

INEBRIATED AND UNBALANCED: *TFWS, INC. V. SCHAEFER*'S MISGUIDED RECONCILIATION OF THE TWENTY-FIRST AMENDMENT WITH THE SHERMAN ACT

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INTRODUCTION

Imagine the State of Virginia has opted to forgo its state-operated, "ABC" liquor stores in favor of adopting a more free-market approach to retail sales. Although abandoning state-run stores, Virginia still intends to maintain some degree of regulatory control over liquor distribution and retail. As such, Virginia chooses to regulate with post-and-hold pricing, which would require liquor wholesalers to post their prices with the state agency and then keep those prices for a set number of days. This system prevents liquor sellers from discriminating among buyers, allows the state to constrain the range of prices offered, and generally leads to higher liquor prices. While Virginia has reason to believe the Twenty-First Amendment grants it the ability to regulate liquor within its borders in almost any capacity it chooses, recent Fourth and Ninth Circuit precedent suggests otherwise. Under the relevant case law, Virginia would have to demonstrate that its post-and-hold pricing system substantially furthers its relevant state interest. Otherwise, the system would face preemption by the federal antitrust laws. Given the current uncertainty present in this area of the law, Virginia is unlikely to adopt such a regulatory measure. This result detracts from state power under the Twenty-First Amendment in a manner that threatens federalism.

In the late 19th century, Congress responded to fears of growing industrial concentration by enacting section 1 of the Sherman Act to prevent contracts, combinations, or conspiracies in restraint of free trade.<sup>1</sup> In 1933, the Twenty-First Amendment ended the United States' fourteen-year prohibition of alcohol and gave states the ability to regulate the importation, dis-

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<sup>1</sup> See, e.g., *United States v. Von's Grocery Co.*, 384 U.S. 270, 274 (1966); see also 15 U.S.C. § 1 (2006). Congress passed the Sherman Act under its commerce power. See *Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 111 (1980) (quoting *Atl. Cleaners & Dyers, Inc. v. United States*, 286 U.S. 427, 435 (1932)).

tribution, and consumption of liquor.<sup>2</sup> To effectively regulate liquor within their borders, states have enacted a variety of different regulations.<sup>3</sup> Sometimes these regulations, while consistent with the Twenty-First Amendment, conflict with the Sherman Act.<sup>4</sup> The Supreme Court provided guidance on whether state control over liquor could be subject to the federal commerce power in *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*<sup>5</sup> when it explained, “[t]he competing state and federal interests can be reconciled only after careful scrutiny of those concerns in a ‘concrete case.’”<sup>6</sup>

In 2001, the Fourth Circuit articulated its own version of the *Midcal* balancing test in *TFWS, Inc. v. Schaefer*.<sup>7</sup> This two-step test (the “*TFWS* inquiry”) instructs courts to (1) examine the expressed state interest and the closeness of that interest to those protected by the Twenty-First Amendment and (2) examine whether—and to what extent—the regulatory scheme serves its stated purpose.<sup>8</sup> In April 2008, the Ninth Circuit used the *TFWS* inquiry to invalidate several liquor regulations in Washington State. Similarly, in July 2009, the Fourth Circuit decided the long-running antitrust lawsuit that had first prompted the *TFWS* inquiry and struck down Maryland’s post-and-hold pricing statute. The *TFWS* inquiry requires that federal courts evaluate the efficacy of state liquor regulations and has already resulted in the invalidation of two different state statutes. This Comment argues that federal courts should abandon the *TFWS* inquiry because it misconstrues Supreme Court precedent, threatens the federalist principles embodied in the Constitution, inappropriately requires judges to evaluate legislation, and contravenes the presumption against preemption. This Comment further recommends that federal courts should replace the *TFWS* inquiry with a rational basis standard of review in evaluating state liquor laws.

First, this Comment provides an overview of the Sherman Act, the Twenty-First Amendment, and basic principles of federalism. In Part II, this Comment explains when state power under the Twenty-First Amendment operates to exempt a state regulatory structure from Sherman Act preemption and why the Fourth Circuit’s recent redefinition of the *Midcal* balancing test is flawed. Part III demonstrates the problems presented by federal courts employing the *TFWS* inquiry and argues in favor of a rational basis standard of review. Part IV uses post-and-hold pricing to explore how the proposed rational basis standard leads to a preferable outcome, as compared

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<sup>2</sup> U.S. CONST. amend. XXI, § 2; see also *State Bd. of Equalization of Cal. v. Young’s Market Co.*, 299 U.S. 59, 62-63 (1936).

<sup>3</sup> See, e.g., RICHARD MCGOWAN, *GOVERNMENT REGULATION OF THE ALCOHOL INDUSTRY* 51-53 (1997).

<sup>4</sup> See, e.g., *Midcal*, 445 U.S. at 110.

<sup>5</sup> 445 U.S. 97 (1980).

<sup>6</sup> *Id.* at 110 (quoting *Hostetter v. Idlewild Bon Voyage Liquor Corp.*, 377 U.S. 324, 332 (1964)).

<sup>7</sup> 242 F.3d 198 (4th Cir. 2001).

<sup>8</sup> *Id.* at 213.

to the *TFWS* inquiry, and better coheres with Twenty-First Amendment precedent.

I. THE SHERMAN ACT, THE TWENTY-FIRST AMENDMENT, AND FEDERALISM

A. *The Sherman Act*

After the Civil War, the American economy changed substantially, resulting in the rapid growth of national markets.<sup>9</sup> In this new national market economy, large producers began to capture greater shares of local markets and drive out smaller firms.<sup>10</sup> By the late nineteenth century, trusts—or business entities formed to monopolize certain industries—ran rampant.<sup>11</sup> Lawmakers feared the concentration of industry into “the hands of a few,” as opposed to competition between many firms, because they believed concentration led to higher prices and therefore harmed consumers.<sup>12</sup> Thus, in 1890, Congress passed the Sherman Act<sup>13</sup> in an attempt to prevent concentration and preserve competition.<sup>14</sup>

Section 1 of the Sherman Act outlaws “[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade.”<sup>15</sup> Section 2 makes it illegal for any person to “monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce.”<sup>16</sup>

The Supreme Court has stated that Congress “exercis[ed] all the power it possessed” under the Commerce Clause in passing the Sherman Act.<sup>17</sup> The Court has also opined on the federal interest in competition policy,

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<sup>9</sup> DON E. WALDMAN & ELIZABETH J. JENSEN, *INDUSTRIAL ORGANIZATION: THEORY AND PRACTICE* 557 (2d ed. 2001).

<sup>10</sup> *Id.*

<sup>11</sup> See *United States v. Von's Grocery Co.*, 384 U.S. 270, 274 (1966); see also ANDREW I. GAVIL, WILLIAM E. KOVACIC & JONATHAN B. BAKER, *ANTITRUST LAW IN PERSPECTIVE: CASES, CONCEPTS AND PROBLEMS IN COMPETITION POLICY 2* (2d ed. 2008) (defining trusts as the combination of “the power to make pricing and output decisions for entire industries” in “one enterprise”).

<sup>12</sup> See 1 PHILLIP E. AREEDA & HERBERT HOVENKAMP, *ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION* ¶ 103a (3d ed. 2006).

<sup>13</sup> For more information on the Sherman Act, see Richard S. Markovits, *The American Antitrust Laws on the Centennial of the Sherman Act: A Critique of the Statutes Themselves, Their Interpretation, and Their Operationalization*, 38 *BUFF. L. REV.* 673 (1990).

<sup>14</sup> *Von's Grocery*, 384 U.S. at 274.

<sup>15</sup> 15 U.S.C. § 1 (2006).

<sup>16</sup> *Id.* § 2.

<sup>17</sup> *Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 111 (1980) (alteration in original) (quoting *Atl. Cleaners & Dyers, Inc. v. United States*, 286 U.S. 427, 435 (1932)) (internal quotation marks omitted).

declaring that the “[a]ntitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise. They are as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms.”<sup>18</sup> Given the origin of the antitrust laws in Congress’s commerce power and the importance of competition policy to the United States’ free market economy, the relevant federal interest embodied in the Sherman Act remains significant. The Sherman Act has maintained its force since 1890 and continues to be utilized by the federal government as one of the primary statutes for antitrust enforcement.<sup>19</sup>

Under section 1, courts have traditionally recognized two categories of restraints. One category of offenses is “illegal per se” violations, which are conclusively presumed to constitute unreasonable restraints of trade.<sup>20</sup> For instance, early section 1 cases established a per se ban on price-fixing agreements, as explained by Justice Stone in *United States v. Trenton Potteries Co.*,<sup>21</sup> “[t]he aim and result of every price-fixing agreement, if effective, is the elimination of one form of competition. The power to fix prices, whether reasonably exercised or not, involves power to control the market and to fix arbitrary and unreasonable prices.”<sup>22</sup> The second category of restraints is composed of anticompetitive behaviors that are not illegal per se, but for which courts employ a “rule of reason” analysis. As described by the Supreme Court in *National Society of Professional Engineers v. United States*,<sup>23</sup> the rule of reason requires an analysis of “the facts particular to the business, the history of the restraint, and the reasons why it was imposed.”<sup>24</sup> In recent years, however, courts in section 1 cases have begun to move away from “focusing upon the category to which a particular restraint should be assigned”<sup>25</sup> and to pay more attention to the essential inquiry under section 1: “whether . . . the challenged restraint enhances competition.”<sup>26</sup>

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<sup>18</sup> *Id.* at 110-11 (quoting *United States v. Topco Assocs., Inc.*, 405 U.S. 596, 610 (1972)).

<sup>19</sup> *See, e.g.*, Christine A. Varney, Assistant Att’y Gen., U.S. Dep’t of Justice, Antitrust Div., Remarks as Prepared for the U.S. Chamber of Commerce: Vigorous Antitrust Enforcement in This Challenging Era 5 (May 12, 2009), <http://www.justice.gov/atr/public/speeches/245777.pdf> (explaining how “[v]igorous antitrust enforcement action under Section 2 of the Sherman Act” will be part of the Antitrust Division’s contribution to the federal government’s response to the economic crisis).

<sup>20</sup> *See Nat’l Soc’y of Prof’l Eng’rs v. United States*, 435 U.S. 679, 692 (1978) (emphasis removed) (defining agreements that are “illegal *per se*” as “agreements whose nature and necessary effect are so plainly anticompetitive that no elaborate study of the industry is needed to establish their illegality” (internal quotation marks omitted)).

<sup>21</sup> 273 U.S. 392 (1927).

<sup>22</sup> *Id.* at 397.

<sup>23</sup> 435 U.S. 679 (1978).

<sup>24</sup> *Id.* at 692.

<sup>25</sup> *Polygram Holding, Inc. v. FTC*, 416 F.3d 29, 35 (D.C. Cir. 2005).

<sup>26</sup> *Id.* (quoting *Cal. Dental Ass’n v. FTC*, 526 U.S. 756, 779-80 (1999)) (internal quotation marks omitted).

Section 2 of the Sherman Act addresses single-firm conduct by outlawing monopolization, attempts to monopolize,<sup>27</sup> and conspiracies and combinations to monopolize.<sup>28</sup> To succeed in demonstrating that a firm has violated section 2 of the Sherman Act, a plaintiff must show the possession of monopoly power and the “willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident.”<sup>29</sup> One of the early cases brought under section 2 of the Sherman Act, *Standard Oil Co. of New Jersey v. United States*,<sup>30</sup> established the “rule of reason.” The rule states that only unreasonable attempts to monopolize constitute violations.<sup>31</sup> In *Standard Oil*, the Court determined that a single firm’s actions, which went beyond “normal methods of industrial development,” were unreasonable.<sup>32</sup> The Sherman Act embodies the federal government’s interest in market-based competition and remains a primary antitrust enforcement statute today.

#### B. *The Twenty-First Amendment*

Congress has only amended the United States Constitution twenty-seven times. Two of these amendments involved liquor regulation: the Eighteenth Amendment<sup>33</sup> and the Twenty-First Amendment.<sup>34</sup> The Eighteenth Amendment, ratified in 1919, outlawed the “manufacture, sale, or transportation of intoxicating liquors within, the importation thereof into, or the exportation thereof from the United States.”<sup>35</sup> Congress also passed the Volstead Act,<sup>36</sup> formally known as the National Prohibition Act, in 1919 to

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<sup>27</sup> As the Court explained in *Spectrum Sports, Inc. v. McQuillan*, “[a] plaintiff charging attempted monopolization must prove a dangerous probability of actual monopolization, which has generally required a definition of the relevant market and examination of market power.” *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 455 (1993).

<sup>28</sup> *Id.* at 454.

<sup>29</sup> *Verizon Commc’ns. Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 407 (2004) (quoting *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966)).

<sup>30</sup> 221 U.S. 1 (1911).

<sup>31</sup> *Id.* at 75; see also WALDMAN & JENSEN, *supra* note 9, at 557. For more information on the rule of reason, see Brian Winrow & Kevin Johnson, *The Rule of Law is the Rule of Reason*, 84 N.D. L. REV. 59 (2008).

<sup>32</sup> *Standard Oil Co. of N.J.*, 221 U.S. at 75.

<sup>33</sup> See U.S. CONST. amend. XVIII (repealed 1933).

<sup>34</sup> See U.S. CONST. amend. XXI.

