

Nos. 06-35538, 06-35542, and 06-35543

IN THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

COSTCO WHOLESALE CORPORATION, a Washington corporation,
Plaintiff-Appellee,

v.

NORM MALENG,
Defendant,

WASHINGTON BEER & WINE WHOLESALERS ASSOCIATION, a Washington
nonprofit corporation,
Defendant-Intervenor,

and

ROGER HOEN; VERA ING; MERRITT D. LONG, in their official capacities as
members of the Washington State Liquor Control Board,
Defendants-Appellants.

APPEAL FROM UNITED STATES DISTRICT COURT FOR THE WESTERN
DISTRICT OF WASHINGTON AT SEATTLE
(DISTRICT COURT NO. CV04-0360P)

APPELLEE AND CROSS-APPELLANT
COSTCO WHOLESALE CORPORATION'S PETITION FOR REHEARING
OR REHEARING EN BANC
(Panel of Judges O'Scannlain, Tashima, and Berzon)

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I. INTRODUCTION AND STATEMENT OF COUNSEL

Costco seeks rehearing or rehearing en banc. The panel decision (Addendum A) addresses "whether certain restrictions imposed by the State of Washington on the sale of wine and beer are preempted by federal antitrust laws." Slip op. at 1391; *see id.* at 1394-96 (describing restraints). Washington eliminates major aspects of ordinary competition among wine and beer producers and distributors, encouraging those private sellers to inflate prices ultimately paid by consumers. *See id.* at 1398-99. Central to the pricing system is requiring producers and distributors to post monthly with the state a price for every item and to hold that price until the next posting. The posted price may not vary with volume purchased or with whether the buyer needs or accepts delivery service, and the seller may not effectively discount by extending credit. Retailers cannot purchase large quantities during a month when price is low and warehouse for later distribution to their stores. The District Court found that the restraints raised prices but, following trial, rejected the State's assertion that such higher prices served to promote temperance. The panel affirmed that factual finding. Slip op. at 1431.

The petition raises two related issues of broad importance—the severability of and the hybrid, or preempted, nature of the restraints. The panel incorrectly evaluated the restraints in isolation from one another, and incorrectly created a rule

of absolute antitrust immunity, regardless of the private discretion in how high prices go, for state laws that, viewed in the isolation created by the erroneous severability analysis, dictate rather than just endorse forbearance from aspects of competition.

The panel affirmed the District Court's invalidation of the core requirements that producers and distributors "post" prices with a state agency and that they "hold" those prices for a month. The panel found posting and holding to be hybrid, involving both private and state action, and had "little trouble" concluding they were per se antitrust violations. *Id.* at 1415-19. At the same time, however, the panel upheld seven other restraints: those that define the posted prices—uniform posted prices, minimum mark-up, single price per item regardless of volume, and "delivered pricing,"—and those that intercept circumvention of the posted prices—the bans on credit, central retailer warehousing, and retailer-to-retailer sales. The panel agreed with Costco that the first five of those ancillary restraints were per se antitrust violations and would be hybrid restraints, not immune from preemption, if considered as a whole.¹ *Id.* at 1420-21 n.19. Only "if the post-and-hold provision

¹ The panel found that the restriction on warehousing was not a per se restraint, erroneously analyzing it as an indirect restraint on the output of wine and beer rather than a direct restriction of the supply of warehousing services (as Costco had proved). Slip op. at 1409-10.

can be severed," could the panel "uphold these [other] restraints" as unilateral. *Id.* at 1423; *see id.* at 1421. To accomplish that, the panel atomized the State's pricing system.

Rehearing or rehearing en banc is required to correct the erroneous conclusions that the upheld restraints are severable from the stricken restraints and from each other and are immunized from federal antitrust scrutiny even though state law allows competitors to set the resulting prices and does not supervise how high those prices go. Specifically, undersigned counsel certifies that rehearing en banc is warranted because:

1) The panel expressly rejected a holding in *Miller v. Hedlund*, 813 F.2d 1344 (9th Cir. 1987), as to the interconnectedness of these restraints, remarkably giving the *Miller* decision less deference than given by a sister circuit in *TFWS, Inc. v. Schaefer*, 242 F.3d 198 (4th Cir. 2001).

