Franchisee Claims for Constructive Termination Under the PMPA After *Mac's Shell*

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Suppose you are a franchise attorney and have two new gas station clients.

Your first client is suffering severe business losses and will likely be forced to close her doors because the price of fuel from the franchisor is simply too high to compete at the retail level and earn a sustainable profit. Sales have dropped, but for the moment your client is hanging on and counting on you to devise a legal strategy that will save the day.

Your second new client has the same underlying problem—the franchisor's fuel pricing is too high for him to operate his gas stations profitably—but the difference is that he has abandoned the business. He is simply looking to you to recover damages—as much as possible.

This article examines the potential claims of each of your clients following the U.S. Supreme Court's recent decision in *Mac's Shell Service, Inc. v. Shell Oil Products Co.*,[1] in which, as we know from Robert Kry's insightful article in the last issue of this *Journal*,[2] the Court, in a unanimous opinion written by Justice Alito, held that the Petroleum Marketing Practices Act (PMPA) does not provide a claim for constructive termination while the franchisee remains in business. The Court expressly declined to decide whether the PMPA provides a remedy for constructive termination where the franchisee is no longer operating its business.[3]

This article examines from the franchisee's viewpoint the claims and remedies that may be available to your new clients in light of the *Mac's Shell* decision. To set the stage, it is worth reviewing the background of the *Mac's Shell* case and considering the state of affairs created by the opinion of the U.S. Court of Appeals for the First Circuit, which the Supreme Court reversed. In 2008, the First Circuit held in *Mac's Shell* that a service station dealer could bring suit and recover damages for constructive termination despite continuing to operate the business while the claim was being litigated.[4] The dealers in *Mac's Shell* complained that the cancellation of a previous rent subsidy, which effectively increased their cost of fuel, spelled the demise of their business and hence was a constructive termination of the franchise relationship. The First Circuit accepted that view, holding that the cancellation of the rent subsidy—which had been implemented by an assignee of Shell, the original franchisor under the contracts at issue—was "such a material change that it effectively ended the lease, even though [the franchisee] continued to operate [its] franchise."[5] The court concluded that "it would be unreasonable . . . [t]o require an actual abandonment of years of work and investment before we recognize a right of action under the PMPA."[6] Thus, the First Circuit affirmed a jury verdict for damages stemming from this constructive termination even though the gas station franchisee, at least for the time being, remained in business.

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A NOVEL APPROACH

Prior to the First Circuit's decision in *Mac's Shell*, claims for constructive termination under the PMPA had generally been limited to the situation where an assignment of the franchise agreement resulted in the loss of one of the three statutory components of a franchise relationship under the PMPA: "(1) the right to occupy leased marketing premises, (2) the right to sell motor fuel under a trademark owned or controlled by a refiner, and (3) the right to be supplied with that fuel."[7] Constructive termination claims under the PMPA were almost always rejected if the franchisee continued to occupy the premises that were leased from the refiner, continued to receive fuel, and continued to enjoy the right to use the franchisor's trademark.[8]

IMPLICATIONS OF THE FIRST CIRCUIT'S DECISION

Under the First Circuit's holding in *Mac's Shell*, just about anything that threatened to run a franchisee out of business would seemingly give rise to a claim for constructive termination. The most common dealer complaint, i.e., that fuel prices are too high, arguably would have been grounds for a claim under the First Circuit's opinion. More esoteric claims, such as one based on lost sales due to a consumer boycott, could also have been pleaded as constructive termination claims under the First Circuit's logic. Boycotts are not uncommon. Shortly after the 2010 Gulf Oil spill, a group of consumers launched a Boycott BP movement on Facebook; environmentalists had started a similar action against Exxon (albeit not on Facebook) after the 1989 Exxon Valdez spill.[9] And citing the so-called Chavez factor, commentators noted that Citgo was unlikely to be affected by a 2006 boycott stemming from Hugo Chavez's critical remarks about President Bush.[10]

