No. 15-35209

In the United States Court of Appeals for the Ninth Circuit

INTERNATIONAL FRANCHISE ASSOCIATION, INC., *ET AL.*,

Plaintiffs-Appellants,

v.

CITY OF SEATTLE, a Municipal Corporation, and FRED PODESTA, Director of the Department of Finance and Administrative Services,

Defendants-Appellees.

Appeal from the United States District Court for the Western District of Washington
Case No. CV14-848

BRIEF OF AMICUS THE STATE OF ARIZONA

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INTERESTS OF *AMICUS CURIAE*

Any case decided under the dormant Commerce Clause implicates the relationship between the States and the federal government. As one of those States—and one governed by the law of this Circuit—Arizona has an interest in the line between permissible and impermissible state and local regulation of interstate commerce. The present case adds the additional and more immediate concern that Seattle's ordinance directly burdens 13 franchisors based in Arizona and their 54 franchise units operating in the City of Seattle. *See* Affidavit of Paul Wilbur (Exhibit A). Arizona therefore seeks to ensure that its resident businesses are safe from discriminatory laws in other jurisdictions while also protecting the appropriate sphere of local regulation, including non-discriminatory wage and hour laws like those in Arizona.

Additionally, the Arizona and Washington Constitutions derive from a common parent and contain virtually identical Privileges or Immunities Clauses. To the extent that this Court reaches the issue, Arizona has an interest in the interpretation of language that its foundational document shares with its counterpart in Washington.

ARGUMENT

I. The District Court Misapplied Commerce Clause Precedent to Require Proof of Lost Market Share by Out-of-State Businesses.

The dormant Commerce Clause bars a state or local government from enforcing a statute that is either unjustifiably discriminatory against interstate commerce or, when neutral, has negative impacts exceeding its advantages. *See, e.g., Pike v. Bruce Church, Inc.* 397 U.S. 137 (1970)*; Hunt v. Washington State Apple Advertising Comm'n*, 432 U.S. 333 (1977); *Alaska Airlines, Inc. v. City of Long Beach*, 951 F.2d 977 (9th Cir. 1991). This Court has employed a disjunctive three-part test to determine whether a statute is discriminatory: "[i]f a statute discriminates against out-of-state entities on its face, in its purpose, or in its practical effect, it is unconstitutional unless it serves a local purpose, and this purpose could not be served as well by available nondiscriminatory means." *Rocky Mountain Farmers Union v. Corey*, 730 F.3d 1070, 1087 (9th Cir. 2013) (quotation omitted). When a statute passes this test, "it will be upheld unless the burden imposed on . . . commerce is clearly excessive in relation to the putative local benefits." *Pike*, 397 U.S. at 142.

In the present case, the lower court augmented the foregoing rule with a requirement that does not appear in this Court's precedent. Specifically, the district court required plaintiffs "to show that the law causes local goods to constitute a larger share[,] and goods with an out-of-state source to constitute a smaller share[,] of the market." ER 19. This additional requirement narrows the ways in which a plaintiff may establish a law's discriminatory effect (option No. 3 in the *Rocky Mountain Farmers* formulation) by equating those effects with loss of market share. ER 20-21.

Moreover, in implementing its new rule, the lower court demanded that Appellants (collectively "IFA") show an "actual, rather than potential" loss in market share in order to show an impact on interstate commerce. ER 21. As a preliminary matter, the demand for actual injury is inconsistent with the procedural posture of the case—*i.e.,* a motion for preliminary injunction, which focuses precisely on injuries that have not yet occurred. This important difference in procedural posture is one reason that reliance on *Black Star Farms LLC v. Oliver*, 600 F.3d 1225 (9th Cir. 2010), is inapt. *Black Star Farms* involved a motion for summary judgment in which the plaintiff "ask[ed

the court] without substantial evidentiary support to speculate and to infer" that the law would have an effect on interstate commerce. *Id.* at 1232; *see also Nat'l Paint & Coatings Ass'n v. City of Chicago*, 45 F.3d 1124, 1132 (7th Cir. 1995) (finding that, despite presenting "evidence for six days," "plaintiffs did not offer any evidence" of a disparate effect on interstate commerce). Not only is the legal threshold for a preliminary injunction different from the requirements of summary judgment, but the Seattle ordinance leaves nothing to "infer." By its terms, the law imposes additional costs on businesses that choose a business model that is 96.3% interstate. No one disputes these facts, and no one has argued that additional costs are not an injury. Instead, the lower court misapprehended the law and conflated a violation of the dormant Commerce Clause with lost market share.

