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VIA E-MAIL

LCB Three-Tier Task Force
c/o Jill Satran
Sterling Associates, LLP
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Re: Legal Analysis of Delivered Pricing, Price Hold, and Central Warehousing Draft Alternatives

Dear Task Force Members:

We have been asked to analyze three draft alternatives to be discussed at the Task Force's October 12 meeting. The three alternatives involve delivered pricing, price holds for discounted products, and central warehousing. By addressing these particular alternatives, we do not mean to suggest that any others are valid.

As shown below, each of these alternatives could not survive a legal challenge. All three alternatives appear intended to narrow the scope of their predecessors that were invalidated in *Costco v. Hoen*. The narrowing does not eliminate the basic anticompetitive nature and illegality of these restraints. Among other things, it does not appear that there has been any meaningful consideration of what non-competition purpose these might serve and whether that purpose could be served through alternatives that do not violate federal antitrust law. Moreover, in attempting to narrow the warehousing ban, the proposal would require in-state warehousing, which presents an additional legal problem under the Commerce Clause.

Analysis of the Proposed Modifications to the Invalidated Restraints

Section I of the Sherman Act provides that "[e]very contract, . . . or conspiracy, in restraint of trade or commerce among the several states . . . is hereby declared to be illegal." 15 U.S.C. § 1. As was undisputed in *Costco v. Hoen*, the Sherman Act preempts a state statute where there is an irreconcilable conflict between the federal and state regulatory schemes (most often when the restraint is a per se Sherman Act violation), *Rice v. Norman Williams Co.*, 458 U.S. 654, 659

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(1982), and the statute is a hybrid, as opposed to unilateral, restraint of trade. *Miller v. Hedlund*, 813 F.2d 1344, 1349-50 (9th Cir. 1987) ("*Miller II*"), *cert. denied*, 484 U.S. 1061 (1988). A hybrid restraint is one in which "nonmarket mechanisms merely enforce private marketing decisions." *Fisher v. City of Berkeley*, 475 U.S. 260, 268 (1986) (quoting *Rice*, 458 U.S. at 665 (Stevens, J. concurring)). A restraint on an element of price or service is hybrid if it still allows private parties a role in setting the prices and does not review the reasonableness of those prices. *Miller II*, 813 F.2d at 1351; *see* Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 226c, at 24 (Supp. 2004).

1. Delivered Pricing

With respect to delivered pricing, the Task Force is considering two alternatives: either eliminating the delivered pricing requirement or maintaining the requirement with different levels of service and allowing for surcharges for fuel or excessive distances. In *Costco v. Hoen*, Judge Pechman has declared delivered pricing invalid for reasons that apply equally to the proposed qualified delivered pricing requirement. The delivered pricing requirement keeps prices uniform where competition would cause them to differ and discourages retailers of all sizes from developing innovative business practices to keep distribution costs low. This restraint allows private parties to set the prices, which the State enforces without reviewing for reasonableness, giving private actors a significant degree of private regulatory power. *TFWS, Inc. v. Schaefer*, 242 F.3d 198, 208-09 (4th Cir. 2001). Under these circumstances, it is settled law that mandatory delivered pricing is a per se hybrid restraint of trade in violation of the Sherman Act. *Miller II*, 813 F.2d at 1347. The number of prices that are stabilized is not a factor in the federal antitrust analysis. Per se violations like this are per se even if only a single price is stabilized.

2. Price Holds for Discounted Products

Rather than eliminating the hold requirement entirely, the Task Force is considering requiring a fourteen day hold only for discounted products. Essentially, this alternative would require manufacturers and distributors to hold all reduced or sale prices for fourteen days. It is transparently intended to deter discounting. Judge Pechman has already found that holding requirements are a clear per se antitrust violation. Regardless of whether the hold applies to all prices or just reduced prices, the hold requirement remains an antitrust violation. Reducing the number of days a price must be held does not reduce the illegality of the restraint. Holding requirements of any type serve to stabilize prices and preclude responding to market forces in a competitive and timely manner. The proposed alternative itself acknowledges that it is intended "to support price stability." This acknowledgment is fatal because "'a combination formed for the purpose and with the effect of . . . stabilizing the price . . . is illegal per se.'" *Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643, 647 (1980) (quoting *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 223 (1940)). Although, again, private parties are setting the prices, the State

