PUBLICATION

High Court Solidifies Rights of Franchisors under the Petroleum Marketing Practices Act

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The Petroleum Marketing Practices Act (PMPA) governs the circumstances under which a franchisor can terminate or fail to renew a service station franchise. In the recent U.S. Supreme Court case of *Mac's Shell Service, Inc. v. Shell Oil Products*, decided March 2, 2010, the court limited the application of the PMPA to claims for actual franchise termination or nonrenewal. Through this decision, the court gave clear direction that state law governs the everyday affairs between franchisors and franchisees, and not every dispute will give rise to a claim under the PMPA. The court held that a franchisee who is offered and signs a renewal franchise agreement cannot maintain a claim for unlawful nonrenewal under the PMPA.

In *Mac's Shell Service*, several service station franchisees filed suit against Shell Oil Products alleging that Shell constructively "terminated" and constructively "failed to renew" their franchise relationships by making substantial changes to certain economic elements of the agreements under which the franchises operated for several years, to the detriment of the franchisees. Even though these franchisees remained in operation, were not forced to abandon their franchises and accepted new agreements with Shell, they argued that material changes to their agreements constituted a "termination" of the franchise relationship. The court reasoned that the PMPA had a very limited scope, and by enacting the statute, Congress did not intend to regulate all aspects of the franchise relationship. Instead, it sought to federalize only the circumstances in which a franchisor could terminate or decline to renew a franchise relationship. All other disputes between franchisors and franchisees remain a matter of state law.

The court found that in order to maintain a claim for constructive termination under the PMPA, a franchisee must show that "the complained-of conduct forced an end to the franchisee's use of the franchisor's trademark, purchase of the franchisor's fuel, or occupation of the franchisor's service station. Because none of the dealers in this litigation abandoned any element of their franchise operations in response to [the franchisor's] elimination of a rent subsidy, they cannot maintain a claim for constructive termination on the basis of that conduct."

Had the court not applied this narrow interpretation of the PMPA, it would have effectively required the court to "articulate a standard for identifying those breaches of contract that should be treated as effectively ending a franchise, even though the franchisee in fact continues to use the franchisor's trademark, purchase the franchisor's fuel, and occupy the service station premises." The court further explained, "How is a court to determine whether a breach is serious enough to effectively end a franchise when the franchisee is still willing and able to continue its operations? And how is a franchisor to know in advance which breaches a court will later determine to have been so serious?... Any standard for identifying when a simple breach of contract amounts to a PMPA termination, when all three statutory elements remain operational, simply evades coherent formulation."

The franchisees argued that a narrow interpretation of the PMPA fails to provide them with much needed protection from unfair and coercive franchisor conduct that does not force an end to the franchise. However, the court found that this argument ignores the state law remedies available to the affected franchisee. The franchisee can still rely on state law remedies to address wrongful franchisor conduct that does not have the effect of ending the franchise.

While the Supreme Court's decision in Mac's Shell Service is limited in its application to the PMPA, does it offer any guidance on similar questions under state franchise/dealer relationship laws? The ruling is arguably at odds with liberal judicial interpretations of several states' franchise relationship laws. Several states, including New Jersey, Rhode Island, Wisconsin and Iowa, have passed franchise relationship legislation that prohibits a franchisor from either terminating or refusing to renew franchise agreements without "good cause." The Wisconsin Fair Dealership Law (WFDL) imposes a good cause standard on any actions that constitute a "substantial change in competitive circumstances." Courts have noted that the language of the WFDL specifically requires that the statute is to be construed liberally in order to protect dealers against the unfair treatment of grantors "who inherently have superior economic power and superior bargaining power in the negotiation of dealerships." Wisconsin courts have ruled that the protections found within the WFDL extend to constructive or "de facto" terminations and that the substantial changes in competitive circumstances include economic duress and threats, whether the franchisor or grantor acted on those threats or not.