To be sure, discrimination against interstate commerce certainly ***can*** cause businesses engaged in that trade to lose market share, but it need not. Companies facing adverse conditions, whether imposed by government or not, can always take measures to maintain their market position, including increased advertising or reduced profit margins. For example, should the State of Washington place a tariff on Apple

iPhones for the local benefit of increasing sales of Microsoft Windows phones, Apple might retain its market share by cutting the price of the iPhone, increasing advertising in the Evergreen State, or simply through good fortune in consumer tastes. In any of these scenarios, however, Apple is harmed by the tariff, which reduces its profit compared to a world in which it did not face discrimination as an interstate participant in the Washington market.

In the present case, franchisees suffer the same harm: they must endure several years of diminished profits to maintain their market share against similarly situated small businesses. In fact, the trial court admitted as much when it suggested that one solution to Seattle's discrimination was for franchisors "to use their greater financial resources to support the franchise by aiding franchisees" during the years when they must pay higher wages than similar in-state employers. ER 25 (quotation omitted). The lower court's recognition that a franchisee could maintain its market share by dint of its own efforts or through the support of a franchisor undermines the court's requirement of lost market share before countenancing a dormant Commerce Clause claim. *See* ER 14 (quoting Councilmember O'Brien

implicitly recognizing the same flaw with reliance on market share: "I don't believe that the large parent companies of these franchises will allow their businesses in Seattle to fail and give up the market to the competition . . . .").

Finally, the district court's distinction of *Hunt v. Washington State Apple Advertising Commission*, 432 U.S. 333 (1977), is particularly unconvincing. *Hunt* considered a facially-neutral North Carolina law requiring apple sellers to list only the USDA rating of their produce (and not, for example, the more rigorous system developed in Washington State). This rule had the "practical effect of not only burdening interstate sales of Washington apples, but also discriminating against them." *Id.* at 350. The Court then listed three independent "various forms" of discrimination. *Id.* Among the three, "[t]he ***first, and most obvious***, is the statute's consequence of raising the costs of doing business in the North Carolina market for Washington apple growers and dealers, while leaving those of their North Carolina counterparts unaffected." *Id.* at 351 (emphasis added). The Court thus found unconstitutional discrimination against out-of-state producers on the basis of costs alone; it said nothing about market share.

Nevertheless, the lower court describes this holding of *Hunt* as if to suggest that the existence of "various forms" of unlawful conduct makes each of them insufficient: "that fact alone was not enough to lead the Court to conclude that the law discriminated against interstate commerce." ER 22-23 (citing *Hunt*, 432 U.S. at 351). The *Hunt* decision says no such thing. Instead, the district court dips into an unrelated part of the opinion, which demanded evidence of harm to determine whether the plaintiffs had satisfied the amount-in-controversy requirement. ER 23 (citing *Hunt*, 432 U.S. at 347). This infelicitous citation is no basis for imposing a new rule that IFA prove the amount of its members' losses as a precondition for asserting a Commerce Clause violation.

Whatever else a plaintiff must show to establish a violation of the dormant Commerce Clause, it need not—especially at the preliminary injunction stage—show a loss in market share. Waiting for such losses to manifest would fail to detect discrimination where the affected businesses shouldered their burden and preserved market share (albeit with lower profits). It would also tolerate harm to out-of-state competitors for as long as it takes them to prove a statistically

significant loss in market share. Neither of these options is suitable to commerce among the coequal States.

II. The Commerce Clause Precludes Seattle's Ordinance for Its Special Burden on a Business Model that is Almost Exclusively Interstate.

