ABA SECTION OF ANTITRUST LAW

DISTRIBUTION

THE NEWSLETTER OF THE DISTRIBUTION AND FRANCHISING COMMITTEE

Antitrust Section — American Bar Association
Vol. 13, No. 3 — April 2010

IN THIS ISSUE

The Supreme Court Rejects Claims For Constructive Termination and Constructive Nonrenewal Under the PMPA Where Service Station Franchisees Continued to Operate

by James C. McGrath and Shuan Lue, Bingham McCutchen LLP

On March 2, 2010, the United States Supreme Court delivered an opinion addressing two questions arising under the Petroleum Marketing Practices Act,[1] ("PMPA" or "the Act") presented in cross-appeals from the First Circuit's decision in *Mac's Shell Service, Inc. v. Shell Oil Products Co. LLC.*[2] At issue was: (1) whether a service station franchisee could sue under the PMPA for - "constructive termination" where the franchisee had not abandoned its franchise; and (2) whether a franchisee could sue under the PMPA for "constructive nonrenewal" where it had executed a renewal franchise agreement "under protest." In an unusual unanimous ruling, authored by Justice Alito, the Court held that the PMPA did not allow recovery for constructive termination where the franchisor's allegedly wrongful conduct did not compel the franchisee to abandon the franchise. The Court also held that a franchisee who accepts a renewal agreement – even under protest – could not maintain a claim for constructive nonrenewal under the PMPA. The Antitrust Division of the United States Department of Justice, as an amicus, had supported this result. Because the franchisees in this case had continued operating their businesses, the Court declined to reach the question of whether the PMPA recognizes claims for constructive termination or constructive nonrenewal under any other circumstances.

I. Background

The case arrived at the Supreme Court after the First Circuit affirmed a jury verdict from the District of Massachusetts awarding a group of franchisees damages on claims of constructive termination, but reversed the jury's verdict on the claims of other franchisees for constructive nonrenewal.[3] The litigation arose out of a dispute between Shell Oil Company and Shell Oil Products Company (collectively, "Shell") and eight independent Shell service station franchisees ("franchisees" or "dealers"). Under the franchise agreements, the dealers were required to pay Shell a monthly "contract rent" for the lease of the service station property.[4] For many years, Shell had offered a program that reduced a dealer's contract rent based on its

---

[1] 15 U.S.C. § 2801 *et seq.*

[2] No. 08-240, 2010 U.S. LEXIS 2203 (Mar. 2, 2010).

[3] 524 F.3d 33 (1st Cir. 2008). The First Circuit decision is discussed at length in James C. McGrath, *When Do Service Station Franchises Run Out of Gas: The Supreme Court Considers Whether the Petroleum Marketing Practices Act Permits Claims for Constructive Termination and Constructive Nonrenewal*, 13(2) DISTRIBUTION, Distribution and Franchising Committee, ABA Section of Antitrust Law (December 2009).

[4] 524 F.3d. at 37-38.

volume of gasoline sales.[5] Although the written program terms provided for its cancellation on thirty days' notice, the dealers claimed that Shell made various oral representations that the program or a similar substitute would always be available.[6]

In 1998, Shell and Texaco formed Motiva, a joint venture that combined their petroleum refining and marketing operations in the eastern United States.[7] Shell assigned its existing franchise agreements to Motiva, which then notified the franchisees that the Shell volume-based rent program would be discontinued.[8] As each dealer's franchise agreement expired, Motiva offered a renewal agreement that calculated rent using a different formula.[9] The new method of calculation resulted in higher rents for some of the dealers.[10]

Unhappy with these changes, the dealers[11] filed suit against Shell and Motiva in the District of Massachusetts, alleging breach of contract under state law and two claims under the PMPA.[12] First, they claimed that the discontinuance of the volume-based rent program amounted to the "constructive termination" of their franchise agreements.[13] Second, the dealers claimed that the offer of new franchise agreements that calculated rent in a different manner amounted to the "constructive nonrenewal" of the franchise relationship.[14] In spite of advancing these theories, however, four of the dealers continued operating through the time of trial almost five years after the elimination of the rent program, paying the "contract rent" in their franchise agreements.[15] Three others continued operating through the expiration of their existing franchise agreements and then signed renewal agreements "under protest" that incorporated the new rent formula.[16] The remaining dealer voluntarily abandoned the service station business for other reasons.[17]

After the jury found against the defendants on all claims, Shell and Motiva moved for judgment as a matter of law, arguing that the PMPA required an actual cessation of the franchise or franchise relationship to support a claim for termination or nonrenewal.[18] The district court

---

[5] *Id.*

[6] *Id.* at 38.

