General Counsel Corner

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Yes Virginia, There Is Protection Against Termination

Given the oft heard complaint that the Petroleum Marketing Practices Act and other laws do not provide any real protection against franchise termination, it is worth considering some recent dealer termination cases.

Chevron U.S.A., Inc. v. Lutz, 271 F. Supp.2d 1196 (N.D. Cal. 2003), is yet another case where Chevron's "flying squad" of accountants blitzed a dealer's financial records to see if Chevron could support termination based upon the dealer's alleged submission of false federal and state tax returns.

Chevron thought it had struck gold and sought a judgment that it could terminate a dealer who had flown the Chevron flag for 34 years.

Chevron's accountants discovered that the dealer's son, a certified public accountant, had significantly understated the station's total sales and gross profit for the year 1999, with the result that the dealer reported taxable income of $142,495, rather than $262,713.

Chevron sought to terminate the dealer under PMPA § 2802(b)(2)(A), because he allegedly had failed to comply with provisions of the franchise agreement that were "both reasonable and of material significance to the franchise relationship," and under § 2802 (b)(C), because of the alleged occurrence of an event which was relevant to the franchise relationship and, as a result of its occurrence, "termination of the franchise is reasonable."

The dealer moved for summary judgment dismissing Chevron's complaint. He argued that Chevron could not justify termination because it could not prove that he *intentionally* filed false tax returns.

In considering the motion, the court carefully considered Chevron's attempt to pigeonhole its termination notice under either § 2802(b)(2)(A) or § 2802(b)(2)(C).

The court first considered, under § 2802(b)(2)(A), whether the unintentional filing of a false tax return could constitute a material breach of the parties' franchise agreement. In so doing, it rejected Chevron's reliance on the provision of the lease agreement permitting termination for "[u]nlawful, fraudulent or deceptive acts or practices or criminal misconduct by a dealer." As a matter of law, the court reasoned, that provision would only apply if the dealer "knowingly and intentionally" misrepresented his true income.

Chevron countered that another provision of the lease flatly required that the dealer "comply with all applicable federal, state and local laws and regulations relevant to the use or operation of the premises." That provision, Chevron emphasized, made no distinction between unintentional and intentional violations of law.

The court responded that Chevron's contractual prohibition was overreaching and unenforceable because the PMPA expressly defined what violations of law could constitute "an event" justifying termination in § 2802(c)(11), which permitted termination only for the "knowing failure of the franchisee to comply with federal, state or local laws."

The court explained:

> Allowing Chevron to expand the statutory grounds for termination simply by writing their terms into its contracts would frustrate the PMPA's purpose of protecting a franchisee from uneven bargaining power and would transform Congress's explicit judgments on the proper grounds for termination into a list of suggestions for fair franchise agreements. This the court declines to do.

Thrust back to the need to prove "an event" involving a "knowing failure" to comply with tax law, Chevron argued that it had submitted sufficient evidence to avoid summary dismissal because the circumstances suggested that the dealer's CPA son had acted intentionally, and that his conduct should be imputed to his father because the son acted as his father's agent with respect to the financial management of the service station.

Not good enough said the court. First, Chevron's own lease agreement differentiated between misconduct personal to the dealer and conduct injurious to the station, regardless of whether performed by the dealer or by his agents. The provisions governing fraud or conviction of a felony involving moral turpitude fell within the first category and not the second.

Second, Chevron's agency theory was inconsistent with the PMPA's language and purpose. Section 2802(c)(11) spoke only of the "knowing failure of the franchisee" to comply with pertinent laws, and not the knowing failure of the franchisee's agent. Moreover, acts of an agent do not normally form the basis for termination under the PMPA because they "do not reflect directly on the dealer's integrity and trustworthiness, and therefore, do not undermine the franchise relationship in the same manner as fraudulent acts by the dealer himself."

In sum, Chevron's termination attempt was terminated with extreme prejudice.

Mobil Oil Guam, Inc. v. Lee, 2003 WL 21544246 (Guam Terr. 2003), arose from Mobil's belated discovery, in October 1999, that over $270,000 of its direct debit draws from the dealer's account had been returned for non-sufficient funds.

Following months of negotiations regarding repayment, Mobil sent the dealer a termination notice dated December 29, 1999, and took over control of the station in mid-January, 2000.