Of the several ways that a local ordinance can impermissibly target interstate commerce, the Seattle law presents a straightforward case of imposing a special burden. Arizona agrees that the law is facially neutral. Moreover, although the record shows a troubling bias against out-of-state franchisors, peering through the vines of legislative history is unnecessary when a special burden on interstate commerce is plain to see. *Comptroller of Treasury of Maryland v. Wynne*, 135 S. Ct. 1787, 1801 n.4 (2015)("The Commerce Clause regulates effects, not motives, and it does not require courts to inquire into voters' or legislators' reasons for enacting a law that has a discriminatory effect.").[1]

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[1] In fact, after *Wynne*, it is possible that legislative intent alone is insufficient to violate the Commerce Clause. This result is consistent with the related doctrine of implied conflict preemption, which requires an "actual conflict with [a] specific federal regulation." *Beveridge v. Lewis*, 939 F.2d 859, 866 (9th Cir. 1991). In any event, IFA has

The Seattle ordinance imposes burdens on a business-model basis. Franchises, regardless of how many employees they have, count as "large" businesses and must pay higher minimum wages if the cumulative employees of the franchisor and other franchisees exceeds 500 people. As the lower court recognized, "[t]his means that the owner of a Subway outlet with only 10 employees will be considered a 'large' employer because of his relationship with the Subway franchisor and other Subway franchisees." ER 7. Targeting a particular business model does not necessarily violate the Commerce Clause. But when the business model in question is virtually always defined by interstate commerce—*i.e.,* interstate franchise agreements—the conclusion is different.

Like the labeling provisions in *Hunt*, Seattle's distinctions based on business model appear neutral with respect to interstate commerce. Only with the additional fact that 96.3% of franchisees in Seattle have affiliated with out-of-state franchisors does the burden become apparent. It is of no moment that a scant 3.7% of Seattle franchisees

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demonstrated a disparate burden on interstate commerce, which is undoubtedly sufficient to violate the federal Constitution.

have agreements with in-state franchisors. The test is not whether a local law achieves a sort of perfect discrimination that leaves all local interests unscathed. Rather, the question is whether the challenged statute "discriminates against out-of-state entities . . . in its practical effect." *Rocky Mountain Farmers Union*, 730 F.3d at 1087; *see also generally McClouth Steel Prods. Corp. v. Thomas*, 838 F.2d 1317, 1320-21 (D.C. Cir. 1988) (rejecting the argument that a policy applicable 96% of the time differed from a rule applicable in every case). To identify laws with impermissible effect, the *Wynne* Court applied the internal consistency doctrine to ask whether, if every State adopted a similar law, the result would be a burden on interstate commerce. 135 S. Ct. at 1802-03. This doctrine clarifies the impermissibility of Seattle's law and the irrelevance of the few Seattle franchisees that have in-state franchisors. ER 19. In each of those arrangements, the franchisor does business across state lines. *Id.* Their interstate business would therefore suffer if every city and State adopted a law similar to Seattle's. Thus *Wynne*'s internal consistency test transforms what appeared to be counterexamples into a case study in why this law cannot survive.

To borrow another technique from the *Wynne* opinion, a simple numerical example shows how the Seattle ordinance burdens the interstate relationship between Seattle franchisees and Arizona franchisors. *See Wynne*, 135 S. Ct. at 1803, 1805. The lower court's opinion presents the different wage scales for "small" and "large" employers. ER 6-7. For the 54 Seattle businesses that have franchise agreements with businesses in Arizona, the difference between those wages is the cost of joining the franchise business model. Over the five years of the ordinance's phase-in, that per-hour cost is as follows:

April 1, 2015	$1
January 1, 2016	$2.50
January 1, 2017	$4
January 1, 2018	$3.50
January 1, 2019	$3
January 1, 2020	$1.50
January 1, 2021	$0

To employ a single employee earning minimum wage for 40 hours per week, the franchisee pays an additional $31,832.00 over the course of the phase-in. Multiplying this burden by the number of employees and

recognizing that many franchises are open more than 40 hours per week reveals a substantial cost arising from the decision to use an interstate business model.

