ABA SECTION OF ANTITRUST LAW
THE PRICE POINT
The Newsletter of the Pricing Conduct Committee
February 2021 Article Highlight

STATE-SANCTIONED PRICE FIXING? A CIRCUIT SPLIT TO WATCH

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Introduction

Prohibition ended in 1933 with the ratification of the Twenty-First Amendment to the Constitution. Instead of opening the door to a free market for the sale and distribution of alcohol, many states opted to subject the industry to complex webs of regulatory schemes. These regulatory schemes often incorporate so-called "post and hold" laws, which, in simplistic terms, require wholesalers to "post" and then "hold" the price of products for a set period of time. States typically adopt post and hold laws in combination with variations on minimum resale price maintenance laws and price discrimination laws (collectively, and together with post and hold laws, "Liquor Pricing Laws").[1] Because these regulatory schemes allow or arguably facilitate horizontal price fixing, various participants in the industry have challenged these laws as preempted by the Sherman Act.

The courts have not necessarily provided much clarity – at least not from a nationwide perspective. Last year, the Supreme Court denied *certiorari* review in a case involving an unsuccessful challenge to three provisions of Connecticut's Liquor Pricing Laws, which (1) require manufacturers and wholesalers to participate in a "post and hold" process; (2) impose mandatory minimum resale price maintenance on retailers; and (3) prohibit price discrimination.[2] In doing so, the Court allowed the courts of appeals to remain divided on whether and when these regulatory schemes are preempted. This article will discuss the circuit split and analyze each side's strongest arguments.

[1] The views and opinions expressed in this article are those of the author and do not necessarily reflect those of Sills Cummis & Gross P.C.

[1] These regulations are commonly referred to as "post and hold laws," but the post and hold requirement is often only one component of the complex web of regulations governing the price of alcohol.

[2] *Conn. Fine Wine & Spirits, LLC v. Seagull*, 140 S. Ct. 2641 (2020).

What Are Liquor Pricing Laws?

The Liquor Pricing Laws at the center of this circuit split vary from state to state; in most cases, these regulatory schemes include variations on post and hold laws, minimum resale price maintenance laws, and price discrimination laws.

First, post and hold laws generally require wholesalers to "post" a bottle price, a can price, and a case price for each product they intend to sell in the coming month.[3] The "hold" portion of the law requires each wholesaler to adhere to its posted price for the month, after a brief period during which each wholesaler may match – but not beat – any lower price for the same brand product.[4] On occasion, wholesalers may offer lower case prices in what are known as "off-post" months. During those months, wholesalers might or might not also lower their bottle prices proportionately. Retailers buy almost exclusively by the case.

Second, minimum resale price maintenance laws preclude retailers from charging less than a price that is determined by a statutory formula – which the statutes usually refer to as "Cost." In Connecticut, for example, the statutorily defined "Cost" for any particular ***bottle*** is determined by adding a markup for shipping and delivery to the wholesaler's posted ***bottle price*** at the time of the sale to the consumer, even if the retailer purchased the product by the ***case***.[5] Therefore, the retailer's prices are maintained – by law – at or above a figure that in some cases may bear no relation to the retailer's true costs. Further, the wholesaler can effectively control the retailer's minimum price and mark-up. The impact of this pricing scheme is particularly significant when retailers buy by the case in "off-post" months, at a discount, when the wholesalers have not discounted their bottle prices. During these months, the retailer is limited in its ability to gain a competitive advantage by passing its ***actual*** cost savings on to the consumer, because its ***bottle*** prices are tied to the wholesaler's posted ***bottle*** price.[6] Indeed, wholesalers have allegedly advertised to retailers that they would guarantee large mark-ups by discounting case prices and raising bottle prices in the following months.[7] The argument made by some is that this scheme allows wholesalers to effectively control competition by requiring retailers to sell at artificially high markups.[8]

Third, liquor price discrimination laws prohibit volume discounts and other forms of price discrimination.[9] These laws differ from the federal Robinson-Patman Act in that they generally require wholesalers to sell a given product to all retailers at the same price, no matter their size or the volume of product being sold. If a wholesaler were to offer a discount to one retailer, it would automatically be in violation of the Liquor Pricing Laws, even if that conduct had no anticompetitive effects.