<sup>35</sup> U.S. CONST. amend. XVIII, § 1 (repealed 1933).

<sup>36</sup> Congress passed the Volstead Act after the ratification of the Eighteenth Amendment to define “intoxicating liquors” and implement the Amendment. See NAT’L COMM’N ON LAW OBSERVANCE AND ENFORCEMENT, REPORT ON THE ENFORCEMENT OF THE PROHIBITION LAWS OF THE UNITED STATES (1931), available at <http://www.druglibrary.org/schaffer/Library/studies/wick/wick1.html>. The Act had three purposes: (1) to “prohibit intoxicating beverages,” (2) to “regulate the manufacture, production,

reinforce the Eighteenth Amendment's prohibition of the manufacture, sale, transportation, or importation of alcoholic beverages in the United States.<sup>37</sup> The period between the Eighteenth and Twenty-First Amendments is commonly referred to as "Prohibition."

By most estimates, the United States' experiment with temperance failed. During Prohibition, alcohol consumption increased approximately 12 percent,<sup>38</sup> and drinking moved "underground," which fueled violence and crime, particularly in large cities.<sup>39</sup> Prohibition's failure to eradicate alcohol consumption, the popular belief that outlawing alcohol had exacerbated political corruption, and the onset of the Great Depression all combined to produce a movement to repeal the Eighteenth Amendment.<sup>40</sup> In 1933, only fourteen years after the passage of the Eighteenth Amendment and the Volstead Act, Congress ratified the Twenty-First Amendment, ending Prohibition.<sup>41</sup> The Twenty-First Amendment reads:

Section 1. The eighteenth article of amendment to the Constitution of the United States is hereby repealed.

Section 2. The transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited.

Section 3. This article shall be inoperative unless it shall have been ratified as an amendment to the Constitution by conventions in the several States, as provided in the Constitution, within seven years from the date of the submission hereof to the States by the Congress.<sup>42</sup>

The Supreme Court has interpreted section 2 of the Twenty-First Amendment to give states the power to regulate alcohol within their borders.<sup>43</sup> Accordingly, although the federal government continues to impose excise taxes on alcohol,<sup>44</sup> as well as regulate safety,<sup>45</sup> the states are responsible for regulating the distribution and consumption of alcohol.<sup>46</sup>

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use and sale of high proof spirits for other than beverage purposes," and (3) to "insure an ample supply of alcohol and promote its use in scientific research and in the development of fuel, dye and other lawful industries." *Id.* (internal quotation marks omitted). It also officially outlawed the manufacturing, selling, bartering, transporting, importing, exporting, delivering, or furnishing of any intoxicating liquor, defined as any beverage containing more than .5 percent alcohol. *Id.*

<sup>37</sup> National Prohibition (Volstead) Act, ch. 85, 41 Stat. 305 (1919), *repealed by* U.S. CONST. amend. XXI.

<sup>38</sup> Carole L. Jurkiewicz & Murphy J. Painter, *Why We Control Alcohol the Way We Do*, in *SOCIAL AND ECONOMIC CONTROL OF ALCOHOL* 1, 6 (Carole L. Jurkiewicz & Murphy J. Painter eds., 2008).

<sup>39</sup> *See id.*

<sup>40</sup> Sidney J. Spaeth, Comment, *The Twenty-First Amendment and State Control over Intoxicating Liquor: Accommodating the Federal Interest*, 79 CAL. L. REV. 161, 178-79 (1991).

<sup>41</sup> U.S. CONST. amend. XXI.

<sup>42</sup> *Id.*

<sup>43</sup> *See State Bd. of Equalization of Cal. v. Young's Market Co.*, 299 U.S. 59, 62-63 (1936).

<sup>44</sup> MCGOWAN, *supra* note 3, at 51.

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

Since the repeal of Prohibition, states have approached alcohol regulation in a variety of ways.<sup>47</sup> After Congress passed the Twenty-First Amendment, states enacted legislation to separate alcohol manufacturers from alcohol retailers to combat the organized crime problems of the Prohibition era.<sup>48</sup> States have since approached this end in two primary ways. Eighteen states, known as “control” states, directly regulate alcohol by controlling retail and/or wholesale distribution.<sup>49</sup> In comparison, the remaining states are “license” states that permit retail alcohol sales in privately operated stores.<sup>50</sup> A desire to separate the production of alcohol and the sale of alcohol led states, particularly license states, to institute a “three-tiered system” that divided the industry into supplier, wholesaler, and retailer levels.<sup>51</sup> Other state liquor regulations include a minimum markup price for the wholesale and retail tiers to maintain alcohol at a certain price level.<sup>52</sup> In addition to these types of regulations, states also impose excise taxes on alcohol.<sup>53</sup>

A controversial example of state liquor regulation is post-and-hold pricing, sometimes referred to as “price posting” or “posted pricing.”<sup>54</sup> Post-and-hold pricing statutes require liquor distributors to announce price lists and to keep those price lists for a specified amount of time.<sup>55</sup> Although mostly implemented at the wholesale level, in the past, some states have also imposed post-and-hold pricing laws on retailers.<sup>56</sup> State rationales for enacting post-and-hold pricing statutes include: the prevention of price dis-

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<sup>47</sup> See, e.g., *id.* at 51-53.

<sup>48</sup> Jurkiewicz & Painter, *supra* note 38, at 8. Professor Carole L. Jurkiewicz and Doctor Murphy J. Painter explain that separating those who made alcohol from those who sold it was aimed “(1) to clean up the system and (2) to rid it of its unsavory rum running association imposed by Prohibition.” *Id.* The organized crime influences would be “weed[ed] out” through the process of creating separate licensed entities, which would ensure a transparent and accountable system. *Id.*

<sup>49</sup> MCGOWAN, *supra* note 3, at 52. As of October 2009, Alabama, Idaho, Iowa, Maine, Michigan, Mississippi, Montana, New Hampshire, North Carolina, Ohio, Oregon, Pennsylvania, Utah, Vermont, Virginia, Washington, West Virginia, and Wyoming are members of the National Alcohol Beverage Control Association. *The Control States*, NAT’L ALCOHOL BEVERAGE CONTROL ASS’N, <http://www.nabca.org/States/States.aspx#> (last visited July 17, 2010); see also MCGOWAN, *supra* note 3, at 52.

<sup>50</sup> See MCGOWAN, *supra* note 3, at 52.

<sup>51</sup> Evan T. Lawson, *The Future of the Three-Tiered System as a Control of Marketing Alcoholic Beverages*, in *SOCIAL AND ECONOMIC CONTROL OF ALCOHOL*, *supra* note 38, at 31.

<sup>52</sup> Jurkiewicz & Painter, *supra* note 38, at 9.

<sup>53</sup> *Id.*; see also MCGOWAN, *supra* note 3, at 53.

<sup>54</sup> For more detail about post-and-hold pricing, see *infra* Part IV.A.

<sup>55</sup> See, e.g., John E. Lopatka & William H. Page, *State Action and the Meaning of Agreement Under the Sherman Act: An Approach to Hybrid Restraints*, 20 YALE J. ON REG. 269, 310-11 (2003).

<sup>56</sup> See, e.g., 204 MASS. CODE REGS. 6.03 (2009); see also Julian L. Simon & David M. Simon, *The Effects of Regulations on State Liquor Prices*, 23 EMPIRICA 303, 304-05 (1996).

crimination and other discriminatory trade practices,<sup>57</sup> the promotion of temperance,<sup>58</sup> and the elimination of price wars.<sup>59</sup> Regardless of the rationales on which these post-and-hold pricing regulations rest, they have been attacked on the ground that they violate the Sherman Act.<sup>60</sup> Specifically, opponents of such schemes argue that post-and-hold pricing violates anti-trust law because a state requiring liquor wholesalers to post prices prevents price competition and constitutes a “restraint of trade.”<sup>61</sup> In sum, the Twenty-First Amendment reserves the power to regulate liquor to the states, but post-and-hold pricing statutes illustrate the problems that can arise when these regulations conflict with federal law.

### C. *Federalism*

State control over liquor, as embodied in the Twenty-First Amendment, is the only state power explicitly listed in the Constitution.<sup>62</sup> The Twenty-First Amendment transferred control over alcohol regulation from the federal government to the states.<sup>63</sup> According to a leading constitutional law treatise: “[t]he Twenty-first-Amendment reserved for the states the power to restrict the importation, sale, and local use of alcoholic beverages without being subject to the same type of commerce clause restraints as are applicable to state regulations of other commodities in interstate commerce.”<sup>64</sup> However, the Twenty-First Amendment did not repeal federal authority over alcohol.<sup>65</sup>

The Framers of the U.S. Constitution established a federalist system, which provided the national government with certain enumerated powers and reserved any remaining powers to the states.<sup>66</sup> The classic theory of

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<sup>57</sup> N.Y. STATE LAW REVISION COMM’N, PRELIMINARY REPORT ON THE ALCOHOLIC BEVERAGE CONTROL LAW AND ITS ADMINISTRATION 43-44 (2008), available at [www.lawrevision.state.ny.us/PreliminaryReportrv90208.pdf](http://www.lawrevision.state.ny.us/PreliminaryReportrv90208.pdf).

<sup>58</sup> Brief of Appellant Liquor Control Board Members at 9, *Costco Wholesale Corp. v. Maleng*, 522 F.3d 874 (9th Cir. 2008) (No. CV04-0360P).

<sup>59</sup> Brief of Appellees & Cross-Appellants at 8, *TFWS, Inc. v. Schaefer*, 242 F.3d 198 (4th Cir. 2001) (Nos. 99-2279, 99-2342).

<sup>60</sup> See, e.g., *Battipaglia v. N.Y. State Liquor Auth.*, 745 F.2d 166, 167 (2d Cir. 1984) (arising because liquor wholesaler sought a declaration that the post-and-hold provision of New York’s Alcoholic Beverage Control Law violated section 1 of the Sherman Act and was therefore invalid under the Supremacy Clause).

<sup>61</sup> *Id.* at 167 (internal quotation marks omitted); see also AREEDA & HOVENKAMP, *supra* note 12, ¶ 217 (explaining how voluntary exchanges of price information have been held per se unlawful for facilitating horizontal collusion).

<sup>62</sup> JOSEPH F. ZIMMERMAN, *FEDERAL PREEMPTION: THE SILENT REVOLUTION* 148 (1991).

<sup>63</sup> See Jurkiewicz & Painter, *supra* note 38, at 8.

<sup>64</sup> JOHN E. NOWAK & RONALD D. ROTUNDA, *CONSTITUTIONAL LAW* § 4.9, n.33 (7th ed. 2004).

<sup>65</sup> *Id.*

<sup>66</sup> See, e.g., *New York v. United States*, 505 U.S. 144, 155 (1992).

dual federalism is defined by the complete separation of national and state powers, with Congress possessing a number of exclusive powers, and the states possessing certain powers not typically subject to national control.<sup>67</sup> When Congress exercises a granted power, however, the federal statute is said to preempt, or take the place of, any existing concurrent state legislation.<sup>68</sup> This is a direct result of the Constitution's Supremacy Clause,<sup>69</sup> which the Supreme Court has interpreted to require that federal law takes precedence over state law in the event of a conflict.<sup>70</sup> Therefore, in instances where Congress lawfully expresses intent to do so, federal law preempts state law.<sup>71</sup>

The federalist system distributes power between the national government and the state governments.<sup>72</sup> Although the Twenty-First Amendment gives states broad power to regulate liquor, this power sometimes conflicts with the federal government's powers, particularly the Commerce Clause.<sup>73</sup> For example, in *South Dakota v. Dole*,<sup>74</sup> the Court upheld a federal statute conditioning each state's receipt of federal highway funds on the establishment of a minimum drinking age.<sup>75</sup> The Court held that this was proper federal legislation under the Commerce Clause and also that the statute did not require South Dakota to give up any of its Twenty-First Amendment powers.<sup>76</sup> The Supreme Court also clarified the limits of state power under the Twenty-First Amendment in *Granholm v. Heald*.<sup>77</sup> In *Granholm*, out-of-state wineries and in-state residents challenged state laws that discriminated against out-of-state wineries by preventing them from shipping directly to in-state customers.<sup>78</sup> The Court held that these regulations violated the non-discrimination principle of the Commerce Clause and that the Twenty-First Amendment did not supersede other constitutional provisions.<sup>79</sup> By comparison, in *North Dakota v. United States*,<sup>80</sup> the Court upheld the application

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<sup>67</sup> ZIMMERMAN, *supra* note 62, at 148.

<sup>68</sup> NOWAK & ROTUNDA, *supra* note 64, § 9.1.

<sup>69</sup> U.S. CONST. art. VI, cl. 2 ("This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.").

<sup>70</sup> NOWAK & ROTUNDA, *supra* note 64, § 9.1.

<sup>71</sup> *See id.*

<sup>72</sup> *See* BLACK'S LAW DICTIONARY 644 (8th ed. 2004).

<sup>73</sup> U.S. CONST. art. I, § 8, cl. 3. Moreover, although the Twenty-First Amendment reserves liquor regulation powers to the states, it does not preclude federal regulation. *See, e.g., South Dakota v. Dole*, 483 U.S. 203, 209 (1987).

<sup>74</sup> 483 U.S. 203 (1987).

<sup>75</sup> *Id.* at 205.