Mobil sued the dealer for the nearly $200,000 it was still owed, and the dealer counterclaimed, charging that his termination violated the PMPA. The trial court ruled for Mobil on its damages claim and threw out the dealer's PMPA claim on summary judgment.

The Supreme Court of the Territory of Guam affirmed Mobil's damages award, but reversed the dismissal of the dealer's PMPA claim.

The Guam Supreme Court rejected the trial court's conclusion that Mobil could terminate based on §2802(b)(2)(A), because that court had found that the dealer's repeated failures to make payment violated provisions of the franchise agreement that were "both reasonable and of material significance to the franchise relationship."

The Guam Supreme Court explained that the trial court had erred because it failed to take into account PMPA § 2802(b)(2)(A)(i), which provides that notice of termination must be given not more than 120 days after the franchisor acquired actual or constructive knowledge of the dealer's default.

Even though Mobil did not figure out what had occurred until early October, 1999, it had received from the dealer's bank the returned draws marked "NSF" between October, 1998 and June, 1999, more than 120 days prior to the December 29, 1999 notice date.

The Guam Supreme Court remanded the dealer's claim to the trial court to provide Mobil an opportunity to justify termination under the alternate statutory basis stated in its December 29, 1999 letter, § 2802(b)(2)(B) – which permits termination under certain circumstances if a dealer fails to correct a noticed violation. It is difficult to see, however, how that provision could apply under the facts of the case.

A third decision, *Shah v. Racetrac Petroleum Co.*, 338 F.3d 557 (6th Cir. 2003), did not involve the PMPA because the dealer operated the station on a consignment basis. Instead, the dealer claimed that his termination was illegal under Tennessee state law, and also charged his supplier with fraud. The trial court threw out all of his claims on summary judgment, forcing him to appeal to the Sixth Circuit Court of Appeals.

According to the dealer, he had been grossly misled by his supplier's conduct. Before paying the previous operator $90,000 to take over the station, the dealer repeatedly had expressed to the supplier his concerns about a provision contained within the new proposed lease, which permitted the supplier to terminate on 30 days written notice. He allegedly received repeated assurances from various of the supplier's representatives that it would not terminate him so long as he performed adequately.

He subsequently learned that, even as his supplier was giving him these assurances, it was attempting to sell the station out from under him. When the station was sold less than 14 months later, the dealer received a 30-day notice of termination.

Reversing the trial court's dismissal of the dealer's fraud claim, the Sixth Circuit rejected the supplier's argument that it was unreasonable as a matter of law for the dealer to have relied on the supplier's oral representations because the contract that they had entered into expressly provided that there existed no other agreement, either "verbal or otherwise," between the parties other than what was set forth in writing in the contract.

Interpreting Tennessee contract law, the appeals court responded that the iron-clad rule espoused by the supplier simply did not exist. It would be up to the jury to determine whether or not the dealer's reliance had been reasonable or unreasonable.

Next, the court of appeals concluded that the trial court had erred in dismissing the dealer's claims because the doctrine of promissory estoppel could bar the supplier from using the 30-day termination provision. That was so because Tennessee, like all states, recognizes the doctrine that a party who makes a promise in order to induce action or forbearance from another party may be bound to the terms of the promise, regardless of whether or not it is in writing.

Further, the court of appeals found that the dealer had asserted a valid claim that the supplier's oral assurances constituted an amendment to the written contract, essentially striking out the 30-day termination provision.

Even though not in writing, the assurances could constitute a valid modification because the dealer relied upon them to his detriment by making substantial investments in the station that he would have made had he known that he was subject to termination on 30 days notice.

Finally, the court of appeals resurrected the dealer's claims under the Tennessee Petroleum Trade Practices Act, rejecting the supplier's argument that the statute was inapplicable because the contract expressly provided that it did not create a franchise relationship. The court explained that a supplier could not remove itself from the law's reach simply by stating in the contract that the law did not apply.

The appeals court declared that if the relationship between the parties was in fact as a "franchise relationship" as defined by the statute, "how the parties described their relationship is irrelevant."

As these cases show, the laws do in fact contain many effective prohibitions against wrongful termination. The dealer who receives a notice of termination should thoroughly explore all legal remedies before throwing in the towel.

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