Purposes and Effects of Liquor Pricing Laws

There is little dispute about the intended purposes of Liquor Pricing Laws. Generally speaking, states enacted Liquor Pricing Laws to prevent unfettered competition in an industry where price wars were thought to

[3] *See Conn. Fine Wine & Spirits, LLC v. Seagull*, 932 F.3d 22, 24 (2d Cir. 2019) ("*Seagull I*") (describing Conn. Gen. Stat. § 30-63 and Conn. Agencies Regs. § 30-6-B12).

[4] *Id.*

[5] *See* Conn. Gen. Stat. §§ 30-68m(a)(1), 30-68m(b). Similarly, in some states, a minimum mark-up law requires wholesalers and/or retailers to mark-up their prices by at least a specified percentage of their statutory "cost." *See, e.g.*, *324 Liquor Corp. v. Duffy*, 479 U.S. 335, 349 (1987) (discussing New York's 12% minimum mark-up).

[6] *See 324 Liquor Corp.*, 479 U.S. at 338–40.

[7] *See* Br. of Appellant, *324 Liquor Corp. v. Duffy*, 479 U.S. 335 (1987) (No. 84-2022), 1986 U.S. S. Ct. Briefs LEXIS 548 at *16–17.

[8] *See id.*

[9] *See, e.g.*, Conn. Gen. Stat. §§ 30-63(b), 30-68k, 30-94(b); Conn. Agencies Regs. § 30-6-A29(a).

be dangerous to public health.[10] Supporters argued that competition would lead to discounted pricing, which in turn would lead to excessive consumption.[11] They also feared that competitive pricing would incentivize retailers to violate other regulations, such as those barring young people from purchasing alcohol and those mandating that retailers close during certain hours.[12] It has also been argued that some Liquor Pricing Laws, particularly those instituting minimum resale price maintenance or prohibiting price discrimination, were adopted to protect small retailers that would be unable to unlock volume discounts if they were legal.[13]

In an empirical examination of the effects of post and hold laws, former Commissioner of the Federal Trade Commission Joshua D. Wright and former Deputy Acting Director of the Federal Trade Commission's Office of Policy Planning James C. Cooper concluded that consumers in states with post and hold laws consume between 2 and 8% less alcohol than consumers in other states.[14] By potentially restricting output, post and hold laws are, therefore, arguably consistent with temperance policy goals, but inconsistent with consumer welfare goals.[15]

Opponents argue that, when taken as a whole, Liquor Pricing Laws have the same anticompetitive effects as if all alcohol wholesalers and retailers engaged in both horizontal price fixing and illegal minimum resale price maintenance. They claim that, under these regimes, there is no incentive for a wholesaler to compete on price, because there would be no competitive advantage in doing so.[16] In addition, retailers are not able to offer discounted prices under these regimes, because their prices are based strictly upon bottle prices – which are set by the wholesalers – and a predetermined markup. In effect, both wholesalers and retailers can potentially charge supra-competitive prices,[17] leading to reduced incentives among industry participants to challenge the regulatory schemes. Essentially, as one plaintiff retailer has argued, "Competition plays no role in pricing; and Connecticut consumers pay grossly inflated above-market prices for every bottle of wine or spirits they purchase."[18]

Even opponents of the Liquor Pricing Laws admit, however, that nothing in the Laws sets prices or requires wholesalers to match each other's prices. The problem, according to opponents, is that the incentives to engage in what would otherwise be illegal price fixing are too high, and in practice, wholesalers almost

[10] *See, e.g.*, *Cal. Retail Liquor Dealers Ass'n v. Midcal Alum.*, 445 U.S. 97, 112–13 (1980) (California's minimum resale price maintenance law was meant to promote temperance and "orderly market conditions"); *TFWS, Inc. v. Schaefer*, 242 F.3d 198, 203 (4th Cir. 2001) (Maryland's scheme had "one overriding purpose: fostering and promoting temperance"). Judge Winter disagreed, however, that New York's Liquor Pricing Laws were "even remotely the result of political pressure exerted by aroused temperance groups." *Battipaglia v. N.Y. State Liquor Auth.*, 745 F.2d 166, 180 (2d Cir. 1984) (Winter, J., dissenting). According to Judge Winter, the "self-evident purpose of the statute is to create a cartel of liquor wholesalers for their benefit." *Id.*

[11] *See Seagull I*, 932 F.3d at 26.

