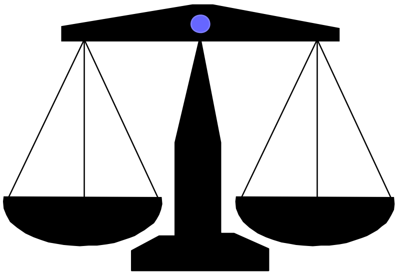

General Counsel Corner

By Peter H. Gunst, Esquire

What Remedies Exist For Unfair Supplier Pricing?

In two recent cases dealers contended that their suppliers had unjustly raised their cost of doing business in order to force them out of business.

They pursued very different litigation strategies. One set of dealers relied on the Petroleum Marketing Practices Act, the other on the implied covenant of good faith and fair dealing.

In *Coast Village, Inc. v. Equilon Enterprises, LLC*, 2001 WL 1097034 (C.D. Cal. 2001), a number of California Shell dealers and a single Texaco dealer sought to use the PMPA to challenge the revised lease and franchise agreements that Equilon rolled out in early 2000. Equilon told the dealers that the agreements were non-negotiable, and that a dealer would be non-renewed if he or she refused to sign its form agreement.

The dealers initially met with success when they filed in federal court in Los Angeles for a preliminary injunction prohibiting Equilon from non-renewal until a full trial could be held on their PMPA claims.

Their principal claim was that Equilon’s new rent formula, which followed Equilon’s elimination of Shell’s old Variable Rent Program, was calculated to drive the dealers out of business, so that Equilon could convert their stations to company operation.

As legal authority for their claim, the dealers relied on 15 U.S.C. §2802(b)(3)(A) of the PMPA, which only permits the supplier to non-renew for failure to agree to the terms of an agreement if the “changes or additions” proposed by the supplier are made “in good faith and in the normal course of business,” and not for the purpose of converting the station to company operation.

The problem with §2802(b)(3)(A) is that it requires a finding of subjective intent that the supplier had a discriminatory motive, or was using the altered contract provisions as a mere pretext to avoid renewal. Proving that the supplier had such a deliberate intent is extremely difficult, if not impossible.

The dealers succeeded at the preliminary injunction stage before Judge Collins because they only had to show that serious questions existed concerning the merits of their claim, and that they would be gravely injured unless the preliminary injunction were entered.

Judge Collins found that the dealers had satisfied their burden because Equilon’s proposed changes significantly altered the economic balance between it and the dealers, and at least some evidence existed from which it might be inferred that Equilon’s true purpose was to convert the dealers’ stations to company operation.

Unfortunately, trial on the merits was a completely different kettle of fish.

At trial, the dealers emphasized that Equilon's marketing plan called for a significant increase in the percentage of company-operated stations in the Los Angeles market. Moreover, the total number of Equilon dealers had declined by almost one-third between May 1998 and November 2000. The dealers could not, however, prove either that the changes to Equilon's form agreement were intended to accomplish that result or that Equilon had deliberately schemed to convert their stations to company operation.

In ruling against the dealers, Judge Collins emphasized that the PMPA did not permit him to second-guess the wisdom or fairness of Equilon's terms. He could only rule for the dealers if he found that Equilon specifically intended to accomplish a purpose forbidden by the PMPA. Judge Collins said:

> What Plaintiffs really seek is to have this Court replace the terms of the new agreement(s) with what Plaintiffs (or this Court) would consider economically reasonable terms. Even if the Court were inclined to do so, such a result is beyond the Court's authority as granted by the PMPA.

The case was not entirely a defeat for the dealers, however. They had earlier obtained partial summary judgment that Equilon's forced inclusion of certain provisions in its proposed lease and franchise agreement violated 15 U.S.C. §2805(f)(1) of the PMPA, which prohibits a supplier from forcing a dealer to surrender any rights under federal or state law as a condition to obtaining the renewal of his or her franchise agreement.

