed rules on small businesses because it viewed the new law, and the implementing rules, as creating new business opportunities for the majority of businesses in the liquor industry. The burdens of the rules adopted by the Board were created by the new statutes, not the Board's rules. Petitioners assert that the Board's limitations on retail-to-retail sales create a disadvantage for restaurants that may be small businesses, but the exception from the 24 liter limit in the statute creates a benefit for the former contract liquor stores, most of which are also small businesses. The "harm" that Petitioners assert is speculative, that of potentially not creating competition between spirits retail licensees and distributors, who supply the majority of spirits and wine to restaurants. Petitioners have not shown that they are harmed in any way by the rules, particularly with regard to any privilege or obligation that is not imposed directly by the statute. [25]

Failure to conduct an SBEIS is reviewed using the APA "arbitrary or capricious" standard. RCW 34.05.570(2)(c). Petitioners protest the Board's failure to conduct an SBEIS, but have not proposed any analysis that would show that the challenged rules have a disproportionate impact on small businesses, particularly those they represent. The Board determined that no SBEIS was necessary because the new statute provides numerous business opportunities to sell spirits, and the positive economic benefits that businesses can derive from adding a new product to their business outweighs any negative impact from any particular rule.

[25] Petitioners cite to the comments of Washington craft distillers who commented that the proposed rules negatively impacted their business. The craft distillers sought a change to the law, which passed the legislature by a 2/3 majority vote, to exempt them from the 17% retail license fee when selling spirits directly to retail customers. *See* ESSB 6635, C. 6, laws of (2d. Spec Session, amending RCW 66.24.630(4).

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For spirits sales, the majority of the negative impacts derive from the language of the Initiative, not the Board's rules. I-1183 exempts the former contract store managers from the 24-liter limit on sales to on-premises retailers, but does not exempt those sales from payment of the 17% spirits retailer license fee on those sales, because the statute imposes the fee on "all spirits sales" not all "*retail* spirit sales." Petitioners are advocating a change to the Initiative in the legislature that purports to "clarify" the obligation for spirits retail licensees to pay a 17% license fee on "all sales", to make the fee payable only on sales to consumers.[26] Small businesses, particularly former contract liquor stores and the auction winners who run former state stores, have protested that they can not sell spirits to bars and restaurants at prices that are competitive with distributors, because the retailers must purchase from distributors, then must pay a 17% license fee when they resell those products, whether to a retailer or to consumers. Former contract liquor stores who formerly sold spirits to restaurants as a substantial part of their liquor sales business allege[27] that they have lost much of their former clients selling to restaurants and bars, which they could do as agents of the Board, as the Board was not subject to the restrictions on sales to retailers.

In their brief, Petitioners fault the Board's logic in determining an SBEIS was not necessary because, they note, the new law also affects wine sales. However, wine retailers are only allowed to sell wine to restaurants and bars if they are a grocery store with more than 9,000 square feet of retail space, and obtain a grocery store wine reseller permit. *See* RCW 66.24.360, I-1183 §104; RCW 66.28.070(2)(a)(iv), I-1182, §118. Thus, the smallest businesses are precluded by law from taking advantage of the retail-to retail sales provisions.

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[26] *See* Exhibit G to Tennyson Decl.

[27] Two different lawsuits have been filed against the Board by former contract liquor stores (CARR, et. al., v. WSLCB and Dep't of Revenue, Thurston County Superior Court #12-2-02279-5; FERREL, et. al., v. WSLCB and Dep't of Revenue, Thurston County Superior Court.#12-2-02678-2). Allegations include that the Board improperly imposes the 17% fee on retail to retail sales. RCW 66.24.630 imposes the fee on "all spirits sales revenue".

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2. The Board provided more opportunity for comment than required by law, and thoroughly considered the comments it received.

Petitioners attempt to portray the Board as precipitously adopting the first set of permanent rules soon after the May 24, 2012 hearing, without fully considering all the comments. Regarding WAC 314-02-103 and WAC 314-02-106 (24-liter rules) the Board first adopted the rules as emergency rules on February 22, 2012. An agency is not required to provide notice of the adoption of an emergency rule, nor to take public comment prior to adoption of an emergency rule,[28] but the Board did so in this case. The Board circulated proposed language by email to stakeholders in advance of the work session scheduled for February 22, 2012, which was well attended. The official full transcript of the hearing is included in the certified record at LCB00001714-1742[29]. Those comments were considered by the Board in its adoption of WAC 314-02-106 and WAC 314-02-103(wine reseller endorsement) on June 5, 2012, after a hearing on May 24, and receipt of nearly 300 written comments. (*See, e.g.,* LCB00001716, question by Board member Marr of Karen McCall, LCB rulemaking coordinator).

3. The Concise Explanatory Statements filed by the Board comply with the statutory requirement.

a. Statute does not specify level of detail required.

RCW 34.05.325 does not require that a Concise Explanatory Statement separately respond to each and every comment the agency received, nor does the statute specify the level of detail required. The Board met the requirements of RCW 34.05.325 by publishing notice of the proposed rule language, supplementing its filing when the content of the proposed rule changed, by taking written comments on the rules, summarizing those comments, and taking

[28] RCW 34.05.310(4)(a). See also, discussion at p. 4 of this brief.

[29] Petitioners include in the Excerpt of Record two versions of the transcript of the February 22, 2012 work session on the proposed emergency rule. The official version of the transcript is found at ER 63-91, found in the Certified Record (CR) at LCB00001714-1742. Petitioners also included in the ER a version of the transcript that their lawyers had prepared, and sent to the Board. (ER 257-285, CR at LCB0000648-285). This brief refers to the official version of the transcript, at ER 63-91, LCB00001714-1742.