enforces those prices for a mandatory hold period without reviewing the prices for reasonableness. It is, therefore, equally settled law that a mandatory holding of posted prices, like the one here, is a per se unlawful hybrid restraint. *Miller II*, 813 F.2d at 1347; *TFWS*, 242 F.3d at 209; *Beer & Pop Warehouse v. Jones*, 41 F. Supp. 2d 552, 560-62 (M.D. Pa. 1999); *Canterbury Liquors & Pantry v. Sullivan*, 16 F. Supp. 2d 41, 46 (D.Mass. 1998); *Anheuser-Busch, Inc. v. Goodman*, 745 F. Supp. 1048, 1056 (M.D. Pa. 1990).

3. Requiring In-State Warehousing

As an alternative to the present ban on central warehousing, the Task Force is considering the proposal to allow central warehousing as long as, among other things, the warehouse is located within Washington. Judge Pechman found that the broad ban on warehousing by retailers amounted to a hybrid restraint on services by multi-store retailers acting as competitors with distributors as to distribution of product within the retailer's organization. The proposal narrows the boycott to those large, multi-state retailers of most competitive concern to distributors, but that does not change the antitrust analysis whatsoever. The restraint is still invalid.

Moreover, the requirement that the warehouse be in Washington adds a Commerce Clause violation to the mix. The United States Supreme Court has consistently held that, "in all but the narrowest circumstances, state laws violate the Commerce Clause if they mandate 'differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter.'" *Granholm v. Heald*, 544 U.S. 460, 472 (2005) (quoting *Oregon Waste Systems, Inc. v. Department of Environmental Quality of Ore.*, 511 U.S. 93, 99 (1994)). (In an amicus brief, the State of Washington supported the analysis and holding in *Granholm*.) A state may not enact laws that burden out-of-state producers or shippers simply to give a competitive advantage to in-state businesses. *Id.* Allowing states to discriminate against out-of-state wine or beer "invite[s] a multiplication of preferential trade areas destructive of the very purpose of the Commerce Clause." *Dean Milk Co. v. Madison*, 340 U.S. 349, 356 (1951).

The requirement of an in-state warehouse is a clear violation of the Commerce Clause. Washington would allow in-state retailers to centrally warehouse, but not multi-state retailers with warehouses outside of Washington. The Supreme Court has "viewed with particular suspicion state statutes requiring business operations to be performed in the home State that could more efficiently be performed elsewhere." *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 145 (1970). This draft alternative is no different. Washington's in-state warehouse requirement runs contrary to the admonition that states cannot require an out-of-state firm "to become a resident in order to compete on equal terms." *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, 72 (1963). For these reasons, Washington would be discriminating against interstate commerce if it were to adopt the in-state warehouse requirement. *See also Granholm*, 544 U.S. at 475-76.

Failure to Follow Federal Standards for Adopting Restraints on Competition

The Supreme Court has created a narrow opening for states to violate the federal antitrust laws if that is really what they want to do. (Such an intent is hard to imagine in light of the fact that the Washington Constitution bans monopolies, and the Washington legislature has copied the Sherman Act into state law at RCW 19.86.030 and has ordered that federal interpretations govern at RCW 19.86.920.) The restraints must be intended to serve an important state purpose other than merely protecting some competitors; there must not be readily available alternatives that would serve that purpose as well or better without violating federal antitrust law; and the restraints must be actively supervised to identify and minimize their unnecessary effect on competition. It serves no purpose for the Task Force to recommend to the Legislature options that have not been tested by those standards and could not possibly survive them.

Consequences of Ignoring Federal Law

You will note that the bulk of cases to which I have referred are from the Supreme Court. The primary lower court decisions are binding law in this jurisdiction. *Miller II* is the governing standard in the federal circuit that includes Washington, and *Costco v. Hoen* is the governing decision as to Washington's LCB activities of this type. Enactment of any of the three alternatives would put the members and staff of the Liquor Control Board in an untenable situation. Actions to enforce clearly unconstitutional state laws expose them to personal monetary liability. Accordingly, acting on advice of their attorneys general, liquor control boards in at least two states recently suspended enforcement of restraints that appeared likely to violate federal law. In this environment, it makes no sense to create new restraints.

Thank you for your consideration of these issues.

Very truly yours,



David J. Burman

cc: John McKay
John Sullivan