<sup>76</sup> *Id.* at 209.

<sup>77</sup> 544 U.S. 460 (2005).

<sup>78</sup> *Id.* at 465-66.

<sup>79</sup> *Id.* at 487.

<sup>80</sup> 495 U.S. 423 (1990).

of North Dakota's state liquor regulations to the Department of Defense within North Dakota's borders.<sup>81</sup> The Court found no clear preemption by federal law and concluded that the regulations requiring an out-of-state liquor supplier to label bottles and report the volume transported fell within the state's power to regulate liquor distribution.<sup>82</sup>

Therefore, state power under the Twenty-First Amendment is not unlimited. As demonstrated by *South Dakota* and *Granholm*, states may not exercise their liquor regulatory power in a manner that contravenes constitutional provisions. At the same time, however, the Twenty-First Amendment empowers state regulation over liquor and constrains Congress's ability to exercise federal power in this area.

## II. WHEN DOES THE TWENTY-FIRST AMENDMENT EXEMPT A STATE REGULATORY SYSTEM FROM THE SHERMAN ACT?

When opponents of a state liquor regulation challenge the regulation on grounds that it violates the Sherman Act, a court must determine two things: (1) whether the state regulation actually violates the Sherman Act, and (2) whether the Twenty-First Amendment saves the offending regulation from preemption.<sup>83</sup> The first section introduces the two-pronged balancing test from *Midcal*, which courts use to determine whether state alcohol regulations are lawful. The second section discusses how courts must determine, as a threshold issue, whether the state regulation actually violates the Sherman Act. The third section illustrates how a regulatory scheme avoided preemption on Twenty-First Amendment grounds prior to *TFWS*. The final section introduces the Fourth Circuit's redefinition of the *Midcal* test, the *TFWS* inquiry, and briefly outlines the alternative approach advocated.

### A. *The Midcal Test*

States utilize their Twenty-First Amendment powers to regulate liquor inside their borders. At times, these regulatory structures conflict with the federal commerce power as it is embodied in the Sherman Act. When a lawsuit poses an antitrust challenge to a state's liquor regulations, courts use the balancing test from *Midcal* to weigh the relative interests.<sup>84</sup>

In *Midcal*, a wine distributor challenged California's wine pricing statutes, which required producers and wholesalers to provide the state with

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<sup>81</sup> *Id.* at 433.

<sup>82</sup> *Id.*

<sup>83</sup> *See* Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97, 111 (1980).

<sup>84</sup> *See id.*

resale price schedules.<sup>85</sup> The Supreme Court analyzed the case in two stages. First, it considered whether the state regulation violated the Sherman Act.<sup>86</sup> The Court held that the regulation violated the Sherman Act because the pricing system amounted to resale price maintenance and therefore constituted an illegal restraint of trade.<sup>87</sup>

Second, the Court examined whether the Twenty-First Amendment could save the offending regulation from preemption by the Sherman Act.<sup>88</sup> The Court rejected California's defense that it was exempt from the Sherman Act based on its Twenty-First Amendment powers.<sup>89</sup> In discussing the limits of state power under the Twenty-First Amendment, the Court concluded that there was no "bright line between federal and state powers over liquor," and that "[a]lthough States retain substantial discretion to establish other liquor regulations, those controls may be subject to the federal commerce power in appropriate situations."<sup>90</sup> The Court went on to clarify that "[t]he competing state and federal interests can be reconciled only after careful scrutiny of those concerns in a 'concrete case.'"<sup>91</sup> Thus, the Court intimated that in a particular case, a state's Twenty-First Amendment powers could trump antitrust concerns. Applying this standard to the facts in *Midcal*, the Court determined that because the record did not indicate that the wine pricing system furthered the state interest in sustaining small retail establishments, "[t]he unsubstantiated state concerns . . . [were] not of the same stature as the goals of the Sherman Act."<sup>92</sup> Although the Court ruled against California's pricing system, *Midcal* established the balancing test that later courts have utilized to determine when a state's interest under the Twenty-First Amendment can overcome federal antitrust law.<sup>93</sup>

In sum, the *Midcal* test consists of two prongs. First, the court must determine if the scheme violates the Sherman Act. Then, upon finding a

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<sup>85</sup> *Id.* at 99.

<sup>86</sup> *Id.* at 102.

<sup>87</sup> *Id.* at 102-03.

<sup>88</sup> *Id.* at 111.

<sup>89</sup> *Midcal*, 445 U.S. at 111. In addition, the Court also determined that state action immunity did not apply because California neither set nor reviewed the privately fixed resale prices for reasonableness. *Id.* at 105-06.

<sup>90</sup> *Id.* at 110. The Supreme Court has also recognized the limits of the state power by holding that the Twenty-First Amendment has not operated to repeal the Commerce Clause. *Granholm v. Heald*, 544 U.S. 460, 487 (2005) (holding that New York statutes imposing additional burdens on out-of-state wineries shipping to New York consumers were unconstitutional under the Commerce Clause); see also Todd Zywicki & Asheesh Agarwal, *Wine, Commerce, and the Constitution*, 1 N.Y.U.J.L. & LIBERTY 609, 640-44 (2005).

<sup>91</sup> *Midcal*, 445 U.S. at 110.

<sup>92</sup> *Id.* at 113-14.

<sup>93</sup> See, e.g., *Miller v. Hedlund*, 813 F.2d 1344, 1352 (9th Cir. 1987) (interpreting *Midcal* to require a weighing of the "substantial" federal interest in the Sherman Act against "the state's interest the challenged regulations serve").

violation, the court must determine whether the Twenty-First Amendment saves the scheme.

B. *Midcal Prong One: Does the State Regulation Violate the Sherman Act?*

In determining if a particular regulatory scheme runs afoul of the Sherman Act, courts assess whether the regulation at issue is a “unilateral” or a “hybrid” restraint.<sup>94</sup> A unilateral restraint is one in which complete control of the restraint remains with the government.<sup>95</sup> Professors John E. Lopatka and William H. Page contrast the characteristics of unilateral and hybrid restraints. The authors note that “a unilateral governmental restraint is one in which public officials determine the nature and extent of the resulting consumer injury” whereas “[a] hybrid restraint, by contrast, is one in which the government specifically empowers private actors to exercise discretion as to the nature or level of consumer injury in a way that closely resembles an antitrust violation.”<sup>96</sup> Lopatka and Page also suggest that distinguishing between unilateral and hybrid restraints requires, “an examination of the underlying goals of the relevant antitrust rules . . . as well as the idiosyncrasies of the government action at issue.”<sup>97</sup> Specifically, hybrid restraints will be marked by “private discretion in the decision-making process” and the government enforcing these private arrangements.<sup>98</sup> The authors argue that because a hybrid restraint consists of private actors exercising discretion, such a restraint resembles an antitrust violation.<sup>99</sup>

When courts determine that a particular regulation constitutes a unilateral restraint, this is equivalent to a finding that the regulation does not violate the antitrust laws.<sup>100</sup> For example, in *Fisher v. City of Berkeley*,<sup>101</sup> the City of Berkeley enacted a rent control ordinance in which the Rent Stabilization Board set rental rates for all real property.<sup>102</sup> In finding that the rent control ordinance did not violate the Sherman Act, the Court explained that “[a] restraint imposed unilaterally by government does not become concerted-action within the meaning of the [Sherman Act] simply because it

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<sup>94</sup> See, e.g., *Costco Wholesale Corp. v. Maleng*, 522 F.3d 874, 886-87 (9th Cir. 2008) (internal quotation marks omitted).

<sup>95</sup> See *Fisher v. City of Berkeley*, 475 U.S. 260, 266-67 (1986).

<sup>96</sup> Lopatka & Page, *supra* note 55, at 273.

<sup>97</sup> *Id.*

<sup>98</sup> *Id.* at 287, 289-90.

<sup>99</sup> See *id.* at 323.

<sup>100</sup> See, e.g., *Costco Wholesale Corp. v. Maleng*, 522 F.3d 874, 890 (9th Cir. 2008) (“[T]he ban on sales by retailers to other retailers is a unilateral restraint of trade that is not subject to preemption by the Sherman Act.”).

<sup>101</sup> 475 U.S. 260 (1986).

<sup>102</sup> *Id.* at 262-63.

has a coercive effect upon parties who must obey the law.”<sup>103</sup> In *Fisher*, the Court held that the rent control ordinance was a unilateral restraint because the Rent Stabilization Board had complete control over the rent levels and there was no private regulatory power.<sup>104</sup>

Other courts have reached similar conclusions. In *Massachusetts Food Ass’n v. Massachusetts Alcoholic Beverages Control Commission*,<sup>105</sup> Massachusetts state law prohibited individuals from owning more than three retail liquor stores.<sup>106</sup> The First Circuit found that this amounted to unilateral action and thus did not violate the Sherman Act because “the state has not ordered or authorized private parties to engage in conduct that, absent immunity, would even arguably violate the antitrust laws; there is no private agreement or arrangement between retailers as to the number of retail outlets and therefore no violation to be shielded.”<sup>107</sup> Similarly, in *Costco Wholesale Corp. v. Maleng*,<sup>108</sup> the Ninth Circuit determined that a number of Washington State’s challenged liquor regulations were unilateral restraints of trade and thus were not preempted by the Sherman Act.<sup>109</sup> These unilateral restraints included a ban on retail-to-retail sales, a central warehousing ban, a volume discount ban, a delivered pricing requirement, a credit ban, a uniform pricing requirement, and a minimum markup requirement.<sup>110</sup> In analyzing these challenged provisions, the Ninth Circuit determined that the regulations did not run afoul of the antitrust laws because they failed to delegate discretion to private individuals.<sup>111</sup> These decisions illustrate that when a court determines that a state regulation does not create private regulatory power, it will typically find a unilateral restraint and therefore that the regulation does not violate the Sherman Act.

On the other hand, courts may determine that a state regulation constitutes a hybrid restraint. While unilateral restraints do not violate the Sherman Act, a finding that a regulation constitutes a hybrid restraint is a necessary, though not sufficient, condition for a subsequent conclusion that the regulation violates the Sherman Act.<sup>112</sup> A hybrid restraint occurs where a regulation “contemplates a private market decision but provides a non-

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<sup>103</sup> *Id.* at 267.

<sup>104</sup> *Id.* Professors Phillip E. Areeda and Herbert Hovenkamp explain in their leading antitrust treatise that the presence of public control was the distinguishing aspect that “saved” the Berkeley ordinance from preemption. AREEDA & HOVENKAMP, *supra* note 12, ¶ 217b3.

<sup>105</sup> 197 F.3d 560 (1st Cir. 1999).

<sup>106</sup> *Id.* at 562.

<sup>107</sup> *Id.* at 564.

<sup>108</sup> 522 F.3d 874 (9th Cir. 2008).

<sup>109</sup> *Id.* at 901.

<sup>110</sup> *Id.*

<sup>111</sup> *See id.* at 891-92, 899-901.

<sup>112</sup> *Canterbury Liquors & Pantry v. Sullivan*, 16 F. Supp. 2d 41, 46 (D. Mass. 1998) (explaining that a hybrid restraint does not necessarily involve a violation of the Sherman Act).

market mechanism for enforcing the decision.”<sup>113</sup> In *Rice v. Norman Williams Co.*,<sup>114</sup> liquor importers challenged California’s “designation statute” on antitrust grounds.<sup>115</sup> This statute prevented a “licensed importer” from purchasing or otherwise receiving alcohol unless he was “designated as an authorized importer of such brand by the brand owner.”<sup>116</sup> The issue in the case was whether the statute constituted a per se violation of the Sherman Act by giving brand owners discretion over who could compete at the import level.<sup>117</sup> The Supreme Court held that the manner in which a distiller utilizes the statute and arrangements between distillers and wholesalers was subject to Sherman Act analysis.<sup>118</sup> In his concurrence, Justice Stevens articulated the idea of the hybrid restraint as a non-market mechanism that oversees a private restraint of trade.<sup>119</sup> He explained that the designation statute fit this definition because it enforced the distillers’ resale price restrictions on importers.<sup>120</sup>

When courts determine that a particular regulation is a hybrid restraint, this often, but not always,<sup>121</sup> leads to a finding that it is also a per se violation of federal antitrust law. However, the converse is nearly always true: when courts find a unilateral restraint, they also do not find an antitrust violation.<sup>122</sup> For example, the Supreme Court found a hybrid restraint in *324 Liquor Corp. v. Duffy*.<sup>123</sup> In *324 Liquor*, a retail liquor and wine dealer challenged a New York law that required retailers to charge 112 percent of the wholesale liquor price.<sup>124</sup> The Court found that this was a hybrid restraint because the private actors had control over wholesale liquor prices and markup, which indicated the existence of the “private regulatory power” discussed in *Fisher*.<sup>125</sup>

To determine whether or not the state regulation in question is exempt from the Sherman Act on the basis of state power under the Twenty-First Amendment, a court must first determine whether the particular regulation violates the Sherman Act. Accordingly, courts only move on to *Midcal*’s

<sup>113</sup> *Rice v. Norman Williams Co.*, 458 U.S. 654, 665 (1982) (Stevens, J., concurring); see also AREEDA & HOVENKAMP, *supra* note 12, ¶ 217b3 (defining a hybrid restraint in the context of *Fisher v. City of Berkeley* and *California Retail Liquor Dealers Ass’n v. Midcal Aluminum, Inc.* as “creating unsupervised private power in derogation of competition”).