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in-person testimony. The Board members personally presided over each of the rulemaking hearings, and actively engaged those providing oral comments in discussion. The CES filed in each case includes the Board's response to the substance of the comments it received.

b. Board's Issue Statements, describing proposed rule, together with the Concise Explanatory Statements filed with the Code Reviser, adequately explain Board's reasons for adopting rules.

Each time the Board was asked to adopt rules, or even to file the CR 012 to publish the proposed rule language, the Board's Rulemaking Coordinator presented an "Issue Paper" to the Board.[30] The Issue Papers describe the effect of the rules, and why the rules were needed. The Board's Concise Explanatory Statement. (CES) (LCB00001029-1037) prepared and filed on June 5, 2012, described the adoption of the first set of Permanent Rules to implement I-1183 summarized the comments "by category or subject matter" as allowed by RCW 34.05.325(6)(a)(ii). The Certified Record contains not only all of the comments, but a table that summarizes the comments received. LCB0000068-91. The CES described both the Board's reasons for rejecting comments that urged the Board to not apply the 17% spirits retail license fee to certain sales, its response to the comments it received on the proposed language of the 24-liter rule, as well as why it structured the rules creating Certificates of Approval in the way it did. Petitioners criticize the Board for not personally preparing or reviewing the CES. *Opening Brief p. 9, line 1-14.* Agencies are required to prepare a CES in order for the rules to take effect, but there is no requirement about who actually prepares the CES.

Similarly, the Board filed a CES to explain the adoption of the rules adopted on August 1, 2012, in the record at LCB0000398-399. The CES described and responded to the only comments the Board received after those rules were filed with the CR-102. In response

[30] Ex A to Tennyson Decl. includes the dates and references to the page of the Certified Record where the Issue Papers can be found.

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to comments it received, the Board decided not to adopt a change to an existing rule that it had proposed to revise. *Id.*

c. Board reviewed all comments, including chart of rules by type of comment, before adopting rule.

Simply because the Board did not separately address each and every comment, or agree with comments and change the rules, does not mean the Board did not substantially comply with APA requirements for rulemaking. The Board provided all the proper notices, took comments, and considered them.[31] The Board held hearings; its staff presented issue papers for the Board's consideration, and prepared concise explanatory statements for each of the rules. The Board made its decisions about how to implement I-1183 in a way that made sense. 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 hearings, then made its decisions about how to implement I-1183 in a way that made sense.[32]

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[31] Contrary to what Petitioners attempt to imply, the Board did not "rush to judgment in adopting the rules. A chronology is illuminating here. The Board held a work session on Feb. 22 on the proposed emergency rule imposing the per day limitation on retail to retail sales. The emergency rule was adopted on April 4, 2012, effective April 8, 2012. The Board filed the proposed Permanent rules for comment on March 14, 2012, with a supplemental CR-10 notice filed on April 18, 2012. The Board held a hearing held on May 24, and extended the comment period to May 30, and the CES was filed on June 5, 2012.

The second set of rules challenged were filed for comment (proposed language, CR-102) on May 3, 2012. WSR 12-11-009, setting the hearing date for June 27, 2012, which date was also the deadline for submission of written comments. A hearing on second set of rules was held on June 27. The Board decided to hold a second hearing on July 25, 2012, and extended the adoption date from July 11 to August 1, 2012.

[32] Petitioners misconstrue the Board member's responses to Interrogatories. Board Member Marr stated that there may be materials in the rulemaking file that he was not aware of, but did not say that he did not review all comments. In fact, the record reflects that the Board's Rulemaking Coordinator, Karen McCall, provided the Board members with copies of all the comments received on the rules. *See, e.g.,* LCB0000985-6: "Board members have been given copies of all correspondence I received."

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IV. CONCLUSION

The Board properly exercised its delegated authority in adopting the challenged rules. The Board substantially complied with the rulemaking process, providing proper notice and opportunity for comments.

Petitioners have not shown that they have been substantially prejudiced by the Board's alleged violation of rulemaking procedures or the substance of the Board's rules, as required by RCW 34.05.570(1)(d). In addition, Petitioners have failed to prove that the rules violate constitutional provisions, exceed the Board's statutory authority, or are arbitrary or capricious. thus the court should not grant the requested relief.

DATED this 28th day of February, 2013.

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RCW 66.08.030
Regulations — Scope.

The power of the board to make regulations under chapter 34.05 RCW extends to:

(1) Prescribing the duties of the employees of the board, and regulating their conduct in the discharge of their duties;

(2) Prescribing an official seal and official labels and stamps and determining the manner in which they must be attached to every package of liquor sold or sealed under this title, including the prescribing of different official seals or different official labels for different classes of liquor;

(3) Prescribing forms to be used for purposes of this title or the regulations, and the terms and conditions to be contained in permits and licenses issued under this title, and the qualifications for receiving a permit or license issued under this title, including a criminal history record information check. The board may submit the criminal history record information check to the Washington state patrol and to the identification division of the federal bureau of investigation in order that these agencies may search their records for prior arrests and convictions of the individual or individuals who filled out the forms. The board must require fingerprinting of any applicant whose criminal history record information check is submitted to the federal bureau of investigation;

(4) Prescribing the fees payable in respect of permits and licenses issued under this title for which no fees are prescribed in this title, and prescribing the fees for anything done or permitted to be done under the regulations;

