

Joint Select Committee on Beer and Wine Regulation

Costco Wholesale Recommendations



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October 30, 2008

VIA REGULAR U.S. MAIL & EMAIL TO  
kohl-welles.jeanne@leg.wa.gov

The Honorable Jeanne Kohl-Welles  
Washington State Senate  
219 John A. Cherberg Building  
P.O. Box 40436  
Olympia, WA 98504-0436

VIA REGULAR U.S. MAIL & EMAIL TO  
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The Honorable Steve Conway  
Washington State House of  
Representatives  
307 John L. O'Brien Building  
P.O. Box 40600  
Olympia, WA 98504-0600

**Re: Joint Select Committee on Beer and Wine Regulation**

Dear Senator Kohl-Welles and Representative Conway:

Costco is very appreciative of the efforts of the Joint Select Committee on Beer and Wine Regulation and looks forward to the continuing discussion and debate on important policy issues facing the State of Washington.

We have been working with other stakeholders in an attempt to present consensus views to the Committee. We support the recommendations for change by the group and urge the Committee to accept them. Nevertheless, we feel it is important to point out our individual perspective, reinforced by the prior court rulings, on the range of items requiring reform.

You will recall that in Second Substitute Senate Bill 6623, passed in 2006, the Legislature required the Liquor Control Board to convene a task force to "conduct a comprehensive review of the current regulatory system controlling the sale and distribution of beer and wine in Washington State."  
[http://www.liq.wa.gov/3ttf-site/3ttfrec\\_intro.htm](http://www.liq.wa.gov/3ttf-site/3ttfrec_intro.htm)

The LCB Task Force recommended several reforms that we believe provide a framework for the work of the Select Committee. We have outlined those proposals below. The task force acted favorably regarding each of these except for item 2, as to which it took no position, and item 5, which was not before it.

1. Eliminate the prohibition of quantity discounts (RCW 66.28.180(2)(d));
2. Eliminate the prohibition against warehousing by retailers (RCW 66.28.180((2)(h); see RCW 66.24.185);
3. Relax the prohibition against extension of credit by distributors to allow (but not require) distributors to extend credit terms of up to thirty days (see RCW 66.28.010(1)(a));
4. Eliminate the mandatory 10% mark-up for producers and distributors (RCW 66.28.180(d)(2)); and
5. Bring uniformity to internet shipments by retailers to consumers by allowing out-of-state retailers the same privilege as in-state retailers (see SB 6384).

We have previously noted before the Committee that the Ninth Circuit's decision vindicated most of Costco's arguments about the anticompetitive nature of even the restraints that survived challenge, rejected the State's argument that the restraints were intended to or actually served temperance purposes, and expressly refused to find that the restraints were wise public policy.

The first issue that the Ninth Circuit addressed after summarizing the history of the case was whether any of the restraints "effect a per se violation of the Sherman Act." 522 F.3d at 886. The Court defined "per se" violations as those that have such a "pernicious effect on competition" and so lack "redeeming virtue" that they are "conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry." *Id.* The Ninth Circuit found that at least five of the restraints it upheld--"the minimum mark-up, volume discount ban, credit ban, uniform pricing requirement, and delivered pricing requirement" (522 F.3d at 896)--were per se violations of the

antitrust laws: "We agree with the district court that these restraints should be considered to be of the per se variety." 522 F.3d at 897 n.19. If the challenged restraints had involved only private parties and not state mandates, the court would have stopped there and struck the restraints down. The involvement of the State, however, necessitated further analysis.

