EXHIBIT A-1

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA

MILLERCOORS LLC, **Plaintiff,** **v.** **CHESBAY DISTRIBUTING CO., INC.,** **Defendant.**	**Civil Action No. 2:12-CV-00530-MSD-LRL**

MEMORANDUM IN SUPPORT OF INTERVENOR REYES HOLDINGS, L.L.C.'s RULE 12 MOTION TO DISMISS OR, IN THE ALTERNATIVE, FOR JUDGMENT ON THE PLEADINGS

Pursuant to Rule 12(b) and (c) of the Federal Rules of Civil Procedure, Intervenor Reyes Holdings, L.L.C. (including its subsidiaries comprising the Reyes Beverage Group division, collectively referred to below as "Reyes"), respectfully moves this Court to dismiss all three counts of the complaint filed by MillerCoors L.L.C. ("MillerCoors"), or, in the alternative, to enter judgment on the pleadings because MillerCoors has failed to state a claim upon which relief can be granted.

INTRODUCTION AND BACKGROUND

In its First Amended Complaint ("Complaint"), MillerCoors contends that federal trademark law gives it unfettered discretion to determine who distributes its trademarked products and, thus, gives it a unilateral veto over its distributors' decisions to transfer their businesses. Any state law that purports to restrict MillerCoors' exercise of absolute control over its distributors, MillerCoors concludes, is preempted. But federal trademark law creates no such right. Every federal court that has considered the issue has rejected MillerCoors' position as a matter of law. And MillerCoors waived any such right when it agreed in its distribution agreement to honor Virginia law. Virginia law sets forth limited bases on which MillerCoors can veto the sale of a distributor, and all of them are consistent with federal trademark law. Importantly, MillerCoors' argument fares even worse in this case than in all the cases that rejected it already because, in the realm of state-regulated alcoholic beverage distribution, MillerCoors' argument raises serious constitutional questions that independently defeat the argument. MillerCoors' preemption claim fails as a matter of law, as do its Lanham Act and breach of contract claims for similar reasons. Accordingly, the Court should grant Reyes' Rule 12 motion.

The Twenty-first Amendment of the United States Constitution gives states the power to structure and regulate the market for producing, distributing, and selling alcohol within their territories. Exercising that power, the Commonwealth of Virginia—like many other states—has put a "three-tier system" into place. "Under this structure, producers and sellers of alcoholic beverages may sell in Virginia only to Virginia-licensed wholesalers, who in turn may sell only to Virginia-licensed retailers, who may then sell to consumers." *Brooks v. Vassar*, 462 F.3d 341, 345 (4th Cir. 2006). A key part of the regulations that constitute Virginia's three-tier system is the Beer Franchise Act, VA. CODE § 4.1-500 *et seq.*, which governs the relationship between breweries in the top tier and distributors in the middle tier.

MillerCoors is a brewery licensed in Virginia. Compl. ¶ 13. Chesbay Distributing Co., Inc., is a licensed distributor that wholesales and distributes products of MillerCoors and others in the tidewater region of Virginia. *Id.* ¶¶ 1, 14. In late August, Chesbay reached a binding agreement to sell its entire business to Reyes, the largest MillerCoors distributor in the United States. *Id.* ¶ 34. MillerCoors objected to the sale. *Id.* ¶ 42. It claimed that Chesbay's distribution agreement with MillerCoors gave MillerCoors the right to block the sale for any reason. *See id.* ¶¶ 42-43. In turn, Chesbay responded that Section 507 of the Beer Franchise Act allows MillerCoors to object only if the purchaser does not meet "the material and reasonable qualifications and standards required of its wholesalers." VA. CODE § 4.1-507(a). *See* Memorandum in Support of Complaint of Chesbay Distributing Company, filed before the Virginia Alcoholic Beverage Control Department in *Chesbay Distributing Company v. MillerCoors LLC*, dated Sept. 18, 2012 ("Chesbay Mem.") ¶ 11 (Ex. 2 to Reyes' Motion to Intervene).

The provisions of the MillerCoors distribution agreement on which MillerCoors relies have encountered administrative and judicial resistance across the country. *See* Chesbay Mem. ¶¶ 22-26 (listing examples). In this case, MillerCoors has staked out its most extreme defense of the provisions to date. It argues that federal law gives it the power to veto the sale of its distributors' businesses—whether or not the purchaser meets MillerCoors' qualifications and standards and regardless of what state law provides. Specifically, MillerCoors contends that the federal Lanham Act, 15 U.S.C. § 1051 *et seq.*, requires MillerCoors to ensure the quality of its trademarked products and thus gives it *alone* the right to decide who distributes those products. Compl. ¶ 24. Anything else, MillerCoors contends, would be "forced licensure." *Id.* MillerCoors accordingly asks the Court to declare that Section 507 of the Beer Franchise Act is preempted. MillerCoors further claims that, because Section 507 is preempted, Chesbay is in breach of its distribution agreement and Chesbay's sale of its business will infringe MillerCoors' trademarks under the Lanham Act.