(5) Prescribing the kinds and quantities of liquor which may be kept on hand by the holder of a special permit for the purposes named in the permit, regulating the manner in which the same is kept and disposed of, and providing for the inspection of the same at any time at the instance of the board;

(6) Regulating the sale of liquor kept by the holders of licenses which entitle the holder to purchase and keep liquor for sale;

(7) Prescribing the records of purchases or sales of liquor kept by the holders of licenses, and the reports to be made thereon to the board, and providing for inspection of the records so kept;

(8) Prescribing the kinds and quantities of liquor for which a prescription may be given, and the number of prescriptions which may be given to the same patient within a stated period;

(9) Prescribing the manner of giving and serving notices required by this title or the regulations, where not otherwise provided for in this title;

(10) Regulating premises in which liquor is kept for export from the state, or from which liquor is exported, prescribing the books and records to be kept therein and the reports to be made thereon to the board, and providing for the inspection of the premises and the books, records and the liquor so kept;

(11) Prescribing the conditions and qualifications requisite for the obtaining of club licenses and the books and records to be kept and the returns to be made by clubs, prescribing the manner of licensing clubs in any municipality or other locality, and providing for the inspection of clubs;

(12) 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;

(13) Specifying and regulating the time and periods when, and the manner, methods and means by which manufacturers must deliver liquor within the state; and the time and periods when, and the manner, methods and means by which liquor may lawfully be conveyed or carried within the state;

(14) Providing for the making of returns by brewers of their sales of beer shipped within the state, or from the state, showing the gross amount of such sales and providing for the inspection of brewers' books and records, and for the checking of the accuracy of any such returns;

(15) Providing for the making of returns by the wholesalers of beer whose breweries are located beyond the boundaries of the state;

(16) Providing for the making of returns by any other liquor manufacturers, showing the gross amount of liquor produced or purchased, the amount sold within and exported from the state, and to whom so sold or exported, and providing for the inspection of the premises of any such liquor manufacturers, their books and records, and for the checking of any such return;

(17) Providing for the giving of fidelity bonds by any or all of the employees of the board. However, the premiums therefor must be paid by the board;

(18) Providing for the shipment of liquor to any person holding a permit and residing in any unit which has, by election pursuant to this title, prohibited the sale of liquor therein;

(19) Prescribing methods of manufacture, conditions of sanitation, standards of ingredients, quality and identity of alcoholic beverages manufactured, sold, bottled, or handled by licensees and the board; and conducting from time to time, in the interest of the public health and general welfare, scientific studies and research relating to alcoholic beverages and the use and effect thereof;

(20) Seizing, confiscating and destroying all alcoholic beverages manufactured, sold or offered for sale within this state which do not conform in all respects to the standards prescribed by this title or the regulations of the board. However, nothing herein contained may be construed as authorizing the liquor board to prescribe, alter, limit or in any way change the present law as to the quantity or percentage of alcohol used in the manufacturing of wine or other alcoholic beverages.

[2012 c 2 § 204 (Initiative Measure No. 1183, approved November 8, 2011); 2002 c 119 § 2; 1977 ex.s. c 115 § 1; 1971 c 62 § 1; 1943 c 102 § 1; 1933 ex.s. c 62 § 79; RRS § 7306-79. Formerly RCW 66.08.030 and 66.08.040.]

Notes:

Finding -- Application -- Rules -- Effective date -- Contingent effective date -- 2012 c 2 (Initiative Measure No. 1183): See notes following RCW 66.24.620.

RCW 66.24.206
Out-of-state winery — Certificate of approval — Fee.

(1)(a) A United States winery located outside the state of Washington must hold a certificate of approval to allow sales and shipment of the certificate of approval holder's wine to licensed Washington wine distributors, importers, or retailers. A certificate of approval holder with a direct shipment endorsement may act as a distributor of its own production. Notwithstanding any language in this title to the contrary, a certificate of approval holder with a direct shipment endorsement may use a common carrier to deliver up to one hundred cases of its own production, in the aggregate, per month to licensed Washington retailers. A certificate of approval holder may not arrange for any such common carrier shipments to licensed retailers of wine not of its own production.

(b) Authorized representatives must hold a certificate of approval to allow sales and shipment of United States produced wine to licensed Washington wine distributors or importers.

(c) Authorized representatives must also hold a certificate of approval to allow sales and shipments of foreign produced wine to licensed Washington wine distributors or importers.

(2) The certificate of approval shall not be granted unless and until such winery or authorized representative shall have made a written agreement with the board to furnish to the board, on or before the twentieth day of each month, a report under oath, on a form to be prescribed by the board, showing the quantity of wine sold or delivered to each licensed wine distributor, importer, or retailer, during the preceding month, and shall further have agreed with the board, that such wineries, manufacturers, or authorized representatives, and all general sales corporations or agencies maintained by them, and all of their trade representatives, shall and will faithfully comply with all laws of the state of Washington pertaining to the sale of intoxicating liquors and all rules and regulations of the Washington state liquor control board. A violation of the terms of this agreement will cause the board to take action to suspend or revoke such certificate.

(3) The fee for the certificate of approval and related endorsements, issued pursuant to the provisions of this title, shall be from time to time established by the board at a level that is sufficient to defray the costs of administering the certificate of approval program. The fee shall be fixed by rule by the board in accordance with the provisions of the administrative procedure act, chapter 34.05 RCW.

(4) Certificate of approval holders are deemed to have consented to the jurisdiction of Washington concerning enforcement of this chapter and all laws and rules related to the sale and shipment of wine.

