



## ***General Counsel Corner***

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### ***Judicial Inconsistency***

So many times, a dealer will come to a lawyer convinced that his grievances against his supplier will be vindicated if only he can explain his situation to a judge. So many times, after carefully analyzing the dealer's situation the attorney will present what he believes to be a strong legal analysis showing that the dealer's legal rights have been violated. A random factor, however, is the judicial system itself.

Consider two decisions reached last November by different federal judges, both sitting in Los Angeles, in two uncannily similar cases, both brought by Chevron in an attempt to justify termination under the Petroleum Market Practices Act.

In *Chevron, U.S.A. Inc. v. El-Khoury*, Franchise Law Rep. ¶11,970 (C.D. Cal. November 6, 2000), the dealer had turned down Chevron's offer of \$400,000 to buy his station. Then Chevron, on short notice, informed the dealer that he had been "nominated for audit," and sent in its accountants to monitor his sales records and examine his tax returns.

The accountants concluded that, although there was no evidence that the dealer had short changed Chevron in paying his percentage rents, the dealer had underreported his sales on his state tax returns.

Even though the dealer promptly amended his state tax returns, Chevron terminated his franchise, contending that termination was justified under

§2802(b)(2)(A) of the PMPA because the dealer had violated the requirement in his franchise agreement that he comply with state law, and also under §2802(b)(2)(C) of the PMPA because the dealer had knowingly failed to comply with state law that was "relevant to the operation of the marketing premises." See 15 U.S.C. §2802(c)(11).

Chevron filed suit to justify its termination in the Los Angeles federal district court, and the dealer counterclaimed for wrongful termination. Both filed for summary judgment.

The dealer first argued that Chevron had no right to examine his tax returns in the first place, submitting Chevron's own letter stating that "Chevron's right to audit clause would be amended to eliminate reference to dealer's tax returns and bank records."

Judge Collins refused even to consider the letter because he viewed it to be inconsistent with the broad audit provision contained within Chevron's standard Dealer Lease Agreement, which permitted audit access to "all documents" of the dealer.

Under California's parol evidence rule, the judge declared, the letter could not be used to narrow the right of audit set forth in the parties' formal agreement.

The court next rejected the dealer's contention that his nonpayment of state taxes did not constitute a meaningful "failure" to comply with state law because, under the PMPA's definition, a "failure" is not meaningful

and cannot justify termination if it is “only technical or unimportant to the franchise relationship.”

The court, however, held that the definition limiting the effect of a “failure” did not apply to a knowing failure to pay state taxes, and alternatively held that the dealer had committed a serious violation of the statute.

Further, the court held that Chevron was entitled, in the alternative, to terminate under §2802(b)(2)(A) because the dealer’s underreporting to the state constituted a violation of “a reasonable and material provision of the franchise agreement,” even though Chevron had suffered no harm as a result of the underpayment.

Finally, the court rejected as irrelevant the dealer’s contention that Chevron’s real reason for termination was the dealer’s refusal to sell his business to Chevron. According to the court, such an argument could only prevail if it were shown that the dealer had been terminated “for his race or any other impermissible basis.”

In short, all of the dealer’s arguments were rejected and his termination was upheld.

In *Chevron, U.S.A. Inc. v. Mebtahi*, 2000 WL 33359294 (C.D. Cal. November 30, 2000), Chevron offered to buy out the dealer for \$450,000, but the dealer refused to sell. Chevron then, on short notice, informed the dealer that he had been “nominated for audit,” and sent in its accountants to review his sales records and examine his tax returns.

The same accounting firm that reviewed Mr. El-Khoury’s records also concluded, with respect to Mr. Mebtahi’s records, that although Mr. Mebtahi had paid his full percentage rents to Chevron, he had underpaid on his sales tax returns to the state.

Once again, Chevron noticed the dealer’s termination and filed suit in the Los Angeles federal district court. Once again, the dealer counterclaimed that Chevron had violated his rights under the PMPA. Once again, the claims went before the court for resolution on cross-motions for summary judgment.