In light of the special costs imposed on the franchise business model, the fact that every franchise operating in Seattle has interstate franchise agreements, and the resulting burden on interstate commerce if every State enacted similar laws, there can remain no doubt that Seattle's ordinance places a special burden on interstate commerce. Even Councilmember Sawant's snide suggestion for how franchisees can survive their mistreatment—"go to CorpHQ & renegotiate your rents," ER 13—proposes to shift the cost of Seattle's law to out-of-state franchisors. The same sentiment underlies Councilmember O'Brien's lament that "we don't have a direct path to the parent corporations." ER 14. To the contrary, unless the Councilmember regrets the ordinance's mere 96.3% precision, it is difficult to imagine a more direct path to interstate commerce.

Because the Seattle ordinance imposes burdens on a business-model basis and targets a model nearly entirely confined to interstate commerce, striking down the ordinance poses no threat to States like

Arizona that maintain their own minimum wage statutes. *See* Ariz. Rev. Stat. Ann. § 23-364. Like 28 other States, Arizona has a minimum wage above the federal rate and thus above the rate in many other States. *See* Resolution, Indus. Comm'n of Ariz. (Oct. 16, 2014), *available at* http://tinyurl.com/qcl3yyu (setting the 2015 minimum wage at $9.05 per hour). Arizona's law unquestionably has the effect of raising the cost of doing business in Arizona, but it does so on identical terms for every type of business and imposes no special burden on interstate commerce. The Arizona statute illustrates the potential for States to experiment with different policies without encroaching on federal authority over interstate commerce. *See generally W. Coast Hotel Co. v. Parrish*, 300 U.S. 379, 57 S. Ct. 578, 81 L. Ed. 703 (1937).

III. The Privileges or Immunities Clause of Washington's Constitution, Which Mirrors Arizona's, Prohibits the Seattle Ordinance.

The Washington Constitution offers a generalized protection to threats against economic liberties through its Privileges or Immunities Clause. Wash. Const. art. I, § 12. Arizona's Constitution contains similar language, which it "borrowed from the Washington State Constitution, which in turn borrowed it from earlier state

constitutions." John D. Leshy, The Arizona State Constitution, p. 73 (Oxford, 2d ed., 2013). As such, both the Arizona and Washington clauses have "antecedents that predate the adoption in 1868 of the Fourteenth Amendment of the U.S. Constitution." *Id.* It is not surprising then that the Washington Supreme Court has recently confirmed that its language should be interpreted independently from similar language in the federal Constitution. *Ass'n of Washington Spirits & Wine Distributors v. Washington State Liquor Control Bd.*, 340 P.3d 849, 857 (Wash. 2015) ("We interpret our privileges and immunities clause independently of the federal clause."). At the same time, Arizona's courts will often consider Washington courts' interpretation of language found in both States' constitutions. *See Schultz v. City of Phoenix*, 156 P. 75, 77 (Ariz. 1916).

The Washington Supreme Court applies a two-part analysis to identify violations of its Privileges or Immunities Clause: (1) does the law at issue involve a privilege or immunity, and, if so, (2) did the legislature have a "reasonable ground" for granting that privilege or immunity? *Ass'n of Washington Spirits & Wine Distributors*, 340 P.3d at 857-58.

First, "[a] 'privilege' is an exception from a regulatory law that benefits certain businesses at the expense of others." *Id.* at 858. In considering challenges claiming a violation based on a right to carry on a business within the State of Washington, the Washington Supreme Court has sketched a fine line between regulatory activities that implicate a privilege and those that are drawn more narrowly. The Court most recently explained this line by contrasting two of its prior holdings:

> We have held that the "right to carry on business therein" is implicated by a municipal ordinance that attempted to insulate resident photographers from out-of-state competition by imposing prohibitive licensing fees and solicitation restrictions on itinerant photographers. *See Ralph v. City of Wenatchee,* 34 Wash.2d 638, 641, 209 P.2d 270 (1949). We have also rejected attempts to assert the right to carry on business when a narrower, nonfundamental right is truly at issue. *See, e.g., Am. Legion Post No. 149,* 164 Wash.2d at 607–08, 192 P.3d 306 (rejecting an attempt to characterize "[s]moking inside a place of employment" as the fundamental right to "carry on business therein").

