GENERAL COUNSEL CORNER

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Consigned to Oblivion

One of the most frustrating types of cases presented to an attorney who represents service station dealers is that of the terminated or non-renewed service station operator who was induced to enter into a consignment arrangement with his or her supplier.

The scenario usually goes something like this. A franchised dealer in financial trouble, usually as a result of high product cost and rent, is induced by his or her supplier, often a distributor, to replace their existing franchise dealership agreement with a consignment arrangement, which purports to guarantee the station operator a given cents per gallon profit margin on consigned motor fuel.

Under the consignment arrangement, the supplier retains legal title to the motor fuel stored in the station tanks, but most of the risk of loss still falls on the now consignment operator.

Unfortunately, the new arrangement too often does not prove to be the panacea promised by the distributor, who ultimately seeks to terminate or non-renew the parties' relationship.

The issue for the court is whether the operator has forfeited his or her right to protection against termination or non-renewal under the Petroleum Marketing Practices Act by entering into the consignment arrangement.

The distributor will argue that the franchise relationship between the parties necessary to form a PMPA relationship was dissolved when the parties converted to a consignment arrangement because the operator no longer qualifies as a "retailer," as defined under the Act to mean "any person who ***purchases motor fuel for sale to the general public*** for ultimate consumption." *See* 15 U.S.C. §2801 (7) (emphasis added).

Too often, federal courts have emphasized that definition while denying relief to operators who had entered into arrangements under which they retained considerable financial risk, but which arguably fell short of a classic franchise dealership agreement.

In *Karak v. Bursaw Oil Corp.* 147 F. Supp.2d 9 (D. Mass. 2001), the parties' supply agreement provided that the motor fuel stored in the station's tanks remained the property of the distributor until the operator withdrew the product for resale to the customer at a marked up price established by the distributor. The risk of loss, however, was borne by the operator. He was accountable for bad checks; for losses resulting from customers who drove away without paying; for accidentally spilled motor fuel; and for credit card chargebacks.

Even though the operator technically fulfilled the the PMPA's "retailer" definition because title to the motor fuel passed to him immediately before it was resold to the ultimate customer, the court denied him PMPA protection and dismissed his complaint, concluding that title had passed to the operator "substantially in name only."

It is difficult to accept the court's rationale. The parties' agreement repeatedly referred to the "purchase" of motor fuel by the operator, and undoubtedly the distributor structured the arrangement so that the operator – and not the distributor – bore direct responsibility as the seller of motor fuel to the ultimate customer. Further, the PMPA definition refers only to the purchase of motor fuel by a retailer; it says nothing about how long the retailer must retain ownership before resale occurs.

A recent New York state court decision reached a very different result. In *Issa v. Getty Petroleum Marketing, Inc.*, 2007 WL 4686539 (N.Y. Sup. 2007), the parties' Lease Commission Contract provided that the supplier retained title to the motor fuel and could establish the price at which it was sold to the motoring public, but also reserved to the supplier the right to deliver gasoline to the operator on a Cash-On-Delivery ("C.O.D.") basis or via electronic wire transfer of funds ("E.F.T."). Further, the operator was charged with the obligation to maintain all necessary licenses and permits and accepted legal responsibility for any losses resulting from shortages, or which were due to "drive off" and credit chargebacks.

The court rejected Getty's contention that, as a matter of law, the operator was not entitled to PMPA protection because legal title to the motor fuel remained with Getty, even if it required the dealer to pay on a C.O.D. or E.F.T. basis. The court instead looked at the totality of the parties' arrangement, and permitted the station operator to amend his complaint to assert a claim under the PMPA.

Reconciling the two decisions is not easy. It is true that the federal court in *Karak* was being asked to provide affirmative relief – issuance of a preliminary injunction – while the state court in *Issa* was only being requested to accept the filing of an amended claim. Nevertheless, the *Karak* court not only denied the injunction but dismissed the claim altogether, a total rejection of any entitlement to relief under the PMPA.

It may be significant that *Issa* was a state court decision, while *Karak* was decided by a federal court. On the whole, state courts appear more willing than federal courts to adopt a liberal stance in evaluating claims brought by small dealers against their suppliers.

It would have been very difficult for Getty to move the operator's claim out of state court. Getty could not seek to remove the case to federal court based on diversity jurisdiction because both it and the dealer were situated in the same state and, in any event, an in-state defendant may not remove a case to federal court even if the plaintiff is an out-of-state entity.

Alternatively, it would have been difficult for Getty to remove the case on the basis that the dealer had introduced a federal law claim by adding a count under the PMPA when, at the same time, Getty was arguing the PMPA claim was defective on its face.

Regardless, the fact remains that PMPA rights may be hazarded – if not entirely lost – when consignment elements are added to what had previously been a clear franchise relationship. Without PMPA rights, a dealer may find himself or herself terminated, non-renewed or otherwise consigned to oblivion.

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