MillerCoors' contentions lack merit. First, as many courts have held, the absolute federal right MillerCoors claims does not exist (and even if it did, MillerCoors has waived that right by agreeing that its distribution agreement gives way to state law). Second, the Lanham Act is concerned with maintaining the quality and integrity of trademarked goods and services. So long as state law preserves a trademark holder's right of quality control, there is no conflict and that law is not preempted. The Beer Franchise Act easily clears that threshold. Beyond that, it supersedes any conflicting provisions of MillerCoors' distribution agreement. With Virginia law controlling, both MillerCoors' breach of contract claim and its trademark infringement and unfair competition claim also must fail.

Finally, MillerCoors' claim totally ignores the Twenty-first Amendment. States—not breweries—have a constitutionally protected power to decide who distributes alcohol in their territories and how. States—not breweries—also have a constitutionally protected power to license and ensure the quality of alcohol distributed, sold, and consumed in their territories. Solicitous of breweries' interests in their trademarks and products, Virginia gives them ample say in the sale or transfer of distributorships, most notably by permitting breweries to challenge a potential purchaser on the ground that it does not meet the brewery's "material and reasonable qualifications and standards." But in imagining that it should have *exclusive* and *unlimited* say, MillerCoors strikes at the heart of the state interests and powers protected by the Twenty-first Amendment.

The consequences of MillerCoors' preemption argument are sweeping, for it is not inherently limited to trademarks associated with alcohol. If accepted, MillerCoors' position would endanger franchise laws in all industries across the country. It is telling, then, that no court has ever adopted or endorsed MillerCoors' overbroad view of the Lanham Act. This Court should not be the first.

RULE 12 STANDARD

The Court may determine that a complaint fails to state a claim upon which relief may be granted on motion under either Rule 12(b)(6) or Rule 12(c). *See Edwards v. City of Goldsboro*, 178 F.3d 231, 243 (4th Cir. 1999). Either way, the standard the Court applies is the same, familiar one. *See id.* To survive Reyes' Rule 12 motion, MillerCoors' "complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). Because MillerCoors attached Chesbay's distribution agreement to the Complaint, the Court may consider the contract and its terms in ruling on the motion. *See CACI Int'l, Inc. v. St Paul Fire & Marine Ins. Co.*, 566 F.3d 150, 154 (4th Cir. 2009). Here, because the Lanham Act, the Beer Franchise Act, MillerCoors' own contract, and the Twenty-first Amendment foreclose MillerCoors' claim as a matter of law, Reyes' motion must be granted.

ARGUMENT

I. MILLERCOORS FAILS TO STATE A CLAIM OF LANHAM ACT PREEMPTION.

A. The Preemptive Effect of the Lanham Act Is Quite Limited.

By virtue of the Supremacy Clause, federal law preempts state law (1) when Congress intends to "occupy the field" completely (field preemption); (2) when a federal statute expressly provides for preemption (express preemption); and (3) when a state law conflicts with federal law (conflict preemption). *See Cox v. Shalala*, 112 F.3d 151, 154 (4th Cir. 1997); *see also Sprietsma v. Mercury Marine*, 537 U.S. 51, 64-65 (2002). Neither field nor express preemption is at issue here. It is "settled" that the Lanham Act does not occupy the field of trademarks. *Attrezzi, LLC v. Maytag Corp.*, 436 F.3d 32, 41 (1st Cir. 2006); *see Mariniello v. Shell Oil Co.*, 511 F.2d 853, 857 (3d Cir. 1975) (finding "unpersuasive" a franchisor's contention that states are "prohibited by the mere existence of the Lanham Act from all lawmaking relating to trademarks"); *see also La Chemise Lacoste v. Alligator Co., Inc.*, 506 F.2d 339, 346 (3rd Cir. 1974) ("[T]he Lanham Act generally does not preempt state regulation of trademarks . . . ."). And courts have consistently rejected efforts to read the Lanham Act's general statement of purpose, *see* 15 U.S.C. § 1127, as manifesting Congress's intent to preempt state law. *See Mobil Oil Corp. v. Virginia Gasoline Marketers & Automotive Repair Ass'n*, 34 F.3d 220, 226 (4th Cir. 1994); *Mariniello v. Shell Oil Co.*, 511 F.2d 853, 858 (3d Cir. 1975); *Am. Petroleum Inst. v. Cooper*, 681 F. Supp. 2d 635, 648 n.9 (E.D.N.C. 2010). The only Lanham Act provision that expressly preempts state law is 15 U.S.C. § 1121, which explicitly precludes states from requiring alteration of a registered mark or its display from the manner contemplated in the certificate of registration. *Mobil Oil*, 34 F.3d at 226 n.3. Needless to say, MillerCoors' complaint does not refer to Section 1121.