Ultimately, the Ninth Circuit found that the legal standard for preemption of state law by federal law under the United States Constitution was deferential even to ill-conceived or unwise state laws. The court held that a state has the power in our federal system to immunize anticompetitive restraints that it imposes on its citizen so long as the State "unilaterally" commanded the restriction on competition and "no degree of discretion [is] delegated to private individuals." 522 F.3d at 898. That technical unilateral distinction, of course, provides no policy basis for the State of Washington to continue the challenged restraints that have a "pernicious effect on competition" and lack "redeeming virtue."<sup>1</sup>

There is no basis in the court decisions from which to argue that the negative effects on consumers are outweighed by reduced harmful effects from the use of alcohol. The Ninth Circuit separately rejected the State's arguments that the restraints are helpful to furtherance of "temperance" under the Twenty-first Amendment. The Court was unconvinced by defendants' argument that the restraints promoted "orderly markets." 522 F.3d at 902 n.23. The appellate court joined the trial court in finding that the "State failed to demonstrate that its restraints are effective in promoting temperance." *Id.* at 903. Further, both courts held that whatever interests the State might have had did not outweigh the public benefits of competition. We attach as an exhibit some excerpts from the District Court's findings on the public health issues, which survived the Ninth Circuit ruling.

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<sup>1</sup> For example, addressing the central warehousing ban, the Court noted that the ban "may well be inefficient and it may decrease competition" but the remedy is "not through Sherman Act preemption, but through political will." 522 F.3d at 892.

Senator Kohl-Welles and  
Representative Conway  
October 30, 2008  
Page 4

Thank you again for your work on these issues.

Sincerely,

COSTCO WHOLESALÉ

A handwritten signature in black ink, appearing to read "J. McKay", written over a faint rectangular box.

John McKay  
Senior Vice President

Cc: Greg Hannon  
Gary Gardner

EXCERPTS FROM COURT RULINGS ON TEMPERANCE ISSUES

JUDGE PECHMAN APRIL 21, 2006

<u>Page:</u> <u>Lines</u>	<u>Excerpt</u>
2:10-11	For the most part, the Court finds that the policies challenged by Costco are not effective in advancing the state's core interests under the Twenty-first Amendment.
7:23-25	<p style="text-align: center;"><u>Temperance</u></p> <p>10. The Washington State Legislature has not used the term "temperance" to describe the purpose of any of the challenged restraints. However, the Legislature has stated RCW 66.28.180 is</p>
8:1-25	<p>intended to promote "effective control of consumption," a statement that may be interpreted as an expression of the state's interest in promoting temperance. In the context of alcohol consumption, the term "temperance" may be understood as "restrained or moderate indulgence." <u>Black's Law Dictionary</u> (5<sup>th</sup> ed. 1979).</p> <p>11. Washington does not seek to promote "temperance" by promoting abstention or by reducing overall consumption of beer and wine. Indeed, the state actively promotes its domestic beer and wine industries and seeks to serve overall lawful demand for beer and wine.</p> <p>12. The parties have stipulated that "[o]n average, prices of beer and wine in Washington are somewhat higher than they would be in the absence of the restraints" challenged in this lawsuit. (Dkt.122 at 3). The amount of this average increase in beer and wine prices are not clearly established at trial. Defendants maintain that the challenged restraints promote temperance by increasing the average price of beer and wine in Washington state.</p> <p>13. Although the challenged restraints result on average in somewhat higher prices for beer and wine, this fact does not mean that all retailers pay higher prices for beer and wine than they would without the challenged restraints. Instead, the evidence suggests that the restraints allow some retailers to pay lower prices for beer and wine than they would without the restraints, while other retailers pay higher prices that they would without the restraints.</p> <p>14. In general, small retailers and retailers in remote locations tend to obtain lower prices for beer and wine than they would without the restraints because distributors must charge uniform prices to all retailers, regardless of actual delivery costs or the volume of products purchased. In effect, the restraints tend to make beer and wine more affordable for higher-cost retailers (such as small convenience stores or remote retailers), while raising prices for other retailers (such as large retailers).</p> <p>15. The Court is not persuaded that the state effectively promotes temperance by lowering the cost of beer and wine for some retailers, while raising the price of beer and wine for other retailers.</p>
9:1-25	<p>Indeed, this policy would appear to increase consumption by making it less expensive for consumers to obtain beer and wine at the most convenient and easily accessible locations.</p> <p>16. There is no persuasive evidence that the purpose of any of the challenged restraints was to promote temperance by raising average beer and wine prices. Prior to this litigation, neither the State Legislature nor the LCB expressed such a purpose. LCB member Vera Ing testified that it is not the LCB's policy to generally raise prices in order to reduce consumption of beer and wine. (Ing. Dep. at 17). Ms. Ing also testified that the LCB has "no mandate to increase or eliminate how the challenged restraints were necessary, effective, or sufficient in promoting temperance, the LCB responded by stating that the question "assume[ed] facts not in evidence, specifically, that the prohibitions and requirements at issue in this lawsuit have the goal. . . of promoting temperance." (Ex. 245 at 4).</p>