Specifically, Equilon's form agreement required the dealers to release any preexisting claims that they might have had against Equilon; limited to one year the period in which they could assert future claims; and limited the nature of the relief the dealers might seek to obtain.

Such provisions are not illegal on their face, the court explained. They become illegal, however, when the supplier insists upon their adoption as a necessary element of renewal.

Following trial, the court found that Equilon's insistence upon another contract provision also violated §2805(f)(1).

Under Equilon's take-it-or-leave-it agreement, if a dealer sought to assign his franchise to a purchaser who had not operated another station in the past five years, Equilon could require a mutual termination, following which the new dealer would receive only a trial franchise. This could significantly impact the marketability of the station because the buyer's trial franchise could be canceled for any or no reason following a one-year term.

Equilon's insistence on this provision, Judge Collins found, diminished the dealers' rights under California franchise law, which prohibits a franchiser from unreasonably refusing to consent to a franchise transfer.

This part of the court's opinion is very significant because many states have similar provisions that either apply generally to all franchise relationships or apply specifically to service station franchises.

If Judge Collins' reasoning is accepted by other courts, as is quite probable, dealers in many states should have a better chance to sell their franchises for a fair price. They would waive their right to challenge the trial franchise provision, however, unless they object to its inclusion in their dealer documents.

Ultimately, the court struck from Equilon's agreement the provisions that it found to violate §2805(f), and gave the dealers thirty days in which to accept or reject all of the remaining provisions.

In *Wilson v. Amerada Hess Corp.,* 773 A.2d 1121 (N.J. 2001), decided by the Supreme Court of New Jersey, the dealers had taken another tack.

They argued that Hess had attempted to drive them out of business, and convert their stations to company operation, by charging them unreasonably high dealer tankwagon prices. This, they argued, violated the covenant of good faith and fair dealing implicit in every commercial contract.

The trial court and intermediate appellate court had ruled that their claim was without merit, and had prohibited the dealers from obtaining from Hess the discovery they had sought concerning its company-operated stations, which the dealers contended would have shown that Hess well knew, based upon its own operating costs, that the dealers could not sustain their businesses given the low margins that the dealers were forced to operate under.

Reversing dismissal and requiring that Hess provide discovery of the pertinent materials, the court found that the dealers would be entitled to recovery if Hess had exercised its discretionary authority in setting dealer tankwagon prices "arbitrarily, unreasonably, or capriciously, with the objective of preventing the other party from reasonably expected fruits under the contract."

The New Jersey Supreme Court's decision is significant because of the broad obligation of good faith dealing that it places on the oil company. But two caveats must be given.

First, different states interpret differently the breadth of the implied covenant of good faith and fair dealing. Some states have limited its application to the interpretation of explicit contract terms, and have not permitted franchisees to use it generally to attack franchiser unfairness. *See, e.g., Burger King Corp., v. Weaver,* 169 F.3rd 1310 (11th Cir. 1999); *Payne v. McDonald's Corp.,* 957 F.Supp. 749 (D. Md. 1997). In those states, the dealer still bears the more substantial burden of demonstrating that its supplier failed to comply in good faith with a specific contract obligation.

Second, the New Jersey Supreme Court did not rule that Hess actually acted unreasonably or in bad faith. It was called on only to decide whether the dealers' claims had been improperly dismissed, and whether they were entitled to the discovery that they had requested. The court's ruling simply permitted them to go forward and present their claim to a judge and jury.

But at least they were given that chance. As the New Jersey Supreme Court concluded:

> If the discovery plaintiffs seek demonstrates that Hess knew from the operations of its own co-op stations and their distress stations that its DTW pricing rendered it impossible for plaintiffs to meet their operating expenses and perform profitably, and unless Hess provides an explanation for its pricing that is not arbitrary, capricious, or unreasonable, then plaintiffs will have established a jury question on their claim for breach of the implied covenant of good faith and fair dealing.

We await with interest future developments.

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