MillerCoors' claim sounds in conflict preemption. A state law is preempted if it "actually conflicts with federal law, either because compliance with both laws is impossible or the state law interferes with the accomplishment of Congressional objectives or the methods chosen for meeting those objectives." *Am. Petroleum*, 681 F. Supp. 2d at 641. Assessing a conflict preemption claim thus entails "a two-step process of first ascertaining the construction of the two statutes and then determining the constitutional question [of] whether they are in conflict." *Chi. & N.W. Tramp. Co. v. Kalo Brick & Tile Co.*, 450 U.S. 311, 317 (1981). Courts considering claims that state law conflicts with the Lanham Act have, at the first step, held that the Lanham Act gives trademark owners the right to control the quality of goods associated with their marks so that "the public may buy with confidence, and the trademark holder will not be pirated." *Mariniello*, 511 F.2d at 858; *see Am. Petroleum*, 681 F. Supp. 2d at 648; *Mobil Oil*, 34

F.3d at 226. Thus, at the second step, a state law is preempted by the Lanham Act if it would "permit confusing or deceptive trademarks to operate, infringing on the guarantee of exclusive use to federal trademark holders." *Mariniello*, 511 F.2d at 858; *see Golden Door, Inc. v. Odisho*, 646 F.2d 347, 352 (9th Cir. 1980); *Keebler Co. v. Rovira Biscuit Corp.*, 624 F.2d 366, 372 n.3 (1st Cir. 1980), *abrogated on other grounds by Two Pesos, Inc. v. Taco Cabana, Inc.*, 505 U.S. 763, 776 (1992). Put differently, the Lanham Act preempts only those state laws that are inconsistent with the trademark owner's "right of quality control" or "detract from its trademark image." *Mobil Oil*, 34 F.3d at 226.

In analyzing whether conflict preemption dooms a state law, the "'starting presumption' is that 'Congress does not intend to supplant state law.'" *Coyne Delany Co. v. Selman*, 98 F.3d 1457, 1467 (4th Cir. 1996) (quoting *N.Y. State Conference of Blue Cross Blue Shield Plans v. Travelers*, 514 U.S. 645, 654–655 (1995)). This is the so-called presumption against preemption, which the Fourth Circuit has applied in Lanham Act cases before. *See Mobil Oil*, 34 F.3d at 227. Other courts have reached the same conclusion: "in trademark law, preemption is the exception, not the rule." *JCW Invs., Inc. v. Novelty, Inc.*, 482 F.3d 910, 919 (7th Cir. 2007).

B. MillerCoors Has No Federal Right to Block Sales of Franchises That Distribute Its Products.

1. MillerCoors claims a federal trademark right that does not exist.

MillerCoors fails in its attempt to generate a conflict between the Lanham Act and the Beer Franchise Act. It contends that the Lanham Act gives it the absolute right to control the identity of its products' distributors and thus to obstruct the sale of a beer franchise *for any reason*—even when the purchaser otherwise meets the requisite standards and qualifications. *See* Compl. ¶¶ 24, 52. But MillerCoors points to no provision of the Lanham Act that expressly grants it such a right. In fact, none exists. MillerCoors instead infers its purported right from several provisions. Given the presumption against preemption, the absence of a provision specifically creating the right MillerCoors claims by itself defeats MillerCoors' preemption claim. Even so, the provisions MillerCoors cites cannot be read to confer such an absolute right.

Specifically, MillerCoors asserts that 15 U.S.C. §§ 1051 and 1055 "prohibit[] any use of the MillerCoors Registered Trademarks by anyone except the registrant, *i.e.*, MillerCoors and a 'related company.'" Compl. ¶ 19. Section 1051 does no more than explain how to apply for a trademark. Section 1055 provides only that the use of a trademark by a "related company" shall inure to the benefit of a registrant and does not invalidate the mark. Neither provision affirmatively (let alone impliedly) grants trademark holders a unilateral right to choose who distributes their trademarked products. At most, the provisions suggest that the Lanham Act confers only the narrower right to quality controls for its trademarked products and services. Importantly, under the Lanham Act, a "related company" is "any person whose use of a mark is controlled by the owner of the mark with respect to the nature and quality of the goods or services on or in connection with which the mark is used." 15 U.S.C. § 1127.[1] Nothing in this mere definition section gives trademark holders an unlimited right to control licensees, as MillerCoors contends. *See* Compl. ¶ 20. If anything, it implies that trademark owners can control licensees only "with respect to the nature and quality of goods or services." That is all that the precedents cited in MillerCoors' Complaint say. *See, e.g.*, *Shell Oil Co. v. Commercial Petroleum, Inc.*, 928 F.2d 104, 107 (4th Cir. 1991) ("The Lanham Trademark Act affords the trademark holder the right to control the *quality* of the goods manufactured and sold under its trademark.") (emphasis supplied). And none of those courts confronted the question

[1] Even if together §§ 1051 and 1055 allowed MillerCoors to prohibit the use of its trademarks by anyone except MillerCoors and a "related company" (which is not the case), Reyes already qualifies as a "related company" and is using MillerCoors' trademarks pursuant to its existing distribution agreement with MillerCoors.

MillerCoors' Complaint poses—whether a trademark holder's attempted exercise of exclusive control over the nature and quality of alcohol-related goods and services is consistent the Twenty-first Amendment.