2) The panel created a presumption of statutory severability that simply does not exist in Washington law and that is of exceptional importance because of its applicability each time the Court addresses the constitutionality of Washington statutes with multiple provisions.

3) The panel rejected the understanding of Supreme Court hybrid restraint principles adopted by *Miller* and *TFWS* and elevated one competing

Supreme Court decision, *Fisher v. City of Berkeley*, 475 U.S. 260 (1986), over other Supreme Court decisions that *Miller* and *TFWS* held controlling. The panel adopted an extreme rule in a "doctrinally confusing area" of exceptional importance. Slip op. at 1402-04. The proper standard for antitrust preemption is implicated in cases challenging many kinds of state laws. In the beverage law area alone, many states have the restraints the panel struck down, and most combine them with at least one of the other restraints.

II. PETITION FOR PANEL REHEARING

The panel's opinion on severability begins with a misstep that undermines its entire treatment of the issue. The panel was under the misapprehension that the severability provision on which it relied is part of Chapter 66.28, which contains the challenged restraints. It is not. The error is made apparent by the panel's mistaken citation to "RCW 66.28.090" as a determinative severability clause. Slip op. at 1426 (emphasis added). There is no such severability clause, and what the panel quoted was RCW 66.98.090, which is part of a catch-all chapter created by the code reviser.² RCW 1.08.015.

² RCW 66.98.090 was never cited in any of the State's briefs in this Court or below. It was raised as a "see also" by the private intervenor but was not included in the addendum of any party. *See* Ninth Cir. Rule 28-2.7 (requiring addendum to include relevant statutes).

RCW 66.98.090 limits its scope to the act (of no relevance here) of which it was a part:

Severability — 1981 1st ex.s. c 5.

If any provision of *this act* or its application to any person or circumstance is held invalid, the remainder of the act or the application of the provision to other persons or circumstances is not affected.

RCW 66.98.090 (emphasis added). "[T]his act" is not Title 66 or Chapter 66.28.³

It is the lone 1981 act identified by the code reviser, an act passed before the challenged restraints were added elsewhere in Title 66 in 1985 and 1995.⁴ There were, in contrast, no severability clauses in the acts, primarily a 1995 cohesive package, that added most of the challenged restraints. Addendum C. The panel held that state law governs this issue, slip op. at 1400, but the only Washington severability precedent cited below and on appeal, and only by the private intervener, holds that such a clause is irrelevant, and that decision instead requires

³ See RCW 1.04.021 (arrangement in code does not change substance).

⁴ The same analysis applies to other severability provisions compiled in Chapter 66.98. RCW 66.98.020 and RCW 66.98.080 are from specific enactments that did not include the restraints. RCW 66.98.020 is from the first post-Prohibition liquor statute, but is limited to sections "at the time of enactment of this act." The fact that the Legislature added specific severability provisions (such as RCW 66.98.080 & .090) to select subsequent amendments to that act shows the limited reach of the original severability clause. See Wash. Const. Art. 2, § 37 (act may not be amended without direct reference to full text).

striking down the entire statute. *In re Parentage of C.A.M.A.*, 154 Wn.2d 52, 67, 109 P.3d 405, 413 (2005) (severability provisions codified in relevant RCW chapter but originally part of specific acts irrelevant because those acts did not include invalid provisions), cited in WBWWA's Motion for Partial Summary Judgment (Dkt. 67) at 23; WBWWA's Reply Brief in Support of Motion for Partial Summary Judgment (Dkt. 101) at 11 n.17; WBWWA Brief on Appeal 57. (The State appropriately never argued or cited to this or any Washington severability precedent. *See note 2 supra.*)

III. PETITION FOR REHEARING EN BANC

A. The Panel Improperly Overruled a Prior Panel Decision on Interconnected Restraints

The panel expressly admitted that it was rejecting a holding of another panel, which struck down Oregon post, hold, and delivered pricing restraints. Slip op. at 1412 & 1419. The panel mistakenly described *Miller* as addressing a prohibition on quantity discounts, an issue that was not appealed there, and the panel did not apply *Miller* to the delivered pricing restraint at issue there and here. *Compare* 813 F.2d at 1347-48 & n.3 *with* slip op. at 1412 n.13. Even if one substitutes delivered pricing for quantity discounts in the panel's reasoning, however, the panel still erred in overruling *Miller*. The stated reason for doing so was that *Miller*

"presumed an interconnectedness to the regulations" without "significant analysis."