<u>Page:</u> <u>Lines</u>	<u>Excerpt</u>
	<p>17. The LCB has sometimes opposed efforts to increase the prices for wine at state liquor stores. In 1981, for instance, the LCB opposed a legislative proposal to increase wine prices in state stores, noting that “state liquor stores sell wine cheaper than grocery stores” and that under the proposed measure “[c]onsumers would suffer. Right now an estimated 500,000 people. . . choose to buy their wine at state stores because prices are lower.” (Ex. 60). Similarly, the LCB opposed a proposal in 1975 to eliminate the state’s role in wine sales, arguing that “[i]f the move to take the state out of the wine business is successful, the consumer will pay higher prices for wine.” (Ex. 51). Such statements do not reflect a consistent view by the LCB that higher wine prices are desirable or necessary to promote temperance.</p> <p>18. The Court is not persuaded that the challenged restraints are effective in promoting temperance, whether viewed individually or as a whole. To be sure, the evidence at trial indicated that Washington has one of the lowest rates in the country for per capita ethanol consumption per drinker, even though Washington ranks well above the national average in terms of the percentage of the</p>
10:1-25	<p>population who consume alcohol. As a result, it appears Washington residents who consume alcohol tend to drink more moderately than alcohol consumers who live in most other states. However, there is no persuasive evidence that the Washington’s relatively low rates of ethanol consumption per drinker are due to any of the challenged restraints, either viewed individually or as a whole.</p> <p>19. There has been little if any research or careful study on whether the type of restraints challenged in this litigation are effective in promoting temperance. Dr. Frank Chaloupka, an expert witness offered by Defendants, indicated that he was not aware of any published studies regarding the impact of the types of policies at issue in this case on alcohol consumption. (Ex. 581 at 16). In his writings, Dr. Chaloupka has also noted that “[i]n general, resulting in part from legal challenges initiated by alcoholic beverage wholesalers or retailers, state laws and regulations limiting competition in the alcoholic beverage markets have been relaxed over time.” He indicates that “empirical evidence on the impact of changes in these policies on alcoholic beverage prices, drinking, and its consequences is almost nonexistent. Clearly, more research is needed to fully understand the impact of the complex and varied policies that affect alcoholic beverage distribution, marketing, and pricing on the retail prices of these beverages.” (Ex. 337 at 547).</p> <p>20. The analyses offered by Dr. Chaloupka do not provide convincing evidence that the challenged restraints are effective in promoting temperance. In these analyses, Dr. Chaloupka concluded that the elimination of certain policies in Nebraska (price posting for wine and spirits and a ban on quantity discounts) and Delaware (a ban on quantity discounts on beer, wine, and spirits) resulted in higher rates of overall alcohol consumption than would have resulted if the restraints had remained in place. However, wine consumption in Nebraska actually decreased significantly after the restraints in that state were eliminated. In addition, Delaware is a small state located near Philadelphia, meaning that cross-border purchases of alcohol likely result in a significant percentage of alcohol sold in the state. The Court finds the critique of Dr. Chaloupka’s analyses offered by Plaintiff’s expert Michael Moore to be persuasive.</p>
11:1-7	<p>21. Washington has adopted a number of policies that may contribute to the state’s moderate rates of ethanol consumption per drinker. Among other things, the state exercises monopoly control over wholesale and retail sales of spirits, imposes relatively high excise taxes on beer and wine, has adopted policies targeting drinking and driving and youth access to alcoholic beverages, and has adopted rules allowing the implementation of “Alcohol Impact Areas.” As Plaintiff’s expert Michael Moore notes, “it is impossible to separately identify the effects of the policies at issue [in this litigation] from all of the other policies” adopted by Washington. (Ex. 240 at 16).</p>

