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March 24, 1988

ATTORNEY GENERAL OPINION NO. 88- 41

Tom Hanna
Director
Alcoholic Beverage Control Division
Kansas Department of Revenue
700 Jackson Street, Jayhawk Tower
Topeka, Kansas 66612

Re: Intoxicating Liquors and Beverages--Bonded Warehouses and Related Provisions--Exclusive Territorial Franchises; Termination or Modification of Franchise

Synopsis: Change of ownership of a brand at the supplier's level does not, in and of itself, constitute "reasonable cause" for a supplier to terminate a franchise agreement pursuant to K.S.A. 1987 Supp. 41-410 of the liquor control act. Cited herein: K.S.A. 1987 Supp. 16-1201; 16-1203; 41-410; L. 1979, ch. 153, §3.

* * *

Dear Director Hanna:

You request our opinion regarding franchising in the liquor industry in Kansas. Specifically, you question whether the acquisition of one supplier by another, or the change of ownership of a liquor brand at the supplier's level, would constitute "reasonable cause" for the supplier who acquires the rights to a brand to terminate and reassign the franchise agreement that existed at the time of the acquisition. You advise us that your predecessor issued a memorandum in May of 1987 indicating that since Kansas has a "brand franchise law,"

a supplier who acquires a brand of liquor does so subject to the original brand owner's previously granted franchise. You thus question the validity of the opinion expressed in that memorandum.

The Kansas liquor control act, K.S.A. 41-101 et seq., contains a provision dealing with the establishment and termination of franchise agreements. K.S.A. 1987 Supp. 41-410 provides that "[n]o manufacturer, importer or other supplier shall grant a franchise for the distribution of a brand to more than one distributor for all or part of any designated territory," and that "[n]o franchise agreement for the distribution of a brand of alcoholic liquor or cereal malt beverage shall be terminated . . . except for reasonable cause." "Reasonable cause" is not defined for purposes of this section, and we are thus left to determine how the courts will define "reasonable cause."

The first rule of statutory construction is to ascertain the intent of the legislature. State v. Ashley, 236 Kan. 551 (1985). The historical background, legislative proceedings and changes made in a statute during the course of its enactment may be considered in determining legislative intent. Hulme v. Woleslagel, 208 Kan. 385 (1972); Ropfogel v. Enegren, 7 Kan. App. 2d 644 (1982). K.S.A. 1987 Supp. 41-410 was originally enacted as a part of 1979 House Bill No. 2020. It was amended into House Bill No. 2020 by the Committee of the Whole Senate on March 22, 1979 and at that time provided in pertinent part as follows:

> "New Sec. 3. (1) No distributor of alcoholic liquor, except beer, shall sell any alcoholic liquor in this state unless such distributor has filed with the director a written notice stating each geographic territory, agreed upon by written agreement between the distributor and a supplier of the distributor, within which the distributor distributes to retailers, one or more brands of such supplier. There shall also be filed with such notice a verified copy of each such written agreement between the distributor and a supplier. Such agreements shall constitute franchises for the distribution of the specified brand or brands within the territory designated. No manufacturer, importer or other supplier

shall grant a franchise for the distribution of a brand to more than one distributor for all or part of any designated territory. No manufacturer, importer or other supplier shall sell any brand of alcoholic liquor to any licensees in this state except to a licensed distributor having a franchise to distribute such brand as provided herein.

"(2) Except for good cause, no franchise for the distribution of a brand shall be terminated or modified nor shall the designated territory be altered without the written consent of the distributor and the manufacturer, importer or other supplier involved. If a manufacturer, importer or other supplier wishes to terminate or modify a franchise or to alter the designated territory without the consent of the distributor, such manufacturer, importer or supplier shall give written notice to the distributor and the director by certified mail. . . . If [after a hearing] the director determines that the termination, modification or alteration is being proposed in good faith and that good cause exists, the director shall enter an order authorizing the supplier to proceed with the proposed termination, modification or alteration not less than thirty (30) days after the entry of the order or at such earlier date as specified in the order. If the director finds that the termination, modification or alteration is not being proposed in good faith or that good cause does not exist, the director shall enter an order prohibiting the proposed termination, modification or alteration.