<sup>114</sup> 458 U.S. 654 (1982).

<sup>115</sup> *Id.* at 657-58.

<sup>116</sup> *Id.* at 656-57 (quoting CAL. BUS. & PROF. CODE § 23672 (West 1997)) (internal quotation marks omitted).

<sup>117</sup> See *id.* at 658.

<sup>118</sup> *Id.* at 662.

<sup>119</sup> *Id.* at 665-68 (Stevens, J., concurring).

<sup>120</sup> *Rice*, 458 U.S. at 667-68 (Stevens, J., concurring).

<sup>121</sup> See *Canterbury Liquors & Pantry v. Sullivan*, 16 F. Supp. 2d 41, 46 (D. Mass. 1998).

<sup>122</sup> See, e.g., *Fisher v. City of Berkeley*, 475 U.S. 260, 267 (1986).

<sup>123</sup> 479 U.S. 335 (1987).

<sup>124</sup> *Id.* at 337.

<sup>125</sup> *Id.* at 345 n.8 (quoting *Fisher*, 475 U.S. at 268) (internal quotation marks omitted).

second prong after finding that a regulation violates the Sherman Act. The primary way in which courts make this initial threshold determination is by categorizing the regulation as a unilateral restraint or a hybrid restraint. As demonstrated by Supreme Court precedent, courts typically find that hybrid restraints run afoul of the Sherman Act because they amount to private actors acting anticompetitively rather than government-imposed restraints.<sup>126</sup>

C. *Midcal Prong Two: Does the Twenty-First Amendment Save the State Regulation from Preemption?*

In *Midcal*, the Supreme Court established the balancing test that courts use to determine whether a state regulatory scheme that violates the Sherman Act can receive exemption based on state power under the Twenty-First Amendment.<sup>127</sup> In balancing the federal interest against the state's interest, the *Midcal* Court deferred to the California Supreme Court's findings that the resale price system did not effectively further California's interest.<sup>128</sup> As a result, the Court concluded that "[t]he unsubstantiated state concerns put forward in this case simply are not of the same stature as the goals of the Sherman Act."<sup>129</sup>

As in *Midcal*, the Supreme Court was forced to reconcile competing state and federal interests in *324 Liquor Corp. v. Duffy*.<sup>130</sup> In *324 Liquor*, the Court determined that a New York statute requiring a minimum markup for retail liquor violated the Sherman Act.<sup>131</sup> Next, the Court considered whether New York's power under the Twenty-First Amendment saved the statute. The *324 Liquor* Court further explained *Midcal*'s requirement that courts "harmonize state and federal powers"<sup>132</sup> in the Twenty-First Amendment context by stating: "[t]he question in each case is 'whether the interests implicated by a state regulation are so closely related to the powers reserved by the Twenty-first Amendment that the regulation may prevail, notwithstanding that its requirements directly conflict with express federal policies.'"<sup>133</sup> As in *Midcal*, the Court again deferred to the state by looking to the New York Court of Appeals's findings that the minimum markup regulation at issue was ineffective at serving New York's interest in preserving small retailers.<sup>134</sup> Because New York's own legislative and judicial findings indicated that the statute was ineffective at preserving small retail-

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<sup>126</sup> See, e.g., *Fisher*, 475 U.S. at 267-68.

<sup>127</sup> See *Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 111 (1980).

<sup>128</sup> *Id.* at 112-13.

<sup>129</sup> *Id.* at 114.

<sup>130</sup> *324 Liquor Corp.*, 479 U.S. at 348-52.

<sup>131</sup> *Id.* at 343.

<sup>132</sup> *Id.* at 347 (quoting *Midcal*, 445 U.S. at 109) (internal quotation marks omitted).

<sup>133</sup> *Id.* (quoting *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691, 714 (1984)).

<sup>134</sup> *Id.* at 348-50.

ers, the Supreme Court concluded that the Twenty-First Amendment did not save the statute from preemption.<sup>135</sup> Therefore, in the two cases where the Supreme Court had to balance a state's interest in its liquor regulation against federal antitrust policy, the Court deferred to state court and state legislature findings as to the strength of the state's interest.

In *Miller v. Hedlund*,<sup>136</sup> the Ninth Circuit became the first Circuit to apply the second prong of the *Midcal* test.<sup>137</sup> The *Miller* court found Oregon's quantity discount ban and post-and-hold requirement to constitute per se violations of the Sherman Act and reiterated that whether the Twenty-First Amendment exempted the regulations from the Sherman Act "may ultimately rest upon findings and conclusions having a large factual component."<sup>138</sup> Because the U.S. District Court for the District of Oregon failed to address whether the regulations advanced the Oregon state interest and the closeness of that interest to those protected by the Twenty-First Amendment, the Ninth Circuit remanded the case for further determination of the Twenty-First Amendment defense.<sup>139</sup> Like the Supreme Court in both *Midcal* and *324 Liquor Corp.*, the Ninth Circuit did not evaluate the sufficiency of the state interest in its liquor regulatory scheme.

Therefore, prior to the Fourth Circuit's redefinition of *Midcal*'s second prong in 2001, neither the Supreme Court nor any of the circuits had interpreted precedent to require a judicial examination into the efficacy of state liquor regulation. Moreover, in both instances in which the Supreme Court "balanced" state power under the Twenty-First Amendment against the Sherman Act, the Court deferred to the state's own findings as to the regulation's effectiveness.

#### D. *The TFWS Inquiry: The Fourth Circuit's Redefinition of Midcal's Second Prong*

The Fourth Circuit was the first federal court to evaluate a state's interest in its liquor regulations absent any state court or legislative guidance,<sup>140</sup> and in doing so, it redefined the second prong of *Midcal*'s balancing test.<sup>141</sup> In *TFWS, Inc. v. Schaefer*, a large liquor retailer challenged two of Maryland's liquor regulations on antitrust grounds: a post-and-hold pricing

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<sup>135</sup> *Id.* at 350-51.

<sup>136</sup> 813 F.2d 1344 (9th Cir. 1987).

<sup>137</sup> *Id.* at 1352.

<sup>138</sup> *Id.*

<sup>139</sup> *Id.*

<sup>140</sup> See *TFWS, Inc. v. Schaefer*, No. WDQ-99-2008, 2007 WL 2917025, at \*10 (D. Md. Sept. 27, 2007), *aff'd sub nom.* *TFWS, Inc. v. Franchot*, 572 F.3d 186 (4th Cir. 2009).

<sup>141</sup> See *TFWS, Inc. v. Schaefer*, 242 F.3d 198, 213 (4th Cir. 2001). *TFWS* did not, however, make any changes to *Midcal*'s first prong: whether the regulation at issue violates the Sherman Act. See *id.* at 206.

system and a volume discount prohibition.<sup>142</sup> The Fourth Circuit first heard the case on appeal after the U.S. District Court for the District of Maryland dismissed the complaint and held that although the regulations violated the Sherman Act, Maryland's interest under the Twenty-First Amendment trumped the federal interest.<sup>143</sup> The Fourth Circuit vacated the district court's decision, which it determined "was made without a record," and remanded for both sides to offer evidence on Maryland's Twenty-First Amendment defense.<sup>144</sup> In instructing the district court on remand, the *TFWS* court interpreted the second prong of *Midcal*'s balancing test to require a two-step inquiry (the "*TFWS* inquiry"):

First, the court should examine the expressed state interest and the closeness of that interest to those protected by the Twenty-first Amendment. . . . Second, the court should examine whether, and to what extent, the regulatory scheme serves its stated purpose in promoting temperance. Simply put, is the scheme effective? Again the answer to this question "may ultimately rest upon findings and conclusions having a large factual component."<sup>145</sup>

In regard to the first step of the *TFWS* inquiry, the interests that courts have recognized as protected by the Twenty-First Amendment include: temperance,<sup>146</sup> ensuring orderly market conditions,<sup>147</sup> raising revenue,<sup>148</sup> and preventing price discrimination.<sup>149</sup> Courts have rejected the promotion of local industry as a state interest protected by the Twenty-First Amendment<sup>150</sup> and declined to determine whether a state's interest in protecting small retailers could ever prevail against the federal interest.<sup>151</sup> The first step of the *TFWS* inquiry does not deviate from precedent, as the Supreme Court stated that

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<sup>142</sup> *Id.* at 201-02.

<sup>143</sup> *Id.* at 202.

<sup>144</sup> *Id.*

<sup>145</sup> *Id.* at 213 (quoting *Miller v. Hedlund*, 813 F.2d 1344, 1352 (9th Cir. 1987)). The Ninth Circuit has since adopted this two-part inquiry. See *Costco Wholesale Corp. v. Maleng*, 522 F.3d 874, 902 (9th Cir. 2008).

<sup>146</sup> *Costco*, 522 F.3d at 902-03 ("We have no doubt that the district court correctly concluded that temperance was a valid and important interest of the State under the Twenty-first Amendment."); see also *TFWS*, 242 F.3d at 213 ("Temperance is the avowed goal of the Maryland regulatory scheme, and the Twenty-first Amendment definitely allows a state to promote temperance.").

<sup>147</sup> *North Dakota v. United States*, 495 U.S. 423, 432 (1990) (listing "ensuring orderly market conditions" among North Dakota's valid Twenty-First Amendment interests). But see *Costco*, 522 F.3d at 902 n.23 (criticizing the *North Dakota* Court for failing to define this concept and finding "no clear error in the district court's conclusion that the restraints were minimally effective in promoting this interest"); *Bainbridge v. Turner*, 311 F.3d 1104, 1115 (11th Cir. 2002) (stating that the court was unsure of the meaning of "ensuring orderly markets").

<sup>148</sup> *North Dakota*, 495 U.S. at 432 (including "raising revenue" as one of North Dakota's valid state interests falling "within the core of the State's power under the Twenty-first Amendment").

<sup>149</sup> *Battipaglia v. N.Y. State Liquor Auth.*, 745 F.2d 166, 178 (2d Cir. 1984) (discussing the prevention of price discrimination as a valid state interest under the Twenty-First Amendment).

<sup>150</sup> *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 276 (1984).

<sup>151</sup> *324 Liquor Corp. v. Duffy*, 479 U.S. 335, 351 n.12 (1987).

courts should assess the closeness of the state interest to the state powers reserved by the Twenty-First Amendment in balancing the competing state and federal interests.<sup>152</sup> The second step, however, constitutes a deviation from precedent. In neither *Midcal* nor *324 Liquor* did the Supreme Court suggest that federal courts should evaluate the effectiveness of state liquor legislation while reconciling the respective state and federal interests.

For a state regulatory system to receive exemption from the Sherman Act on the basis of the Twenty-First Amendment, the *Midcal* balancing test must weigh in the state's favor. In *TFWS*, the Fourth Circuit, while keeping *Midcal*'s first prong intact, redefined the second prong. Under the Fourth Circuit's redefinition of *Midcal*'s second prong—the *TFWS* inquiry—a court must first examine the validity of the state's interest and determine whether it is the type of interest that the Twenty-First Amendment was intended to protect.<sup>153</sup> Then, upon finding a legitimate state interest, a court should evaluate the efficacy of the state regulation to determine whether it serves the proffered state interest.<sup>154</sup> Since the Fourth Circuit's formulation of the *TFWS* inquiry in 2001, the Ninth Circuit adopted the approach in *Costco Wholesale Corp. v. Maleng*.<sup>155</sup>

The approach used in *TFWS* is a substantial departure from the guidance the Supreme Court provided in *Midcal* and *324 Liquor*. In both *Midcal* and *324 Liquor*, the Supreme Court did not purport to evaluate the sufficiency of the state's interest in its liquor regulatory scheme, but rather deferred to state court and legislative findings on this point.<sup>156</sup> In addition to contravening Supreme Court precedent, the *TFWS* inquiry also raises other legal issues, which include concerns of federalism, the presumption against preemption, and whether judges should evaluate state legislation. A better approach would be for federal courts to replace the *TFWS* inquiry's requirement that the challenged regulation “substantially advance”<sup>157</sup> the

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<sup>152</sup> *Id.* at 347; see also *Miller v. Hedlund*, 813 F.2d 1344, 1352 (9th Cir. 1987).

<sup>153</sup> *TFWS, Inc. v. Schaefer*, 242 F.3d 198, 213 (4th Cir. 2001).

<sup>154</sup> *Id.*

<sup>155</sup> See *Costco Wholesale Corp. v. Maleng*, 522 F.3d 874, 901-02 (9th Cir. 2008).

<sup>156</sup> See *324 Liquor Corp.*, 479 U.S. at 350-51; *Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 112-14 (1980). Although there were no state court findings in *TFWS*, the Fourth Circuit could have paid more deference to the Maryland legislature's policy decision to implement the state liquor regulations. In addition, the Second Circuit also indicated it would apply a more deferential standard of review in *Battipaglia v. New York State Liquor Authority*. See *Battipaglia v. N.Y. State Liquor Auth.*, 745 F.2d 166, 178-79 (2d Cir. 1984). In *Battipaglia*, the Second Circuit did not formally apply the *Midcal* test, as it found that the post-and-hold pricing system did not violate the Sherman Act. *Id.* The *Battipaglia* court did, however, opine on the issue and concluded that if a violation had been found, “§2 of the Twenty-first Amendment dictates deference to the state.” *Id.* at 179.