Id. Under this framework, Washington courts have correctly focused on whether a challenged statute implicates "a fundamental right" that "come[s] within the prohibition of the constitution," or that was "in [the] mind [of] the framers of that organic law." *Ockletree v. Franciscan Health Sys.*, 317 P.3d 1009, 1015 (2014).

The framers of Washington's Privileges or Immunities clause were "motivated by a desire to prevent governmental favoritism in commercial affairs. . . . Washington's framers wanted to embed protections against governmental favoritism in the constitution itself, rather than simply trusting future legislatures to refrain from engaging in such behavior." Michael Bindas, et. al., *The Washington Supreme Court and the State Constitution: A 2010 Assessment*, 46 Gonz. L. Rev. 1, 24 (2011). The district court improperly failed to consider the framers' motivation, a failure that is fatal to its analysis under the first step of this analysis.

Moreover, Washington courts have consistently recognized the fundamental right to "carry on business." *Grant Cnty. Fire Prot. Dist. No. 5 v. City of Moses Lake*, 83 P. 3d 419, 429 (2004) (citation omitted). Where the government exempts certain businesses from a regulation to their financial benefit, it has granted a privilege subject to constitutional scrutiny. *Am Legion Post #149 v. Wash. State Dep't of Health*, 192 P.3d 306, 325 (Wash. 2008).

Second, the "reasonable ground" requirement asks "whether the law applies equally to all persons within a designated class, and . . .

whether there is a reasonable ground for distinguishing between those who fall within the class and those who do not." *Okletree*, 317 P. 3d at 1017. The district court erred in improperly defining the "designated class." While the Seattle ordinance distinguishes among small businesses based on whether they are a franchise, the lower court simply defined the class to be coterminous with the ordinance's distinctions—that is, it considered a "class" comprised of franchises alone. ER 40. Adoption of this analytical framework nullifies the protections in the Privileges or Immunities Clause. By narrowing the "designated class" to include only the disfavored group, any discrimination could be made licit.

With its designated class in hand, the district court accurately noted that it must identify "real and substantial differences bearing a natural, reasonable, and just relation to the subject matter" upon which the distinctions at issue rest. *Id.* (quotation omitted). The court's failed analysis in this final instance is the consequence of its layered earlier failures: neglecting the necessary historical framework and drawing an artificially narrow class. Both missteps contribute to the conclusion that, because there may be "certain benefits" to operating as a

franchise, it is reasonable to burden small franchise businesses commensurately with large businesses. *Id.* The court failed to consider whether the "certain benefits" to which it points are sufficient to transform the economics of a 10-employee Subway franchise to match those of truly large corporations with several hundred employees.

In summary, the district court eschewed the Washington Supreme Court's thoughtful guidance on how to apply that State's Privileges or Immunities Clause. Washington's framers, like Arizona's, intended this protection against government favoritism to have meaning in its application. The State of Arizona requests that this Court refuse to enshrine the lower court's various errors in precedent that will be persuasive in state courts and controlling—absent clarification by the States—in federal court.

CONCLUSION

The power to regulate interstate commerce belongs exclusively to the federal Congress. Where a municipal ordinance that imposes burdens on a business-model basis levies a special cost on one such business model, belonging 96.3% to the realm of interstate commerce, it cannot survive the Commerce Clause. Likewise, the protections in the

Washington (and Arizona) Privileges or Immunities Clause prevent the same favoritism for a different reason.

June 12, 2015

Respectfully Submitted,

/s/ Dominic E. Draye

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CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Fed. R. App. P. 29(d) because it is no more than one-half the maximum length authorized for a party's principal brief, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word 2010 in 14-point Century type.

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CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on June 12, 2015. All participants in the case are registered CM/ECF users and will be served by the appellate CM/ECF system.

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EXHIBIT A

AFFIDAVIT OF PAUL G WILBUR

I, Paul G. Wilbur, being duly sworn, do hereby make the following affidavit:

1. I am the Chief Operating Officer at Franchise Information Services, Inc. dba FRANdata. I have been in this position for the past 10 years, previously holding the positions of Director of Technology, Director of Research and Director of Marketing.