[2007 c 16 § 1; 2006 c 302 § 4; 2004 c 160 § 4; 1997 c 321 § 7; 1981 1st ex.s. c 5 § 34; 1973 1st ex.s. c 209 § 13; 1969 ex.s. c 21 § 10.]

Notes:

Effective date -- 2006 c 302: See note following RCW 66.24.170.

Effective date -- 2004 c 160: See note following RCW 66.04.010.

Effective date -- 1997 c 321: See note following RCW 66.24.010.

Severability -- Effective date -- 1981 1st ex.s. c 5: See RCW 66.98.090 and 66.98.100.

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PROOF OF SERVICE

I, Dianne S. Erwin, certify that I caused a copy of this document, **Brief of Respondents Washington State Liquor Control Board, Chris Marr, Sharon Foster and Ruthann Kurose, Members,** to be served on all parties or their counsel of record on the date below as follows:

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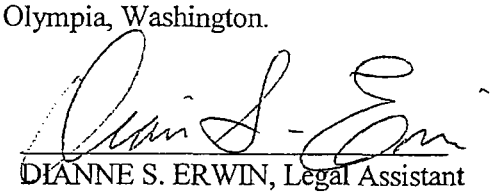
I certify under penalty of perjury under the laws of the state of Washington that the foregoing is true and correct.

DATED this 28th day of February, 2013, at Olympia, Washington.



DIANNE S. ERWIN, Legal Assistant

I certify to be true under penalty of perjury
Under the laws of the State of Washington that
I delivered/mailed a copy of this document to:
attorneys on 4/29,
2013, at Olympia, WA
Signed

FILED
APR 29 2013
SUPERIOR COURT
BETTY J. GOULD
THURSTON COUNTY CLERK

SUPERIOR COURT OF WASHINGTON
IN AND FOR THURSTON COUNTY

COSTCO WHOLESALE CORPORATION *et al*, Plaintiff(s), v. STATE LIQUOR CONTROL BOARD, Defendant(s).	NO. 12-2-01312-5 COURT'S OPINION **(CLERK'S ACTION REQUIRED)**

This matter comes before the Court on Petitioners Washington Restaurant Association, Northwest Grocery Association, and Costco Wholesale Corporation's ("Petitioners") Petition for Review challenging a variety of rules promulgated by Respondent Washington State Liquor Control Board ("Board") as a result of the passage of Initiative 1183 ("I-1183"). I-1183 was passed by a vote of the people in November 2011. The parties summarize the Initiative as follows:

> The Initiative changed the State's approach to regulating the distribution and sale of liquor in Washington, as acknowledged in the first section of I-1183, the recitation of purpose: "The people ... find that the state government monopoly on liquor distribution and liquor stores in Washington and the state government regulations that arbitrarily restrict the wholesale distribution and pricing of wine are outdated, inefficient, and costly to local taxpayers, consumers, distributors, and retailers." Laws of 2012, ch. 2, §101(1). The Initiative removed the State government from the commercial business of distributing, selling, and promoting the sale of liquor. *Id.* The recitation of purpose further stated that privatization would "allow[] the state to focus on the more appropriate

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government role of enforcing liquor laws and protecting public health and safety concerning all alcoholic beverages." Laws of 2012, §101(2)(b).

Joint Statement of Facts, ¶ 7. In short, the Initiative was an ambitious modification of the long-standing three-tier structure in this state that, among other features, ended state-owned liquor stores.

On March 14, 2012, the Board filed the first set of proposed permanent rules implementing I-1183. This first set contained 16 new rules to implement the Initiative and amended six existing regulations. Joint Statement of Facts, ¶ 17. On April 18, 2012, the Board filed a second set of proposed permanent rules. Joint Statement of Facts, ¶ 19.

The Notice of Rulemaking for both sets of rules stated that the Board decided not to conduct a Small Business Economic Impact Statement ("SBEIS") pursuant to RCW 19.85.030(1) because the proposals had "a positive impact on businesses or individuals who wish to sell spirits in the state of Washington." Joint Statement of Facts, ¶¶ 18-19.

Following a series of public hearings and receipt of other industry comment, the Board's Rules Coordinator filed the first set of rules on June 5, 2012, along with the required Concise Explanatory Statement ("CES"). On August 1, 2012, the Rules Coordinator filed the second set of rules and the required CES. Joint Statement of Facts, ¶¶ 22, 24.

On June 21, 2012, Petitioners filed an action in Thurston County Superior Court challenging the substance of six rules and the process by which the Board adopted the first set of rules. Joint Statement of Facts, ¶ 27. Petitioners filed a second petition for review to challenge the second set of rules on August 17, 2012.

Broadly speaking, Petitioners make two types of challenges. First, they challenge the procedural adequacy of the rulemaking process through the sufficiency of the CESs and the failure to prepare a SBEIS. Second, Petitioners substantively challenge several specific rules, labeled by the Court as follows:

a. "24 Liter" Rules (WAC 314-02-103; WAC 314-02-106).
b. COA Ten Percent Fee Rule (WAC 314-23-030).
c. Delivery Location Rule (WAC 314-23-020; WAC 314-24-180).

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d. Rules that Fail to Mirror Statute (WAC 314-23-001; WAC 314-02-103).

The Court reviewed the voluminous pleadings and attachments submitted by the parties and heard oral argument on April 4, 2013. Having considered these materials and arguments, the Court addresses Petitioners' procedural complaints first, followed by the substantive challenges to the specific rules.

Standard of Review.

