General Counsel Corner

By Peter H. Gunst, Esquire

Open Price Term Litigation: Run Over at the Crossroads

Some months ago, we wrote an article entitled “Open Price Term Litigation at a Crossroads,” which addressed the legal arguments that were then being presented to the Supreme Court of Texas in the case of *HRN, Inc. v. Shell Oil Co.* Unfortunately, we must return to the subject.

We say unfortunately because the Texas Supreme Court has now released its opinion dismissing the open price term claims brought by several hundred lessee Shell dealers located in seventeen different states, who charged that Shell was attempting to drive them out of business and convert their stations to company operation by charging them unreasonably high dealer tankwagon prices.

The Texas Supreme Court’s opinion hinged on its interpretation of §2-305(2) of the Uniform Commercial Code, which obligates a supplier to exercise good faith in setting prices pursuant to an open price term. The phrase “open price term” refers to a contractual relationship in which a supplier is given the discretion to set future prices depending upon market conditions.

An earlier federal decision interpreting Texas’ enactment of §2-305(2), *Mathis v. Exxon Corp.*, 302 F.3d 448 (5th Cir. 2002), had held that a supplier would be liable for damages if it set prices at levels intended to drive a dealer out of business even if its prices fell within the range of prices charged by competing refiners to their dealers.

The opinion of the Texas Supreme Court on the issue remained critical because it -- and not the federal court -- is the ultimate arbitrator on issues concerning the interpretation of Texas state law.

To the consternation of the dealer plaintiffs in the *HRN* litigation, as well as claimants in several other class actions and multi-dealer actions that had been filed in Texas in the wake of the *Mathis* decision, the Texas Supreme Court rejected the reasoning of the federal court decision.

The critical issue before the Texas Supreme Court was whether Shell should be entitled to a complete defense to the dealers’ open price term claim because (1) it charged the same posted dealer tankwagon price to similarly-situated dealers, and (2) its dealer tankwagon price fell within the range of those charged throughout the industry.

The *Mathis* court had determined that a supplier might still be liable under those circumstances, if it could be shown that it had intentionally set about to drive its customers out of business.

The Texas Supreme Court disagreed with the federal decision on this critical point. The Texas Supreme Court concluded that so long as the price charged by the supplier was “commercially reasonable” -- *i.e.*, within the range of prices charged by other competitors in the market and not discriminatory -- the supplier's subjective intent was almost wholly irrelevant.

The Texas Supreme Court reasoned that "if these dealers were charged the same [dealer tankwagon] price by another refiner who did not have a similar plan to thin their ranks, presumably the price would pass muster." Therefore, inquiring into the supplier's subjective intent would only inject unnecessary "uncertainty" into the law of contracts.

Nor was the Texas Supreme Court swayed by the fact that the dealers were "captive" buyers, who were required to purchase from Shell even though it charged "on the high end of the wholesale pricing spectrum" within its market.

The fact that the dealers were "captive" buyers under the parties' supply agreements was deemed by the Texas Supreme Court to be irrelevant because the dealers voluntarily became "captive" by entering into their supply contracts in the first place. Moreover, the Texas Supreme Court would not second-guess Shell's pricing determinations, so long as its "relatively high" dealer tankwagon prices were not so completely out of bounds as to be commercially unreasonable.

The Texas Supreme Court's reluctance to re-examine Shell's pricing policies highlights the soft spot in many open price term claims. As long as a supplier's pricing falls within the *range* of competitive prices charged within the market, courts may be unlikely to question its motivations.

Even given that reluctance to probe into Shell's subjective intentions, it is difficult to understand the Texas Supreme Court's refusal to consider a more objective criterion of commercial unreasonableness: the substantial differentiation that existed between Shell's rack price to jobbers and its dealer tankwagon price.

The dealers complained that Shell had created an extreme and unjustifiable gap between its rack and dealer tankwagon pricing, with the foreseeable result that its lessee-dealers would be unable to compete with jobber-supplied locations. Yet the Texas Supreme Court opined without explanation, "Evidence that different prices are available to different classes of trade is not evidence of bad faith" under §2-305(2).

But beyond dispute, a discriminatory price is *not* a commercially reasonable price within the meaning of §2-305(2). Why then was Shell's discriminatory pricing scheme irrelevant?

The obvious source for determining what constitutes a discriminatory pricing scheme is the federal price-discrimination statute, the Robinson-Patman Act, as interpreted by the United States Supreme Court. In two influential decisions involving refiner-jobber-dealer pricing issues, the Supreme Court recognized that a refiner may be held liable for price discrimination where it is unable to justify an unreasonable disparity between rack and dealer tankwagon pricing, which ultimately impacts competition at the dealer level.

As the Supreme Court concluded in *Texaco Inc. v. Hasbrouck*, 496 U.S.

543, 567 (1990), "The additional link in the distribution chain [*i.e.*, sales to the separate jobber class of trade] does not insulate [the supplier] from liability if [the supplier's] excessive discount otherwise violated the Act." *See also Perkins v. Standard Oil Co.*, 395 U.S. 642 (1969). If this is true in the context of a Robinson-Patman Act price-discrimination claim, then why is it not equally true with respect to price discrimination within the meaning of the Uniform Commercial Code?

At least the Texas Supreme Court recognized that an open price term claim could remain viable under some circumstances. Where, as in the Florida discount-for-cash case, *Allapattah Serv., Inc. v. Exxon Corp.*, 61 F.Supp.2d 1308 (S.D. Fla. 2002), *aff'd*, 333 F.3d 1248 (11th Cir. 2003), the supplier engages in actual fraud through double charging its customers, even the Texas Supreme Court would recognize a cause of action. But this leaves little protection indeed to dealers whose livelihood is threatened by their suppliers' predatory or discriminatory pricing policies.

pgunst@agtlawyers.com

astrachan gunst thomas

attorneys at law
a professional corporation