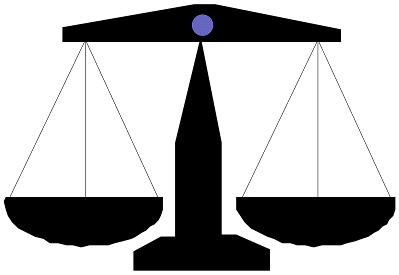

GENERAL COUNSEL CORNER

By Peter H. Gunst, Esquire

A Bitter Lesson

Some years ago, a pattern emerged in Petroleum Market Practices Act cases involving Chevron in California.

Chevron would make low-ball offers to buy out its more successful lessee dealers. If its offer was refused, Chevron would send in its flying squad of auditors to examine the dealer's books to see if it could make a case that the dealer was underreporting sales either to it or to the taxing authorities.

When that appeared to be the case, Chevron would send out a termination notice and file a federal declaratory judgment action seeking a determination that it had valid grounds for termination under the PMPA.

Sometimes Chevron succeeded and sometimes it did not.

A recent case, *Chevron USA, Inc. v. M&M Petroleum Services, Inc.,* 2009 WL 2431926 (C.D. Cal. 2009), appears to bear all the hallmarks of that *modus operandi.*

After acquiring in 1998 the Newport Beach location that it leased from Chevron, the dealer succeeded in increasing the station's gross revenues from less than $4,000,000 in 1998 to almost $7,400,000 in 2004. Its success attracted Chevron's attention.

In approximately 1999, Chevron offered to buy out the dealer so that it could convert the service station to company operation. It proposed a less than generous offer that did not even cover the price that the dealer had paid for the station almost two years earlier. Not surprisingly, the offer was rejected.

Thereafter, Chevron first attempted to terminate the dealer in March 2002. When the dealer protested, the dispute was sent to arbitration. Chevron lost, and the arbitrator prohibited it from terminating the dealer's franchise agreement and ordered it to enter into a successor agreement with the dealer.

During the course of arbitration, a Chevron representative admitted rather candidly Chevron's strategy. If it won the arbitration, it would "get the station for free." If it did not, the dealer would still be required to pay Chevron a significant rental based upon both its motor fuel sales and its automotive service bay ("ASB") sales.

In sum, if Chevron won it received a bonanza; if it lost it still did quite well, thank you.

Two months following its arbitration loss, Chevron tried again to get the station. This time, it filed a federal lawsuit in an attempt to terminate its franchise relationship with the dealer. It lost again, the court finding that Chevron's lawsuit was barred by the previous arbitration award won by the dealer.

Apparently out of frustration or as a means of retaliation, Chevron refused to pay the dealer's legal fees despite its written policy that, when it lost a termination dispute, it would pay the dealer's attorneys' fees.

In May 2007, Chevron sent in its auditor, who was charged to determine if the dealer had paid Chevron all rents due for the period from January 1, 2004 to December 31, 2006. With the assistance of the dealer's apparently disloyal bookkeeper, the auditor found internal work sheets indicating that the dealer had significantly underreported its ASB revenues to Chevron, with the result that Chevron had been short changed in its rent collections.

Chevron sued again in federal court to terminate the dealer's franchise. Its claim was eventually tried in July 2009 before a judge and not a jury.

In a lengthy opinion, the judge stated early on that he was "gravely concerned" about Chevron's "general practice" of attempting to convert successful lessee stations to company operation. He cited the statement made by Chevron's representative during the course of the old arbitration proceeding as demonstrating Chevron's long-held desire to take over the dealer's station. Unfortunately for the dealer, the court's opinion then assumed quite a different tenor.

Meticulously tracing the dealer's maintenance of double books; its attempt to conceal its internal accounting records from Chevron; and the dealer's dissimulations under oath about the station's business records, the court decided that Chevron had a more than ample basis for termination.

Ultimately, the court decided that the dealer would be required to abandon the station; pay Chevron a contempt sanction of $25,000 for concealing the station's records during the course of discovery; and pay Chevron's legal expenses, in an amount yet to be determined but undoubtedly significant.

The *M&M Petroleum Services* case teaches a bitter lesson. Even if a supplier's motivation for seeking termination is one of self-aggrandizement, courts will cut a dealer little or no slack if it finds that the dealer engaged in dishonest conduct over an extensive period of time.

Many refiners today no longer appear to share Chevron's interest in converting a lessee station – even a very profitable location – to company operation. Instead, they appear more interested in exiting from downstream distribution by selling off stations and assigning leases and supply agreements to distributors.

But the scenario that played out in *M&M Petroleum Services* case may still be with us. A distributor may be more keenly interested than a refiner in converting a successful leased location to company operation. The dealer runs a very real risk of losing its business if it does not live up to its rental and other commitments. As occurred in that case, a million dollar plus business could be lost in its entirety.

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