2. FRANdata is an independent research and consulting firm that studies franchising activity. We are located at 4075 Wilson Boulevard Suite 410, Arlington VA 22203 and have been in business since 1989. The firm has been solely owned by Darrell M Johnson since February of 2004; prior to that, it was founded by a franchise attorney, Jeffrey Kolton, and later owned by National Cooperative Bank.

3. FRANdata collects information about franchise companies operating in the USA and internationally. Our largest source of information about these companies is their Franchise Disclosure Documents or FDD (formerly Uniform Franchise Offering Circular or UFOC.) We believe we have the largest library of FDDs on earth – some 40,000+ documents going back more than 25 years on more than 10,000 companies who have franchised over that period.

4. The Federal Trade Commission (FTC) mandates that companies that sell franchises in the US must provide prospective buyers a copy of their FDD. The FTC provides formal guidelines for standard content and format of the information provided in these documents. FDDs are updated annually for each year the company is selling franchises and include information such as explanations of the terms and conditions contained in the franchise agreement that a franchisee would sign with the company, as well as pertinent company background, executive management team, franchise system performance information, and lists of existing franchisees that can be contacted by a prospect during their due diligence research.

5. FRANdata acquires copies of these FDDs for its library from two main sources: 1) the franchisor company themselves, and 2) state business registrations. FRANdata databases some of the information contained in the FDD including such data as contact information for each franchisor and franchised business locations.

6. From our database based on information contained in FDDs, FRANdata was able to provide the information contained in Exhibit A. This table shows, as best that we can verify, the Arizona HQ locations of franchisors that have franchised units in the city of Seattle (as defined by the US Post Office zip code database) as part of their franchise systems. The table shows that there are 13 franchisors headquartered in AZ that sell franchises under 15 different brand names; the brands have a total of 54 franchised businesses in Seattle, WA.

7. Among the employees of FRANdata, besides me, who assisted with producing this information are Wen Lin, Database Analyst, and Anthony Crews, Director of Research.

8. Attached as Exhibit A is the table showing the full information provided.

Further, the affiant sayeth not.

Paul G. Wilbur

Subscribed and sworn to before me this 11th day of June, 2015

Samia Freeman

Notary Public

My commission expires:

SAMIA K FREEMAN
Notary Public
Commonwealth of Virginia
7591585
My Commission Expires Sep 30, 2018

Exhibit A

Franchisor Companies Hqed in Arizona who have Franchised Locations in the city of Seattle,WA

FRUNS	BRANDS	INCNAME	CITY	STATE	Franchisee Units in Seattle City, WA
11794	HOMESMART	HomeSmart International, LLC	Phoenix	AZ	1
10734	CARTRIDGE WORLD	Ink Southwest, LLC	Tempe	AZ	1
13846	THE ENTREPRENEUR'S SOURCE	JMK Consulting, LLC	Phoenix	AZ	2
10900	COLD STONE CREAMERY	Kahala Franchising, L.L.C.	Scottsdale	AZ	1
12569	NRGIZE LIFESTYLE CAFE	Kahala Franchising, L.L.C.	Scottsdale	AZ	1
13763	TACO TIME	Kahala Franchising, L.L.C.	Scottsdale	AZ	1
12295	MASSAGE ENVY SPA	Massage Envy Franchising, LLC	Scottsdale	AZ	1
12468	MUCHO BURRITO	Mucho Burrito Franchising USA, Inc.	Scottsdale	AZ	1
12586	OPENWORKS	O.P.E.N. America, Inc.	Phoenix	AZ	31
13581	SPEEDPRO IMAGING	SP Franchising LLC (fka Speedpro USA, LLC)	Scottsdale	AZ	1
13743	SYNERGY HOMECARE	SYNERGY HomeCare Franchising, LLC	Gilbert	AZ	1
11093	THE DETAIL DIFFERENCE	The Detail Difference, Inc.	Scottsdale	AZ	1
13879	THE LITTLE GYM	The Little Gym International, Inc.	Scottsdale	AZ	4
10857	CIRCLE K	TMC Franchise Corporation	Tempe	AZ	4
12867	PILLAR TO POST	Trestle NW, Inc.	Glendale	AZ	3