Agency rules are presumed valid. *Anderson, Leech and Morse, Inc. v. WSLCB*, 89 Wn.2d 688, 695, 575 P.2d 221 (1978). The party claiming a rule is invalid has the burden of proof, and the rules only need to be reasonably consistent with the statutes they implement. *Id.* In addition, because this case is reviewed under the provisions of the Administrative Procedures Act, chapter 34.05 RCW, a rule is invalid only if it (1) "exceeds the statutory authority of the agency," (2) "violates constitutional provisions," (3) "was adopted without compliance with statutory rulemaking procedures," or (4) "is arbitrary and capricious." RCW 34.05.570(2)(c).

Allegations of Procedural Defects.

Petitioners make two general procedural arguments that, if accepted, could invalidate all of the rules. First, Petitioners argue that the Board failed to have sufficient "Concise Explanatory Statements" for each set of rules as required by RCW 34.05.325(6). Second, Petitioners argue that the Board failed to undertake a Small Business Economic Impact Study as required by chapter 19.85 RCW.

1. Concise Explanatory Statement ("CES") (RCW 34.05.325(6)).

Petitioners claim that the Board's CESs were insufficient because they failed to adequately explain the bases for the rules (citing *Anderson, Leech & Morse, Inc. v. Liquor Control Bd.*, 89 Wn.2d 688, 693, 575 P.2d 221 (1978)); *see also* RCW 34.05.325. The Board responds that CESs adequately described the Board's response to the comments it received and the reasons for rejecting certain stakeholder comments.

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The Court agrees with Petitioners that more complete statements directly addressing the concerns of the stakeholders who were unsuccessful in the rulemaking process would have been more complete. But strict compliance with the statute is not required; only *substantial* compliance is required. *See Anderson, Leech & Morse, Inc.*, 89 Wn.2d at 693. Here, these CESs do no more than the minimum, but the Court is persuaded that they are sufficient to meet the minimum requirements of the law.

2. "Small Business Economic Impact Statement" (Chapter 19.85 RCW).

It is undisputed that the Board did not conduct a Small Business Economic Impact Statement ("SBEIS") under chapter 19.85 RCW. Joint Facts ¶ 20 ("The agency record does not include, and the Board did not otherwise consider, any specific information regarding the anticipated regulatory impact of the proposed rules as contemplated by RCW 19.85.030."). SBEISs are addressed in RCW 19.85.030 that provides, in part, "[i]n the adoption of a rule under chapter 34.05 RCW, an agency shall prepare a small business economic impact statement ... [i]f the proposed rule will impose more than minor costs on businesses in an industry ... ."

In this case, the Board's stated reason for not preparing such a statement was because the proposals had "a positive impact on businesses or individuals who wish to sell spirits in the state of Washington." In briefing and at oral argument, the Board further supports its decision by stating that any imposition of costs on business is caused by the underlying statute (I-1183), not its rules.

Neither party has offered authority to the Court to assist the interpretation of chapter 19.85 RCW. No appellate authority has been cited that answers such questions as when an agency may avoid the obligation of preparing an impact statement, how the Court should evaluate an agency decision under RCW 19.85.030, or what happens if the failure to prepare such a statement is deemed a violation of the statute.

Notwithstanding the absence of guidance, the Court is not persuaded by the Board's argument that any imposition of costs on small business should be blamed on the underlying

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statute, not its rules. Since all rules must be reasonably consistent with their related statutes, *all* imposition of costs on business by any given rule could be blamed on its underlying statute. Further, even when the bulk of the impact on industry is arguably caused by an underlying statute, rule drafting still involves a series of judgments by the agency; certainly, industry participants can be affected differently depending on those rulemaking judgments.

In this case, the Board made an initial threshold decision that these rules did not negatively affect small business and, therefore, no further study was necessary. Restraint dictates that courts should be hesitant to second-guess this threshold decision that a given set of rules do, or do not, impose costs on business. However, at a minimum, some level of deliberation would appear to be necessary and required by chapter 19.85 RCW on this initial decision of whether to prepare an SBEIS in the first place. Here, notwithstanding the Board's optimistic statement about the "positive impact" on spirits sales, it is stipulated that the Board made no attempt to consider "the anticipated regulatory impact of the proposed rules." Joint Facts ¶ 20. Given that admission, there is nothing that the Court needs to "second-guess" – the record is devoid of *any* consideration by the Board of the imposition of costs of these rules on small business.

While the precise boundaries of what chapter 19.85 RCW requires may be unclear, more is necessary than what was done by the Board. Accordingly, the Court finds that the Board failed to substantially comply with chapter 19.85 RCW. However, subject to the validity of specific rules discussed below, the Court will permit all other rules to remain effective pending the Board compliance with this statutory requirement.

Challenges to Specific Rules.

1. "24 Liter Rules" (WAC 314-02-103; WAC 314-02-106).

Under the modified three-tier system created by I-1183, on-premises retailers of alcohol (such as restaurants) are not generally permitted to purchase spirits and wine from off-premises retailers (such as grocery stores). I-1183, however, included an exception – the

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ability of on-premises retailers to purchase spirits and wine from off-premises retailers of the limited quantity of 24 liters "per transaction."

The record shows much disagreement about how 24 liters "per transaction" should be interpreted. Ultimately, the Board determined that the statute would mean very little without a temporal restriction. As a result, a "per day" limitation was written into the rules.

> No single sale to an on-premises liquor licensee may exceed twenty-four liters. *Single sales to an on-premises licensee are limited to one per day.*

WAC 314-02-103(2) (ital. added); *see also* WAC 314-02-106(1)(c).