At bottom, MillerCoors' attempt to equate the Lanham Act right to quality controls with an absolute right to determine the identity of its distributors is untenable. MillerCoors does not argue that the Lanham Act (somehow) prevents states from requiring licenses for trademarked products and distributors of those products, nor does MillerCoors dispute that states can independently determine whether a potential distributor will ensure quality and safety. It follows that a state can reject a distributor chosen by a trademark owner—even when the trademark owner believes that distributor is the best (or only) one who can ensure the quality of its products. Indeed, it also follows that a state can prohibit a trademark owner *itself* from distributing its own products or owning its distributor—even when the trademark owner believes that such a combination is the best (or only) way to serve its interests in quality control.

Likewise, MillerCoors makes no attempt to reconcile its asserted novel, absolute right of control with the myriad cases under the Lanham Act that have upheld various and significant restrictions of precisely such a claimed right. Courts consistently have held that "state laws are not preempted even if they operate to compel a mark owner to license its mark, so long as the mark continues to be associated with the owner's product." *Storer Cable Commc'ns v. City of Montgomery*, 806 F. Supp. 1518, 1540 (M.D. Ala. 1992) (holding that the Lanham Act did not preempt a cable television ordinance requiring programmers such as ESPN to license programming—including trademarks—to cable companies). There is "no authority for [the] proposition that a state law which acts to force a party to license its product against its will conflicts with trademark rights." *Id.* Two precedents are especially notable for rejecting the argument that MillerCoors makes.

In *Mariniello v. Shell Oil Co.*, Shell argued that a state law that allowed franchise terminations only for "good cause" was preempted because the law curtailed Shell's (supposed) right under the Lanham Act to select its licensees and thus terminate a franchisee at will. *See* 511 F.2d at 856. The Third Circuit disagreed. A state law conflicts with the Lanham Act only if it "would permit confusing or deceptive trademarks to operate." *Id.* at 858. A state law that requires franchisors to license their trademarks against their will does not necessarily cause confusion or deception. *Id.* On the contrary, because Shell could decline a franchise for "good cause," the Third Circuit found "[n]o deception of the public" and "no dilution of Shell's investment in its trademark." *Id.* Thus, the Third Circuit held that the law Shell challenged was not preempted by the Lanham Act.

FMS, Inc. v. Volvo Construction Equipment North America, No. 00-C-8143, 2007 WL 844899 (N.D. Ill. Mar. 20, 2007), is similar. Like MillerCoors, Volvo argued that "[f]orcing Volvo to license the Volvo mark . . . would run afoul of the Lanham Act because it would interfere with Volvo's right, pursuant to Section 45 of the Lanham Act, to control its registered trademarks." *Id.* at *6. The court found that Volvo's claim was "simply not true" because Volvo was entitled to terminate for "good cause." *Id.*

Because the Lanham Act does not create the absolute right upon which Count II of MillerCoors' Complaint depends, MillerCoors' claim fails as a matter of law.

2. MillerCoors has waived its claimed right, in any event.

Even if the Lanham Act gave MillerCoors the absolute and unilateral right to determine its distributor without regard to state law, MillerCoors waived that right both in its distribution agreement with Chesbay and through its application for, and acceptance of, its beer importer's license from the Virginia Alcoholic Beverages Control Board ("VABC Board").

Notwithstanding the several provisions of Section 8 of the agreement, which supposedly preserve MillerCoors' (supposed) right under the Lanham Act, Compl. ¶¶ 27-31, another provision of the agreement cancels those provisions in this case. Section 13.2 of the agreement incorporates the laws of the Commonwealth of Virginia "to the extent that such laws . . . are lawfully required to be so incorporated," and Section 13.2 further provides that state laws incorporated into the agreement "shall supersede any conflicting provision" of the agreement. Ex. A to Compl., § 13.2, at 21. Here, Virginia requires that all parts of the Beer Franchise Act—including Section 507(a)—apply to and be incorporated into MillerCoors' agreement. *See* VA. CODE §§ 4.1-501, 4.1-515. Section 507(a), accordingly, supersedes the conflicting provisions of the agreement. Thus, even assuming the Lanham Act gives trademark holders the absolute federal right MillerCoors claims, MillerCoors knowingly waived that right in its agreement with Chesbay and cannot assert it here.[2]

Moreover, MillerCoors does not dispute that it applied to the VABC Board for a beer importer's license to qualify as a "brewery" under the Beer Franchise Act and accepted that license upon the VABC Board's approval. Having accepted the benefit of this state-issued license, MillerCoors cannot now claim that it is not subject to the laws of the Commonwealth of Virginia.

C. The Beer Franchise Act Is Consistent with the Lanham Act.

MillerCoors' right under the Lanham Act is the right to quality controls for goods and services associated with its mark. *See Mobil Oil*, 34 F.3d at 226; *Mariniello*, 511 F.2d at 858;

[2] MillerCoors confirmed this interpretation of its Distributor Agreement in a May 2009 letter to the Virginia Alcoholic Beverage Control Board in response to an inquiry from the Board. *See* Request for Judicial Notice, filed concurrently with this motion, at Exs. 1, 2.