Slip op. at 1419.

That rationale, of course, could be invoked by any panel seeking to evade a prior panel's ruling, eviscerating the rule of stare decisis. Moreover, *Miller* set out the interconnected provisions in question, 813 F.2d at 1347 n.1, Addendum F, and, as the panel conceded, the Fourth Circuit has expressly adopted the *Miller* analysis in striking down a ban on quantity discounts along with post and hold provisions. *TFWS*, 242 F.3d at 209 (quoted at slip op. at 1419-20) ("volume discount ban is a part of the hybrid restraint" in which "discounts [from posted prices] of any nature are prohibited"). If *Miller* is followed, both in the letter (as to delivered pricing) and spirit (as to quantity discounts, per the Fourth Circuit), the remaining, similarly integrated restraints in RCW 66.28.180 must fall. The provisions here plainly are no less interconnected than those in *Miller* and *TFWS*. Compare Addendum E with Addendum F and Addendum G. Even were it true that the holding in *Miller* was insufficiently explained, departure from that holding is the prerogative of the en banc Court, which should grant rehearing.

B. The Panel Incorrectly Created a Presumption of Severability Under Washington Law and Based Its Severability Analysis on an Erroneous Premise of an Independent Uniformity Obligation

Instead of following *Miller*, the panel held that the (inapplicable) severability clause created a "presumption" that the Legislature intended to sever valid from invalid provisions. Slip op. at 1426. The panel cited no authority for this presumption, and Washington courts do not describe or apply any such presumption. As is made clear by the only severability Washington precedent defendants cited, any presumption goes the other way. "[U]nless we conclude the Legislature would have passed the statute absent the unconstitutional provisions, the proper remedy is complete statutory invalidation rather than changing legislative intent by upsetting the legislative compromise." *Parentage of C.A.M.A.*, 154 Wn.2d at 67, 109 P.3d at 413. That is particularly apropos here, where the Legislature originally was misled into believing that the 1995 enactment was not controversial among involved parties. SER 360; WER 663.

In short, Washington courts view severability clauses only as "evidence" of intent, less important than the language of the provisions, their structural and functional relationship, and the ability of the remaining provisions to accomplish the legislative objectives. *Parentage of C.A.M.A.*, 154 Wn.2d at 67-68, 109 P.3d at 414. Washington courts have not hesitated to strike down entire statutes, even

those with severability clauses,⁵ including an entire wine and beer distribution statute. *Mt. Hood Beverage Co. v. Constellation Brands, Inc.*, 149 Wn.2d 98, 112, 118-19, 63 P.3d 779, 787, 790 (2003).

This is an issue of exceptional importance. The circuit frequently addresses the constitutionality of Washington statutes, and those statutes frequently contain more than one suspect provision.

The issue also is determinative of this case. The panel applied its presumption without addressing the Legislature's specific language, and the presumption allowed the panel to ignore *defendants'* vigorous arguments that the restraints were functionally inseparable and could not accomplish their purposes without posting and holding. *See* notes 8 & 9 *infra*.

The panel criticized the District Court for finding that posting and holding was the "center of Washington's solar system of alcohol regulation." Slip op. at 1426. That was a natural finding, however. Among other things, most of the restraints appear under subsections (2) and (3) of RCW 66.28.180 entitled "Beer and wine distributor price posting" and "Beer and wine supplier's price filings."