[7] *Id.* at 37.

[8] *Id.*. at 37-38.

[9] *Id.* at 38.

[10] *Mac's Shell*, 2010 U.S. LEXIS 2203, at *10.

[11] Originally, 63 dealers filed suit against Shell and Motiva. The district court selected eight plaintiffs to proceed to trial first.

[12] Enacted in 1978, the PMPA limits the circumstances in which petroleum franchisors may "terminate" or "fail to renew" a franchise relationship.

[13] *Mac's Shell*, 2010 U.S. LEXIS 2203, at *10.

[14] *Id.*

[15] *See* Brief of Shell and Motiva at 10.

[16] *Id.* at 10-11.

[17] *Id.* at 11.

[18] *Mac's Shell*, 2010 U.S. LEXIS 2203, at *11.

denied the motion.[19] On appeal, the First Circuit affirmed the judgment on the constructive termination claims, holding that a franchisee was not required to abandon its franchise to recover for constructive termination under the PMPA.[20] Rather, the court held, a breach of contract by the assignee of a franchise agreement could amount to constructive termination under the PMPA if the breach resulted in "such a material change that it effectively ended the lease."[21] The First Circuit, however, vacated the judgment on the constructive nonrenewal claim, holding that a franchisee could not maintain such a claim under the PMPA where the franchisee had signed and operated under the new agreement.[22] The parties cross-appealed from the First Circuit's decision, and the Supreme Court granted certiorari.

II. Constructive Termination

The Supreme Court first addressed the issue of whether a dealer could recover for constructive termination under the PMPA when the franchisor's allegedly wrongful conduct did not force the dealer to abandon the franchise. Agreeing with Shell and Motiva, the Court held that "a necessary element of any constructive termination claim under the PMPA is that the complained-of conduct forced an end to the [franchise]."[23]

The Court began by considering the meaning of the text of the PMPA, which allows a franchisor to "terminate" a franchise only under certain conditions.[24] Although the Act specifies that "'termination' includes cancellation,"[25] it does not further define either term. The Court reasoned that the ordinary meanings of those terms meant to "put an end to" and to "annul or destroy," and therefore concluded that "the Act is violated if an agreement for the use of a trademark, purchase of motor fuel, or lease of a premises is 'put [to] an end' or 'annul[ed] or destroy[ed].'"[26] In contrast, the Court concluded that "[c]onduct that does not force an end to the franchise…is not prohibited by the Act's plain terms."[27]

The Court noted that such a result was consistent with the doctrine of constructive termination in analogous legal contexts, such as employment and landlord-tenant, where a plaintiff must actually end a legal relationship in order to maintain a claim for constructive termination.[28] Absent any indication to the contrary, the Court found no reason to apply a different understanding to potential constructive termination claims brought under the PMPA.

Furthermore, the Court reasoned that allowing relief under the PMPA for conduct that did not force an end to the franchise relationship would unduly extend the

---

[19] *Marcoux v. Shell Oil Products Co., Inc.*, 2005 WL 2323181 (Sept. 19, 2005).

[20] *Mac's Shell*, 2010 U.S. LEXIS 2203, at *11-12.

[21] 524 F.3d at 46.

[22] *Mac's Shell*, 2010 U.S. LEXIS 2203, at *12.

[23] *Id.* at *27.

[24] 15 U.S.C. § 2802(a)-(b).

[25] 15 U.S.C. § 2801(17).

[26] Mac's Shell, 2010 U.S. LEXIS 2203, at *14.

[27] *Id.* at *14-15.

[28] *Id.* at *16-18.

reach of the Act. Prior to 1978, the regulation of petroleum franchise agreements was primarily governed by state law. When Congress enacted the PMPA, it purposefully addressed only the circumstances under which termination and nonrenewal could occur; leaving the continued regulation of other areas of the relationship between petroleum franchisors and franchisees remained to the realm of state law.[29] As such, the Court stated that "[r]eading the Act to prohibit simple breaches of contract…would be inconsistent with the Act's limited purpose and would further expand federal law into a domain traditionally reserved for the States."[30] Finally, the Court also expressed concern that articulating a standard to identify those breaches of contract that should be treated as effectively ending a franchise under the PMPA would be "indeterminate and unworkable."[31]