But Judge Cooper viewed the matter quite differently from Judge Collins. First, he emphasized the same letter that Judge Collins had refused even to consider as proof that Chevron did not truly deem the dealer’s underreporting to the state to be material to the franchise relationship between itself and the dealer.

Rejecting Chevron’s parol evidence argument, the court found that its duty to determine whether a term of a franchise agreement was truly material to the franchise relationship “necessarily involves an examination of the facts and circumstances surrounding the franchisor’s inclusion of the provision in the franchise agreement.” The letter that Judge Collins had excluded, therefore, constituted “strong evidence” that the dealer’s “tax reporting is not material to the franchise relationship.”

Second, Judge Cooper rejected Chevron’s reliance for termination on §2802(c)(11), holding that Chevron had failed to demonstrate that the dealer’s “failure” to comply with state law was in

fact material to the parties' franchise relationship.

Third, Judge Cooper found no basis for termination under §2802(b)(2)(A) of the PMPA because the dealer's breach was not material to the parties' franchise relationship. Judge Cooper found that the dealer was not "untrustworthy" merely because he contended that he had relied upon his accountant's concededly bad advice that the dealer could resort to self-help by underreporting his sales taxes to offset excessive payments that he had claimed to have made in earlier years.

Finally, although making no definitive ruling on the dealer's claim that the true cause for termination was his refusal to sell Chevron his station, Judge Cooper did acknowledge that the record contained at least some evidence that Chevron was guilty of pretextual conduct. The court was not required, however, to reach the issue because it found that Chevron had no basis for termination and, therefore, violated the dealer's rights under the PMPA.

Is there some basis for reconciling the diametrically opposed conclusions reached in the *El-Khoury* and *Mebtahi* cases?

On one level, differences can always be found between any two cases. The dealer in *El-Khoury* frankly admitted that he had originally underpaid because he lacked the funds to make a full payment, although he did ultimately amend his returns and did in fact make full payment. The dealer in *Mebtahi*, on the other hand, contended that he had relied upon the bad advice of his accountant to resort to self-help, and that

he in fact had paid all he truly owed to the state.

It is doubtful that these differing explanations would have changed the result in either case. What comes across from reading the two opinions is a fundamental disagreement concerning the equities underlying the dispute between the franchisor and franchisee.

Why did two federal judges applying the same law at the same time in the same court come to such dramatically different results? Neither case appears to have turned on the impression that the individual dealer made on the court because both cases were decided without trial on summary judgment. Neither result is traceable to a unique legal argument because identical arguments appear to have been raised in both cases.

At bottom, the difference in result is probably attributable to the undeniable fact that two judges can look at the same facts and the same law quite differently, each imparting his or her own judicial philosophy and life experiences.

A third decision reached during that same fateful month, November 2000, in the same federal district court by yet another federal judge, Judge Lew, is worthy of note.

In *Chevron, U.S.A. Inc. v. Gulesarian*, Franchise Law Rep. ¶11,975 (C.D. Cal. November 22, 2000), yet a third Los Angeles Chevron dealer had been "nominated for audit." Once again, he was terminated because the sales that he reported on his state tax return were less than those that he had reported to Chevron in connection with his rent payments. Once again, Chevron

terminated and instituted suit in federal court in Los Angeles.

The dealer in *Gulesarian* made a serious mistake. He failed to cooperate in the discovery proceedings, first disappearing from the jurisdiction and then twice failing to attend his deposition, ignoring a court order directing him to appear. Not surprisingly, the court had little difficulty in entering summary judgment upholding the validity of Chevron's termination.

Would the result have been different if the dealer had more diligently pursued his claim? The answer is, who knows?

Amid the uncertainty of litigation, one fact is clear. Once involved in litigation, a party must diligently pursue his or her position. Otherwise, uncertainty becomes a most unpleasant certainty, an easy to predict adverse result.

One final note. If you receive an audit request, contact your lawyer immediately. Particularly if the request comes from Chevron.

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