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Other implications from the First Circuit's decision stemmed from the PMPA itself and created some dilemmas for the practitioner. Under the PMPA, a strict one-year statute of limitations begins running from "the later of—(1) the date of termination of the franchise or nonrenewal of the franchise relationship; or (2) the date the franchisor fails to comply with the requirements of section 2802, 2803 or 2807 of this title."[11] Determining the date when a constructive termination occurs (while the franchisee remains in business) would not be an easy task. On the facts of *Mac's Shell*, was it the day that the rent subsidy was first taken away? Or did the statute not begin to run until dealers actually went out of business and closed their doors? Few lawyers would have been comfortable assuming the latter. The First Circuit opinion thus created an incentive for the early filing of constructive termination claims whenever a franchisor's business practices threatened to drive the franchisee out of business, even if the dealer went out of business sometime later.

No doubt *Mac's Shell* has closed the doors on claims for constructive termination under the PMPA when the franchisee remains open.

A related dilemma arising from the First Circuit's opinion resulted from the PMPA's express preemption of state law claims. The Act provides:

> To the extent that any provision of this subchapter applies to the termination (or the furnishing of notification with respect thereto) of any franchise, . . . no State or any political subdivision thereof may adopt, enforce, or continue in effect any provision of any law or regulation (including any remedy or penalty applicable to any violation thereof) with respect to termination (or the furnishing of notification with respect thereto) of any such franchise or to the nonrenewal (or the furnishing of notification with respect thereto) of any such franchise relationship unless such provision of such law or regulation is the same as the applicable provision of this subchapter.[12]

From this broad preemption language, it was obvious that constructive termination under the PMPA, as interpreted by the First Circuit, threatened to displace state law claims for breach of contract arising from the same conduct. Worse, if a franchisee did not file suit for constructive termination within the one-year period under the PMPA, it ran the risk that the franchisor would argue that the state law claims were preempted when the franchisee did attempt to file them. The franchisee thus would be exposed to the possibility of being left with no viable claims after the expiration of one year from the beginning of the contract breach at issue.

The First Circuit's decision, in effect, encouraged franchisees to file constructive termination claims within one year of the first signs of trouble in the franchise relationship whenever the issues that the franchisee was experiencing might be sufficient to drive it out of business. Such a result could be problematic. For example, although franchisees might experience high fuel costs during a certain period of time, fuel costs fluctuate. What if, after the case was filed but before trial, the circumstances changed and the franchisee was not at immediate risk of going out of business? Where a claim is based on high fuel prices, circumstances might change due to market fluctuations, or the franchisor itself might be able to influence the circumstances. Finally, if a franchisor faced claims for constructive termination based on high fuel prices, nothing would stop it from lowering those prices before the trial to damage the credibility of the dealer/plaintiff.

For all of these reasons, the First Circuit's decision in *Mac's Shell*, while applauded by the franchisee/dealer bar, actually created some interesting dilemmas for potential plaintiffs that had not been fully resolved at the time of the Supreme Court's decision.

HAS THE SUPREME COURT ACTUALLY EXPANDED FRANCHISEE RIGHTS?

As Mr. Kry explained in his article, the Supreme Court reversed the First Circuit, holding that there can be no claim for constructive termination under the PMPA where the franchisee remains in business.[13] Focusing on the literal definition of *termination* as being "the end" of something, the Court drew a bright line and held that "a necessary element of any constructive termination claim under the PMPA is 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."[14]

However, in three separate footnotes in its opinion, the *Mac's Shell* Court made clear that it was not deciding whether the PMPA recognizes any claim for constructive termination and was "leav[ing] the issue for another day."[15] To be clear, it would have been dicta for the Court to have reached this issue on the facts presented in *Mac's Shell*, but predictably the Court's opinion has brought to the forefront the issue of whether a franchisee can state an actionable claim under the PMPA for constructive termination where the franchisee establishes that the franchisor's conduct drove it out of business. Moreover, and as Mr. Kry has noted, this issue is likely to be highly relevant under statutes that regulate the manner in which franchisees or dealers may be terminated.