In response to the dealers' contention that the Court's interpretation of the PMPA failed to protect franchisees from coercive franchisor conduct that fell short of actually ending a franchise, the Court reiterated that state law remedies were still available.[32] Nor did it agree that this reading of the PMPA rendered other provisions of the Act meaningless. For example, the Court disagreed with the dealers' argument that the Court's interpretation would require franchisees to go out of business before obtaining preliminary relief, thus rendering the PMPA's preliminary injunction component meaningless. Although a dealer must show that its franchise has been "terminated" in order to obtain preliminary relief, that did not necessarily mean that a franchisee had to go out of business before doing so. Rather, a dealer that receives notice of impending termination can seek preliminary injunction under the Act well in advance of having to abandon its business.[33] Furthermore, the Court's interpretation was also consistent with the PMPA's statute-of-limitations period, which runs from the later of either (1) "the date of termination of the franchise" or (2) "the date the franchisor fails to comply with the requirements of" the Act.[34] Because some violations of the PMPA cannot occur until after termination,[35] the Court reasoned that the second accrual date reflected only that the limitations period ran from the date of these post-termination violations, not that Congress intended the Act to apply to franchisor conduct that did not end the franchise.[36] For all of these reasons, the Court held that, to the extent the PMPA recognized a claim for constructive termination at all, such a claim required an actual cessation of the franchisee's operations or, in the case of preliminary injunctive relief, the imminent threat of such a result.

---

[29] *Id.* at *20.

[30] *Id.* at *21.

[31] *Id.* at *22.

[32] *Id.* at *23.

[33] *Id.* at *25.

[34] 15 U.S.C. § 2805(a).

[35] For example, a franchisor must share with a dealer certain parts of a condemnation award when the termination was the result of a condemnation or taking. 15 U.S.C. § 2802(d)(1).

[36] *Mac's Shell*, 2010 U.S. LEXIS 2203, at *27.

III. Constructive Nonrenewal

The Supreme Court then turned to the issue of whether the PMPA allows a dealer who signed a renewal agreement under protest to maintain a claim for constructive nonrenewal. For reasons similar to those advanced in its holding regarding constructive termination, the Court concluded that "a franchisee that chooses to accept a renewal agreement cannot thereafter assert a claim for unlawful nonrenewal under the Act." [37]

The Court first looked to the plain text of the statute, noting that the PMPA is violated only when a franchisor "fail[s] to renew" a franchise relationship for a reason not enumerated in the Act or by failing to provide proper notice.[38] Under the PMPA, "fail to renew" is defined as a "failure to reinstate, continue, or extend the franchise relationship."[39] Therefore, "the threshold requirement of any unlawful nonrenewal action…is that the franchisor did not 'reinstate, continue, or renew' the franchise relationship once a franchise agreement expired."[40] Once a dealer signs a renewal agreement, the franchisor has clearly "reinstate[d], continue[d], or extend[ed]" the franchise relationship, even if the dealer objects to some of the terms in the renewal agreement.[41] Since the PMPA prohibits only unlawful "fail[ures] to renew" and allows such renewals to be on different terms, a dealer that signs a renewal agreement "cannot carry the threshold burden of showing a 'nonrenewal of the franchise relationship'…and thus necessarily cannot establish that the franchisor has violated the Act."[42]

The dealers argued that they preserved their right to assert a claim for unlawful nonrenewal under the PMPA because they signed their renewal agreements "under protest." The Court rejected this argument, noting that the dealers misunderstood the legal significance of signing a renewal agreement. Signing a renewal agreement did not constitute a waiver of a dealer's legal rights, a situation that signing "under protest" could sometimes avoid; "[i]nstead, signing a renewal agreement negates the very possibility of a violation of the PMPA. When a franchisee signs a renewal agreement - even 'under protest' - there has been no 'fail[ure] to renew,' and thus the franchisee has no cause of action under the Act."[43]

The Court noted that this interpretation was buttressed by the PMPA's structure and purpose. The PMPA allows franchisors to respond to market conditions by proposing new terms at the expiration of a franchise agreement.[44] Specifically, the Act only requires franchisors to renew the "franchise relationship"[45] – as opposed to the same franchise agreement – thereby permitting franchisors to decline to renew the relationship if the dealer refuses to accept modifications proposed "in good faith and in the normal course of business" and are not for the purpose of converting the

---

[37] *Id.* at *29.

[38] 15 U.S.C. § 2802.

