Madigan, Dahl & Harlan Submits Amicus Brief to the 9th Circuit Court of Appeals in a 1st Amendment Challenge to Tied House Laws

Three-tier and tied-house laws stand as two of the time-tested pillars of effective alcohol regulation. Enacted pursuant to the 21st Amendment of the U.S. Constitution, these laws prevent vertical and horizontal integration of the liquor industry. Specifically, they inhibit the creation of monopolies, prohibit exclusive dealing arrangements, and promote temperance and the maintenance of an orderly and accountable alcohol market. In this way, competition and effective control are carefully balanced in order to prevent the over-marketing, over-promotion, and over-consumption of alcohol while still preserving a free market with healthy competition and widespread consumer choice.

As recently noted by the Louisiana Court of Appeals,

Without the three-tier system, the natural tendency historically has been for the supplier tier to integrate vertically. With vertical integration, a supplier takes control of the manufacture, distribution, and retailing of alcoholic beverages, from top to bottom. The result is that individual retail establishments become tied to a particular supplier. When so tied, the retailer takes its orders from the supplier who controls it, including naturally the supplier's mandate to maximize sales. A further consequence is a suppression of competition as the retailer favors the particular brands of the supplier to which the retailer is tied—to the exclusion of other suppliers' brands. With vertical integration, there are also practical implications for the power of regulators. A vertically integrated enterprise-comprising manufacture, distribution, and retailing—is inevitably a powerful entity managed and controlled from afar by non-residents.

Manual v. State of Louisiana, 982 So. 2nd 316 (La. Ct. App. 2008).

In California, Section 25503 was passed as an aspect of its liquor regulations and specifically its tied-house laws. These laws prohibit manufacturers and distributors from giving anything of value to retailers in order to limit the influence and ability of these industry members to coerce retailers into over-marketing and over-promoting alcohol. This broad prohibition also prevents an industry member from providing “value” to retailers by paying for advertising.

In a recent case, *Retail Digital Network LLC vs. Appelsmith*, a middleman involved in the advertising industry brought a lawsuit in U.S. District Court in California asserting that Section 25503, to the extent that it prohibits an industry member from paying for advertising in a retail account, impermissibly restricts commercial speech under the 1st Amendment. A prior 9th Circuit decision, *Actmedia, Inc. vs. Stroh*, 830 F.2d 957 (9th Cir. 1986), had validated the law under a similar challenge. However, a recent U.S. Supreme Court case, *Sorrell vs. IMS Health*, Inc. 131 S. Ct. 2653 (2011), called into question the validity of the *Actmedia* decision. The District Court reaffirmed *Actmedia* and held that the law did not violate the 1st Amendment. That decision was appealed to the 9th Circuit.

In the *Retail Digital Network* decision filed last month, the 9th Circuit Court of Appeals reversed and remanded the case to the District Court for further proceedings and the development of a record. In an unusual opinion, the Court construed Section 25503, which is a broad commercial regulation that simply prohibits suppliers and retailers from providing "value" to a retailer, to be a content- or speaker-based restriction on commercial speech, triggering 1st amendment scrutiny. While the 9th Circuit acknowledged that the three-tier system is unquestionably legitimate and that the pursuit of temperance was a legitimate governmental interest, the case was remanded to consider whether California had shown that Section 25503(f)—(h) (dealing with advertising) materially advances the state's goals of preventing vertical and horizontal integration and promoting temperance. The Court imposed the burden of proving that relationship on the state rather than requiring Retail Digital Network to prove the absence of a causal relationship between the challenged regulation and its underlying purposes.

Madigan, Dahl & Harlan submitted an amicus brief to the 9th Circuit on behalf of the National Beer Wholesalers Association and the Wine & Spirits Wholesalers Association in support of the State of California's Petition for Panel Rehearing and for Rehearing En Banc ("the State of California's Petition"). The amicus brief highlights the far reaching and detrimental consequences this decision could have on effective state-based regulation. If the California tied -house regulation prohibiting industry members from providing anything of value to retailers is deemed unconstitutional, in whole or in part, it will create a large loophole that would enable industry members to engage in what is tantamount to commercial bribery by claiming that the illegal payments were made to retailers for "advertising." This in turn would have the effect of benefiting monopolistic suppliers and retailers by enabling exclusive dealing arrangements, leading to less consumer choice and variety, and disrupting an orderly and accountable alcohol