In *Al's Service Center v. BP Products North America, Inc.*, decided after *Mac's Shell*, Judge Posner of the Seventh Circuit interpreted the Supreme Court's three footnotes as an expression of its "skepticism" that such claims exist.[16] However, Judge Posner added that "[w]e don't know *why* the Court is skeptical; without a doctrine of constructive termination,

there would be . . . a big loophole in the Petroleum Marketing Practices Act."[17] Coming from a jurist who admittedly views the entire PMPA as "rank interferences with liberty of contract," Judge Posner's observation that the PMPA is not complete without judicial recognition of a constructive termination doctrine is quite compelling.[18]

Mr. Kry questions Judge Posner's observation that the absence of judicially recognized constructive termination claims would create a loophole in the PMPA and suggests that the purported loophole is only superficial. However, it is fair to say that Mr. Kry's apparent reluctance to see the courts recognize claims for constructive termination under the PMPA may stem from the fact that gas station franchisees already have other remedies under state law for oppressive franchisor conduct. These are primarily claims for breach of contract in one form or another, including claims under U.C.C. § 2-305 for bad faith in setting fuel prices under the open-price term of a fuel supply contract. However, it is equally fair to say that the existence of state law remedies for breach of contract arguably would stand as an objection to the existence of the PMPA itself. This is the basis for Judge Posner's questioning why Congress decided to enter this field in the first place.[19] For franchisors to object to the recognition of a constructive termination remedy under the PMPA on the grounds that state law provides remedies for breach of contract is a bit like a general's fighting the previous war.

Federal courts are naturally reluctant to expand remedies beyond the express language of a statute or to create an implied cause of action.[20] But franchisees that have ceased operating their business should not be deterred by this historical reluctance. In the three footnotes that caught Judge Posner's attention, the Supreme Court in *Mac's Shell* clearly invited further litigation on whether constructive termination is actionable under the PMPA. Given the potentially powerful remedies available under the PMPA, including three that would not be available under state law, i.e., punitive damages[21] and attorney fees and expert witness fees (if the plaintiff recovers more than nominal damages),[22] it is likely that "terminated" gas station franchisees will file constructive termination claims until the questions left open by *Mac's Shell* are definitively resolved.

DO CONSTRUCTIVE TERMINATION CLAIMS HAVE A FUTURE?

Franchisees seeking to pick up where *Mac's Shell* left off have some persuasive arguments at their disposal. Several passages in the Supreme Court's opinion that strongly suggest the Court would uphold a constructive termination claim under the PMPA under the right facts, beginning of course with the fact that the franchisee is no longer operating the business.

First, the Court noted that constructive termination claims had been recognized in other analogous areas of law, such as employment law, where "courts have long recognized a theory of constructive discharge," and landlord-tenant law, which has "long recognized the concept of constructive eviction."[23] The Court explained that "in these and other contexts, a termination is deemed 'constructive' because it is the plaintiff, rather than the defendant, who formally puts an end to the particular legal relationship—not because there is no end to the relationship at all."[24] Significantly, the Court continued by observing that

> [t]here is no reason why a different understanding should apply to constructive termination claims under the PMPA. At the time when it enacted the statute, Congress presumably was aware of how courts applied the doctrine of constructive termination in these analogous legal contexts. . . . And in the absence of any contrary evidence, we think it reasonable to interpret the Act in a way that is consistent with this well-established body of law.[25]

To be clear, the Court was seeking to be consistent with other areas of law in requiring an actual termination before there could be any discussion of a constructive termination claim, as opposed to actually recognizing the claim for constructive termination under the PMPA when an actual termination occurs. However, by the Court's own words, and in the absence of any contrary congressional intent, it would seem eminently logical to construe the PMPA as recognizing constructive termination in a way that is analogous to the constructive discharge of an employee or the constructive eviction of a tenant.