. . . .

"(5) As used in this section, 'good faith' means the duty of each party to any franchise, and all officers, employees or agents thereof, to act in a fair and equitable manner towards each other, and

> 'good cause' means: (a) Failure of the distributor to comply substantially with the provisions of this franchise law; or (b) use of bad faith or failure to observe reasonable commercial standards of fair dealing in the trade; or (c) failure of the distributor to reasonably efficiently represent the supplier in the distribution of the brands of the supplier. . . ."
> 1979 Senate Journal 404, 405.

Prior to its final enactment, this provision was amended into its substantially current form, thus making the termination provisions more mutual, doing away with the administrative procedure for determining "good faith" and "good cause," and eliminating the definitions of those terms. See L. 1979, ch. 153, §3.

While the above-quoted definition of "good cause" for termination of a franchise agreement was eventually eliminated from the statutory language and the term was changed from "good cause" to "reasonable cause," we believe the above definition provides an excellent indication of what the legislature intended "reasonable cause" to encompass. We believe the definitions were removed in accordance with the amendments making the termination provisions more mutual, and to avoid having such a narrow definition as to prohibit a finding of good cause simply because the activity or reason in question was not specifically listed as good cause for termination.

Further evidence of legislative intent may be drawn from the general purpose of franchise termination regulations. In H & R Block, Inc. v. Lovelace, 208 Kan. 538 (1972) the Kansas Supreme Court adopted the following definition of a franchise:

> "In its simplest terms a franchise is a license from the owner of a trademark or trade name permitting another to sell a product or service under that name or mark. More broadly stated, the franchise has evolved into an elaborate agreement under which the franchisee undertakes to conduct a business or sell a product or service in accordance with methods and procedures prescribed by the franchisor and the franchisor undertakes to assist the franchisee through advertising,

> promotion and other advisory service. The franchise may encompass an exclusive right to sell the product in a specified territory (see 15 Business Organizations, Glickman, Franchising, §2.01)." 208 Kan. at 545.

Thus, both parties to the franchise agreement have significant investments in the relationship: the franchisee (distributor) in time and money; the franchisor (supplier) in reputation and brand. Historically, because of the disparity in the bargaining power of the parties, franchisors have drafted contracts permitting them to terminate franchises at will or for a variety of reasons including failure to comply with unreasonable conditions, often leaving franchisees with nothing in return for their investment. See Westfield Centre Service, Inc. v. Cities Service Oil Co., 432 A.2d 48, 53 (N.J. 1981) and authorities cited therein. States have thus sought to regulate the termination of franchise agreements to prevent such unfairness and to even-up the bargaining powers. Generally, the idea is "to protect the franchisee from undue usurpation of his franchise while yet allowing franchisor to protect its trade name, trademark and good will interests in the franchise agreement." Westfield Centre Service, Inc. v. Cities Service Oil Co., 386 A.2d 448, 457 (N.J. 1978), citing Amerada Hess Corp. v. Quinn, 362 A.2d 1258 (N.J. 1976). While some courts have held that good faith and bona fide business judgments are sufficient to constitute good cause to terminate a franchise agreement, see, e.g., American Mart Corp. v. Jospeh E. Seagram & Sons, Inc., 824 F.2d 733, 734 (9th Cir. 1987), based upon the above-cited reasons for regulating franchise terminations we are more inclined to agree with authorities who believe good faith business decisions alone are inadequate to permit terminations which must be for "good cause." The goals sought through regulation are not met if a franchisor is able to terminate an agreement on the sole basis that it is believed to be good for business. See, e.g., Gellhorn, "Limitations on Contract Termination Rights - Franchise Cancellations," 1967 Duke L.J. 465, 504-505; Note, 74 Colum L. Rev. 1487, 1493 (1974); Westfield, 386 A.2d at 459; C.C. Hauff Hardware, Inc. v. Long Manufacturing Co., 148 N.W.2d 425 (Iowa 1967).