Petitioners challenge the second sentence of these rules claiming that the Board improperly added to the plain language of the statute. Since I-1183 did not include any "per day" limit, Petitioners argue that the rules are invalid. The Board counters that I-1183's language is subject to more than one interpretation, and that its chosen solution to add the "per day" restriction is a "legitimate clarification" that is consistent with legislative scheme, comments from stakeholders, and common sense. *See e.g.* Board's Brief at p. 16. Without the "per day" restriction, argues the Board, multiple "transactions" of 24 liters could take place at one time which would effectively gut the general prohibition against sales between these types of retailers.

The parties agree, however, that the rule without the "per day" restriction would not be meaningless – there would still be some measure of "friction" to the transactions between retailers (there is disagreement on how much friction would result). The Board concedes that even without the "per day" restriction, multiple transactions of 24 liters would still require multiple invoices and other record-keeping obligations.

The Board has argued persuasively that the 24 liter limitation makes much more sense with a "per day" limitation. The Court agrees that the 24 liter rules with a "per day" restriction may actually be more consistent with the overall statutory scheme than I-1183's original statutory language. Without question, the 24 liter rules would be more meaningful with the

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inclusion of "per day" restriction. But the question is not whether the rules are more meaningful with this added restriction, the question is the Board's authority to impose them.

Petitioners cite authority suggesting that agencies may not correct poorly considered laws through rulemaking. *Dot Foods, Inc. v. Department of Revenue,* 166 Wn.2d 912, 215 P.3d 185 (2009); *Edelman v. State ex rel. Pub. Disclosure Commission*, 152 Wn.2d 584, 99 P.3d 386 (2004). In *Dot Foods*, our Supreme Court observed that, even though the agency's interpretation resulted in the statute being clearer, affirming the agency's interpretation would require importing "additional language into the statute that the legislature did not use. [The court] cannot add words or clauses to a statute when the legislature has chosen not to include such language." *Id.* at 920 (citing *State v. J.P.*, 149 Wn.2d 444, 450, 69 P.3d 318 (2003)).

Consistent with these authorities, it is not the Board's place, nor this Court's, to infuse a policy into statutory language that is not there, even if that policy improves the statute. *State v. Wilson*, 117 Wn. App. 1, 14, 75 P.3d 573 (2003) (the Court must ascertain the legislative intent not from what should have been said, but from the language of the statute.). I-1183 included no temporal restriction on sales between retailers, merely a "per transaction" limitation. The Court is persuaded that this original language is not meaningless, and, further, that the additional "per day" restriction substantively changes this original language. Accordingly, the Board exceeded its authority in adding to these provisions in the statute; the 24 liter rules (WAC 314-02-103(2); WAC 314-02-106(1)(c)) are invalid.

2. <u>Ten Percent (10%) Fee Rule (WAC 314-23-030)</u>.

Petitioners next challenge the rules that require Certificate of Authority (COA) holders to pay a 10% fee on all liquor sales. Under the new statutory scheme put in place by I-1183, distributor licensees must pay a 10% fee on sales. RCW 66.24.055. Meanwhile, certain non-distributors are entitled to sell limited quantities as if they were distributors under a "Certificate of Authority."

The challenged rule requires these COA holders to pay the 10% fee on all liquor sold when they act as a distributor. Petitioners argue that imposing these fees on these COA

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holders is directly contrary to I-1183 which was precise in its language -- the fee is assessed only on actual licensed distributors.

The Board, on the other hand, justifies imposing this fee by referencing its overall regulatory scheme. Before the passage of I-1183, the law required that an "industry member" operating "as a distributor" be subject to the laws and rules applicable to distributors. RCW 66.24.640.[1] Since this law, RCW 66.24.640, remains, the Board argues that harmonizing the assessment of fees required by I-1183 with RCW 66.24.640 requires that the 10% fee be assessed to COA holders when they "operate as distributors."

The Court agrees with the Board that imposing the 10% fee on COA holders for their sales as distributors is reasonably consistent with the statutory scheme read as a whole and does not directly conflict with provisions of I-1183. Accordingly, imposing this fee is within the Board's authority.

3. Delivery Location Rule – (WAC 314-23-020; WAC 314-24-180).

Petitioners next challenge WACs 314-23-020 and 314-24-180 which impose new delivery restrictions on wine and spirits purchases by requiring distributors to sell and deliver product only from their licensed premises. Petitioners base their challenge on the absence of explanation justifying these rules in the record, arguing that the record contains no comments, discussion, or other analysis of these new restrictions.

The Board claims that it has the authority to adopt these rules under its general authority provided by RCW 66.08.030, and, further, that the new delivery requirements are necessary to assure proper tracking of product. According to the Board, it has always had the authority as part of its public safety functions to regulate the tracking of the product that enters the state, where it goes, and who has possession of it.

[1] "'Industry member' means a licensed manufacturer, producer, supplier, importer, wholesaler, distributor, authorized representative, certificate of approval holder, warehouse, and any affiliates, subsidiaries, officers, directors, partners, agents, employees, and representatives of any industry member." RCW 66.28.285.

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The Court agrees with the Board. "The powers of the Board are very broad." *Anderson, Leech & Morse, Inc.*, 89 Wn.2d at 694. While the passage of I-1183 modified fundamental aspects of the three-tier system, the Board's underlying obligation to regulate the commercial flow of beverage alcohol remains unchanged. Viewed in this context, the delivery location rules were a valid exercise of the Board's rulemaking authority.

