# *General Counsel Corner*

By Peter H. Gunst, Esquire

## *Station Rents in the Aloha State*

We follow with interest Chevron's challenge of the Hawaiian law limiting dealer rents to 15% of gross margin both because the statute represents a unique attempt to protect independent dealers — and the public — from the effect of excessive rent increases, and because it explores the constitutional limits imposed on such legislation.

In January 1997, Chevron rolled out a new rental program that required lessee dealers to pay an escalating rent based on the dealer's gross margin. Under Chevron's program, rent would be calculated as 18% of gross margin up to $18,000; 32% of the portion between $18,000 and $28,000; and 38% of the portion over $28,000.

Fearful that the public would be hurt by a resulting increase in gasoline retail prices, the Hawaiian legislature stepped in. In June 1997 it enacted Act 257, which established 15% of gross margin as a rent maximum.

The Hawaiian legislature made clear that it was aiding the dealers as a means to protect Hawaiian consumers against increased market concentration and above-market retail prices.

Chevron sued in federal court, claiming that the Act's rent cap constituted an unconstitutional taking of its property because the Act failed to substantially advance any legitimate state interest.

In the course of the litigation, Chevron and the State stipulated that existing dealers might be able to sell their stations at a premium, given the reduced rent imposed by Act 257, and that Chevron was free, in any event, to increase wholesale prices to its dealers.

In *Chevron USA, Inc. v. Cayetano*, 57 F.Supp.2d 103 (D.Haw. 1998), Chief Judge Kay entered summary judgment for Chevron. Judge Kay concluded that the Act was unconstitutional on its face because the "taking" of Chevron's right to control the rent it charged did not substantially advance any legitimate state interest.

According to Judge Kay, the Act would not protect consumers from the harmful effects of a highly concentrated petroleum market because existing dealers could sell their stations at a premium, thus saddling successor dealers with a higher cost structure that would prevent any reduction of retail prices. According to Judge Kay, wealth would simply be transferred from Chevron to the original dealer, to no appreciable benefit to the motoring public.

In addition, Judge Kay concluded that the rent cap would be ineffective in protecting consumers because Chevron could get around the statute simply by raising its wholesale price.

Very recently, the Ninth Circuit reversed Judge Kay's opinion in *Chevron USA, Inc. v. Cayetano*, 2000 U.S. App. LEXIS 22938 (9th Cir. 2000).

Circuit Judge Beezer, writing for the majority, initially concluded that the lower court had applied the proper standard by focusing on whether the statute substantially advanced a legitimate government purpose. The problem, however, was that the lower court had engaged in impermissible fact finding by concluding that the statute lacked any nexus to consumer welfare.

The Ninth Circuit's majority opinion stressed that the state's expert witness, an economist, had testified through affidavit that consumers were likely to benefit because more dealers were likely to stay in business, thus maintaining a greater supply of fuel to consumers that would lead to lower retail prices.

In addition, the economist had testified that Chevron would be unlikely to attempt to recapture the full rent increase by increasing wholesale prices because its dealers would react by raising their street price, thus reducing the volume of gasoline that Chevron might sell at wholesale.

Moreover, the expert had testified that it was unlikely that incumbent dealers would capture the full "premium" value of their stations on resale because of market imperfections in the market for the sale of service stations.

Finally, the expert had testified that the Act would likely benefit customers because it would encourage more dealers to stay in business longer by lowering their fixed costs.

The Ninth Circuit did not agree or disagree with the economist's conclusions. It simply held that the trial court had erred by not recognizing that the economist's testimony created genuine issues of dispute that could be resolved only through a full trial on the merits.

In concurrence, Circuit Judge Fletcher expressed his opinion that the majority had not gone far enough. He would not have required a showing that the statute substantially advanced a legitimate state interest, but only that the legislature acted in a reasonable manner in passing the law. This linguistic difference is significant. It would largely remove from the court the ability to second guess the legislature.

As things now stand, the case will be remanded for a full trial on the merits, presumably before the same judge who ruled against the State on summary judgment. Hopefully, the court will retain an open mind and not prejudge the State's case.

Regardless of the ultimate outcome, this writer is concerned about the Ninth Circuit's adherence to the "substantially advances" standard.

Increasingly, federal courts appear to be usurping the legislature in economic areas. It is difficult to understand why it is that a federal judge, or a panel of federal judges for that matter, is better able to evaluate the likely impact of legislation than the legislature itself, which consists of elected representatives chosen by the community to make the very decisions that are at issue.

Predicting economic impact is extremely difficult if not impossible in any case. Even for federal judges.

If the law does survive, however, it will serve as a strong model for legislation in other states.

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