[12] *Id.*

[13] *See, e.g.*, *324 Liquor Corp.*, 479 U.S. at 348–49 ("[T]he purpose of [New York's] 12-percent minimum markup is to protect small retailers."); *see also Seagull I*, 932 F.3d at 26 (acknowledging that Connecticut's price discrimination provision has been "justified as guarding against favoritism within the liquor industry and protecting smaller retailers"). Others have claimed that protecting small retailers is an ***unintended*** consequence of Liquor Pricing Laws.

[14] James C. Cooper & Joshua D. Wright, *Alcohol, Antitrust, and the 21st Amendment: An Empirical Examination of Post and Hold Laws*, 32 Int'l Rev. L. & Econ. 379, 380, 382–83, 388 (2012).

[15] Cooper and Wright concluded, however, that post and hold laws have no measurable effect on drunk driving accidents or various measures of teen drinking. *See id.*

[16] *See* Pl.'s Consolidated Opp'n to Defs.' & Intervenors' Mot. to Dismiss at 4, *Conn. Fine Wine & Spirits, LLC v. Harris*, 255 F. Supp. 3d 355 (D. Conn. 2017) ("*Harris*") (No. 3:16-cv-1434 (JCH)), ECF No. 82.

[17] *Id.* at 5 ("Retailers who want to keep retail prices artificially high . . . have every reason to collude with, or at least encourage, wholesalers to post and maintain high minimum 'bottle' prices, in order to prevent more efficient retailers like [the plaintiff retailer] Total Wine from passing along cost savings . . . .").

[18] Br. for Plaintiff-Appellant at 9, *Seagull I*, 932 F.3d 22 (No. 17-2003-cv), ECF No. 58.

always match, thereby fixing prices across a state's industry and setting retailers' profit margins. As it turns out, the question of whether it is the state or the wholesaler that sets prices is critical to the legal analysis.

The Legal Framework

The Supreme Court established the framework for analyzing facial preemption claims in *Rice v. Norman Williams Co.*, 458 U.S. 654 (1982). The ultimate inquiry is whether "there exists an irreconcilable conflict between the federal and state regulatory schemes."[19] Importantly, the "existence of a hypothetical or potential conflict is insufficient to warrant the pre-emption of the state statute. A state regulatory scheme is not pre-empted by the federal antitrust laws simply because in a hypothetical situation a private party's compliance with the statute might cause him to violate the antitrust laws."[20] Therefore, a state statute is preempted "only if it mandates or authorizes conduct that necessarily constitutes a violation of the antitrust laws in all cases, or if it places irresistible pressure on a private party to violate the antitrust laws in order to comply with the statute."[21] In most cases, courts have focused on whether a plaintiff challenging a state statute as preempted by the Sherman Act can show that the conduct contemplated by the statute "is in all cases a *per se* violation" of the Sherman Act.[22]

In addition, to prove that a state statute is preempted by the Sherman Act, the plaintiff must establish that the challenged statute qualifies as a "hybrid" restraint rather than a "unilateral" restraint.[23] Restraints on competition that are unilaterally imposed by the government are outside the purview of § 1 of the Sherman Act, because the Sherman Act "does not apply 'to the anticompetitive conduct of a State acting through its legislature.'"[24] In contrast, a "hybrid" restraint is one that authorizes private parties to violate the Sherman Act. That is, where private actors are "granted 'a degree of private regulatory power,'" and essentially effectuate the restraint permitted by the state, the state statute "may be attacked under § 1 as a 'hybrid' restraint."[25]

Courts disagree on which prong of the test should be examined first. This article will discuss the question of whether a restraint is a "hybrid" restraint first, because that question is often easier to grapple with. If a court determines that a restraint is unilateral, there is no need to determine whether the conduct contemplated by the statute is in all cases a *per se* violation of the Sherman Act.