⁵ *E.g.*, *Leonard v. City of Spokane*, 127 Wn.2d 194, 201, 897 P.2d 358, 362 (1995) (despite severability clause, unconstitutional funding mechanism was "heart and soul" of act); *City of Seattle v. Yes for Seattle*, 122 Wn. App. 382, 393-95, 93 P.3d 176, 181-82 (2004) (notwithstanding severability clause, constitutional "sections on their own would not accomplish the goals of the initiative").

Even if the panel were correct that uniform pricing is the "relevant center" of the pricing system, those subsections discuss uniformity only in the context of posting and holding.⁶ For example, RCW 66.28.180(2)(c) prohibits selling "at a price differing from the price for such package or container as shown in the price posting filed" by the distributor and "held" for a month. There is no separate statutory provision requiring distributors to sell at uniform prices.⁷ And the panel was clear

⁶ The legislative history shows how tightly connected the other restraints are to posting and holding. The Legislature first enacted a concise version of post and hold in 1985, as Section 4 (now the introductory portion of RCW 66.28.180) of Chapter 226, 1985 Washington Laws, an act with no severability clause. Addendum B. Section 4 made it unlawful for producers and distributors "to modify any prices without prior notification to and approval of the board." The bulk of what is now RCW 66.28.180, adding the ancillary restraints and detailing the posting mechanism, was added by Section 10 of Chapter 232, 1995 Washington Laws. Addendum C. In deciding where the new restraints should go, the 1995 Legislature decided to elaborate on the post and hold section of the 1985 act. For example, the Legislature placed the distributor uniform price (Section 10(2)(c)), volume discount and minimum mark-up (Section 10(2)(d)), and warehousing (Section 10(2)(h)(i) & (ii)) restraints together, with every subsection not just "geographically" related to posting and holding but referring explicitly to "posting" or "posted." Addendum C (highlighting added in Addendum). Those restraints are indeed "part-and-parcel of the posting scheme." Slip op. at 1421.

⁷ The panel referred, with a "*see also*" signal, to an antidiscrimination provision, RCW 66.28.170, but did not suggest that it requires uniformity. Slip op. at 1394-95. That law applies only to producers, not distributors, and it was enacted in conjunction with posting in 1985, Addendum B, not with uniformity in 1995. The regulations in effect in 1985 (and used as the model for the 1995 statute) already required uniformity. Addendum D.

that if uniformity cannot be saved, "[a]ll of the other restraints revolve around" it and must fall. Slip op. at 1426.

Striking the references to posting and holding makes RCW 66.28.180 worse than meaningless as to uniformity. Unless the Court adds new language, the mutilated statute would provide that "[no] distributor may sell or offer to sell . . . at a price differing from"—what? Without posted prices, there is nothing left to tell distributors what that price must be.

The panel never attempted to show what, short of the entirety of RCW 66.28.180, is the "post-and-hold provision" that somehow "can be excised," slip op. at 1426, and leave behind something meaningful. "[R]espect for the functions of the states in our federal system," slip op. at 1422, should extend to a state supreme court's clear direction as to how best to honor a state legislature that has included invalid provisions in an integrated approach to accomplishing its objectives: "We show greater respect for the legislature by preserving the legislature's fundamental role to rewrite the statute rather than undertaking that legislative task ourselves. Therefore we hold the statute unconstitutional in its entirety." *Parentage of C.A.M.A.*, 154 Wn.2d at 69, 109 P.3d at 414. That is the correct result for at least RCW 66.28.180.

Even were the ancillary restraints grammatically severable from posting and holding, they are not functionally severable. Defendants argued the restraints were interconnected and had to be considered as a package in terms of their purpose,⁸ and that posting and holding were essential to enforcement of uniformity and other restraints.⁹ The panel inexplicably ignored these positions when balkanizing the restraints for purposes of severability, though it found that the other restraints are "a *mechanism* for enforcing the uniform price requirement." Slip op. at 1427 (emphasis in original). The treatise upon which the panel relied makes clear that they are also mechanisms to facilitate the collusion the panel identified as a great

⁸ Trial Transcript 14:1-5 (defense opening statement: restraints are "complex and interconnected"); WER 479 (LCB Chair Long) ("the system is one that you just can't look at in any component by itself, but you have to look at the whole system"); WER 963 (Admission 2); Defendants' Response to Plaintiff's Motion for Summary Judgment on Antitrust Claims (Dkt. 96) at 5-7 (minimum mark-up "sets the distributor's posted price"; RCW 66.28.180(2)(c) requires uniform prices "as part of the price posting obligation"; "RCW 66.28.180(2)(d) states in the context of the price posting mandate that 'quantity discounts are prohibited'"; ban on central warehousing is "[a]gain in the context of the price posting mandate").

