GENERAL COUNSEL CORNER

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New Legislation, Old Litigation Strategy

In 2005, Congress passed the Energy Policy Act, establishing a national renewable fuel program. It subsequently amended the Act through the Energy Independence and Security Act of 2007. Yes, Congress actually managed to pass two bills despite its normal condition of gridlock.

In legislating a national renewable fuel program based upon blending ethanol with gasoline, Congress used a carrot-and-stick approach directed toward refiners, importers and blenders. Each year, the Environmental Protection Agency is to determine what percentage of transportation fuel must be renewable fuel. Then, each obligated party is responsible for meeting that percentage. That is the stick.

Congress' carrot was its separate enactment of a considerable excise tax credit amounting to between forty-five cents and fifty one cents for each gallon of gasoline blended with ethanol.

In 2008, North Carolina passed its own Ethanol Blending Statute, which was intended to ensure that the state's distributors and retailers would have on opportunity to participate in the blending process, and thereby secure the benefit of the generous tax break.

First, the North Carolina law required that suppliers who imported gasoline into the state give local distributors and retailers the option of purchasing gasoline that was not preblended.

Second, the statute barred insertion of any provision in a supply contract that would prevent a distributor or retailer from blending gasoline or from qualifying for a resulting tax break.

In sum, the statute required suppliers to give distributors and retailers the option to buy and blend unblended gasoline.

Two national trade associations that represent suppliers and refiners – the American Petroleum Institute and the National Petrochemical and Refiners Association – sued North Carolina in federal court in *American Petroleum Institute v. Cooper*. They contended that the North Carolina statute wrongfully infringed upon a supposed monopoly given by Congress to the associations' members to blend ethanol into gasoline and to secure the resultant tax credit.

The method chosen by the associations to attack the North Carolina law was nothing new. They argued that the state law was preempted by federal law because it impermissibly interfered with federal regulatory schemes.

Such preemption arguments are commonplace, and repeatedly have been used as a means of attacking innovative state programs.

On their motions for summary judgment, the associations first argued that the North Carolina statute impermissibly interfered with the federal renewable fuel program by diluting the supposed monopoly given to refiners to accomplish Congress' renewable fuel goals.

Rejecting the associations' argument as characterizing Congress' objectives "too narrowly," the court refused to find that any monopoly had been granted to refiners for the production of renewable fuel. Rather, Congress' intent was to further the production of renewable fuel regardless of who did the blending.

The court concluded that --

> the "flexibility" that the renewable fuel program envisions is manifestly *not* the flexibility of refiners to develop a system where they blend all of their gasoline with ethanol and sell only blended gasoline to distributors. … [T]he federal renewable fuel program does not contemplate the monopoly the plaintiffs are seeking, and plaintiffs have not shown that the [North Carolina law] will interfere with Congress's objective to increase production of renewable fuel.

Next, the associations contended that the North Carolina statute was preempted because it interfered with the refiners' federal trademark right to control the quality of products bearing their trademarks. They argued that the state law destroyed the refiners' trademark right because it authorized distributors and retailers to produce blended gasoline without the refiners' consent or oversight.

Rejecting that argument, the federal court emphasized that the North Carolina law only provided distributors and retailers the opportunity to participate in the blending process and to qualify for resultant tax credit, and did not interfere with the refiners' right "to engage in quality control over the blending of their trademarked gasoline."

Lastly, the associations argued that the North Carolina law interfered with the operation of the Petroleum Marketing Practices Act because it restricted the refiners' right to terminate or nonrenew franchise agreements for unauthorized blending. Any state statute that interfered with a refiner's right to terminate or nonrenew a franchise agreement should be preempted, the associations argued, because questions of termination and nonrenewal fall within the exclusive domain of the federal statute.

Once again the federal court disagreed. It emphasized that §2801(13)(C) of the PMPA expressly excludes as a basis for termination or nonrenewal "any failure based on a provision of the franchise which is illegal or unenforceable under the law of any State." Thus, the PMPA expressly recognizes the efficacy of state statutes, such as the North Carolina law, to provide "safe harbors" for franchisees against grounds for termination or nonrenewal.

If all of this sounds technical and legalistic, it is. But it is important because of the important role that state legislatures may play in protecting the interests of local dealers and distributors in the face of a changing petroleum industry.

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