The Circuit Split

Guided by this legal framework, courts have applied a two-part test: first, whether the state statute qualifies as a hybrid restraint, and if so, then, whether the conduct contemplated by the statute is a *per se* violation.[26] In applying this test, courts have both upheld and struck down remarkably similar Liquor Pricing Laws, creating a split among the courts of appeals.[27] The Hon. Richard J. Sullivan of the Court of Appeals for the Second Circuit recently wrote that by denying rehearing *en banc* in a case challenging Connecticut's Liquor Pricing

[19] *Rice v. Norman Williams Co.*, 458 U.S. 654, 659 (1982).
[20] *Id.*
[21] *Id.* at 661.
[22] *Id.*
[23] *Fisher v. Berkeley*, 475 U.S. 260, 266–67 (1986).
[24] *324 Liquor Corp.*, 479 U.S. at 343; *see also Fisher*, 475 U.S. at 266–67. Legislation that is pre-empted by the Sherman Act may nonetheless survive if it is immune from antitrust scrutiny under *Parker v. Brown*, 317 U.S. 341 (1943). *Parker* state-action immunity is outside the scope of this article.
[25] *324 Liquor Corp.*, 479 U.S. at 345 n.8.
[26] *See generally, e.g.*, *TFWS*, 242 F.3d at 207; *Harris*, 255 F. Supp. 3d at 364.
[27] *Compare, e.g.*, *Battipaglia*, 745 F.2d 166 (upholding New York's Liquor Pricing Laws) *and Seagull I*, 932 F.3d 22 (upholding Connecticut's substantially similar Liquor Pricing Laws) *with TFWS*, 242 F.3d at 206–10 (striking down Maryland's Liquor Pricing Laws, which comprised a post and hold component and a volume discount ban) *and Midcal*, 445 U.S. at 103 (holding that California's system for wine pricing constituted resale price maintenance in violation of the Sherman Act).

Laws, the court was "perpetuat[ing] a longstanding circuit split and continu[ing] to allow de facto state-sanctioned cartels of alcohol wholesalers to impose artificially high prices on consumers and retailers across all three states in our Circuit."[28]

Part One of the Test: Unilateral vs. Hybrid Restraints

Courts generally agree that post and hold laws are "classic hybrid restraint[s]" because the state does not set, review, or supervise the price that wholesalers are required to post and hold.[29] Nor do these laws require wholesalers to match the lowest posted price, though in reality, that practice may be inevitable.[30] As a result, wholesalers are "granted a significant degree of private regulatory power."[31] Generally speaking, courts must examine post and hold laws under the second prong of the test.

In contrast, there is no consensus on whether liquor price discrimination bans and/or minimum resale price maintenance laws are "hybrid" restraints, and often the question explicitly or implicitly turns on severability of the state's post and hold law. The Second and Ninth Circuits have both held that price discrimination bans are unilateral restraints (and therefore, not preempted), but the Fourth Circuit has held that price discrimination bans are hybrid restraints. The Second Circuit explained that Connecticut's price discrimination ban was a unilateral restraint because each wholesaler is "at liberty to choose the price it will charge all retailers" while "prohibiting each from charging different prices to different retailers."[32] The Ninth Circuit struck down Washington's post and hold law, but upheld its volume discount ban, price discrimination ban, and minimum mark-up of 10%, because in the absence of the post and hold requirement, it concluded, these were unilateral restraints.[33] Refusing to sever the Liquor Pricing Laws and treat each on an individual basis, the Fourth Circuit held that Maryland's volume discount ban was "part of the hybrid restraint because it reinforces the post-and-hold system by making it even more inflexible."[34]

Minimum resale price maintenance laws fare no better. While the Second Circuit held that it was bound by *324 Liquor Corp. v. Duffy*, 479 U.S. 335, 349 (1987) to hold that minimum resale price maintenance laws are hybrid restraints,[35] the Ninth Circuit held that these laws are unilateral restraints provided that the post and hold law could be severed.[36]

Part Two of the Test: *Per Se* vs. Rule of Reason Violations

There is significant controversy over whether the conduct required or authorized by Liquor Pricing Laws constitutes a *per se* violation of the Sherman Act. The question can be dispositive to the preemption analysis, and courts have struggled with both adhering to precedent and yet incorporating changes in the law.