In *JPM, Inc. v. John Deere Industrial Equipment Co*., the grantor, John Deere Industrial Equipment, threatened to terminate JPM's franchise if it did not sell the franchise to a particular entity. JPM sold as instructed by John Deere and subsequently instituted an action against John Deere, alleging that the franchise was constructively terminated in violation of WFDL as a result of its threats to terminate. John Deere argued that the franchise was terminated as a result of JPM's actions in selling the franchise and that the franchise was not constructively terminated. The court disagreed and ruled that the franchisor's threats amounted to constructive termination of the dealership agreement. The court further ruled that allowing grantors to threaten dealers with termination in order to achieve their goals would "inhibit the law's purpose of ensuring dealers fair treatment." It did not matter, the court concluded, that the grantors had not yet carried out their threats. The very existence of the threats and their adverse effect on the dealers were enough to make the threats sufficiently completed actions.

New Jersey also considers the bargaining positions of franchisors and franchisees as unequal and affords similar protections to franchisees under the New Jersey Franchise Practices Act. In *Maintainco, Inc. v. Mitsubishi Caterpillar Forklift America, Inc*., decided July 30, 2009, the New Jersey Superior Court decided that a manufacturer violated the New Jersey Franchise Practices Act by constructively terminating a dealer protected by the NJFPA without good cause, even though the franchise was never terminated. The NJFPA provides that it is unlawful "for a franchisor directly or indirectly through any officer, agent, or employee to terminate, cancel or fail to renew a franchise without good cause." It further defines "good cause" as a "failure by the franchisee to substantially comply with those requirements imposed on him by the franchise", and requires that the franchisor not impose "unreasonable standards of performance" on the franchisee.

In *Maintainco*, the dealer and franchisor signed a contract wherein the dealer became Mitsubishi's exclusive dealer in Connecticut. Mitsubishi later entered into a joint venture with Caterpillar, and the dealer believed the franchisor gave the Caterpillar brand certain marketing advantages. As a result, the dealer also began selling Toyota forklifts, and the franchisor responded by giving the dealer incentives to focus on sales of the Mitsubishi line. The franchisor's representative later sent a letter to the dealer indicating that he perceived a "lack of long term commitment" to Mitsubishi and that he intended to ask the franchisor to begin searching for another dealer to represent Mitsubishi products in Northern New Jersey. The dealer responded that it would not accept termination or any other action to undermine its market share and profits. The franchisor later appointed a second dealer in the dealer's area of primary responsibility, and invited customers to use the second dealer for all of their needs.

In response to the dealer's lawsuit, the franchisor argued that the NJFPA prohibits only actual terminations of a franchise. Therefore, because the dealer was never terminated, there was no violation of the Act. The court disagreed, and found that "termination" under the NJFPA includes constructive termination in accordance with traditional contract law principles. The court reasoned that "[t]o conclude otherwise would undercut the

remedial purposes of the Act by allowing a franchisor to engage in such blatant attempts to "ditch", or constructively terminate, a franchisee, but escape liability under the Act because it did not entirely succeed." In this case, considering whether the loss of exclusivity, in and of itself, qualifies as a constructive termination, the court held that for a franchisee that actually enjoys a contractual right of exclusivity, the franchisor's offer to renew only if the franchisee agrees to become a non-exclusive dealer is tantamount to termination or failure to renew the agreement.

While the leading constructive termination cases under state franchise relationship laws offer limited guidance as to what franchisor conduct amounts to constructive termination as a matter of law, *Mac's Shell Service* arguably stands for an outer limit on this rubric, at least in the context of renewal franchise agreements. A franchisee cannot expect much sympathy regarding its inability to bargain at arms' length from a court if it elects to continue its affiliation under the terms of a renewal franchise agreement. Assuming such terms are the same as those offered to all other prospective franchisees and the expiring franchisee is not singled out for less favorable terms, there is no distinction between the franchise relationship and the space lease with a limited term and no renewal options. If the franchisee wants to continue operating the same business in the same location, it must accept the new economic realities and weigh moving the business and changing the business' name against renewal under a new contract and lease terms. In either case, the franchisee did not bargain for or receive a right to renew under its existing contract. To argue otherwise is contrary to long-standing public policy that disfavors agreements in perpetuity that do not allow either party to terminate or opt not to renew in its discretion absent one party's express and unequivocal decision to forego those rights.

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