Second, in reaching its holding, the Court noted "that a necessary element of any constructive termination claim under the PMPA is 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."[26] If the Court were not inclined to recognize a claim for constructive termination under the PMPA, this language would appear superfluous.

Third, the Court's interpretation of the PMPA gives further support for the recognition of a constructive termination claim under the PMPA. As the Court explained, "when given its ordinary meaning, the text of the PMPA prohibits only that franchisor conduct that has the effect of ending a franchise."[27] The emphasis on franchisor conduct, as opposed to the franchisor's decision to implement a termination, leaves plenty of room for franchisor misconduct that causes the franchisee to announce the end of the relationship, in ways that a court could find analogous to an employee's resignation under circumstances giving rise to a constructive discharge claim.

Thus, claims for constructive termination may prove to be viable in cases where the franchisor's conduct has indeed led the franchisee to end the relationship, most likely by going out of business. Other possible scenarios are also foreseeable. For example, instead of closing its doors, a franchisee might feel compelled to sell the business at a loss to mitigate its damages. In *Mac's Shell*, the Court was clearly creating a bright-line test, i.e., the franchise relationship has either ended or it has not (and if it has not ended, there can be no

claim for constructive termination). But in cases in which the relationship has ended, it will not always be clear where to draw the line when a franchisor's conduct compelled the franchisee to end the relationship, as opposed to other cases where a franchisor's conduct contributed to the franchisee's business decision to quit the relationship. Assuming the courthouse doors will be open to constructive termination claims under the PMPA, the ultimate contours of this potential claim remain to be decided in the classic common law tradition on a case-by-case basis.

BURDEN OF PROOF

Returning to the hypothetical of high fuel prices actually driving the franchisee out of business, the next question becomes: What is the franchisee's burden of proof to establish the franchisor's liability? Case law construing U.C.C. § 2-305 has created numerous defenses for franchisors in their pricing decisions, discussion of which is beyond the scope of this article. Would the standard defenses to a U.C.C. pricing claim apply under the PMPA? Arguably, the answer would be no. Under *Mac's Shell*, the simple question would be framed as whether the franchisor's conduct has effectively ended the franchise relationship,[28] but merely framing the issue and determining the type of proof that will be needed to prevail may be two different things. In making an analogy to employment law, the Supreme Court in *Mac's Shell* cited *Pennsylvania State Police v. Suders*, where the Court held that employment conditions must be "so intolerable that a reasonable person would have felt compelled to resign."[29] To the Court, this formulation for a constructive discharge claim (based on a hostile environment) went beyond the standard for hostile work environment sexual harassment claims, where the offending behavior "must be sufficiently severe or pervasive to alter the conditions of the victim's employment."[30]

Thus, it would appear that if the Supreme Court is to recognize claims for constructive termination in violation of the PMPA after a franchisee is driven out of business, the claim will not be available for every breach of contract that would be actionable under state law. Only where the franchisor's misconduct is so egregious that the franchisee is left without real choice except to shut down can we expect to see the Supreme Court uphold constructive termination claims in this area. In these more extreme cases, a court would be more than justified in allowing the plaintiff to invoke the more powerful statutory remedies than would be available under state law. Of course, claims for constructive termination under this standard will raise serious questions of fact as the courts will have to sort out the franchisees that were truly forced out of business from those that were merely disgruntled and looking to seize the first opportunity to head for the exit. But this is exactly what trials are for, and the judicial determination of whether a constructive termination occurred should be no more difficult than determining whether an employee was constructively discharged or a tenant constructively evicted.