⁹ E.g., WER 969 (Pretrial Order Contentions 14-16); Defendants' Response to Plaintiff's Motion for Summary Judgment on Antitrust Claims (Dkt. 96) at 5-7 ("posting system is the mechanism by which the Board can ensure" uniform prices; "price posting requirement . . . allows the Board to enforce the ban on quantity discounts"; "[a]gain, the price posting system is the mechanism by which the LCB is able to observe whether the delivered price requirements are being observed"); Defendants' Motion for Judgment on the Pleadings (Dkt. 29) at 19 ("Price postings . . . enforce the uniform price rule, the ban on discriminatory pricing and the minimum markup rule.").

risk of posting and holding. PHILLIP AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 2022c (3d ed. 2006) (purpose of "agreement eliminating discounts or rebates is to facilitate collusion or oligopoly by keeping prices visible").

Ironically, although the panel upheld some of the restraints, in addressing posting and holding it found that none of the possible state purposes for any of the restraints was valid. *See slip op.* at 1429-32.

Despite the failure of the temperance purpose concocted for this lawsuit, the panel decided on the state legislature's behalf that it nonetheless would want to keep restraints that serve no purpose and cannot practically be enforced without posting and holding. Proper Washington severability analysis instead requires invalidating the entire package when the Legislature's goals cannot be accomplished without the invalid provisions. *See note 5 supra; Washington State Republican Party v. Washington*, 460 F.3d 1108, 1124 (9th Cir. 2006) (striking entire primary initiative because reasonable Washington voters would not have passed initiative without unconstitutional provisions). Severing simply makes no sense as to restraints the Legislature enacted at the same time, in the same section, and with linguistic integration mirroring the functional integration.

C. The Panel's New Standard for Determining Whether a Restraint Is Hybrid Conflicts With Another Panel Decision and with Decisions of the Supreme Court and Another Circuit, and Is an Exceptionally Important Issue

The panel departed from *Miller* a second time by creating a new test for identifying hybrid restraints. *Miller* explicitly held that a state law directing private parties not to engage in certain forms of competitive conduct (such as changing prices or giving a discount to buyers who arranged their own product delivery) was hybrid if those private parties had unsupervised discretion over ultimate prices despite the compulsion as to some elements of that discretion. 813 F.2d at 1349-51. The panel here rejected that approach and held, at least as to the restraints it preserved, that the focus only be on the state directive. Slip op. at 1408, 1410, 1422-25. Of course, if one looks only at the directive it will always appear unilateral. The panel thus had to depart from that approach in more broadly assessing posting and holding as "highly likely to facilitate horizontal collusion" and involving "[s]tate enforcement of privately set, supra-competitive prices." Slip op. at 1418-19. In its ruling as to the other restraints, though, the panel overlooked the record, where both sides' economic experts testified that the other restraints facilitated horizontal price collusion. WER 578-79, 801 (Leffler Dep. 51-52; Chaloupka Dep. 72). That record is consistent with established economic

principles from a treatise the panel elsewhere cites, demonstrating that the other restraints facilitate collusion no differently than do posting and holding.¹⁰

In *Miller*, the Court reconciled the Supreme Court cases and expressly rejected the narrow focus later adopted by the panel here, cautioning that state compulsion "requires a more refined analysis" than simply focusing on a "lack of concerted activity" among private parties. 813 F.2d at 1349-51 (unilateral compliance is not dispositive). A restraint that compels that private parties not compete on aspect of prices (delivery charges, discounts, or how long a price is held) is hybrid, not unilateral, if the state "allows private parties to set the prices and does not review the reasonableness of those prices." *Id.* at 1351.