Am. Petroleum, 681 F. Supp. 2d at 648. In the preemption analysis, therefore, the "only question for the court to decide is whether the [state law] interferes with [the franchisor's] ability to engage in quality control or is otherwise substantially likely to lead to consumer confusion as to the trademarked product." *Am. Petroleum*, 681 F. Supp. 2d at 649. For the Beer Franchise Act, the answer is clearly no, it does not.

1. State franchise laws governing franchisee-distributors' rights as business owners do not conflict with the franchisor's rights under the Lanham Act.

Laws that protect a franchisee-distributor's right as a business owner to control and dispose of the business do not offend the Lanham Act. Notwithstanding franchisors' characterizations, such laws do not undermine quality control or inhibit franchisors' enforcement of their trademarks.

Mobil Oil, for example, involved a Virginia law prohibiting oil refiners from requiring franchisees to operate for a minimum number of hours, from limiting the number of stations they could operate, and from imposing sales quotas. Mobil argued that the law was "inconsistent with its right of quality control" under the Lanham Act because it "prevent[ed] Mobil's effective regulation of the quality of goods and services sold in Mobil gas stations." 34 F.3d at 226. The Fourth Circuit disagreed, holding that none of the prohibitions prevented Mobil from maintaining quality products and services and its trademark image. *See id.* at 226-227. In fact, none of the challenged provisions "alter[ed] the franchisee's obligations to uphold Mobil's standards as set forth in the franchise agreement regarding business operations, customer service, and maintenance of the station premises." *Id.* at 226; *see id.* at 227.

Similarly, *American Petroleum* involved a North Carolina law prohibiting refiners from preventing distributors and retailers from blending gasoline or receiving federal tax credits for doing so. A trade association argued the Lanham Act preempted the law because it interfered with refiners' quality controls. *See* 835 F. Supp. 2d at 648. The district court disagreed because the statute was "concerned with the restrictions on the quantity of blending (and the resulting amount of the federal tax credit) rather than the quality of blending." *Id.* at 650-651. Because refiners "maintain[ed] the ability to engage in quality control and bring suit to enforce their trademarks," they could not contend that the law likely would cause consumer confusion or adversely affect their trademarked image. *Id.* at 651.

2. The Beer Franchise Act adequately protects MillerCoors' right to control quality and prevent consumer confusion.

Like the state laws at issue in *Mobil Oil* and *American Petroleum*, the Beer Franchise Act does not interfere with MillerCoors' ability to control the quality of its products and services and leaves intact all of the distributor's contractual obligations to maintain such quality and preserve the integrity of MillerCoors' trademarks. Pursuant to Section 507 of the Act, the purchaser of a distributor's business steps into the shoes of the seller, assuming "all the obligations imposed on … the selling wholesaler by virtue of any agreement between the selling wholesaler and [the brewery]." VA. CODE § 4.1-507(a). Thus, in this case, the purchaser of Chesbay's distributorship assumes, by operation of law, the same restrictions and quality-control requirements as Chesbay, making MillerCoors no worse off. Because Section 507 "does not alter the franchisee's obligations to uphold" quality controls required by the franchise agreement, *Mobil Oil*, 34 F.3d at 226-27, it does not conflict with the Lanham Act.

Furthermore, much like the "good cause" exception involved in *Mariniello*, MillerCoors retains the right under Section 507 of the Act to withhold consent to a transfer of the wholesaler's business if the purchaser fails to meet the material and reasonable qualifications and standards required of wholesalers.[3] VA. CODE § 4.1-507(a). And Section 505 provides other similar relief; it gives MillerCoors the additional power to seek cancellation of a distributor agreement for good cause. *Id.* § 4.1-505. Those provisions allow a brewery, both *ex ante* and *ex post*, to protect its trademarks from a franchisee that is provably unqualified or unable to maintain the quality associated with the marks. Thus, the Beer Franchise Act is fully consistent with the Lanham Act and sits comfortably "in the interstices of the federal regulatory matrix" relating to trademark law. *Mariniello*, 511 F.2d at 857.

D. Even If the Beer Franchise Act Conflicts with the Lanham Act, the Twenty-first Amendment Saves the State Law.

For all the reasons given above, there is no merit in MillerCoors' contention that the Beer Franchise Act contravenes rights the Lanham Act supposedly grants MillerCoors. But even if there were, that would not end the matter because the Beer Franchise Act is no ordinary state law that must automatically give way to contrary federal law. Virginia enacted the Act pursuant to its constitutionally protected power to regulate the consumption and distribution of alcohol within its territory. In light of its close connection with core Twenty-first Amendment interests, the Beer Franchise Act is not preempted.

At a minimum, however, the Court should apply the canon of constitutional avoidance and strive to avoid holding that the federal and state laws conflict. "[T]he principle of constitutional avoidance . . . requires the federal courts to strive to avoid rendering constitutional rulings unless absolutely necessary." *Norfolk So. Ry. Co. v. City of Alexandria*, 608 F.3d 150, 156-157 (4th Cir. 2010). So even if the Lanham Act could arguably be interpreted as

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[3] Instead of asserting that Reyes lacks reasonable qualifications, MillerCoors asserts that its trademarks will be infringed simply by Reyes' acquisition of Chesbay without MillerCoors' consent. Particularly because Virginia law requires Reyes to accede to Chesbay's contract obligations, including obligations to protect MillerCoors' trademarks, MillerCoors cannot claim infringement by its own unreasonable decision to withhold consent to the transfer.