4. Rules that "Fail to Mirror" Underlying Statutes (WAC 314-23-001; WAC 314-02-103).

In this final category, Petitioners challenge several rules for failure to include all the statutory exceptions found in the associated statute. As an example, Petitioners explain:

> RCW 66.28.330 governs spirits pricing. One restriction prohibits a spirits distributor from selling below acquisition cost, but provides an exception if "the item sold below acquisition cost has been stocked" for at least six months. RCW 66.28.330(1). But WAC 314-23-001(2) omits this exception. Facts ¶ 27(e).

Petitioners' Opening Brief at 28 (*see also id.* re: WAC 314-02-103).

The Board agrees that these rules do not include all portions of their underlying statutes. However, the Board argues that nothing requires a rule to copy its underlying statute verbatim, and, in the end, the statutory provisions will still always govern.

At oral argument, the Board conceded that drafting rules that list some, but not all, of the parts of the underlying statute is not "the best way to do it." The Court agrees. Heavily regulated entities *should* understand that both statutes and administrative rules must be consulted prior to determining a course of action. However, it is, in the Court's view, poor agency practice to draft rules that, on their face, appear to cover all aspects of a regulatory issue, but in fact do not. Agencies should endeavor to clarify obligations for regulated entities through rulemaking. Far from providing clarification, these rules risk creating unnecessary confusion.

That being said, neither party cited to the Court authority that the failure of rules to be inclusive of all parts of the underlying statute is fatal. To be sure, if rules become too

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confusing, even if they are technically correct, the line of arbitrary and capricious is approached. These specific rules (WAC 314-23-001; WAC 314-02-103), however, even with their imperfections, fall short of being invalid.

CONCLUSION

Accordingly, the Petition for Review will be granted in part and denied in part. The Court will sign an order consistent with this ruling. The order should reflect that the Board failed to appropriately address its obligations under chapter 19.85 RCW regarding the preparation of a Small Business Economic Impact Statement, and the 24 liter rules (WAC 314-02-103; WAC 314-02-106) are invalid. The ruling should also reflect that while the Board is undertaking its obligations under chapter 19.85 RCW, the invalidity of the remaining rules is stayed.

Dated : April 29, 2013.

Erik D. Price, Judge

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APPENDIX B

State Ex Rel McCue vs. Sheriff of Ramsey County, 48 Minn. 236, 51 N.W. 112.

Supreme Court of Minnesota.
STATE EX REL. MCCUE
v
SHERIFF OF RAMSEY COUNTY.

Jan. 19, 1892.

***112 (Syllabus by the Court.)*

1. ***236** Subjects of legislation may be classified under the constitution, but such classification must not be arbitrarily made. A statute must treat alike all of the class to which it applies, and must bring within its classification all who are similarly situated or under the same conditions.

2. The classification attempted to be made in the act of the legislature of Minnesota (chapter 375, Sp. Laws 1889) declaring the emission of dense smoke within the city of St. Paul a nuisance, under certain conditions, held arbitrary, and unauthorized.

3. Sections 1 and 3 of the act held to be so connected and related that both must stand or fall together.

Habeas corpus proceedings on petition of William B. McCue against the sheriff of Ramsey county. Petitioner discharged.

West Headnotes

Constitutional Law 92 ⚷2884

92 Constitutional Law
92XXIV Privileges or Immunities; Emoluments
92XXIV(A) In General; State Constitutional Provisions
92XXIV(A)2 Particular Issues and Applications
92k2884 k. Trade, business, profession, or occupation, regulation of. Most Cited Cases
(Formerly 92k205(3))

Sp.Laws 1889, c. 375, prohibiting the emission of dense smoke within the city of St. Paul, and providing (section 3) that the act shall not apply to manufacturing establishments using the entire product of combustion, and the heat, power, and light produced thereby, within the building where they are generated, or within a radius of 300 feet therefrom, is unconstitutional, being an arbitrary classification.

Constitutional Law 92 ⚷2970

92 Constitutional Law
92XXV Class Legislation; Discrimination and Classification in General
92k2970 k. In general. Most Cited Cases
(Formerly 92k208(1))

Subjects of legislation may be classified under the constitution, but such classification must not be arbitrarily made. A statute must treat alike all of the class to which it applies, and must bring within its classification all who are similarly situated or under the same conditions.

Constitutional Law 92 ⚷2989

92 Constitutional Law
92XXV Class Legislation; Discrimination and Classification in General
92k2989 k. Nuisances. Most Cited Cases
(Formerly 92k208(10))

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Nuisance 279 ⚷60

279 Nuisance
279II Public Nuisances
279II(A) Nature of Injury, and Liability Therefor
279k60 k. Provisions of statutes and ordinances. Most Cited Cases

The classification attempted to be made in the act of the legislature of Minnesota, chapter 375, Sp.Laws 1889, declaring the emission of dense smoke within the city of St. Paul a nuisance, under certain conditions, held arbitrary, and unauthorized.

Environmental Law 149E ⚷246

149E Environmental Law
149EVI Air Pollution
149Ek243 Constitutional Provisions, Statutes, and Ordinances
149Ek246 k. Validity. Most Cited Cases
(Formerly 268k606)

Statute prohibiting emission of dense smoke within city was invalid (Sp.Laws 1889, c. 375, § 3).

Statutes 361 ⚷1535(21)

361 Statutes
361VIII Validity
361k1532 Effect of Partial Invalidity; Severability
361k1535 Particular Statutes
361k1535(21) k. Environment and health. Most Cited Cases
(Formerly 361k64(2))

Sections 1 and 3 of chapter 375, Sp.Laws 1889, declaring emission of dense smoke within city of St. Paul a nuisance under certain conditions held to be so connected and related that both must stand or fall together.

