November 28, 2007 Supplier Termination of a Franchise Agreement

The Honorable Shannon Robinson
New Mexico State Senator
716 Indiana SE
Albuquerque, NM 87108

The Honorable George Hanosh
New Mexico State Representative
P.O. Box 1299
Grants, NM 87020

RE: Request for Opinion – Supplier Termination of a Franchise Agreement

Dear Senator Robinson and Representative Hanosh:

You requested our advice on whether a supplier of alcoholic beverages may terminate its franchise agreement with a wholesaler when the wholesaler is merged with another wholesaler. The New Mexico Alcohol Beverages Franchise Act ("Act"), NMSA 1978, Sections 60-8A-7to -11 (1981, as amended through 1993), governs this inquiry. Based on our examination of the relevant New Mexico constitutional, statutory and case law authorities, and on the information available to us at this time, we conclude that if a supplier terminates a franchise agreement because of a prospective merger, it will violate the Act.

The New Mexico Alcohol Beverages Franchise Act generally prohibits a supplier from terminating, canceling, or not renewing a franchise with a wholesaler. See NMSA 1978, § 60-8A-8(B) (1993). A supplier is a "business enterprise engaged in business as a manufacturer, importer, broker, [or] agent…that distributes any or all of its brands of alcoholic beverages through licensed wholesalers in this state." NMSA 1978, § 60-8A-7(C) (2003). Excepted from the prohibition is a termination, cancellation or failure to renew that is "done in good faith and for good cause." NMSA 1978, § 60-8A-8(B) (1993). See also NMSA 1978, § 60-8A-10 (in an action brought by a wholesaler, it is a "complete defense for the supplier to prove that the termination, cancellation or failure to renew was done in good faith and for good cause."

For purposes of the Act, "good cause" includes:

> failure by the wholesaler to substantially comply with the essential and reasonable provisions of a contract, agreement or understanding with a supplier, …use of bad faith on the part of the wholesaler in carrying out the terms of the franchise; and does not include failure or refusal on the part of the wholesaler to engage in any trade practice, conduct or activity that may result in a violation of any federal law or regulation or any law or regulation of this state.

§ 60-8A-7(B)(1)-(3) (2003). "Good faith" is defined within the Act as "honesty in fact in the conduct or transaction concerned and the observance of reasonable commercial standards of fair dealing in the trade as evidenced by all surrounding circumstances." § 60-8A-7(E) (2003).

Case law from jurisdictions other than New Mexico provides some guidance on what constitutes good cause and good faith. The Tenth Circuit Court of Appeals has held that suppliers and distributors may terminate franchise agreements when there are irreconcilable conflicts. See State Distributors, Inc. v. Glenmore Distilleries Co., 738 F.2d 405, 413 (10th Cir. 1984). Yet, the supplier may not terminate for failure to meet unrealistic goals. Id. at 414. There must be a good cause for termination based on the other party's substantial deficiencies or good faith compelling business reasons and not merely on vindictive or otherwise improper motives. See American Mart Corp. v. Joseph E. Seagram & Sons, Inc., 824 F.2d 733 (9th Cir. 1987). Compelling business reasons have been found where the wholesaler promised, but failed to meet, sales expectations, followed a marketing philosophy and campaign contrary to that of the supplier or where the wholesaler failed to take corrective steps to improve its performance. State Distributors Inc., 738 F.2d at 413.

We understand that New Mexico suppliers anticipate a divergence in the new ownership and business philosophies resulting from the merger, but that there is currently no evidence of conflict or a declining commercial standard. Under these circumstances, and absent a violation of a supplier's franchise contract, agreement or understanding with the wholesaler, it is doubtful that a termination based on mere conjecture or anticipation would constitute "good cause" for terminating a franchise under Section 60-8A-8.

A consolidation signifies such a union that results in the creation of a new corporation and the termination of the constituent ones, while a merger signifies the absorption of one corporation by another, yet retains its name and corporate identity with the added capital, franchises and powers of a merged corporation. See 15 W. Fletcher, Cyclopedia of the Law of Private Corporations § 7041, at 6 (1961 Rev. Vol.). It is well-settled law that in both a consolidation and a merger, the resulting corporation acquires all the property, rights and franchises of dissolved companies. See Pinellas Ice & Cold Storage Co. v. C.I.R., 57 F.2d 188 (C.A.5 1932); New Orleans Gas-light Co. v. Louisiana Light & Heat Producing & Manufacturing Co., 115 U.S. 650, 6 S.Ct. 252, (U.S.1885). Thus, "a 'merger' *in and of itself,* does not create 'just and sufficient cause' for a termination of a distributorship." quoting All Brand Importers, Inc. v. Department of Liquor Control 213 Conn. 184, 204, 567 A.2d 1156, 1167 (1989).

However, it is important to note that the mere purchase of the assets of one corporation by another for a sufficient consideration is neither a "merger" nor a "consolidation." Pankey v. Hot Springs Nat. Bank, 46 N.M. 10, 119 P.2d 636 (1941). It follows that the general rule of franchise transferability does not apply when a wholesaler sells its business.

Your request to us was for a formal Attorney General's Opinion on the issues discussed within. Such an opinion is a public document available to the general public. Although we are providing you our legal advice in the form of a letter instead of an Attorney General's Opinion, we believe this letter is also a public document, not subject to the

attorney-client privilege. Therefore, we may provide copies of this letter to the public. If there are any further questions that I can assist you with, do not hesitate to contact me.

Sincerely,

TANIA MAESTAS
Assistant Attorney General

cc: Albert J. Lama, Chief Deputy Attorney General