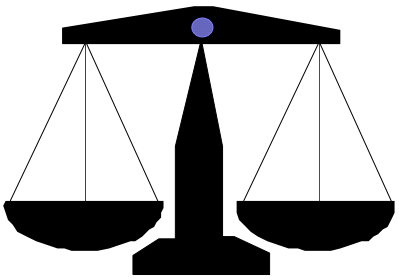

GENERAL COUNSEL CORNER

By Peter H. Gunst, Esquire

Arguments for State Right of First Refusal Legislation

Facing the plans of major refiners – especially ExxonMobil and Shell – to assign station leases and supply agreements to branded distributors, independent dealers have sought relief in several state legislatures to obtain a right of first refusal providing them an opportunity to purchase their stations.

The legislation that the dealers purpose generally follows the model of the ground-breaking California right-of-first-refusal law found in §20999.25(a) the California Business and Professions Code.

In arguing their case to state legislators, dealers point to the disastrous result of far too many previous assignments of franchise agreements to branded distributors: increased rents and uncompetitive pricing policies that have forced numerous dealers to turn in their keys.

Generally, legislators have sympathized with the dealers' contention that it is only fair that they – who have built up their businesses over many years or decades and now face the prospect of seeing their businesses destroyed – be given an opportunity to acquire their stations before they are turned over to branded distributors.

Opponents of the bills have raised several legal objections, which appear to be complete red herrings. Following are the principal legal objections opponents have raised along with brief rejoinders.

1. <u>Independent dealers already are fully protected by the PMPA.</u> **<u>NOT SO.</u>**

The purpose of state right-of-first-refusal laws is to plug a hole in the protections provided the federal Petroleum Marketing Practices Act ("PMPA"). 15 U.S.C. §§2801-2807.

The PMPA applies only when a dealer's franchise is ended through termination or nonrenewal, while the proposed state legislation is directed to situations where the franchisor intends to sell the service station premises to a third party and then assign (but not end) the dealer's franchise. The PMPA provides the dealer with no direct protection in that circumstance.

It is true that dealers occasionally have attempted to argue in court that the effects of a particular assignment would be so dire as to be tantamount to termination. Generally, however, courts have been unreceptive to such "construction termination" claims, concluding that the injuries feared by the dealers are too hypothetical to provide a basis for relief under the PMPA.

Dealers are told to come back to court only after they have been driven out of business, when they no longer possess the financial means to pursue expensive federal court litigation. Some remedy!

Moreover, assigning refiners have argued that ***all*** claims of constructive termination are barred by the PMPA's

termination or nonrenewal requirement. Indeed, Shell is presently pursuing a petition to the Supreme Court seeking a determination that the PMPA includes no remedy whatsoever for constructive termination. It is two-faced for them to argue that dealers are fully protected by the PMPA.

2. The proposed legislation is preempted by the PMPA. **NOT SO.**

One of the attacks commonly launched against state legislation intended to protect independent dealers is that the entire field is preempted by federal legislation, the PMPA. The argument runs that – as a matter of law – proposed state legislation like the right-of-first-refusal bills improperly interferes with the operation of superseding federal legislation.

Upholding the California right-of-first-refusal law and rejecting just such a preemption argument, a California state appeals court recognized the valid and independent purpose of the California law. *Forty-Niner Truck Plaza, Inc v. Union Oil Co.,* 58 Cal. App. 4th 1361 (1997).

In so ruling, the California court emphasized that the state statute "foreclose[s] a franchisor from impermissibly using an assignment … to skirt the termination or nonrenewal requirements of the PMPA." 58 Cal. App. 4th 1274-75.

The California law, the court said, is not preempted because its reach is limited to instances where a dealer's lease and supply agreement is merely assigned to a third party, and does not address instances where a supplier expressly terminates or nonrenews a dealer's franchise.

Indeed, the reason why major oil companies like ExxonMobil and Shell are utilizing the assignment device is to ***avoid*** the protections against termination and nonrenewal conferred upon dealers by the PMPA. Once again, it is two-faced for the oil companies to argue that right-of-first-refusal provisions are preempted by the PMPA, even while they structure their assignments to eliminate dealers' PMPA rights.

Moreover, the PMPA contains an express preemption provision which refers ***only*** to termination or nonrenewal of the franchise relationship, and ***not*** to assignment. *See* 15 U.S.C. §2806(a). Rather, the PMPA expressly leaves issues of the validity of assignment to state and not federal law. *See* 15 U.S.C. §2806(b).

3. The proposed legislation constitutes an illegal impairment of contract. **NOT SO.**

In the *Forty-Niner Truck Plaza* case, the California appeals court also rejected the argument that the California statute constituted an unconstitutional taking of the franchisor's property rights because it conditioned the supplier's contractual right of assignment upon offering the dealer a right of first refusal.

The court held that the California legislature properly enacted the law because it "substantially advances a legitimate state interest" in that "[i]t facilitates the purchase of retail service stations by their independent lessee-franchisee in contexts outside franchise termination or nonrenewal, thereby ensuring the motoring public access to

service and furthering a more dynamic and full-service oriented retailing atmosphere." 58 Cal. App. 4th at 1273.

Also significant is a decision of Maryland's highest court upholding the constitutionality of state legislation in an analogous context, which decision was subsequently affirmed by the United States Supreme Court. *Governor of Maryland v. Exxon Corp*., 279 Md. 410 (1977), *affirmed,* 437 U.S. 117 (1978).

In the Maryland case, the courts rejected the oil companies' argument that an act prohibiting major oil companies from opening or operating retail service stations with company personnel imposed an unconstitutional burden on the oil companies.

In reaching that conclusion, Maryland's highest court noted that oil companies were not deprived of "all beneficial uses" of their properties. Likewise, merely requiring that a right of first refusal be provided to independent dealers does not deprive an oil company of "all beneficial uses" of a service station property.

pgunst@agtlawyers.com

To access the latest articles by the Service Station Dealer's legal counsel, please visit the "Service Station Dealers: Legal Issues" section of the Astrachan Gunst & Thomas P.C. website at: http://www.agtlawyers.com/resources/petroleum.html.