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Law Office of Carroll Gilbert & Bachor

CGB LawLetter

Important Information and Advice For Gasoline Retailers

Special Interest

- *Shell is "not obligated to price its gasoline with their interests in mind or to protect them from competition."*
- *73% to 80% of other dealers in Houston were paying rack or lower.*
- *UCC doesn't require its DTW to be competitive, only that it be applied uniformly to all and within the DTW range charged by other refiners, making it "commercially reasonable."*
- *Texas Supreme Court decisions have no direct effect in California, but the oil companies will certainly point to it*

Texas Supreme Court Rejects Shell Dealer Class Action Claims Against Equilon

Texas
PRICING CLASS ACTION KILLED

More than 400 dealers in 17 states filed a class action against Equilon over four years ago. They saw their case dismissed by the Texas trial court, then resurrected by the state appeals court, and now killed by the Texas Supreme Court.

The Texas Supremes ruled that while Shell dealers may have to pay more for fuel than other retailers, the major is "not obligated to price its gasoline with their interests in mind or to protect them from competition."

Shell Oil et al v. HRN Inc et al, arose out of the Shell-Texaco merger in 1998 and was based on dealers' claim that Shell had violated the Uniform Commercial Code by setting its DTW prices so high that they couldn't compete with the 73% to 80% of other dealers in Houston who were paying rack or lower.

The dealer attorneys claimed that Equilon used "illegal, strong-armed business practices," to drive Shell and Equilon dealers out of business so it could replace them with more profitable company-ops.

At the heart of the case was the argument that the Uniform Commercial Code requires that where a supplier unilaterally sets prices, they must price in good faith.

Dealers also claimed that Equilon raised DTWs if they failed to lower posted prices, broke oral promises about rents, wouldn't let them buy cheaper product from jobbers, and required them to install only Shell island card readers, all designed to run the dealers into the ground.

Shell claimed that if retailers lost money or went out of business, it was due to hypermarts, that there was no evidence its DTW pricing caused dealers to fail and even if there were, the retailers would have no case because UCC doesn't require its DTW to be competitive, only that it be applied uniformly to all and within the DTW range charged by other refiners, making it "commercially reasonable."

Dealer's hopes had earlier been raised by the Court of Appeals in Houston, when it ruled that the dealers were "captive buyers" and that inferences could be drawn from some circumstantial evidence the dealers had presented about how Shell arrived at DTW prices, but the latest ruling dashed those hopes.

The rulings of the Texas Supreme Court have no direct effect on cases in California, but the oil companies, in responding to California UCC cases, will certainly point to the Texas Supreme Court's ruling to argue that if a price was commercially

- *If the Oil Company price was commercially reasonable and non-discriminatory, the intent behind it is immaterial.*
- *Shell & Texaco replacement franchise agreements made in good faith and in normal course of business, and not for purpose of precipitating franchise terminations by Equilon*
- *if the dealers are "captive," it is as a result of their own choice to become Shell-branded lessees*

reasonable and non-discriminatory, the intent behind it is immaterial. The opinion argues that, if these dealers were charged the same DTW price by another refiner who did not have a similar plan to thin their ranks, presumably the price would pass muster under the dealers' view of the law.

The Supreme Court also criticized the Appeals Court for using a wholesale cost analysis that compared Shell's DTW price to prices available to other classes of trade, which it found was not evidence of bad faith.

Adding insult to injury, the Supremes added a parting dig that if the dealers are "captive," it is as a result of their own choice to become Shell-branded lessees!

What does This Mean For California?

UCC Good Faith Pricing:

We last covered the issue of pricing in issue 220 of the CGB Lawletter. California Business and Professions Code section 2305 requires a supplier to set a price in "good faith" where the original supply contract leaves the matter of price open. In other words, your supply contract probably requires you to pay your franchisor's "posted" DTW price. This means the supplier must act in a "commercially reasonable" manner.

The Texas decision in *Shell Oil et al v.* HRN *Inc et al* addresses two elements of the California law: "good faith" and "commercially reasonable."

There are a few previously reported cases applying the UCC to the petroleum industry. The most notable is a 1985 California Supreme Court decision, *E.S. Bills, Inc. v. Tzucanow* 215 Cal.Rptr. 278. The court there held that the following factors are relevant in determining whether a motor fuel supplier was charging a "commercially reasonable" price:

(a) Retail prices charged by the supplier at its own stations;

(b) Wholesale prices the supplier charged a larger volume purchaser;

(c) A published Lundberg report of current refiner prices;

(d) Wholesale prices charged by refiners;

(e) company-op. pricing: the retail prices charges at such a station can be considered in determining whether the wholesale price that the same supplier charged you is commercially reasonable. If the company station is selling at or below your cost, then there is potentially a serious legal issue.