First, while the conduct authorized by post and hold laws may resemble horizontal price fixing, which typically warrants *per se* treatment, courts do not always see it that way.

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[28] *Conn. Fine Wine & Spirits, LLC v. Seagull*, 936 F.3d 119, 120 (2d Cir. 2019) ("*Seagull II*") (Sullivan, J., dissenting).

[29] *TFWS*, 242 F.3d at 208–09.

[30] In his dissent in *Seagull II*, Judge Sullivan concluded: "Since wholesalers will never be punished for artificially high prices, or rewarded for market-based low prices, they are likely to eventually degenerate into a de facto cartel in which wholesalers vie to post the highest possible prices without fear of market reprisal." *Seagull II*, 936 F.3d at 122 (Sullivan, J., dissenting).

[31] *TFWS*, 242 F.3d at 208–09.

[32] *Seagull I*, 932 F.3d at 33.

[33] *Costco Wholesale Corp. v. Maleng*, 522 F.3d 874, 892–94, 896–98 (9th Cir. 2008).

[34] *TFWS*, 242 F.3d at 209.

[35] *Seagull I*, 932 F.3d at 32.

[36] *Costco*, 522 F.3d at 899.

In *Battipaglia v. N.Y. State Liquor Auth.*, 745 F.2d 166 (2d Cir. 1984), the Hon. Henry Friendly held that the conduct contemplated by New York's post and hold laws does not violate § 1 of the Sherman Act, because merely broadcasting prices is not *per se* illegal, and there was no evidence of an agreement to fix prices.[37] Instead, the posted prices were the "individual acts" of the wholesalers.[38] In dissent, the Hon. Ralph K. Winter disagreed, focusing on the "hold" requirement, and opining that the conduct would be *per se* illegal if accomplished solely through private agreement.[39] He explained: "The relevant issue under the supremacy clause has to do with the degree to which a state may bring about the very anti-competitive arrangements the Sherman Act was designed to avoid"; *i.e.*, the issue is not whether the relevant statute compelled private parties to enter into an anti-competitive agreement that would violate the Sherman Act.[40]

The question of whether a plaintiff must show that there is an agreement to successfully challenge a state statute as preempted by § 1 of the Sherman Act has caused trouble ever since. The Fourth and Ninth Circuits agreed with Judge Winter's assessment, holding that post and hold laws in Washington, Oregon, and Maryland violated the Sherman Act.[41] In *Connecticut Fine Wine & Spirits, LLC v. Harris*, the district court appeared "inclined to agree" with Judge Winter's argument that the conduct authorized by Connecticut's laws would be a *per se* violation of the Sherman Act absent the regulatory scheme.[42] However, the court concluded that it was constrained by *Battipaglia* and held that Connecticut's post and hold law was not preempted.[43] When the Second Circuit considered the question on appeal, it similarly concluded that it was bound by *Battipaglia*.[44] But, in dissent from the court's denial of rehearing *en banc*, Judge Sullivan stated plainly that *Battipaglia* was wrongly decided and presented a forceful argument echoing Judge Winter's dissent.[45]

Second, opponents of Liquor Pricing Laws argue that minimum resale price maintenance laws and price discrimination bans constitute *per se* illegal vertical restraints. Given that minimum and maximum vertical price restraints were *per se* illegal prior to *Leegin Creative Leather Prods. v. PSKS, Inc.*, 551 U.S. 877 (2007), there are a number of pre-*Leegin* cases holding that minimum resale price maintenance laws and/or price discrimination laws are preempted by the Sherman Act.[46] After *Leegin*, Maryland argued that its volume discount ban was not preempted because a ban on volume discounts, in the absence of all else, is a vertical restraint that would be afforded rule of reason analysis under *Leegin*. The Fourth Circuit rejected this argument, holding that *Leegin* did not change its analysis.[47] The Court

[37] *Battipaglia*, 745 F.2d at 175 ("New York wholesalers can fulfill all of their obligations under the statute whiteout either conspiring to fix prices or engaging in 'conscious parallel' pricing.").

[38] *Id.* at 170.

