General Counsel Corner

By Peter H. Gunst, Esquire

"Loss of the Franchisor's Right to Grant Possession" Subterfuge

As originally enacted, the Petroleum Marketing Practices Act contained a straight-forward provision permitting an oil company to terminate or non-renew a franchise relationship in the event that it lost the "right to grant possession of the leased marketing premises through expiration of an underlying lease."

In 1994, the PMPA was amended to require an oil company seeking to disengage from a franchise relationship on that basis to offer to assign to the lessee dealer "any option to extend the underlying lease or option to purchase the marketing premises" held by the oil company.

Congress' intent in enacting these provisions, which are found at 15 U.S.C. § 2802(c)(4), was to create a workable balance pursuant to which an oil company could terminate a lessee dealer's franchise if it lost its underlying lease, but only if it assigned any options that it possessed to the lessee dealer, so that he or she had an opportunity to deal directly with the oil company's landlord.

Those provisions have spawned a surprising amount of litigation, with dealers complaining that their suppliers were attempting to subvert the law to affect non-renewal or termination, even where they really intended to retain possession of the leased marketing premises. A case decided in late April of this year by a federal appellate court having jurisdiction over several western states, the Ninth Circuit Court of Appeals, illustrates the problem.

In *Mustang Marketing, Inc. v. Chevron Products Co.*, ___ F.3d ___ (9th Cir. 2005), Chevron's underlying lease with the property owner was due to expire on May 31, 2001. Its lease provided, however, that it could retain its leasehold interest by matching any competitive offer. Evidently, Chevron desired to continue its occupancy past May 31, 2001, but to rid itself of its sublessee dealer.

After the dealer rejected its buyout offer, Chevron presented him with a notice of non-renewal on February 21, 2001, citing as its sole ground the pending expiration of its underlying lease on May 31, 2001. According to the dealer's testimony, Chevron never offered to assign him the right of first refusal provision contained in the underlying lease.

Thereafter, Chevron repeatedly advised the dealer in writing that it would not renew the underlying lease unless and until a "mutually satisfactory agreement" was reached to terminate the dealer's sublessee interests. At the same time, Chevron made clear to the landlord and other third parties its intention to use the right of first refusal provision to block any effort by the landlord to lease the marketing premises to anyone other than Chevron.

The dealer testified that in early May 2001, Chevron advised him that it had discontinued all negotiations with the landlord for a new underlying lease. After the dealer was forced to give up the station, however, Chevron reopened negotiations with the landlord, whose efforts to re-lease the property had been frustrated by Chevron's continuing threat to exercise its right of first refusal.

Nine months later, Chevron and the landlord entered into a new twenty-year lease. Chevron also agreed to pay the landlord $129,000 as a "lease inducement fee" for supposed "environmental liabilities." In fact, the payment represented back rent to June 2001, the date upon which Chevron supposedly had been forced to abandon the marketing premises.

Invoking § 2802(c)(4), the dealer sued Chevron, claiming that its "new lease" was only a subterfuge, and that it had always intended to retain the station, but to convert it to company-operation.

The trial court bought Chevron's argument that it was legally entitled to enter into a new leasehold arrangement, independent from its initial, expired lease, and ruled against the dealer on summary judgment. He appealed to the Ninth Circuit Court of Appeals.

In a lengthy and unanimous decision, the Ninth Circuit reversed the trial court's decision and remanded the case for trial. Succinctly cutting through Chevron's two-lease scenario, the court said:

> In order facially to comply with the PMPA, Chevron attempted to maneuver through this law by ending Mustang's franchise by the termination of the underlying lease while holding on to the Prior Right to Termination so as to be able to keep its grip on the Service Station premises, and then by going through protracted negotiations of nine months with [the landlord] and finally placating [the landlord] with a $129,000 payment. Chevron then could point to the fact that nine months had elapsed between the expiration of the original lease and the commencement of the new lease and say that it was merely exercising its right in the marketplace to do business where it pleased.
>
> These actions by Chevron are exactly what Congress intended to prohibit with its enactment of the PMPA. Therefore, the district court's grant of summary judgment in favor of Chevron is reversed and remanded.

It could not have been better said.

pgunst@agtlawyers.com

astrachan gunst thomas
attorneys at law
a professional corporation