<sup>157</sup> Although the *TFWS* court does not use the language “substantially advance” when enunciating the test, it did state that a small impact on the state interest in promoting temperance was insufficient to outweigh the federal interest. *TFWS, Inc. v. Schaefer*, No. WDQ-99-2008, 2007 WL 2917025, at \*10 (D. Md. Sept. 27, 2007), *aff'd sub nom. TFWS, Inc. v. Franchot*, 572 F.3d 186 (4th Cir. 2009). This

state's interest with a rational basis standard of review.<sup>158</sup> Furthermore, under this approach, federal courts would be able to better balance federal and state interests more consistently with other Twenty-First Amendment precedent.

### III. PROBLEMS ARISING FROM THE *TFWS* INQUIRY

The approach adopted by the Fourth and Ninth Circuits to determine when a state liquor regulatory scheme can avoid preemption by the Sherman Act based on state power under the Twenty-First Amendment misconstrues Supreme Court precedent and raises a plethora of additional legal issues. These include concerns of federalism, the presumption against preemption, and whether judges should evaluate state legislation, along with additional policy concerns. Such problems could be avoided by changing the *TFWS* inquiry to resemble a rational basis standard of review.

#### A. *The TFWS Inquiry Should Be Replaced with a Rational Basis Standard of Review*

A rational basis standard of review<sup>159</sup> should replace the *TFWS* inquiry's requirement that a state regulation "substantially advance" the state's interest to avoid the federalism concerns posed by the current approach. Such an approach would still ensure that the state "substantiate" its interest within the meaning of *Midcal*.<sup>160</sup> A possible inquiry could consist of: (1) whether the state interest is one recognized under the Twenty-First Amendment,<sup>161</sup> and (2) whether a reasonable person could find a connection between the regulation and the expressed state interest.<sup>162</sup> Under this approach, courts would balance the federal and state interests as instructed in *Midcal* and in a manner more consistent with other Twenty-First Amendment jurisprudence and federalism.<sup>163</sup>

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gives rise to the inference that in order for a state to prevail under the *TFWS* inquiry, it must demonstrate evidence that the challenged regulation substantially advances the state interest.

<sup>158</sup> See, e.g., *San Antonio Indep. Sch. Dist. v. Rodriguez*, 411 U.S. 1, 55 (1973) (describing the rational basis test as requiring a showing that "the challenged state action rationally furthers a legitimate state purpose or interest").

<sup>159</sup> See *id.*

<sup>160</sup> See *Midcal*, 445 U.S. at 113-14.

<sup>161</sup> Thus the first prong of the *TFWS* inquiry could remain intact. *TFWS, Inc. v. Schaefer*, 242 F.3d 198, 213 (4th Cir. 2001) ("First, the court should examine the expressed state interest and the closeness of that interest to those protected by the Twenty-first Amendment.").

<sup>162</sup> See *Rodriguez*, 411 U.S. at 55.

<sup>163</sup> See *infra* Part III.B.

The highly deferential standard advocated here has been upheld as preferable in similar contexts.<sup>164</sup> One example of such a deferential standard is the Supreme Court's decision to reject a Takings Clause test that asked whether regulations affecting private property "substantially advance[]" legitimate state interests.<sup>165</sup> Like the state liquor issues here, in *Lingle v. Chevron U.S.A. Inc.*,<sup>166</sup> the regulation challenged under the Takings Clause was a Hawaii statute limiting the rent that oil companies could charge dealers.<sup>167</sup> The *Lingle* Court rejected a test that would have required federal courts to determine the efficacy of state legislation, as this was a "task for which courts are not well suited."<sup>168</sup> The Court's analysis in *Lingle* can be applied to the Twenty-First Amendment context. As with the Takings Clause, the legislature is best suited to determine the efficacy of state liquor laws at promoting state interests. Furthermore, considering the stronger presumption of validity for legislation passed under the state's Twenty-First Amendment powers, the argument that courts should not be "substitut[ing] their predictive judgments for those of elected legislatures" rings even stronger.<sup>169</sup>

In addition to being more consistent with preemption precedent in the Twenty-First Amendment context, a rational basis review is also more reconcilable with how standards of review are generally employed in constitutional law jurisprudence. As demonstrated, the *TFWS* inquiry employs a heightened rational basis review by requiring that the challenged state liquor regulation *substantially* further the state interest at issue.<sup>170</sup> Such a requirement can be considered somewhere in between intermediate scrutiny<sup>171</sup>

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<sup>164</sup> See, e.g., *Lingle v. Chevron U.S.A. Inc.*, 544 U.S. 528, 540 (2005). Another example of deferential review of state legislation exists for Dormant Commerce Clause challenges. See *Brown v. Hovatter*, 561 F.3d 357, 367 (4th Cir.), cert. denied, 130 S. Ct. 741 (2009).

<sup>165</sup> *Lingle*, 544 U.S. at 548 (internal quotation marks omitted).

<sup>166</sup> 544 U.S. 528 (2005).

<sup>167</sup> *Id.* at 533.

<sup>168</sup> *Id.* at 544.

<sup>169</sup> See *id.*

<sup>170</sup> See *TFWS, Inc. v. Schaefer*, No. WDQ-99-2008, 2007 WL 2917025, at \*10 (D. Md. Sept. 27, 2007), *aff'd sub nom.* *TFWS, Inc. v. Franchot*, 572 F.3d 186 (4th Cir. 2009) (finding the *TFWS* inquiry to weigh in favor of the federal interest because Maryland failed to demonstrate more than a "minimal impact" in furthering the state interest in temperance).

<sup>171</sup> Intermediate scrutiny requires a government showing "that the challenged legislative enactment is substantially related to an important governmental interest." *Kerrigan v. Comm'r of Pub. Health*, 957 A.2d 407, 423 (Conn. 2008); see also *Clark v. Jeter*, 486 U.S. 456, 461 (1988) ("To withstand intermediate scrutiny, a statutory classification must be substantially related to an important governmental objective. Consequently we have invalidated classifications that burden illegitimate children for the sake of punishing the illicit relations of their parents, because 'visiting this condemnation on the head of an infant is illogical and unjust.'" (quoting *Weber v. Aetna Cas. & Sur. Co.*, 406 U.S. 164, 175 (1972))).

and strict scrutiny.<sup>172</sup> Typically, a stricter than rational basis review is conducted when a state tries to pass a statute that interferes with a constitutionally protected interest.<sup>173</sup> Here, the situation is the opposite.<sup>174</sup> The proponents of a stricter than rational basis review—namely, the Fourth and Ninth Circuits—are effectively arguing that a statute, the Sherman Act, should get preferable treatment over a constitutional amendment that explicitly gives states the power to regulate liquor within their borders.<sup>175</sup> Because the state interest is protected by a constitutional amendment and the relevant federal interest is a statute, federal courts should apply a review that more closely resembles the rational basis test as opposed to one approaching strict scrutiny.

In sum, the standard of review that federal courts use to consider state legislation under the *TFWS* inquiry is inappropriate because it empowers courts to improperly assess the efficacy of state policy and suggests that a federal law should receive preferable treatment over a constitutionally protected state interest. Because a rational basis standard of review would eliminate these problems, federal courts should replace the *TFWS* inquiry with such a standard.

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<sup>172</sup> Strict scrutiny requires that the state demonstrate “a compelling state interest” and show that legislation is “narrowly drawn to express only the legitimate state interests at stake.” *See, e.g., Roe v. Wade*, 410 U.S. 113, 155-56 (1973).

<sup>173</sup> Intermediate scrutiny review is applied to review laws that use “quasi-suspect” classifications. *See, e.g., Kerrigan*, 957 A.2d at 422-25 (applying intermediate scrutiny review because Connecticut’s use of sexual orientation constituted a “quasi-suspect” classification under the state constitution’s equal protection provisions). Strict scrutiny is employed “[w]hensoever a state law infringes a constitutionally protected right.” *Att’y Gen. of N.Y. v. Soto-Lopez*, 476 U.S. 898, 904 (1986).

<sup>174</sup> A possible explanation for the heightened review, though not one proffered by the Fourth or Ninth Circuits, is that the liquor regulatory schemes violate the Dormant Commerce Clause. The Dormant Commerce Clause prohibits the States from enacting legislation that affects interstate commerce. *See Healy v. Beer Inst.*, 491 U.S. 324, 326 n.1 (1989). According to the Supreme Court in *Healy v. Beer Institute*, the “critical inquiry is whether the practical effect of the regulation is to control conduct beyond the boundaries of the State.” *Id.* at 336. The post-and-hold pricing system only requires action by in-state wholesalers and does not place any constraints or requirements on out-of-state wholesalers. In *Healy*, the Supreme Court struck down Connecticut’s beer price affirmation statute, which effectively precluded the alteration of out-of-state prices as well as in-state prices and therefore violated the Dormant Commerce Clause. *See id.* at 338-39. Unlike the regulation struck down in *Healy*, the post-and-hold requirement does not affect out-of-state wholesalers. Assuming the post-and-hold statutes achieved their goal of raising in-state liquor prices, the only clear effect on other states would be making out-of-state prices relatively cheaper and therefore more attractive, which would not constitute an interference with interstate commerce.

<sup>175</sup> *See TFWS*, 2007 WL 2917025, at \*10 (applying the *TFWS* inquiry and finding a small effect on the state interest insufficient to overcome the federal interest in upholding the Sherman Act); *Costco Wholesale Corp. v. Hoen*, No. C04-360P, 2006 WL 1075218, at \*10 (W.D. Wash. Apr. 21, 2006), *aff’d in part, rev’d in part sub nom. Costco Wholesale Corp. v. Maleng*, 522 F.3d 874 (9th Cir. 2008) (same).

B. *The TFWS Inquiry Threatens Federalism*

The *TFWS* inquiry contravenes federalist principles by requiring federal courts to assess the effectiveness of state liquor regulation. In instructing courts to “examine whether, and to what extent, the regulatory scheme serves its stated purpose,”<sup>176</sup> the *TFWS* inquiry tells federal courts to evaluate state policy. The requirement that federal courts gauge the effectiveness of state legislation is generally problematic because this is a task to which the courts are ill-suited.<sup>177</sup> Moreover, having federal courts evaluate the state’s interest in the Twenty-First Amendment context contravenes federalist principles. In addition to the notion that the federal government generally lacks the power to define state policy, this argument is more persuasive when applied to the one state power explicitly provided for in a constitutional amendment.<sup>178</sup> By comparison, in *Midcal* and *324 Liquor*, the Supreme Court did not define state public policy but rather deferred to the findings of state courts and legislatures on the relevant state interest.<sup>179</sup> This deference demonstrates the Court’s respect for and adherence to the federalist system, which separates state power from the national government.<sup>180</sup>

The Fourth Circuit’s misconstruction of *Midcal* represents a departure not only from Supreme Court precedent, but also from the federalist principles that undergird the U.S. Constitution. The Constitution created a federalist system with limited powers for the national government.<sup>181</sup> As demonstrated by the Tenth Amendment, the powers not delegated to the federal government by the Constitution were reserved to the states or to the people.<sup>182</sup> The result of this system is that “if a power is an attribute of state sovereignty reserved by the Tenth Amendment, it is necessarily a power the Constitution has not conferred on Congress.”<sup>183</sup> Even more explicit than the Tenth Amendment, the text of the Twenty-First Amendment makes clear that liquor regulation is a state power.<sup>184</sup> Under the federalist system, states

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<sup>176</sup> *TFWS, Inc. v. Schaefer*, 242 F.3d 198, 213 (4th Cir. 2001).

<sup>177</sup> See *infra* Part III.C.

<sup>178</sup> See ZIMMERMAN, *supra* note 62, at 148.

<sup>179</sup> See *324 Liquor Corp. v. Duffy*, 479 U.S. 335, 350-51 (1987); *Cal. Retail Liquor Dealers Ass’n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 112-13 (1980).

<sup>180</sup> For more information on federalism, see John F. Manning, *Federalism and the Generality Problem in Constitutional Interpretation*, 122 HARV. L. REV. 2003 (2009).

<sup>181</sup> See *Printz v. United States*, 521 U.S. 898, 918-20 (1997) (explaining that the system of dual sovereignty was instituted to prevent Congress from regulating the states); *New York v. United States*, 505 U.S. 144, 155 (1992).

<sup>182</sup> U.S. CONST. amend. X.

<sup>183</sup> *New York*, 505 U.S. at 156.

<sup>184</sup> See U.S. CONST. amend. XXI; see also *Granholm v. Heald*, 544 U.S. 460, 484-85 (2005).

have the power to define and implement their own policies.<sup>185</sup> In contrast, the *TFWS* inquiry allows federal courts to determine the sufficiency of the state interest furthered by the liquor regulation in question. Granting federal courts such a role represents a substantial intrusion into the state legislative realm, which is improper generally,<sup>186</sup> but even more troublesome in the Twenty-First Amendment context.<sup>187</sup> Because the *TFWS* inquiry creates a federalism conflict that contravenes the principles upon which the U.S. governance structure stands, it should be abandoned in favor of a rational basis review.