[39] *Id.* at 179 (Winter, J., dissenting).

[40] *Id.*

[41] *See, e.g.*, *Miller v. Hedlund*, 813 F.2d 1344 (9th Cir. 1986); *TFWS*, 242 F.3d at 206–10. Opponents of post and hold laws argue that *324 Liquor Corp. v. Duffy*, 479 U.S. 335, 345–46 n.8 (1987) and *Freedom Holdings, Inc. v. Spitzer*, 357 F.3d 205, 223 n.17 (2d Cir. 2004) (Winter, J.) establish that a statute need not bring about an agreement between private parties to be preempted by § 1 of the Sherman Act because the anticompetitive effects of compelled price fixing are the same as those of price fixing by voluntary agreement. *See, e.g.*, *324 Liquor*, 479 U.S. at 345–46 n.8 ("Our decisions reflect the principle that the federal antitrust laws pre-empt state laws authorizing or compelling private parties to engage in anticompetitive behavior.").

[42] *Harris*, 255 F. Supp. 3d at 371 ("While this court might be inclined to agree with the analysis of Judge Winter, it is ultimately bound by the Second Circuit's holding in *Battipaglia*. It cannot distinguish the statute in *Battipaglia* from the one at issue in this case in any meaningful way. The court thus concludes that the post and hold provisions are subject to rule of reason analysis . . . .").

[43] *Id.*

[44] *Seagull I*, 932 F.3d at 34–35.

[45] *Seagull II*, 936 F.3d at 120, 123.

[46] *See, e.g.*, *Midcal*, 445 U.S. at 103 ("California's system for wine pricing plainly constitutes resale price maintenance in violation of the Sherman Act."); *see also Schwegmann Bros. v. Calvert Distillers Corp.*, 341 U.S. 384 (1951).

[47] *TFWS, Inc. v. Franchot*, 572 F.3d 186 (4th Cir. 2009).

explained that the volume discount ban was "part of a single regulatory scheme" that amounted to a form of horizontal price fixing.[48] Therefore, in the court's view, *Leegin* was inapposite.

The Second Circuit again departed from the Fourth Circuit when it recently considered whether Connecticut's minimum resale price maintenance and price discrimination laws were preempted by the Sherman Act. Citing *Leegin*, the court held that "the need to analyze vertical pricing arrangements under the rule of reason means that § 1 cannot preempt as *per se* unlawful even a statute that overtly mandates such arrangements."[49] There, the plaintiff had argued that industry-wide vertical price restraints were an exception to *Leegin* and were still *per se* illegal. There may be some merit to that argument, at least insofar as the industry-wide vertical restraint is inextricably linked with a horizontal price-fixing restraint, and the "essence" of the overall restraint is horizontal,[50] but the Second Circuit did not view Connecticut's Liquor Pricing Laws as falling in that category.

What Comes Next?

Of course, we can only speculate as to why the Supreme Court declined to hear the challenge to Connecticut's Liquor Pricing Laws. It is possible that members of the Court did not want to meddle with Connecticut's right to regulate the sale and distribution of alcohol under the Twenty-First Amendment. Or, perhaps the Court viewed the Second Circuit, bound as it is by *Battipaglia*, as an outlier, though several other states in other circuits – including New Jersey, Michigan, Georgia, and Oklahoma – also have similar Liquor Pricing Laws that have been challenged or could be challenged.

Finally, as many states wade into unchartered territory with regard to the regulation of cannabis, it is possible that these types of laws will see a resurgence in that industry. After all, the stated purposes of the Liquor Pricing Laws could be said (by some) to have equal weight with respect to cannabis. If that is the case, then we are sure to see more litigation in this complex corner of antitrust law.

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[48] *Id.* at 189, 192.

[49] *Seagull I*, 932 F.3d at 33.

[50] In a pre-*Leegin* decision, the Supreme Court distinguished industry-wide resale price fixing from vertical restraints imposed by a single manufacturer, noting that "[m]andatory industrywide resale price fixing is virtually certain to reduce interbrand competition as well as intrabrand competition, because it prevents manufacturers and wholesalers from allowing or requiring retail price competition." *324 Liquor Corp.*, 479 U.S. at 342.