(f) The profitability of the station when it was operated by the previous dealer;

(g) The reasons for the decline in a station's business;

(h) The supplier's awareness of retail prices charged by the dealer's competitors; and

(i) Any evidence showing that the supplier was deliberately trying to drive the dealer out of business.

(j) cost of complying with franchise agreement: Although no court has ruled directly on the issue, we believe that the franchisee should be able to show the amount of gross profit he must generate to comply with the rent, royalty, minimum volume and other provisions of the franchise agreement.

The *Shell Oil et al v. HRN Inc et al.* decision calls into question several points that we made in our earlier article.

If California courts accept the Texas Supreme Court's rational, evidence of pricing to other classes of trade

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• We never recommend that you purchase product from alternative sources without first obtaining legal advice.

• Any kind of agreement among competitors to set, peg or fix prices or margins is a criminal offense.

could be ruled inadmissible, including- retail prices charged by the supplier at its own stations; wholesale prices the supplier charged a larger volume purchaser; published Lundberg type reports of current refiner prices and wholesale prices charged by refiners. The only issue left would be whether the oil company's pricing was within the DTW range charged by other refiners.

Since the Texas court found that the motivation of the oil company is immaterial, evidence of the reasons for the decline in a station's business, the supplier's awareness of retail prices charged by the dealer's competitors evidence showing that the supplier was deliberately trying to drive the dealer out of business may also be ruled out.

Finally, evidence of the cost of complying with the franchise agreement would not be admissible evidence of bad faith. This would rule out arguments that high rents contribute to bad faith pricing, prohibitions by the oil company from buying cheaper product from jobbers, and requiring dealers to pay for required equipment at jacked up prices such as Shell card readers (Mobil Speedpass readers, ARCO PIC machines etc.)

Recommended procedures: We suggest the following in this area:

(1) Generally: If you feel that your buying price is non-competitive, you might want to have your attorney send the supplier a letter citing the leading California case: *E.S. Bills v. Tzucanow*. You might also want to gather some of the kind of evidence that the courts have said can be used to support a claim that a wholesale price is not commercially reasonable.

(2) Jobber-supplied dealers: Jobber-supplied dealers in particular should take note of this court ruling as well as in *Shell Oil et al v.* HRN *Inc et al*. If you feel that your buying price is non-competitive, you might want to have your attorney send the jobber a letter citing this case. You might also want to gather some of the kind of evidence that the court in the *E.S. Bills v. Tzucanow* case said can be used to support a claim that a wholesale price is not commercially reasonable. You may want to include the information in the letter.

(3) Major-brand dealers: Experience indicates that majors usually are not too responsive to an individual dealer's contention that the wholesale price is unlawfully high. You may therefore want to analyze whether you might have a possible damage claim under the applicable law. The case discussed above should give you a good idea of what kind of evidence would be relevant. We also suggest that you review the article on proving damages in service station cases in *CGB Lawletter No. 196.*

(4) Purchasing from alternative sources: We never recommend that you purchase product from alternative sources without first obtaining legal advice. This is particularly true if you are a major brand dealer.

(5) Price discussions: Dealers must be extremely careful about discussing price with each other. You have a right to discuss problems and legal issues. *Nevertheless, any kind of agreement among competitors to set, peg or fix prices or margins is a criminal offense.* Prosecutors are always very interested in filing such cases due to their political appeal. (E.g., *see Lawletter No. 191).*

(6) Pricing discussions with suppliers: Refiners sometimes refuse to discuss company station

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pricing or price breaks given to other dealers. Often marketing personnel claim that any such discussion would be illegal price fixing. However, you have a right to discuss with your supplier whether the price that you are being charged is "commercially reasonable." Furthermore, the wholesale and retail prices of your competitors, including stations operated by your supplier, are a lawful, legitimate and relevant factor in such discussions.

Military Leave Law

Do You Have Employees Enlisted in the Military? California law requires all public and private employers to provide military leave. These obligations are activated by an employee's involvement in military duty, training, drills, encampments, cruises, or special exercises. The employer may require evidence establishing the length and nature of military service. The employer is under no obligation to compensate employees while they are absent on military leave. Like the Uniformed Services Employment and Re-employment Rights Act of 1994 (USERRA), California state law prohibits employers from discriminating against an employee because of membership in the uniformed services. Further, military service cannot be the basis for a denial of employment opportunities. Violations of the California law constitutes a misdemeanor, and a person injured in violation of those laws may recover attorney's fees. The military leave laws can be tricky for employers to maneuver.

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