### C. *The TFWS Inquiry Allows Judges to Evaluate State Policy*

In addition to the federalist concerns discussed above, the *TFWS* inquiry's requirement that federal courts assess the efficacy of the state liquor regulatory scheme presents problems, as federal courts are not well-equipped to determine matters of state public policy. Courts simply are not in as good a position as legislatures to evaluate policy.<sup>188</sup> As the Supreme Court explained in *Duke Power Co. v. Carolina Environmental Study Group, Inc.*,<sup>189</sup> a legislature is better placed to judge the "profound and far-reaching consequences" of the legislation, as opposed to a court.<sup>190</sup> The traditional explanation for why a legislature should be tasked with balancing the "advantages and disadvantages" of legislation is that people can easily protect themselves through the polls.<sup>191</sup>

While the above precedents illustrate the drawbacks of courts evaluating the efficacy of legislation in general, there is a strong argument that it is even more improper in the Twenty-First Amendment context. A federal court assessing state legislation almost certainly presents more opportunities for judicial error, as federal judges, by definition, are removed from the local concerns that state legislatures face. Therefore, it makes more sense

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<sup>185</sup> See, e.g., *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 543-45 (1994) (discussing how the power to ensure title to real estate "inheres in the very nature of [state] government" (alteration in original) (quoting *Am. Land Co. v. Zeiss*, 219 U.S. 47, 60 (1911)) (internal quotation marks omitted)).

<sup>186</sup> See, e.g., *Duke Power Co. v. Carolina Env'tl. Study Grp., Inc.*, 438 U.S. 59, 83-84 (1978), *superseded by statute*, Price-Anderson Amendments Act of 1988, Pub. L. No. 100-104, 102 Stat. 1066.

<sup>187</sup> See *North Dakota v. United States*, 495 U.S. 423, 433 (1990).

<sup>188</sup> See, e.g., *Star Scientific, Inc. v. Beales*, 278 F.3d 339, 349 (4th Cir. 2002); see also *Keystone Bituminous Coal Ass'n. v. DeBenedictis*, 480 U.S. 470, 487 n.16 (1987) (reiterating that courts do not "have a license to judge the effectiveness of legislation" (quoting *id.* at 511 n.3 (Rehnquist, J., dissenting)) (internal quotation marks omitted)).

<sup>189</sup> 438 U.S. 59 (1978), *superseded by statute*, Price-Anderson Amendments Act of 1988, Pub. L. No. 100-104, 102 Stat. 1066.

<sup>190</sup> *Id.* at 83.

<sup>191</sup> *Star Scientific*, 278 F.3d at 349 (quoting *Williamson v. Lee Optical of Okla.*, 348 U.S. 483, 487 (1955)) (internal quotation marks omitted).

for the circuits to follow the Supreme Court's example from *Midcal* and *324 Liquor* and defer to the state legislatures and state courts rather than applying the *TFWS* inquiry.

D. *The TFWS Inquiry Contravenes the Presumption Against Preemption*

Apart from the *TFWS* inquiry improperly allowing federal courts to assess state policy preferences, it is also in tension with the general presumption against federal law preempting state social and economic legislation.<sup>192</sup> Beyond this general presumption, an even stronger presumption against preemption has been recognized where a state legislates pursuant to its Twenty-First Amendment powers.<sup>193</sup> As the Supreme Court stated in *North Dakota v. United States*, “[g]iven the special protection afforded to state liquor control policies by the Twenty-first Amendment, they are supported by a strong presumption of validity and should not be set aside lightly.”<sup>194</sup> Therefore, when the state interests at issue are “closely related” to the state powers reserved by the Twenty-First Amendment, the Court has held that deference to state legislatures is appropriate.<sup>195</sup> Furthermore, federal antitrust laws do not expressly preempt state laws and were instead intended as a supplement to existing state laws.<sup>196</sup> In particular, the Supreme Court explained in *Parker v. Brown*<sup>197</sup> that the Sherman Act “gives no hint that it was intended to restrain state action or official action directed by a state.”<sup>198</sup> Therefore, the *TFWS* inquiry contravenes the general presumption of non-preemption and is especially violative of this principle given the particular deference due to states when they legislate under their Twenty-First Amendment powers.

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<sup>192</sup> See *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485 (1996) (“[W]e start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.” (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)) (internal quotation marks omitted)). The general presumption against preemption was most recently reiterated in *Wyeth v. Levine*, 129 S. Ct. 1187, 1194-95 (2009).

<sup>193</sup> See *North Dakota v. United States*, 495 U.S. 423, 432-33 (1990).

<sup>194</sup> *Id.* at 433.

<sup>195</sup> See *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691, 693 (1984) (finding that Oklahoma’s advertising ban was unrelated to the state’s central power under the Twenty-First Amendment).

<sup>196</sup> *California v. ARC Am. Corp.*, 490 U.S. 93, 102 (1989) (finding that “Congress intended the federal antitrust laws to supplement, not displace, state antitrust remedies”).

<sup>197</sup> 317 U.S. 341 (1943).

<sup>198</sup> *Id.* at 351.

E. *The TFWS Inquiry Should Be Abandoned for Policy Reasons*

Federal courts should apply a more deferential standard of review in cases where state liquor regulations conflict with the Sherman Act for policy reasons, in addition to the legal reasons already illustrated. One policy issue implicated by the current state of the law is the effect of the *TFWS* inquiry on the current split on severability between the Fourth and Ninth Circuits.<sup>199</sup> Notably, the Ninth Circuit determined that it could “sever” the post-and-hold pricing system from the rest of Washington State’s regulatory scheme and invalidate it while upholding the remaining liquor regulations.<sup>200</sup> The problem here is that the Ninth Circuit concluded that despite evidence of Washington State’s “moderate rates of ethanol consumption per drinker,”<sup>201</sup> the state’s failure to show that the post-and-hold provision, *on its own*, had the effect of promoting temperance meant it could not survive preemption.<sup>202</sup>

Here, the Ninth Circuit is telling states that they must be able to demonstrate that each aspect of their liquor regulatory structure, which a court could construe as being preempted by federal law, substantially promotes the state’s interest *by itself*. It seems unlikely that most individual aspects of state regulatory structures could meet this burden. This is a result of states designing different components of state regulatory structures to work together to achieve the expressed state interest.<sup>203</sup> Forcing states to defend each component of their liquor regulatory structure from preemption by demonstrating it substantially promotes the state’s interests will greatly hamper future state liquor legislation. Such an outcome contradicts an un-

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<sup>199</sup> Despite following some parts of *TFWS*, notably the Fourth Circuit’s reworking of the *Midcal* test or the *TFWS* inquiry, the Ninth Circuit held contrary to the Fourth Circuit on the issue of severability. *See Costco Wholesale Corp. v. Maleng*, 522 F.3d 874, 900 (9th Cir. 2008). Both the Fourth Circuit and the Ninth Circuit had to decide whether the post-and-hold provision could be severed from the rest of the state liquor regulations; the Fourth Circuit held that it could not, but the Ninth Circuit found that it could. *See id.*; *TFWS, Inc. v. Schaefer*, 242 F.3d 198, 209 (4th Cir. 2001).

<sup>200</sup> *Costco*, 522 F.3d at 900. In finding severability, the court cited a severability provision in the regulatory alcohol scheme and concluded that the post-and-hold provision was not the “center” of the regulatory scheme, instead finding that the uniform pricing requirement was the center. *Id.* Here, the Ninth Circuit explained that all of the other restraints, except for the post-and-hold provision, were mechanisms for enforcing this requirement and, therefore, that the Washington State legislature would have passed the other restraints even if it knew that the post-and-hold pricing scheme was invalid. *Id.*

<sup>201</sup> *Costco Wholesale Corp. v. Hoen*, No. C04-360P, 2006 WL 1075218, at \*6 (W.D. Wash. Apr. 21, 2006), *aff’d in part, rev’d in part sub nom. Costco Wholesale Corp. v. Maleng*, 522 F.3d 874 (9th Cir. 2008).

<sup>202</sup> *Id.*

<sup>203</sup> *See, e.g., TFWS*, 242 F.3d at 202-03 (explaining how the volume discount ban functioned to reinforce the post-and-hold pricing requirement).

derlying principle of the Twenty-First Amendment: limited federal restrictions on state power to regulate liquor.<sup>204</sup>

An additional policy reason justifying a more deferential standard of review is that under current law it is unlikely that a state will succeed in showing that its post-and-hold provision, or any other hybrid liquor restraint, substantially furthers an expressed state interest on its own. In *TFWS, Inc. v. Franchot*,<sup>205</sup> the state of Maryland had over ten years to show that its scheme was effective, but it was still unable to provide sufficient evidence.<sup>206</sup>

Because states will be unlikely to meet this threshold, it is likely that they will transition away from post-and-hold pricing and promote temperance through different regulations. One alternative to a pricing requirement is the imposition of higher excise taxes on liquor. Critics of excise taxes, however, point out how manufacturers that produce several different liquor brands can respond to an excise tax increase by adjusting their pre-tax prices in a way that keeps prices lower for low-end products and higher for high-quality products.<sup>207</sup> This drawback is part of what made post-and-hold attractive to lawmakers: the ability to constrain the range of prices offered.<sup>208</sup> Forcing states to abandon their preferred legislative measures in favor of potentially less-effective alternatives is inconsistent with state power under the Twenty-First Amendment and an undesirable policy end. Because states having flexibility in regulating alcohol within their borders creates a better policy outcome, the *TFWS* inquiry should be replaced with a rational basis standard of review.

Because the *TFWS* inquiry contravenes Supreme Court precedent, threatens the federalist principles embodied in the Constitution, requires judges to evaluate legislation, contravenes the presumption against preemption, and creates adverse policy outcomes, it should be replaced with a rational basis standard of review.

#### IV. POST-AND-HOLD PRICING: AN EXAMINATION OF THE *TFWS* INQUIRY AS COMPARED TO THE RATIONAL BASIS STANDARD OF REVIEW ADVOCATED BY THIS COMMENT

The recent fate of Maryland and Washington State's post-and-hold pricing systems provides a timely and relevant example of the impact of the

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<sup>204</sup> See, e.g., MCGOWAN, *supra* note 3, at 51.

<sup>205</sup> 572 F.3d 186 (4th Cir. 2009).

<sup>206</sup> *Id.* at 188-89, 195.

<sup>207</sup> Paul J. Gruenewald, William R. Ponicki, Harold D. Holder & Anders Romelsjö, *Alcohol Prices, Beverage Quality, and the Demand for Alcohol: Quality Substitutions and Price Elasticities*, 30 ALCOHOLISM: CLINICAL & EXPERIMENTAL RES. 96, 103-04 (2006).

<sup>208</sup> *Id.*

*TFWS* inquiry on state liquor regulations. This Part uses post-and-hold pricing as an application of the proposed rational basis standard to demonstrate the alternative to the *TFWS* inquiry. First, this Part provides an overview of post-and-hold pricing. Next, it explains how post-and-hold pricing violates the Sherman Act. Finally, this Part compares the *TFWS* inquiry to the rational basis standard in the post-and-hold pricing context.

#### A. *Introduction to Post-and-Hold Pricing*

In April 2008, the Ninth Circuit struck down Washington State's post-and-hold pricing requirement.<sup>209</sup> In July 2009, the Fourth Circuit invalidated Maryland's post-and-hold pricing statute.<sup>210</sup> In addition to these recently struck down provisions, states with post-and-hold pricing laws as part of their liquor regulatory scheme currently in effect include: Connecticut,<sup>211</sup> Delaware,<sup>212</sup> Michigan,<sup>213</sup> New York,<sup>214</sup> Oklahoma,<sup>215</sup> and Vermont.<sup>216</sup> Additionally, some states, like California,<sup>217</sup> Georgia,<sup>218</sup> Kansas,<sup>219</sup> Massachusetts,<sup>220</sup> New Hampshire,<sup>221</sup> New Mexico,<sup>222</sup> and South Dakota,<sup>223</sup> require price filing but do not appear to mandate holding. However, a number of states removed their post-and-hold pricing statutes in the 1970s.<sup>224</sup> Regardless, the number of states that continue to use post-and-hold pricing—

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<sup>209</sup> WASH. REV. CODE § 66.28.180 (2006), *invalidated by* Costco Wholesale Corp. v. Maleng, 522 F.3d 874, 902-04 (9th Cir. 2008).

<sup>210</sup> MD. CODE ANN., art. 2B § 12-103 (West 2009), *invalidated by* TFWS, Inc. v. Schaefer, No. WDQ-99-2008, 2007 WL 2917025, at \*9-10 (D. Md. Sept. 27, 2007), *aff'd sub nom.* TFWS, Inc. v. Franchot, 572 F.3d 186, 197 (4th Cir. 2009).

<sup>211</sup> CONN. GEN. STAT. § 30-63 (2008).

<sup>212</sup> 4-029 DEL. CODE REGS. § VI (LexisNexis 2009).

<sup>213</sup> MICH. ADMIN. CODE r. 436.1726 (2009).

<sup>214</sup> N.Y. ALCO. BEV. CONT. LAW § 65.2 (McKinney 2009).

<sup>215</sup> OKLA. ADMIN. CODE § 45:30-3-8 (2008).

<sup>216</sup> 26-020-021 VT. CODE R. § 12 (2009).

<sup>217</sup> CAL. BUS. & PROF. CODE § 25000 (West 2009) (requiring beer manufacturers, importers, and wholesalers to file price schedules).