For the client who has been driven out of business, the PMPA arguably provides a claim for constructive termination. At a minimum, it is impossible for franchisors at this juncture in the law to argue conclusively that no such claim exists. However, it simply is not clear just how egregious the franchisor's conduct will have to be to constitute a constructive termination under the PMPA; undoubtedly, the lower courts may reach inconsistent results, and indeed some lower courts may elect categorically to reject these claims until they are approved at the circuit level. However, the good news is that if these claims are allowed to proceed, at least the Supreme Court's bright-line approach to whether a termination has occurred should resolve at least some of the practical dilemmas raised by the First Circuit's decision. There should no be no lingering doubt as to when the statute of limitations will run, i.e., it will run from the point that the franchise is ended.

The ultimate contours of potential claims under the PMPA remain to be decided in the classic common tradition on a case-by-case basis.

WHAT ABOUT THE FRANCHISEE THAT IS STILL OPERATING?

Unfortunately, *Mac's Shell* apparently leaves the franchisee that remains in business without a PMPA remedy. The injunctive relief provided by the PMPA is available where "the franchisee shows—the franchise of which he is a party has been terminated."[31] The statute states the fact of termination in the past tense. The PMPA contains no express statutory provision for an injunction against termination before it occurs, i.e., before it is announced by the franchisor in the case of an actual termination as contemplated in the statute. Because we know from *Mac's Shell* that constructive termination does not occur until the franchisee is actually driven out of business, it would appear to be an insurmountable stretch to try and invoke the PMPA injunction provisions while the franchisee is still operating.

Moreover, although the prospect of declaratory relief might be promising in theory, the Supreme Court in *Mac's Shell* rejected that argument en route to concluding that the franchisee must end the business before any claim of constructive termination may be considered under the PMPA.[32]

This means that to protect a gas station franchisee that complains of being driven out of business by high fuel prices but is still operating, an attorney will be forced to pursue state law remedies while the franchisee remains in business. One can envision the scenario of a franchisee initially pleading a state law claim for breach of the duty under U.C.C. § 2-305 to set fuel prices fairly under the open

price term of a fuel supply agreement and arguably seeking both injunctive relief and damages for lost profits. Hopefully, that strategy would suffice; but if not, a constructive termination claim theoretically could be pleaded if the dealer is ultimately forced to close its doors before trial. In that situation, the preemptive effect of the PMPA presumably would apply. If the PMPA claim is upheld, the state law breach of contract claims arguably would arguably be dismissed, and the litigation would most likely shift to federal court. For the franchisee, this could be a positive trade, given the PMPA's enhanced remedies of punitive damages and attorney fees.

Or is it really that simple? If a franchisee attempts under state law to obtain and successfully gets an injunction against a continuing breach of contract that threatens its viability, a constructive termination presumably has been prevented. But what if the request for a state court injunction is denied? Is it realistic to expect the franchisee to prevail later on a PMPA constructive termination claim where the burden of proof may be higher than that for a breach of contract under state law? This question cannot be answered in the abstract. A request for injunctive relief might be defeated for numerous reasons, but certainly there will be reason for concern on the part of the franchisee's counsel. Moreover, the franchisor's counsel would be expected in this scenario to bring the franchisee's defeat at the state court injunction stage to the attention of the federal court once a constructive termination claim is filed.

CONCLUSION

No doubt *Mac's Shell* has closed the door on claims for constructive termination under the PMPA when the service station franchisee remains open, leaving the franchisee in those dire straits to its traditional remedies under state law. However, the language and logic of the Supreme Court's opinion certainly leaves open the prospect for constructive termination claims if the franchisee is forced out of business. Future litigation will be necessary not only to settle the viability of constructive termination claims but also to clarify the franchisee's burden of proof to establish that it was truly forced out of business in ways that would meet the criteria for this still-undefined claim.

Moreover, as Mr. Kry notes, we can expect to see *Mac's Shell* being argued with respect to claims for constructive termination under state franchise acts and other industry-specific statutes that are intended to protect franchisees and dealers from arbitrary terminations that destroy their equity. Absent distinctions based on the language of particular statutes or legislative histories, the Supreme Court's opinion in *Mac's Shell* will be highly persuasive.

ENDNOTES

1. 130 S. Ct. 1251 (2010).