While acknowledging that the issue is "elusive" and that the Supreme Court has not provided "clear guidance" as to what "hybrid" means, slip op. at 1402-04, the panel chose (without expressly recognizing so) not to follow *Miller's* reading of the Supreme Court cases. According to the panel, the Supreme Court introduced a new "wrinkle" in *Fisher*, where it "*appeared* to preempt application of the preemption inquiry by holding that some *types* of regulations are entirely immune."

¹⁰ PHILLIP AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW, ¶ 1435 (3d ed. 2006) (uniform delivered pricing practices "facilitate tacit price coordination"); *id.* ¶ 2022 (ban on private parties competing on delivery, credit, or other competitive terms without review of the resulting bundle of terms "would almost certainly make the market more conducive to collusion or oligopoly").

Slip op. at 1401 (first emphasis added). Yet, *Miller* considered *Fisher*, 813 F.2d at 1049-50, and the panel's view that *Fisher* created a new absolute immunity is contrary to *Miller*, as well as to *324 Liquor Corp. v. Duffy*, 479 U.S. 335 (1987), which came after *Fisher* and was also considered in *Miller*. Slip op. at 1413 n.14; *see id.* at 1417 n.17 (noting that "Supreme Court has expressed strong disdain for state laws which leave unsupervised regulatory power in the hands of ... private actors").

The panel's repudiation of *Miller* is reflected in its more explicit rejection of the Fourth Circuit's 2001 holding in *TFWS*, despite acknowledging that *TFWS* "expressly agreed with our decision in *Miller*," slip op. at 1413, and that it struck down not just posting and holding but a prohibition on "discounts of any nature." 242 F.3d at 209, quoted by slip op. at 1419-20. *TFWS* shows what a faithful reading of *Miller* requires, a reading that the panel rejected without cause.

The panel recognized that the analysis of hybrid restraints and the application of antitrust immunity are important issues not consistently resolved by the courts. Slip op. at 1402-04. That status alone explains why the case merits en banc consideration. The proper hybrid analysis is critical to federal preemption, which involves competing fundamental interests and arises frequently. With respect to beverage regulation alone, many states impose restraints at issue here.

See Amici Brief of National Beer Wholesalers Association and Wine and Spirits Wholesalers of America, Inc. at 1-2 n.1. Both the general issues and their specific application to these restraints are of broad concern.

In choosing among alternative tests, the panel adopted an extreme view, creating a rule of absolute immunity that allows states, even those competing in the commercial marketplace,¹¹ to circumscribe national rules of competition and immunize the resulting private price, with no state supervision of that price. Whatever might be the merits of such a new and absolute approach, it should not be adopted without en banc consideration.

IV. CONCLUSION

The panel should reconsider its repeatedly mistaken severability analysis. At the very least, if the panel has any question about the error of its analysis under state severability law, it should certify the question to the Washington Supreme Court. *See* RCW 2.60.020; Order of Feb. 1, 2008, *Cascade Health Sys. v. PeaceHealth*, Ninth Cir. No. 05-35627 (because plaintiff's antitrust claim "raises an important, dispositive issue of Oregon law, we respectfully certify a question for review by the Supreme Court of Oregon").

¹¹ Washington operates state stores that sell wine and beer to retailers and consumers. This issue was raised by Costco but never mentioned by the panel.

If the panel chooses not to act, the Court en banc should consider the panel's departures from the holdings and rationale of *Miller*, the Fourth Circuit, and the Supreme Court, and from recognized principles of antitrust economics, in dealing with exceptionally important severability and hybrid restraint issues.

DATED: February 18, 2008

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**CERTIFICATION OF COMPLIANCE PURSUANT TO
CIRCUIT RULE 35-4 AND 40-1**

I certify that, pursuant to Circuit Rule 35-4 and 40-1, the attached Petition for Rehearing or Rehearing En Banc is proportionately spaced, has a typeface of 14 points or more, and contains 4,124 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

RESPECTFULLY SUBMITTED this 18th day of February, 2008.

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