<sup>218</sup> GA. COMP. R. & REGS. 560-2-3-.45 (2009); GA. COMP. R. & REGS. 560-2-7-.20 (2009) (requiring distilled spirit and beer wholesalers to post prices).

<sup>219</sup> KAN. STAT. ANN. § 41-1101 (2008) (requiring distributors to file price lists with the director).

<sup>220</sup> 204 MASS. CODE REGS. 6.03 (2009) (requiring wholesalers to file price lists for each month with the Commission).

<sup>221</sup> N.H. REV. STAT. ANN. § 179:33 (2009) (requiring beer wholesalers to file price lists with the commission).

<sup>222</sup> N.M. STAT. ANN. § 60-8A-12 (2009) (requiring liquor wholesalers to file price schedules).

<sup>223</sup> S.D. ADMIN. R. 64:75:03:02 (2009) (requiring price filing).

<sup>224</sup> Simon & Simon, *supra* note 56, at 303-04. These states include Arkansas, Arizona, California, Hawaii, Indiana, and Rhode Island. *Id.* at 312-14. Two scholars suggest that these changes are related to the move away from resale price maintenance ("RPM") following the end of the antitrust exemption for state "fair trade laws." *Id.* at 303 (internal quotation marks omitted).

coupled with those that mandate only posting—demonstrates that whether these systems can achieve exemption under the Twenty-First Amendment is a significant issue.

After Congress ratified the Twenty-First Amendment in 1933, states began regulating liquor within their borders in a variety of ways. Post-and-hold pricing statutes were one type of regulation used. States primarily implemented a post-and-hold pricing requirement at the wholesale level.<sup>225</sup> This regulatory scheme requires liquor wholesalers to “post” their prices, usually by filing them with the relevant state agency, and then to “hold” them, keeping the same price for a specified amount of time (often thirty days).<sup>226</sup> Maryland’s post-and-hold pricing system became law in 1951.<sup>227</sup> According to Maryland’s defense of its post-and-hold regulation in 1958, it implemented the system to “provide against discrimination by manufacturers and wholesalers in price, discounts, or quality of merchandise between one customer and another.”<sup>228</sup> Nearly fifty years later, in *TFWS*, Maryland again explained its post-and-hold requirement as intended “to eliminate price wars, which unduly stimulate the sale and consumption of wines and liquors and disrupt the orderly sale and distribution thereof.”<sup>229</sup>

Other states proffer similar rationales for their regulation of liquor through post-and-hold pricing. Connecticut’s post-and-hold statute requires that all manufacturers, wholesalers, and out-of-state shippers post the price of their goods with the Department of Consumer Protection by the twelfth day of each month and then maintain that price for the following month.<sup>230</sup> Lawmakers in Connecticut describe the system as “not tak[ing] the element of free enterprise out of business, as it allows each manufacturer, out-of-state shipper and wholesaler to fix his own prices on his commodities, but it prevents him . . . from discrimination as to prices among the various buyers.”<sup>231</sup>

Washington State’s Liquor Control Board enacted post-and-hold pricing in 1935, requiring “brewers and wholesalers to post with the Board a ‘price list which shall be uniform for the same class of trade buyers in any

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<sup>225</sup> *But see id.* at 313 (analyzing the effects of state regulations, including retail price posting).

<sup>226</sup> *See, e.g.,* MD. CODE ANN., art. 2B § 12-103 (West 2009), *invalidated by* *TFWS, Inc. v. Schaefer*, No. WDQ-99-2008, 2007 WL 2917025, at \*9-10 (D. Md. Sept. 27, 2007), *aff’d sub nom.* *TFWS, Inc. v. Franchot*, 572 F.3d 186, 197 (4th Cir. 2009).

<sup>227</sup> *Id.*

<sup>228</sup> *Melrose Distillers, Inc. v. United States*, 258 F.2d 726, 729 (4th Cir. 1958), *aff’d*, 359 U.S. 271 (1959).

<sup>229</sup> Brief of Appellees & Cross-Appellants, *supra* note 59, at 8 (quoting art. 2B § 12-103(a)).

<sup>230</sup> CONN. GEN. STAT. § 30-63 (2008).

<sup>231</sup> PAUL FRISMAN, CONN. GEN. ASSEMBLY, OFFICE OF LEGISLATIVE RESEARCH, LIQUOR REGULATION QUESTIONS (2001) (quoting *Liquor Control, Pt. 1: Hearing on P.A. 47-316 Before the Conn. Joint Standing Comm.*, 1947 Sess. 95 (Conn. 1947)) (internal quotation marks omitted), available at <http://www.cga.ct.gov/2001/rpt/olr/htm/2001-r-0278.htm>.

trade area within the state.”<sup>232</sup> According to the Liquor Control Board’s Second Report in 1935, post-and-hold pricing was intended to prevent free gifts of beer to retail licensees and to prevent brewers and wholesalers from allowing retailers to incur large amounts of credit and then force them to only buy their products.<sup>233</sup> The Liquor Board explained in its brief to the Ninth Circuit that the post-and-hold requirement was aimed at furthering the Liquor Board’s goals of controlling the distribution and sale of alcohol and ensuring its availability.<sup>234</sup>

A common thread in states that have implemented post-and-hold pricing to prohibit price discrimination among wholesalers, such as Connecticut, Maryland, and Washington, is that these states believe they are furthering temperance by incentivizing wholesalers to price higher.<sup>235</sup>

B. *Midcal’s First Prong as a Threshold Matter: Does Post-and-Hold Pricing Violate the Sherman Act?*

1. The Economics of Post-and-Hold Pricing

In their leading treatise, *Antitrust Law: An Analysis of Antitrust Principles and Their Application*, Professors Phillip E. Areeda and Herbert Hovenkamp indicate that post-and-hold pricing constitutes a hybrid restraint and a violation of the Sherman Act.<sup>236</sup> The authors discuss post-and-hold pricing in the context of a Second Circuit case, *Battipaglia v. New York State Liquor Authority*,<sup>237</sup> in which a New York statute required alcohol manufacturers and wholesalers to post and keep their prices for thirty days.<sup>238</sup> Although the majority concluded that the post-and-hold regulation was not a per se violation of the Sherman Act, Areeda and Hovenkamp state that they found Judge Winter’s dissent more consistent with *Midcal*.<sup>239</sup> In enunciating their agreement with Winter, the authors explain that the adherence aspect of post-and-hold pricing increases the likelihood that the

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<sup>232</sup> Brief of Appellant Liquor Control Board Members, *supra* note 58, at 41.

<sup>233</sup> *Id.* at 42.

<sup>234</sup> *Id.*

<sup>235</sup> See, e.g., *Costco Wholesale Corp. v. Maleng*, 522 F.3d 874, 902-03 (9th Cir. 2008); *TFWS, Inc. v. Schaefer*, 242 F.3d 198, 213 (4th Cir. 2001). In addition to the states already discussed, Oklahoma’s Alcoholic Beverage Laws Enforcement Commission has also publicly stated that its post-and-hold pricing system was designed to maintain consistency in alcohol prices between wholesalers. See Sarah Clough, *Oklahoma ABLE Commission Sees No Threat in FTC Price-Posting Request*, J. REC. (Okla. City), Sept. 24, 2007, available at 2007 WLNR 1880471.

<sup>236</sup> See AREEDA & HOVENKAMP, *supra* note 12, ¶ 217.

<sup>237</sup> 745 F.2d 166 (2d Cir. 1984).

<sup>238</sup> AREEDA & HOVENKAMP, *supra* note 12, ¶ 217 (citing *Battipaglia*, 745 F.2d at 166).

<sup>239</sup> *Id.*

agreement would facilitate horizontal collusion.<sup>240</sup> Thus, Areeda and Hovenkamp demonstrate how the tendency of these pricing statutes to lead to collusion explains why courts have found post-and-hold pricing to violate the Sherman Act.

Similarly, Lopatka and Page explain how post-and-hold pricing allows liquor wholesalers to agree on price.<sup>241</sup> Lopatka and Page argue that a law requiring each wholesaler to adhere to its own prices “is a sensible adaptation of the law of facilitating practices to the context of state regulation” because “[u]nder conventional models of oligopoly behavior, the dissemination of information about prices and a credible commitment to maintain those prices reduce a firm’s uncertainty about its rivals’ pricing behavior and thereby predictably foster a non-competitive outcome.”<sup>242</sup> The authors conclude that post-and-hold regulations increase the possibility of tacit collusion and that the pricing scheme could lead to an anticompetitive outcome.<sup>243</sup> In sum, the economic theory behind post-and-hold pricing suggests that the practice could facilitate collusion and lead to higher prices.

## 2. Judicial Rationale for Why Post-and-Hold Pricing Violates the Sherman Act

The general consensus among courts is that post-and-hold pricing is both a hybrid restraint and a per se violation of the Sherman Act.<sup>244</sup> In

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<sup>240</sup> *Id.*

<sup>241</sup> Lopatka & Page, *supra* note 55, at 311.

<sup>242</sup> *Id.*

<sup>243</sup> *Id.* Despite the strong theoretical basis for economists to conclude that post-and-hold pricing results in higher prices, no economic study has yet to empirically verify the connection between post-and-hold pricing and higher liquor prices. For instance, Professor Julian L. Simon and David M. Simon conducted a study in which they considered the impact of three types of state liquor regulations on liquor prices: resale price maintenance, mandatory markup, and price posting. Simon & Simon, *supra* note 56, at 303-04. The authors specifically examined 1961 to 1983 because during this time period—particularly in the 1970s—a number of states removed these regulations and hence allowed for “before-versus-after analysis.” *Id.* at 313. Simon and Simon concluded that price posting at the wholesale level had no observable effect on prices. *Id.* at 315 n.7. They did find, however, that both resale price maintenance and retail price posting raised liquor prices over this time period. *Id.* at 313.

<sup>244</sup> *Costco Wholesale Corp. v. Maleng*, 522 F.3d 874, 892-95 (9th Cir. 2008); *TFWS, Inc. v. Schaefer*, 242 F.3d 198, 209 (4th Cir. 2001); *Canterbury Liquors & Pantry v. Sullivan*, 16 F. Supp. 2d 41, 46 (D. Mass. 1998) (finding Massachusetts’s price posting scheme to be a hybrid restraint and a per se violation of the Sherman Act). *But see Battipaglia v. N.Y. State Liquor Auth.*, 745 F.2d 166, 174-75 (2d Cir. 1984) (finding no agreement where wholesalers posted and adhered to their own prices and therefore no per se violation under section 1 of the Sherman Act); *Wine & Spirits Specialty, Inc. v. Daniel*, 666 S.W.2d 416, 419 (Mo. 1984) (finding that Missouri’s price posting laws were not preempted by the Sherman Act because the laws did “not authorize or compel wholesalers to agree among themselves for the purpose of contracting, combining or conspiring to fix prices”). The Second Circuit’s decision in *Battipaglia* was accompanied by a spirited dissent by Judge Winter, who argued that the post-and-hold pricing system was a per se violation because “[a] requirement of adherence to announced

*Miller v. Hedlund*, the Ninth Circuit held that Oregon's post-and-hold statute constituted a hybrid restraint because the statute "allow[ed] private parties to set the prices and d[id] not review the reasonableness of those prices."<sup>245</sup> Next, the Ninth Circuit likened the statute to the regulations found to violate the Sherman Act in both *Midcal* and *Schwegmann Bros. v. Calvert Distillers Corp.*<sup>246</sup> and decided that, like those regulations, Oregon's post-and-hold pricing requirement was a private restraint that constituted a per se violation of section 1 of the Sherman Act.<sup>247</sup>

The Fourth Circuit followed the Ninth Circuit's reasoning in *TFWS*, finding Maryland's post-and-hold pricing system to be both a hybrid restraint of trade and a per se violation of the Sherman Act.<sup>248</sup> The *TFWS* court stated that "[t]he post-and-hold system is a classic hybrid restraint: the State requires wholesalers to set prices and stick to them, but it does not review those privately set prices for reasonableness; the wholesalers are thus granted a significant degree of private regulatory power."<sup>249</sup> Next, the court examined whether the pricing system, as a hybrid restraint, violated the Sherman Act. The court concluded that it did because the system mandated the exchange of price information and adherence to previously-announced prices, which, according to the Fourth Circuit, essentially constituted horizontal price fixing.<sup>250</sup>

A growing consensus of judicial circuits has concluded that post-and-hold pricing is a hybrid restraint in which alcohol wholesalers use private discretion to set their prices and that the state, a public non-market mechanism, requires adhesion to these prices. Furthermore, courts also generally conclude that post-and-hold pricing results in an exchange of price information, which increases the likelihood of horizontal collusion and thus constitutes a per se violation of the Sherman Act.

### C. *Post-and-Hold Pricing Under the TFWS Inquiry*

After determining that post-and-hold pricing violates the Sherman Act, a court following the *TFWS* inquiry would next consider whether state power under the Twenty-First Amendment could exempt the regulation

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prices has been uniformly held illegal without regard to its reasonableness." *Battipaglia*, 745 F.2d at 179 (Winter, J., dissenting). The leading antitrust treatise has expressed its support for Judge Winter's dissent in *Battipaglia* over the majority's finding of no per se violation. See AREEDA & HOVENKAMP, *supra* note 12, ¶ 217 (finding the dissent more consistent with *Midcal* "[g]iven the great danger that agreements to post and adhere will facilitate horizontal collusion").

