

# **The Working of the Petroleum Marketing Practices Act and Its Effect upon the Franchising of Retail Gasoline**

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*This paper reviews the impact of the Petroleum Marketing Practices Act (PMPA) and its subsequent amendments. PMPA was designed to protect gasoline franchisees from arbitrary termination or nonrenewal by franchisors. An earlier work analyzed the PMPA over its first six years (1978-1984), while the present research examines its record from 2001-2010 and compares its effectiveness over the two periods. Regression and correlation analysis are employed to measure the influence of the PMPA on the number of franchisee-owned gasoline stations. The paper also discusses gas franchising in China, although China does not have specific regulation comparable to that of PMPA.*

## **INTRODUCTION**

The Petroleum Marketing Practice Act (PMPA), originally passed in 1978 and amended in 1994 and 2007, is essentially an Act designed to protect gasoline franchisees from arbitrary and capricious termination by gasoline franchisors. As such, the Act stipulates the conditions under which a franchisor is permitted to terminate or fail to renew franchises, giving that the notification requirements established by the Act are satisfied (15 U.S.C. §§2801-2841(1982)). Actually, precedent for the PMPA had been established in 1956 with the passage of the Automobile Dealers' Franchise Act (ADFA) by the 84<sup>th</sup> Congress (15 U.S.C. §§1221-1225 (1982)). This particular law was enacted in response to numerous complaints by automobile dealers and extensive subsequent investigation into the vertical relationship between automobile dealers and automobile manufacturers. Specifically, the ADFA was intended to enhance the power of automobile dealers by enabling franchised dealers to initiate suits in U.S. district courts to recover damages sustained due to the failure of automobile manufacturers to act in good faith in their compliance with the terms of franchise agreements or in terminating or failing to renew franchises with their dealers. Similarly, after several complaints emanated from gasoline service station operations in the 1970s regarding the termination or nonrenewal of franchise agreements by the oil companies, Congress passed the PMPA to address the complaints and to provide a

more level playing field between franchisors and franchisees. In general the PMPA is much more specific with regard to franchisor terminations and nonrenewals than is the ADFFA.

In an earlier work, the first author had discussed the economic effects of franchising operations, and had delineated and compared the provisions of the Automobile Dealers' Franchise Act of 1956 and the Petroleum Marketing Practices Act of 1978. He then undertook an analysis of the working of the PMPA over the first six years of its existence 1978-1984 (Greco, 1988). In the present paper, the authors review the franchise cancellation and nonrenewal provisions of the PMPA and examine its record over the 2001-2010 period, having chosen this period based on the availability of verifiable data. The effectiveness of the Act is then compared between the earlier period (1978-1984) and the most recent period (2001-2010).

### **Cancellation and Nonrenewal Provisions of the PMPA**

Assuming that the franchisor satisfies certain notifications of termination or nonrenewal requirements, the PMPA provides nine grounds for such action(s) within two of its subsections. The first subsection deals with five grounds for termination or nonrenewal of a franchise relationship. These grounds include: (1) the failure of the franchisee to comply with any reasonable and materially significant provision of the franchise relationship, (2) the failure of the franchisee to exert good faith efforts to carry out provisions of the franchise, (3) the occurrence of an event which is relevant to the franchise relationship and which makes termination or nonrenewal of such relationship reasonable (see appendix A), (4) a written agreement between the franchisor and the franchisee to terminate or not to renew the franchise relationship, and (5) a determination made by the franchisor in good faith and in the normal course of business to stop marketing motor fuel through retail outlets in the relevant geographic area (15 U.S.C. §2802 (b)(2)(c)).

Four additional grounds for nonrenewal of a franchise under the PMPA provided in a second subsection of the Act are: (1) the failure of the two parties to agree to changes suggested as a result of determinations made by the franchisor in good faith and in the normal course of business (provided that such failure is not the result of the franchisor's insistence on such changes and additions in order to convert the leased premises to operation by the franchisor's employees or agents for the franchisor's benefit or to otherwise prevent the renewal of the franchise); (2) the receipt of numerous legitimate customer complaints by the franchisor relative to the franchisee's operation of the marketing premises, provided that the franchisee was promptly apprised of these complaints and failed to take prompt action to correct the problem suggested by said complaints; (3) failure by the franchisee to operate the marketing premises in a clean safe, helpful manner, if such franchisee had failed to do so on two or more previous occasions and the franchisor had notified the franchisee of such failures; and (4) good faith determinations made by franchisors in the normal course of business to convert the leased marketing premises to some other use, or to materially alter, add to, or replace such premises, or to sell such premises, or simply not to renew the franchise because of a belief that the renewal would not be economical to the franchisor despite any reasonable changes or additions to the provisions of the franchise (15, U.S.C. §2802 (b) (3)).

### **The Franchisor-Franchisee Relationship in China**

Over the period from 2003-2011, real GDP growth in China has averaged 10.7%. It grew each year over the five year period from 2003-2007, advancing from a rate of growth of 10.0% in 2003 to over 14.2% for 2007. Then in 2008, China's rate of real GDP growth decreased to

9.6% and further fell to a 9.2% rate of growth for 2009. The real GDP growth rate accelerated to 10.3 for 2010. However, it fell again in 2011 to 9.2% and is projected to fall to 8.2% for 2012. However, it is expected to rise to 9.3% for 2013. The recent decline in the rate of growth in real GDP was largely attributable to a decline, first in exports and then in inventories. Nevertheless, accelerating household incomes and slower inflation helped to buoy fiscal domestic demand. However, despite the recent deceleration in the rate of growth of real GDP, China has remained the fastest growing economy in the world (OECD, 2012).