<u>Page:</u> <u>Lines</u>	<u>Excerpt</u>
13:12-25	<p>30. The challenged restraints ensure that all retailers are able to purchase beer and wine from distributors at the same prices offered to larger retailers. The uniform pricing requirements (as reinforced by the delivered pricing requirement, as well as the bans on volume discounts, credit sales, and central warehousing) ensures that a distributor must charge the same price for a particular product to every retailer, regardless of actual delivery costs or other factors that may justify different prices. In the absence of the restraints, it is likely that smaller and more remote retailers would tend to pay somewhat higher prices for beer and wine than larger and more economically-efficient retailers.</p> <p>31. The Court regards these restraints as only minimally effective in promoting the state's interest in "orderly market conditions." In a sense, the challenged restraints make the beer and wine market in Washington somewhat more "orderly" by ensuring that all licensed retailers, regardless of their size, location, or efficiency, are able to purchase beer and wine at the same price from any given distributor. However, there is no persuasive evidence that smaller or remote retailers would be unable to survive economically without the challenged restraints or that they would otherwise be unable to purchase or profitably sell beer or wine.</p>
14:9-22	<p style="text-align: center;"><u>Raising Revenue</u></p> <p>33. The Court finds that the challenged restraints, viewed either individually or as a whole, are not effective in advancing the state's interest in raising revenue. There is no persuasive evidence that the challenged restraints play an appreciable role in raising revenue for the state or in ensuring efficient collection of taxes. Taxes on alcohol products can be collected at both the retailer and distributor level, just as sales taxes for other goods.</p> <p>34. If the state in fact wishes to promote temperance by artificially increasing the price of beer and wine, the challenged restraints appear to result in a significant amount of lost potential revenue for the state. The state could increase beer and wine prices by raising excise taxes, an action that would increase the state's revenues. By contrast, the challenged restraints increase the average price of beer and wine in a manner that leaves most of the increased revenue to beer and wine wholesalers, rather than the state. As Defendants' expert Frank Chaloupka testified, "somebody gets the money from the higher prices" and "the majority of the surplus would end up with the wholesalers."</p>
16:22-25	<p>7. The Court concludes that the challenged restraints are not preserved by the Twenty-first Amendment to the Constitution. As discussed above, these restraints are either ineffective or only of minimal effectiveness in promoting temperance, ensuring orderly markets, or raising revenue. To the extent that the restraints may have a minimal effect in advancing the state's core interests under the</p>
17:1-3	<p>Twenty-first Amendment, the state's interests do not outweigh the federal interest in promoting competition under the Sherman Act. Therefore, the Court concludes that the challenged restraints are preempted by the Sherman Act.</p>
20:19-24	<p style="text-align: center;"><u>Conclusion</u></p> <p>The restraints challenged by Costco are plainly anti-competitive, and there is no dispute that these restraints increase the average cost of beer and wine in Washington. Defendants argue that the restraints should nonetheless be upheld as a valid exercise of the state's power under the Twenty-first Amendment, notwithstanding their anti-competitive nature. However, the effectiveness of these restraints in advancing the state's interests under the Twenty-first Amendment has largely gone</p>
21:1-2	<p>unstudied, and there is little evidence that the restraints are effective in advancing the state's interests in promoting temperance, ensuring orderly market conditions, or raising revenue.</p>



<u>Page:</u> <u>Lines</u>	<u>Excerpt</u>
21:9-13	However, the Court's ruling does not leave the state powerless to achieve its legitimate interests of promoting temperance, ensuring orderly market conditions for beer and wine, and raising revenue. For example, the state may raise revenue through the sale of alcohol and the collection of taxes, control who is selling alcohol by enforcement of licensing, and educate the public on the societal costs of abusive alcohol consumption.