2. Robert Kry, Mac's Shell *and the Future of Constructive Termination*, 30 Franchise L.J. 67 (2010).

3. *Mac's Shell*, 130 S. Ct. at 1251.

4. Marcoux v. Shell Oil Prods. Co., 524 F.3d 33, 44–47 (1st Cir. 2008).

5. *See Mac's Shell*, 130 S. Ct. at 1257 (quoting Mac's Shell v. Shell Oil Prods. Co., 524 F.3d 33 (1st Cir. 2008)).

6. *Mac's Shell*, 524 F.3d at 46.

7. Paul D. Sanson, Vaughan Finn & Karen T. Staib, *A Tale of Two Claims: The First Circuit Weighs In on Constructive Termination and Constructive Non-Renewal*, Am. Bar Ass'n Section of Env't, Energy, & Resources 23d Annual Petroleum Marketing Roundtable (Oct. 15, 2008) (citing Ackley v. Gulf-Oil Corp., 726 F. Supp. 353, 361 (D. Conn. 1989), *aff'd*, 889 F.2d 1280 (2d Cir. 1989)).

8. *Id.* (citations omitted). Sanson, Finn, and Staib note that the lone exception prior to the First Circuit's decision in *Mac's Shell* had been *Barnes v. Gulf Oil Corp*., 795 F.3d 358, 362–63 (4th Cir. 1986), where the court allowed a constructive termination claim to proceed based on the franchisee's claim that it could no longer receive motor fuel at the stipulated franchise price. *Id.*

9. Sarah Wheaton, *Protesters Gather at BP Gas Stations*, N.Y. Times, June 2, 2010.

10. Mark Jewell, *Citgo Likely Not Hurt by Chavez Factor*, Wash. Post., Nov. 7, 2006, *available at* www.washingtonpost.com/wp-dyn/content/article/2006/11/07/AR2006110700928.html.

11. 15 U.S.C. § 2805(a).

12. 15 U.S.C. § 2806(a)(1).

13. Mac's Shell Serv., Inc. v. Shell Oil Prods. Co., 130 S. Ct. 1251, 1261–62 (2010).

14. As Mr. Kry has explained, "[u]nder the PMPA, the trademark rights, fuel-supply agreement, and lease of the premises are three distinct components of the petroleum franchise, and termination of any one suffices to implicate the statute. 15 U.S.C. § 2801(1)(B)." Kry, *supra* note 2, at 68 n.15.

15. *Mac's Shell*, 130 S. Ct. at 1257 n.4, 1260 n.8, 1261 n.9, 1262 n.11.

16. *See* Al's Serv. Ctr. v. BP Prods. N. Am., Inc., 599 F.3d 720, 726 (7th Cir. 2010).

17. *Id.* at 726 (citations omitted) (emphasis in original).

18. *Id*. at 722 (citations omitted); *see also* State Oil Co. v. Alayoubi, 966 F. Supp. 653 (N.D. Ill. 1997) (citing Brach v. Amoco Oil Co., 677 F.2d 1213 (7th Cir. 1982) (noting that the PMPA protects the "goodwill built up over years by a hard-working franchisee")).

19. *Id.*

20. Sanson, Finn & Staib, *supra* note 7, at 4 (citations omitted).

21. 15 U.S.C. § 2805(d)(1)(B).

22. 15 U.S.C. § 2805(d)(1)(C).

23. Mac's Shell Serv., Inc. v. Shell Oil Prods. Co., 130 S. Ct. 1251, 1258 (2010) (citations omitted).

24. *Id.* at 1259.

25. *Id.* (citation omitted).

26. *Id.* at 1262.

27. *Id.* at 1254.

28. *Id.*

29. 542 U.S. 129, 130 (2004).

30. *Id.* at 131.

31. 15 U.S.C. § 2805(b)(2)(A)(i).

32. *Mac's Shell*, 130 S. Ct. at 1258.