<sup>245</sup> *Miller v. Hedlund*, 813 F.2d 1344, 1351 (9th Cir. 1987).

<sup>246</sup> 341 U.S. 384 (1951).

<sup>247</sup> *Miller*, 813 F.2d at 1351.

<sup>248</sup> *TFWS, Inc. v. Schaefer*, 242 F.3d 198, 208-09 (4th Cir. 2001).

<sup>249</sup> *Id.*

<sup>250</sup> *Id.* at 209.

from the Sherman Act. The *TFWS* inquiry requires: (1) an examination into the validity of the state's interest as to whether it is the type of interest protected by the Twenty-First Amendment, and (2) an evaluation into the effectiveness of the particular regulation in promoting the state's interest.<sup>251</sup>

Both the Fourth and the Ninth Circuits recently examined post-and-hold pricing under the *TFWS* inquiry. The Fourth Circuit evaluated Maryland's post-and-hold pricing system in *TFWS* in the context of a liquor retailer's running challenge to two aspects of Maryland's liquor regulatory scheme.<sup>252</sup> While the Fourth Circuit easily found Maryland's interest in promoting temperance to be a protected interest under the Twenty-First Amendment,<sup>253</sup> each side presented conflicting data as to whether the post-and-hold statute furthered this interest.<sup>254</sup> Both Maryland and TFWS used American Chamber of Commerce Research Association ("ACCRA") retail price data, among other data, to compare liquor prices in Maryland and Delaware.<sup>255</sup>

On remand from the Fourth Circuit, the U.S. District Court for the District of Maryland evaluated the effectiveness of Maryland's post-and-hold pricing at furthering temperance. The district court concluded that Maryland's price data demonstrated that wholesaler costs would have been thirty-three cents more per bottle in Maryland.<sup>256</sup> In comparison, TFWS's price data showed that the average wholesale cost would have been about two or three cents more.<sup>257</sup> The court held that "the State has proven that the challenged regulations have at best only a minimal impact in furthering the State's interest in temperance, which is outweighed by the federal interest in promoting competition under the Sherman Act."<sup>258</sup> In affirming the district court's finding that the regulations had only a minimal effect on the state interest in *TFWS*, the Fourth Circuit agreed that, "the legal conclusion that the federal interest outweighed the state interest followed more or less as a matter of course."<sup>259</sup>

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<sup>251</sup> *Costco Wholesale Corp. v. Maleng*, 522 F.3d 874, 902 (9th Cir. 2008); *TFWS*, 242 F.3d at 213.

<sup>252</sup> *See TFWS, Inc. v. Franchot*, 572 F.3d 186, 188-89 (4th Cir. 2009).

<sup>253</sup> *TFWS, Inc. v. Schaefer*, 183 F. Supp. 2d 789, 790 (D. Md. 2002), *vacated*, 325 F.3d 234 (4th Cir. 2003).

<sup>254</sup> *TFWS, Inc. v. Schaefer*, No. WDQ-99-2008, 2007 WL 2917025, at \*3-5 (D. Md. Sept. 27, 2007), *aff'd sub nom. TFWS, Inc. v. Franchot*, 572 F.3d 186 (4th Cir. 2009).

<sup>255</sup> *TFWS, Inc. v. Schaefer*, 315 F. Supp. 2d 775, 777-79 (D. Md. 2004), *vacated*, 147 F. App'x 330 (4th Cir. 2005). The Maryland and Delaware comparison was a useful one because prior to 1992, Delaware had the same liquor regulations as Maryland, including post-and-hold pricing and a volume discount ban. *Id.* at 778. In 1992, however, Delaware eliminated the quantity discount ban and modified the price filing requirements. *Chaloupka Dep.* 53:4-12, Oct. 9, 2003.

<sup>256</sup> *TFWS*, 2007 WL 2917025, at \*3.

<sup>257</sup> *Id.* at \*4-5. After finding slightly higher wholesale prices in Maryland, the district court then went on to assess whether higher wholesale prices resulted in higher retail prices and affected consumption. *See id.* at \*9.

<sup>258</sup> *Id.* at \*10.

<sup>259</sup> *TFWS, Inc. v. Franchot*, 572 F.3d 186, 197 (4th Cir. 2009).

The Ninth Circuit also employed the *TFWS* inquiry to determine whether Washington State's post-and-hold pricing requirement could survive preemption by the Sherman Act in *Costco Wholesale Corp. v. Maleng*.<sup>260</sup> Although Washington State proffered two state interests, temperance and orderly market conditions,<sup>261</sup> as being furthered by post-and-hold pricing, the U.S. District Court for the Western District of Washington focused on temperance as the legitimate state interest under the Twenty-First Amendment.<sup>262</sup> The district court found that the regulations lowered the cost of beer and wine for some retailers and raised it for others.<sup>263</sup> As for promoting "orderly market conditions," the district court did not find the regulations to be effective at supporting the three-tier system of ensuring that prices reflected the cost of production, preventing beer and wine "gluts," or reducing scarcities.<sup>264</sup> Thus, for both of Washington State's expressed interests, the district court found that the post-and-hold pricing system was not effective enough.<sup>265</sup>

In balancing these state interests against the federal interest, the district court held that the Twenty-First Amendment did not save the challenged restraints from preemption by the Sherman Act: "[t]o the extent that the restraints may have a minimal effect in advancing the state's core interests under the Twenty-First Amendment, the state's interests do not outweigh the federal interest in promoting competition under the Sherman Act."<sup>266</sup> As in *TFWS*, the Ninth Circuit upheld the district court's findings, agreeing that "the [s]tate failed to demonstrate that its restraints [were] effective in promoting temperance."<sup>267</sup>

Taken together, *TFWS* and *Costco* show how difficult it is for states to successfully demonstrate the efficacy of their post-and-hold statutes under the *TFWS* inquiry. Most notably, Maryland had nearly ten years to produce data to demonstrate effectiveness and still failed to make the required evidentiary showing.<sup>268</sup> Despite the states in both cases proffering evidence of

<sup>260</sup> *Costco Wholesale Corp. v. Maleng*, 522 F.3d 874, 902 (9th Cir. 2008). In *Costco*, the plaintiff challenged a number of Washington State alcohol sale and distribution regulations, including the state's post-and-hold statute. *Id.* at 881, 892.

<sup>261</sup> *Costco Wholesale Corp. v. Hoen*, No. C04-360P, 2006 WL 1075218, at \*3-7 (W.D. Wash. Apr. 21, 2006), *aff'd in part, rev'd in part sub nom.* *Costco Wholesale Corp.*, 522 F.3d 874 (9th Cir. 2008).

<sup>262</sup> *See id.* at \*7 ("It is not clear what the term 'orderly market conditions' or 'orderly distribution' encompasses. . . . Defendants did not provide a clear or consistent definition of the terms . . . ." (quoting *Bainbridge v. Turner*, 311 F.3d 1104, 1115 (11th Cir. 2002))).

<sup>263</sup> *Id.* at \*5-6.

<sup>264</sup> *Id.* at \*7-8.

<sup>265</sup> *Id.* at \*6-8.

<sup>266</sup> *Id.* at \*10.

<sup>267</sup> *Costco Wholesale Corp. v. Maleng*, 522 F.3d 874, 903 (9th Cir. 2008). Another aspect of the *Costco* court's holding was the Ninth Circuit's additional conclusion that it could not "segregate the effects" of the post-and-hold pricing scheme, given the presence of other liquor regulations aimed at promoting temperance. *Id.*

<sup>268</sup> *See TFWS, Inc. v. Franchot*, 572 F.3d 186, 188-89 (4th Cir. 2009).

higher prices, the federal courts rejected these showings as not substantial enough.<sup>269</sup> Given the high evidentiary showing required by the *TFWS* inquiry, it remains an open question whether a state could ever make a sufficient showing of efficacy for its post-and-hold pricing statute to outweigh the federal interest. This outcome under the *TFWS* inquiry is troubling because it demonstrates how federal courts can invalidate a widespread state policy merely by concluding it is not “effective enough.” In addition to the argument that judges are not generally well suited to analyze the efficacy of legislation, allowing federal judges to evaluate the effectiveness of state policy contravenes important principles of federalism. This is particularly so in the Twenty-First Amendment context in which a constitutional amendment explicitly gives states the power to regulate liquor. Therefore, the post-and-hold pricing application illustrates how the *TFWS* inquiry results in the invalidation of state legislation and, in doing so, contravenes important federalist principles, the presumption against preemption of state legislation, and the circumscribed role of federal judges.

#### D. *Post-and-Hold Pricing Under a Rational Basis Standard of Review*

In comparison to the *TFWS* inquiry, the rational basis standard of review advocated by this Comment does not require federal judges to assess the effectiveness of state policy and contravene the principles of federalism. Rather, the proposed rational basis review would consist of: (1) whether the state interest is one recognized under the Twenty-First Amendment, and (2) whether a reasonable person could find a connection between the regulation and the expressed state interest.<sup>270</sup> Applying this standard of review to the challenged post-and-hold pricing system in *TFWS* and *Costco* would almost certainly result in the pricing systems being upheld on the basis of state power under the Twenty-First Amendment.

As under the *TFWS* inquiry, the rational basis review would first require the federal court to examine whether the state interest furthered by post-and-hold pricing is one recognized under the Twenty-First Amendment. In the Maryland and Washington State cases, temperance was the state interest served by the post-and-hold pricing requirement.<sup>271</sup> Next, the court would determine whether a reasonable person could find a connection between post-and-hold pricing and temperance. In *TFWS* and *Costco*, both states provided price data that showed higher alcohol prices. Although

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<sup>269</sup> *Id.* at 195; *Costco*, 2006 WL 1075218, at \*6-8.

<sup>270</sup> See *San Antonio Indep. Sch. Dis. v. Rodriguez*, 411 U.S. 1, 55 (1973).

<sup>271</sup> *Costco*, 2006 WL 1075218, at \*3-4; *TFWS, Inc. v. Schaefer*, 183 F. Supp. 2d 789, 790 (D. Md. 2002), *vacated*, 325 F.3d 234 (4th Cir. 2003). Although Washington State also proffered “orderly market conditions,” the district court focused its analysis on temperance. See *Costco*, 2006 WL 1075218, at \*7. For ease of comparison, only temperance will be discussed in the application here as well.

Washington State's data showing increases in some alcohol prices and decreases in others<sup>272</sup> was not powerful evidence that post-and-hold pricing increases alcohol prices, it would still likely pass muster under a rational basis review.<sup>273</sup> By comparison, however, Maryland's price data showing price increases would almost certainly be upheld under the rational basis standard of review.<sup>274</sup>

If federal courts applied the rational basis standard of review to post-and-hold pricing, the law would be upheld based on state power under the Twenty-First Amendment. This is preferable to the regulation being struck down under the *TFWS* inquiry. Such an outcome is wholly consistent with the federalist system set forth in the Constitution. Not only do federalist and separation of powers principles generally weigh against courts evaluating legislation, this is particularly so in the Twenty-First Amendment context in which states are explicitly charged with control over the regulation of liquor within their borders. Because the replacement of the *TFWS* inquiry with a rational basis standard of review is more consistent with precedent, federalism, and the role of judges, federal courts should adopt this approach.

#### CONCLUSION

The Fourth Circuit's *TFWS* inquiry articulated a high burden that a state must meet for its liquor regulatory scheme to avoid preemption by the Sherman Act. The *TFWS* inquiry's requirement that the state liquor regulations substantially further the state's proffered interest is inconsistent with Supreme Court precedent in this area, as the Court has repeatedly deferred to state legislative and judicial findings in determining efficacy. In addition to misconstruing precedent, the *TFWS* inquiry also poses federalism issues because it allows federal courts to define and evaluate state interests. While courts are generally not well suited to define public policy, federal court intrusion into the state arena is particularly inappropriate in the Twenty-First Amendment context because the ability to regulate liquor is explicitly reserved to the states in the U.S. Constitution. In addition, the high burden placed on states by the *TFWS* inquiry contravenes the general presumption against preemption of state economic regulations and the even greater presumption present when a state legislates under the Twenty-First Amendment. Given the problems presented by the Fourth Circuit's balancing test,

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<sup>272</sup> *Costco*, 2006 WL 1075218, at \*5-6.

<sup>273</sup> A leading constitutional law treatise describes the minimal showing required under rational basis review to consist only of the Court "ask[ing] only whether it is conceivable that the [challenged law] bear[] a rational relationship to an end of government which is not prohibited by the Constitution." NOWAK & ROTUNDA, *supra* note 64, § 14.3.

<sup>274</sup> *TFWS, Inc. v. Schaefer*, No. WDQ-99-2008, 2007 WL 2917025, at \*3-5 (D. Md. Sept. 27, 2007), *aff'd sub nom. TFWS, Inc. v. Franchot*, 572 F.3d 186 (4th Cir. 2009).

a rational basis standard of review should replace the *TFWS* inquiry. This standard of review would ask: (1) whether the state interest is one recognized under the Twenty-First Amendment, and (2) whether a reasonable person could find a connection between the regulation and the expressed state interest. Such a test would be more consistent with Supreme Court precedent, important federalist principles underlying the Constitution, and the scope of the federal judiciary.