General Counsel Corner

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The Right to Assign

A principal asset of most small business operators is the goodwill that they have built up in their businesses. When it is time to retire or to finance a different business venture, they can cash out through the sale of their businesses.

Independent dealers who lease their service stations from their suppliers are no different. They pour significant capital and sweat equity into their businesses, often for many decades. They, too, have the reasonable expectation that the sale of their businesses will help fund their retirement.

Increasingly, suppliers have sought to undercut lessee dealers' ability to sell or to benefit from the sale of their businesses. They have done this either by inserting requirements into dealers' franchise or lease agreements or by insisting at the time of sale (1) that the selling dealer pay the supplier substantial "administrative fees" to finance the supplier's transfer approval process; (2) that the purchaser receive only a trial franchise; (3) that the supplier receive a right of first refusal before the dealership is sold to anyone else; (4) that the supplier receive some or all of the goodwill value of the station; and/or (5) that the seller release all claims that it may have against the supplier for injuries suffered during the operation of the dealership.

What right do dealers have to resist these demands, either when the supplier seeks to insert them into the dealer's lease or franchise agreement or at the time that the dealership is sold?

To begin with, the dealer's rights are almost exclusively established by applicable state law and not the Petroleum Marketing Practices Act. The PMPA is not directly implicated because it governs only the termination or non-renewal of franchise relationships, and not the assignment to a new franchisee of the remaining term of an existing franchise relationship.

The only provision of the PMPA that comes into play is § 2805(f), which prohibits a franchisor from requiring, as a condition of entering into or renewing a franchise relationship, that the franchisee waive any right that he or she may enjoy under state or federal law. That provision confers no new rights on the dealer, but only seeks to preserve whatever rights -- if any -- the dealer may possess under state or federal law.

Fortunately, many jurisdictions have passed laws prohibiting suppliers from unreasonably refusing to consent to the assignment of an existing franchise to a new dealer. Many such statutes provide that the supplier may not unreasonably withhold consent even if it has inserted into the dealer's franchise or lease agreement a provision restricting the dealer's right of assignment.

These statutes constitute a significant deviation from ordinary real estate law, which generally prohibits a landlord from unreasonably refusing to consent to an assignment only if the parties have not agreed otherwise in their lease agreement.

When is it unreasonable for a supplier to refuse to consent to an assignment? There are few judicial decisions in the area and the answers vary from jurisdiction to jurisdiction, depending upon the specific language of the applicable state law. Some observations, however, can be offered.

First, generally it is not unreasonable for a supplier to refuse consent if it has legitimate concerns about the business qualifications, financial standing or projected business plan of the proposed purchaser. The supplier is usually on safe ground so long as it employs standardized guidelines to measure a candidate dealer's financial and business qualifications. A recent decision deferring to such guidelines is that of the federal district court in *Mikeron, Inc. v. Exxon Company, USA*, 264 F.Supp.2d 268 (D.Md. 2003).

Next, although there is very little law in the area, a supplier probably can charge a reasonable administrative fee to cover any legitimate costs it encounters as a result of the assignment process. This is so because the state statutes only prohibit unreasonable refusals and do not speak in absolute terms. In any event, as a practical matter, it would likely cost far more to challenge a not outrageous transfer fee than simply to pay it.

If a supplier demands more it may well be overreaching. In *California Service Station & Automotive Repair Ass'n v. Union Oil Company*, 232 Cal. App.3d 44, 283 Cal. Rptr. 279 (1991), a California state appellate court held that Unocal violated the California statute by conditioning approval upon the assignee's acceptance of a trial franchise agreement. A trial franchise agreement wholly lacks the PMPA's prohibitions on unreasonable termination or non-renewal and lasts only a year.

The court found that Unocal had materially infringed dealers' right to assign by insisting that buyers operate under trial franchise agreements because few prospective purchasers would assume the risk that their trial franchises would not be renewed, or could obtain necessary financing if they only received a one-year franchise contract.

In *Dege v. Milford*, 574 A.2d 288 (D.C. 1990), the District of Columbia Court of Appeals held that Exxon's insertion in the dealer's franchise agreement of a right of first refusal provision in the event that the dealer sought to sell his business violated the local statute. Of critical importance to the court was the specific prohibition in D.C. Code § 10-221(a), which prevented suppliers from "indirectly" interfering with the dealer's ability to sell his business.

The court said that the very existence of Exxon's right of first refusal provision might discourage third parties from negotiating to purchase a dealership because they risked having their negotiations trumped at the last moment by Exxon's preexisting right. Notwithstanding the *Dege* decision, however, such right of first refusal provisions are still very often contained in franchise and lease agreements, and may or may not be enforceable depending upon the wording of the applicable state statute.

Other conditions to assignment imposed by suppliers are at least as suspect. A supplier's insistence that it receive all or a portion of the sales price attributable to the goodwill value of the business could well be held invalid. True, the supplier may argue that its efforts contributed to the development of the station's goodwill. A court could well find, however, that such a provision either constitutes an impermissible effort to bar the dealer from selling his or her business in the first instance, or is an unlawful, opportunistic grab for a portion of the sales proceeds that truly belongs to the dealer.

Finally, conditioning the dealer's right to sell upon his or her release of all preexisting claims against the supplier is also problematic. In an unreported decision issued by a California federal district court in *Coast Village, Inc. v. Equilon Enterprises, LLC* (C.D.Cal. 2001), the court found that Equilon violated § 2805(f) of the PMPA by requiring dealers, as a condition of their renewal, to release all of their preexisting claims under state or federal law. Although not directly on point, this decision buttresses the argument that it would be unreasonable for a supplier to insist that a selling dealer waive all of his or her preexisting claims under state law or federal law in order to secure the supplier's consent to transfer.

In sum, there are real limitations upon what a supplier may demand as its price to approve the sale of a dealer's business. Rather than bow blindly to the supplier's demands, the dealer should explore his or her options under law.

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