MillerCoors interprets it, the Court's "duty is to adopt" Reyes' equally arguable interpretation and avoid the constitutional question. *See Harris v. United States*, 536 U.S. 545, 555 (2002).

1. The Twenty-first Amendment protects states' core interests in regulating alcohol and the alcohol market.

The purpose of the Twenty-first Amendment is to protect states' "'core interests' in 'promoting temperance, ensuring orderly market conditions, and raising revenue' through regulation of the manufacture, distribution, and sale of alcoholic beverages." *Beskind v. Easley*, 325 F.3d 506, 513 (4th Cir. 2003) (quoting *North Dakota v. United States*, 495 U.S. 423, 432 (1990)). Among the many powers granted by the Twenty-first Amendment is the broad power to adopt, enforce, and promote systems for distributing alcohol. Section 2 of the Twenty-First Amendment gives states "*virtually complete control* over the importation and sale of liquor and *the structure of the liquor distribution system*." *North Dakota*, 495 U.S. at 431 (internal citation omitted) (emphasis supplied); *see TFWS Inc. v. Franchot*, 572 F.3d 186, 189 n.4 (4th Cir. 2009) (noting that Section 2 "has been interpreted to give states very broad authority to regulate the sale and *distribution* of alcoholic beverages within their borders") (emphasis supplied). Virginia has joined many states in adopting a three-tier system for distributing alcoholic beverages. *See Brooks*, 462 F.3d at 345. The Supreme Court and the Fourth Circuit repeatedly have rejected efforts to undo or undermine three-tier systems, always admonishing that the three-tier system is "unquestionably legitimate." *Granholm v. Heald*, 544 U.S. 460, 488-489 (2005) (citing *North Dakota*, 495 U.S. at 432); *Brooks*, 462 F.3d at 352.

Because the Twenty-first Amendment affirmatively grants states power, the preemption analysis is fundamentally different when a challenged state law is connected with a state's regulation of alcohol and alcohol distribution. "[W]hereas ordinarily a federal law preempts a conflicting state law, if the state law regulates alcoholic beverages the court must balance the federal and state interests." *Lebamoff Enters. Inc. v. Huskey*, 666 F.3d 455, 458 (7th Cir. 2012). The 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." *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691, 714 (1984). Balancing the state and federal interests is not always easy (which is one reason why the canon of constitutional avoidance applies), as courts have "an ill-defined sense of what does and what does not fall within the core of the Twenty-first Amendment." *Ryan v. Molson USA, LLC*, No. 05-CV-3984, 2005 U.S. Dist. LEXIS 42973, at *27-28 (E.D.N.Y. Nov. 7, 2005). Synthesizing the cases that have considered it, one district court distinguished between "state laws that directly regulate the state alcohol sale, importation and distribution system" and "laws that have little, if any, effect on a state's system of alcohol sale, importation and distribution." *Id.*

2. Section 507 of the Beer Franchise Act directly concerns core Twenty-first Amendment interests.

Consistent with the Twenty-first Amendment, the Court should reject MillerCoors' preemption claim for two reasons.

First, the right MillerCoors claims under the Lanham Act—the right to block the sale of a franchise and unilaterally control the identity of the purchaser—fundamentally conflicts with Virginia's core Twenty-first Amendment power to ensure the safety and quality of alcohol sold in its territory and to identify and regulate the persons and businesses eligible to distribute alcohol. As noted above, MillerCoors does not appear to dispute Virginia's power to license and regulate alcohol distributors. If, consistent with its regulatory framework, Virginia determines that a distributor is not eligible for a license, it may not distribute alcohol—period—even if the distributor was "chosen" by the brewery as best suited to ensure the quality of its products. No state leaves determinations about quality and safety to the sole discretion of the brewery. MillerCoors' claimed right to unilaterally control the identity of the purchaser as part of its right of quality control would require a repeal of the Twenty-first Amendment and the overturning of the state laws enacted pursuant to it, such as Section 507.

Second, Section 507(a) of the Beer Franchise Act directly regulates the distribution of alcohol and thus implicates core Twenty-first Amendment interests—especially the three-tier system itself. A three-tier system like Virginia's does not exist *in vacuo* but is the result of several laws mandating separation of alcohol manufacturing, distribution, and retail sale. Keeping the tiers separate, distinct, and independent has been a constant goal of the General Assembly. The General Assembly found that it is "necessary and proper to require a separation between manufacturing interests, wholesale interests and retail interests in the production and distribution of alcoholic beverages in order to prevent suppliers from dominating local markets through vertical integration and to prevent excessive sales of alcoholic beverages caused by overly aggressive marketing techniques." VA. CODE § 4.1-215(c). Along the same lines, one of the General Assembly's expressly stated goals for the Beer Franchise Act is "to preserve and protect the existing three-tier system."[4]

Section 507(a) is a critical component of the Act and ensures that Virginia's system remains a true *three*-tier system instead of, say, a *two*-tier system in which one tier dominates or controls another. As has been recognized in other contexts, "[t]he right to dispose of an asset is an important incident of ownership." *Propat Int'l Corp. v. RPost, Inc.*, 473 F.3d 1187, 1191 (Fed. Cir. 2007). The General Assembly embraced that notion in enacting the Beer Franchise

[4] In *Virginia Imports, Ltd. v. Kirin Brewery of America, LLC*, 589 S.E.2d 470, 477 (Va. Ct. App. 2003), the Court of Appeals held that the legislative purposes of the Wine Franchise Act, VA. CODE § 4.1-400, are the legislative purposes of the Beer Franchise Act as well.