[39] 15 U.S.C. § 2801(14).

[40] Mac's Shell, 2010 U.S. LEXIS 2203, at *30.

[41] *Id.*

[42] *Id.*

[43] *Id.* at 31.

[44] *Id.*

[45] *See* 15 U.S.C. § 2802.

premises into a company-owned store.[46] Further, the PMPA provides a procedural mechanism for resolving disputes over proposed modifications because the franchisor must provide the dealer with written notice of any modifications well in advance of the date the nonrenewal becomes effective.[47] Once the dealer receives the notice, it can seek a preliminary injunction to preserve the franchise relationship while the dispute is resolved. Allowing dealers to pursue nonrenewal claims even after signing renewal agreements, the Court reasoned, would undermine this procedural mechanism because a dealer could simply sign the new agreement and decide later whether to bring a claim under the PMPA. Since the PMPA has a one-year statute of limitations for bringing such claims,[49] this would "cast a cloud of uncertainty over all renewal agreements and could chill franchisors from proposing new terms in response to changing market conditions and consumer needs."[50]

Finally, as in its discussion of constructive termination, the Court found that allowing a dealer who has signed a renewal agreement to bring a claim for nonrenewal would expand the reach of the PMPA beyond its language and legislative intent. Under the balance struck by Congress, a dealer who decides to reject the proposed new terms runs the risk that the franchisor will seek nonrenewal and that a court will ultimately find that the proposed terms were lawful.[51] According to the Court, this risk "acts as a restraint, limiting the scope of franchisor liability under the Act to that with which Congress was most concerned: the imposition of arbitrary and unreasonable new terms on a franchisee that are designed to force an end to the petroleum franchise relationship."[52] Allowing dealers to sign a renewal agreement and then bring a claim under the PMPA would eliminate that restraint, permitting dealers to challenge a broader range of franchisor conduct than the Act was intended to address.[53]

IV. Conclusion

Initially, it is important to recognize that the Court assumed but did not decide whether a dealer could in fact assert claims for constructive termination or constructive renewal at all under the PMPA.[54] Ultimately, the Court held that even if such claims existed, the ones at issue in this case failed because the dealers had not abandoned their franchises and had signed offers for renewal. Therefore, the Court did not decide whether a claim for constructive termination would be available in a scenario where, even though a franchisor did not issue a notice of termination, the dealer actually abandoned the franchise due to the franchisor's conduct and then claimed that this conduct violated the PMPA. The Court also did not decide whether a dealer could maintain a claim for constructive nonrenewal where the dealer rejects the modified terms

---

[46] 15 U.S.C. § 2802(b)(3)(A).

[47] 15 U.S.C. § 2804(a)(2).

[48] 15 U.S.C. § 2805(b).

[49] 15 U.S.C. § 2805(a).

[50] *Mac's Shell*, 2010 U.S. LEXIS 2203, at *34.

[51] *Id.* at *34-35.

[52] *Id.* at *35.

[53] *Id.*

[54] *Id.* at *13 n.4, *29 n.11.

but the franchisor does not give notice of nonrenewal despite the impending expiration of the franchise agreement. The Court, however, recognized the possibility that a franchisor could fail to renew a franchise relationship without providing notice, and suggested that in that circumstance "a franchisee would not only have a surefire claim for unlawful nonrenewal…but also presumably could seek a preliminary injunction forcing the franchisor to resume providing the franchise elements for the duration of the litigation."[55]

One consequence of the Court's decision is that the Act's lenient injunction standard,[56] as well as mandatory fee awards and potential for punitive damages,[57] will no longer be available in situations where a franchisor's conduct has not forced an end to the franchise relationship or where a dealer signs a nonrenewal agreement even while objecting to its terms. In addition, dealers will have to choose between abandoning the franchise or not renewing the agreement in order to assert a claim under the PMPA on the one hand, or seeking remedies under state law instead. However, such a calculation is simply an attendant risk of doing business.

Although the Court ruled against the dealers on both the constructive termination and constructive nonrenewal claims, franchisees retain all of the available remedies under state law. Indeed, the jury's award of $1.3 million for the dealers' breach of contract claims in the instant case (an award that was not before the Supreme Court) demonstrates that franchisees have meaningful protection under state law against franchisor misconduct.[58]

---

[55] *Id.* at *33 n.12.

[56] 15 U.S.C. § 2805(b).

[57] 15 U.S.C. § 2805(d).

[58] Brief of Shell and Motiva at 15 n.13.