Statutes 361 ⚷1535(6)

361 Statutes
361VIII Validity
361k1532 Effect of Partial Invalidity; Severability
361k1535 Particular Statutes
361k1535(6) k. Criminal justice. Most Cited Cases
(Formerly 361k64(6))

In Sp.Laws 1889, c. 375, § 1, prohibiting the emission of dense smoke within the city of St. Paul, section 2, prescribing the penalty, and section 3, providing that the act shall not apply in certain cases, are so connected with each other that, on section 3 being held unconstitutional, the other sections fall with it.

***237** McKean, Rendler & Goodwin, for relator.

***238** Dan. W. Lawler, City Atty., and J. C. Michael, Asst. City Atty., for respondent.

***239** VANDERBURGH, J.

The relator was arrested upon a charge of creating or maintaining a nuisance in violation of chapter 375, Sp. Laws 1889, declaring the emission of dense smoke within the city of St. Paul, under certain circumstances, a nuisance, and prescribing a penalty. He is brought before this court upon habeas corpus, and asks to be discharged on the ground of the invalidity of the act in question. One of the chief objections urged against its constitutionality is that it is partial or class legislation. Section 1 prohibits the emission of dense smoke within the city, with certain limitations as to distance, location, and surroundings; section 2 prescribes the penalty; and section 3 is as follows: "Nothing herein contained shall be construed to apply

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to manufacturing establishments, using the entire product of combustion, and the heat, power, and light produced thereby, within the building, where they are generated or within a radius of three hundred feet therefrom." Legislation in different forms relating to particular classes or subjects has been under consideration by this court in Commissioners v. Jones, 18 Minn. 302, (Gil. 182;) Bruce v. Commissioners, 20 Minn. 391, (Gil. 339;) Johnson v. Railroad Co., 29 Minn. 431, 432, 13 N. W. Rep. 673; ****113**Herrick v. Railroad Co., 31 Minn. 16, 16 N. W. Rep. 413; Merritt v. Boom Co., 34 Minn. 246, 25 N. W. Rep. 403; Nichols v. Walter, 37 Minn. 264, 33 N. W. Rep. 800; State v. Spaude, 37 Minn. 323, 34 N. W. Rep. 164; Lavalle v. Railroad Co., 40 Minn. 252, 41 N. W. Rep. 974; Johnson v. Railroad Co., 43 Minn. 224, 45 N. W. Rep. 156; State v. Donaldson, 41 Minn. 78, 42 N. W. Rep. 781. In Nichols v. Walter, supra, it was held that a law was general and uniform in its operation which operates equally upon all the subjects within the class for which the rule is adopted, but that the legislature cannot adopt an arbitrary classification, though it be made to operate equally upon each subject within the class; and the classification must be based on some reason suggested by such a difference in the situation and ***240** circumstances of the subjects placed in different classes as to disclose the necessity or propriety of different legislation in respect to them. In State v. Donaldson, 41 Minn. 74, 42 Minn. 781, a distinction or classification of dealers in medicines, based on the location of their places of business in respect to distance from drug–stores, was held reasonable, and not a mere arbitrary distinction. In Johnson v. Railroad Co., 43 Minn. 224, 45 N. W. Rep. 156, this court, in dealing with chapter 13, Laws 1887, defining the liability of railway companies to their employes, said, in substance, that not only must the statute treat alike, under the same conditions, all who are brought within it, but in its classifications it must bring within it all who are under the same conditions. "Such law must embrace all and exclude none whose condition and wants render such legislation necessary or appropriate to them as a class." Randolph v. Wood, 49 N. J. Law, 88, 7 Atl. Rep. 286. This language is, of course, used in a broad and general sense, and is not to be given so technical or narrow a construction as to interfere with practical legislation. But applying the rule, as well established in this court, to the legislation under consideration, it can hardly stand the test of legal criticism. The provisions of section 3 are somewhat obscure; but the only fair and reasonable construction to be given it is that it is intended to except a class of manufacturers who limit the use of the heat, light, and power resulting from the combustion of smoke–producing material wholly within the prescribed radius. The counsel for the state contend that this must apply equally to all within the designated class, and that the exception thus made in the operation of the act is a reasonable one, because, from the nature of the prescribed limitations, the public injury or annoyance from the emission of smoke from such establishments would not be serious or specially objectionable to the public. The argument applies in so far as the particular class who are excepted from the operation of the statute is concerned, but it does not reach the objection that the classification is not sufficiently broad. No arbitrary distinction between different kinds or classes of business can be sustained, the conditions being otherwise similar. The statute is leveled against the nuisance occasioned by dense smoke, and it can ***241** make no practical difference in what business the owners or occupants of the buildings in which such smoke is produced are engaged, or whether the heat evolved from the combustion of the fuel producing such smoke is applied to the generation of steam or other useful purposes; or, further, whether steam–power is used in manufacturing, or is applied to other uses, as a grain elevator or hoisting apparatus in a warehouse. We are obliged to hold that the distinction or classification attempted to be made is untenable. Section 3 must be read in connection with section 1, and is evidently intended to be a limitation upon the latter section, and is so connected with it that its provisions must be regarded as inseparable from the general purpose and object of the act, so that the whole must stand or fall together. For these reasons we hold the act invalid. The petitioner is

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therefore discharged.

COLLINS, J., absent, and took no part.

Minn. 1892.
State ex rel. McCue v. Sheriff of Ramsey County
48 Minn. 236, 51 N.W. 112, 31 Am.St.Rep. 650

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