Act, finding that a distributor's decision to provide for the transfer or "continuation" of its business is a fundamental aspect of what it means to own and operate a distributorship. *See* VA. CODE § 4.1-400. Accordingly, by preventing breweries in the top tier from controlling the disposition of the assets of distributors in the middle tier except for good cause, Section 507(a) prevents breweries from controlling distributors. If a brewery could arbitrarily exert control over a distributor's end-of-business transfer, the brewery could leverage that power to control other aspects of the distributor's business, thereby circumventing the ownership and control restrictions Virginia places on licensed breweries. *See* § 4.1-223(2) (barring breweries from having an ownership interest in distributors); *see also* § 4.1-208 (separate licenses for each tier). For instance, when a brewery can control the disposition of an entire distributorship, the brewery can directly or indirectly coerce that distributor to favor the brewery over that brewery's competitors long before the distributor decides to sell its business. *See In re Pascal & Weiss, P.C.*, D.C. Alcoholic Beverage Control Bd. Advisory Op. No. 2012-120, ¶ 22 at 10 (Mar. 28, 2012); *see also* Chesbay Mem. ¶¶ 22-26 (listing similar criticism from other jurisdictions). Section 507(a), therefore, "ensur[es] orderly market conditions" in the alcohol market. *North Dakota*, 495 U.S. at 432.

MillerCoors complains that Section 507(a) forces it into unwanted business relationships. Because the purchaser MillerCoors purports to reject in this case is actually MillerCoors' largest United States distributor, which MillerCoors repeatedly has approved to distribute its products in Virginia and elsewhere, MillerCoors' concern rings hollow. But even if true, that is simply an unavoidable consequence of a three-tier system. After all, the Twenty-first Amendment guarantees a state *carte blanche* to decide who distributes alcohol within its territory. Like the plaintiffs in *Brooks*, MillerCoors is essentially mounting an attack on Virginia's three-tier system by isolating one component of it. *See Brooks*, 462 F.3d at 352-354. So, as with the plaintiffs in *Brooks*, the Court should reject MillerCoors' complaint.

The Twenty-first Amendment balancing test should take into account the effectiveness of a state law in meeting the Twenty-first Amendment interests it purportedly promotes. *See TFWS Inc. v. Schaefer*, 325 F.3d 234, 237 (4th Cir. 2003). And while effectiveness ordinarily may be a question of fact, *see id.*, the Court need not wait until after discovery to reject MillerCoors' claim. MillerCoors has not even alleged that Section 507(a) is ineffective and so has failed to allege facts necessary to support an essential element of its claim. *See Iqbal*, 556 U.S. at 678; *Twombly*, 550 U.S. at 555.

II. MILLERCOORS FAILS TO STATE A CLAIM OF LANHAM ACT TRADEMARK INFRINGEMENT AND UNFAIR COMPETITION.

In Count I, MillerCoors claims that, if Chesbay consummates the sale of its franchise without MillerCoors' consent, the purchaser (*i.e.* Reyes) will be engaged in trademark infringement and unfair competition in violation of the Lanham Act, 15 U.S.C. §§ 1114(1), 1125(a). As preventative relief, MillerCoors seeks a declaration that "Chesbay has no right to assign the MillerCoors Trademarks to the Purchaser, that the Purchaser has no right to use the MillerCoors Trademarks, [and] that MillerCoors has no obligation to license the MillerCoors Trademarks to the Purchaser or approve Chesbay's attempted transfer [of its license]." Compl. Prayer for Relief ¶ a.

MillerCoors' Lanham Act claim fails along with its preemption claim because the premise of both claims is MillerCoors' purported, absolute right to control the identity of the distributor of its products under the Lanham Act and thus block a distributor's sale of its business for any reason MillerCoors wants. As explained in Part I, MillerCoors has no such right. The Beer Franchise Act gives MillerCoors a limited right to withhold consent to Chesbay's sale to

Reyes only if Reyes does not meet "the material and reasonable qualifications and standards required of its wholesalers." VA. CODE § 4.1-507(a). If Reyes in fact fails to meet those qualifications (MillerCoors' Complaint alleges absolutely nothing about Reyes' qualifications), MillerCoors can exercise its limited veto right under Virginia law. If Reyes meets those qualifications, the sale will go through. When that happens, by operation of law, Reyes will step into Chesbay's shoes, and, critically, Reyes' use of MillerCoors' trademarks will be licensed via Chesbay's distribution agreement. Either way, the public will not be confused and no trademark infringement will occur. *See, e.g.*, *Storer Cable Commc'ns*, 806 F. Supp. at 1541 (noting that there is "no deception of the public" in the forced use of a franchisor's trademarks "by what would be, under state law, a true . . . franchisee"). Therefore, MillerCoors has failed to state a Lanham Act claim.