Finally, in construing statutes, courts may take into consideration other statutory enactments on the same or similar subject which might shed light on legislative intent. State v. Roudybush, 235 Kan. 834 (1984). The Kansas

agricultural equipment dealership act, K.S.A. 1987 Supp. 16-1201 et seq., provides that no farm equipment manufacturer may "terminate, cancel, fail to renew or substantially change the competitive circumstances of a dealership agreement without good cause." K.S.A. 1987 Supp. 16-1203. The purpose of the act, stated at K.S.A. 1987 Supp. 16-1201, is "to prevent arbitrary or abusive conduct and to preserve and enhance the reasonable expectations for success in the business of distributing farm equipment." "Good cause" is defined in this act as:

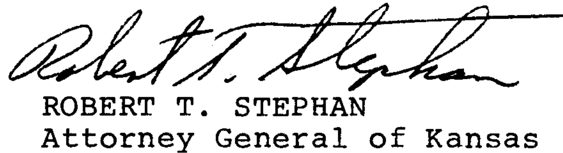
> "[T]he failure by a farm equipment dealer to substantially comply with essential and reasonable requirements imposed upon the dealer by the dealership agreement, provided such requirements are not different from those requirements imposed on other similarly situated dealers either by their terms or in the manner of their enforcement." K.S.A. 1987 Supp. 16-1203

In addition, the definition lists nine specific "good causes" for termination, including change of ownership of the dealer without consent of the manufacturer, dealer's bankruptcy, change of dealership location without consent, dealer's default on a security agreement between the parties, failure of the dealer to operate for seven consecutive days, dealer's conviction of a felony affecting the relationship, dealer's engaging in conduct detrimental to its customers and the public welfare, and the dealer's failure to meet reasonable market penetration requirements. In that the subject matter, purpose and language of this act appear similar to that of K.S.A. 1987 Supp. 41-410, it is our opinion that the definition of "good cause" in K.S.A. 1987 Supp. 16-1203 may be instrumental in determining the definition of "reasonable cause" as that term is used in K.S.A. 1987 Supp. 41-410. Also persuasive are several cases from other jurisdictions which define or state a statutory definition of "good cause" for terminating various types of franchise agreements as some failure on the part of the franchisee to comply with his obligations under the agreement or to adequately represent the franchisor's business interest. Consumers Oil Corp. v. Phillips Petroleum Co., 488 F.2d 816, 818 (3d Cir. 1973) (citing N.J. Stat. Anno. §56:10-5); DeMoss v. Kelly Services, Inc., 493 F.2d 1012, 1015 (1st Cir. 1974); Kealey Pharmacy & Home Care Service, Inc. v. Walgreen Co., 539 F.Supp. 1357, 1364 (W.D. Wis. 1982) [citing Wis.

Stats. §135.03 (1977)]; Shell Oil Co. v. Marinello, 307 A.2d 578 (N.J. 1973); Annot., 19 A.L.R.3d 196, 218 (1968).

Given the general legislative intent behind establishing termination restrictions on franchise agreements and that this intent appears to be the basis for enacting K.S.A. 1987 Supp. 41-410, it is our opinion that the mere change of ownership of a brand at the supplier's level would not constitute "reasonable cause" for termination of the franchise agreement to distribute that brand.

Very truly yours,



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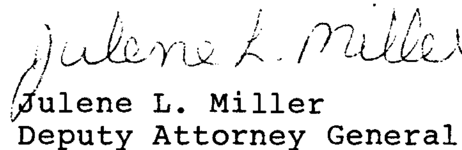

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