III. MILLERCOORS FAILS TO STATE A CLAIM OF BREACH OF CONTRACT.

MillerCoors' breach of contract claim also fails as a matter of law. In Count III, MillerCoors claims that Chesbay breached Section 8.8.3 of the distribution agreement, which provides MillerCoors a right of first refusal upon notice of Chesbay's intent to sell its business to a third party, and Section 8.8.4, which prohibits Chesbay from entering into any agreement with a third party that would deprive MillerCoors of its right of first refusal. MillerCoors seeks, among other relief, specific performance and a declaration that its right of first refusal under Section 8.8.3 is valid and enforceable. The Court should dismiss Count III because the Beer Franchise Act governs Chesbay's distribution agreement, both by operation of law and by virtue of the parties' express agreement. Accordingly, the Beer Franchise Act permits Chesbay to sell its business to any distributor that meets MillerCoors' material and reasonable qualifications.

"A statutory requirement affecting a private contract, [even] if not expressed in the written agreement, nevertheless becomes a part of its terms. A pertinent statute is as much a part of the contract as if it were incorporated in it." *Harbour Gate Owners' Ass'n v. Berg*, 348 S.E.2d 252, 257 (Va. 1986) (citing *Paul v. Paul*, 203 S.E.2d 123, 125 (Va. 1974); *Maxey v. American Cas. Co.*, 23 S.E.2d 221, 223 (Va. 1942)); *accord Marriott v. Harris*, 368 S.E.2d 225, 233 (Va. 1988). The Beer Franchise Act expressly provides that it "shall apply to all agreements in effect on or after January 1, 1978." VA. CODE § 4.1-501. It further provides that "[n]o brewery shall require any wholesaler to waive compliance with any provision of this chapter. Any contract or agreement purporting to do so is void and unenforceable to the extent of the waiver or variance." *Id.* § 4.1-515.

Any brewery entering into a distribution agreement subject to the Beer Franchise Act, therefore, assumes the obligation under Section 4.1-507 to consent to a distributor's transfer of its business when the purchaser meets the brewery's material and reasonable qualifications and standards. *See Sanders v. UDR, Inc.*, No. 3:10-cv-459, 2010 WL 3927804, at *3-4 (E.D. Va. Oct. 4, 2010) (holding that a landlord entering into an agreement subject to Virginia's landlord-tenant statute "assumes the legal duties required in the Act as if they were incorporated into the lease agreement, and a violation of the statute gives rise to a breach of contract action"). MillerCoors cannot, without breaching the distribution agreement, block Chesbay's sale of its franchise to Reyes. Nor can it seek to enforce the provisions of its distribution agreement as a purported waiver of Chesbay's rights under Section 4.1-507 of the Beer Franchise Act. To the extent MillerCoors contends that Chesbay waived its statutory protections by agreeing to Section 8 of the distribution agreement, Section 8 is void and unenforceable as a matter of Virginia law. *See* VA. CODE § 4.1-515.

By including Section 13.2 in its distribution agreement, MillerCoors acknowledged that it cannot, and did not, seek to vary Chesbay's statutory protections under Virginia law that permit the very conduct that MillerCoors now claims constitutes breach. As explained in Part I.B.2 *supra*, Section 13.2 of the distribution agreement incorporates the laws of Virginia "to the extent that such laws . . . are lawfully required to be so incorporated," and further provides that state laws incorporated into the agreement "shall supersede any conflicting provision" of the agreement. Ex. A to Compl., § 13.2, at 21. Thus, not only does Virginia law, of its own force, allow Chesbay to enter and enforce its purchase agreement with Reyes, but the parties expressly agreed that MillerCoors' obligations and Chesbay's rights under Section 507(a) of the Beer Franchise Act were incorporated into the distribution agreement and superseded any conflicting provisions of the agreement. *See Mathews v. PHH Mortg. Corp.*, 724 S.E.2d 196, 201 (Va. 2012) (incorporating and enforcing agency regulations where deed of trust expressly provided that agency regulations limited lender's authorization to accelerate or foreclose, manifesting parties' unambiguous intent that lender's rights do not accrue unless permitted by regulations). Because Section 507(a) clearly conflicts with the restrictions and rights in Section 8 of the distribution agreement that MillerCoors seeks to enforce, Section 13.2 provides an additional and independent reason why Count I must be dismissed.

CONCLUSION

WHEREFORE, Reyes respectfully requests that this Court grant its Motion to Dismiss or, in the Alternative, for Judgment on the Pleadings.

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 8th day of October 2012, a true and accurate copy of the foregoing was filed with the Clerk of Court using the CM/ECF system, which will send a notification of such filing (NEF) to the following:

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