Consequently, it is not surprising that China's gas consumption had increased fourfold from 2000-2011 and its demand for gas is expected to double from 2011-2015. China is already the fourth largest gas consumer in the world having consumed 130 bcm in 2011. In fact, China consumes more gas than any OECD country with the exception of the United States (IEA, 2012). Accordingly, revenue generated for automotive fuel retailers in China has been increasing. Such revenue was expected to exceed \$173 billion for 2011, an increase of 13.5% over 2010. Further, this revenue had an annual rate of growth of 16.4% over the five-year period from 2006-2011. In addition, there were expected to be over 98,000 establishments operating within China's automobile fuel retail industry in 2011. Employment within the industry was projected to be 860,000 with an estimated payroll of over \$2.75 billion. However, the fuel retailing industry is not highly profitable especially in the face of rising international oil and petroleum prices due to governmental controls on domestic petroleum prices. Independent entry into the retailing of fuel which involves start-up costs, storage and distribution costs, as well as annual rent is costly. However, entry through the purchase of existing retail stations usually amounts to the costly sum of \$1 million (IbisWorld, 2011). In compliance with its commitment to the World Trade Organization, China opened the oil retail market to foreign investors in December 2004, three years after joining the organization. Though considerable progress has been achieved since its entry into the WTO, China's domestic market is still not entirely accessible to foreign investors. In fact, foreign investment into China is classified into four categories: 1) encouraged, 2) permitted, 3) restricted, and 4) prohibited. Foreign investors must, of course, be sure to avoid the "prohibited" category. Further, the only restriction that specifically applies to foreign investors is that they cannot establish partnership enterprises in China (Ren, 2011). Finally, Foreign Invested Enterprises (FIEs) were permitted by the Administrative Measures for the Refined Oil Market of 2006 to retail gasoline in China. In fact, by April 2007 China's Ministry of Commerce (MFCOM) had approved entry for nine joint ventures and wholly foreign-owned enterprises into the refined oil retail market. These foreign concerns had plans to build over 2500 fuel stations in China, 1500 of which were completed in 2007 (Sheng, 2010).

China, like the United States, is one of thirty-three countries that have laws explicitly regulating franchising. However, China does not currently have a law comparable to the Petroleum Marketing Practices Act of the United States. Rather, gasoline franchising in China, as other franchising arrangements in that country, are subject to the Regulations on Administration of Commercial Franchise which was passed by the State Council in January 2007 and which became effective on May 1, 2007. These regulations are delineated in 34 articles contained in five chapters. Article 3 of said Regulations essentially defines a commercial franchise as the business activities whereby the franchisor executes contracts to permit the franchisee the use of the franchisor's operational resources, such as registered trademarks, logos, patents, etc. For his part, the franchisee undertakes business in accordance with the provisions of these contracts and agrees to pay franchise fees to the franchisor (DLA Piper, 2007).

Article 4 of the Regulations requires that franchising activities comply with the principles of “free will, fair dealing, honesty, and good faith.” Article 11 essentially mandates that a written franchise contract be entered into by the parties to the franchise agreement and stipulates the main contents of said contract. Among these general stipulations are: 1) the amendments, rescission, and termination of the franchise contract; 2) liability for breach of contract; and 3) methods of dispute resolution. Hence, these franchise relational issues, which are specifically governed by the Petroleum Marketing Practices Act in the U.S., are negotiated among franchisor and franchisee in China, with said negotiations conducted under Article 4’s requirements of fair dealing, good faith, etc (DLA Piper, 2007).

The Regulations in Administration do provide some protection for the franchisor. Namely, Article 18 prohibits franchisees from transferring its franchise to others without the consent of the franchisor. Further, this same article forbids franchisees from divulging or permitting others to use the trade secrets of franchisors. In addition, there is no mandatory provision requiring a franchisor to renew a franchise agreement unless said agreement contains any provisions to the contrary. However, the Regulations provide even more protections for franchisees. For example, Article 12 requires the parties to a franchise agreement to provide the capability for the franchisee to unilaterally rescind the franchise contract within a certain period of its signing. Article 13 mandates that the term of the franchise agreement be at least three years. Article 14 provides that the franchisor makes available the franchise operations manual to the franchisee, as well as gives the franchisee operational guidance and other services and support agreed upon by the parties to the franchise agreement. Article 16 requires franchisors, in cases where franchisees must pay fees before franchise contracts are signed, to explain the purpose of the fees and the procedures for seeking refunds of the same. Article 17 states that promotion and advertisement fees paid by franchisees shall be used as stipulated in the franchise contract and that the franchisees be given timely notice of the status of such fees. This article also prohibits franchisors from engaging in fraudulent and misleading activities in the advertising and publicizing of franchises. Further, in its advertising, a franchisor cannot include information concerning a franchisee’s operating results. Article 19 requires a franchisor to report the information concerning the conclusion of franchise contracts in the previous year to the Administration of Industry and Commerce (Ren, 2011). Articles 21 and 22 deal with information that franchisors must provide to franchisees at least 30 days prior to the signing of a franchise contract. Such information includes types, amounts, and payment methods of franchise fees, prices and conditions for the provision of products, services, or equipment to franchisees, the number and evaluation of the operational status of the existing franchisees in China, information on litigations and arbitrations involving franchising activities over the preceding five years (DLA Piper, 2007).

Moreover, Article 23 requires that information provided by the franchisor to the franchisee shall be true, accurate, and complete. The franchisor must inform the franchisee in a timely manner of any material changes occurring relative to information previously provided. The Article permits the franchisee to rescind the franchise contract in cases where the franchisor has either concealed relevant information or has given false information. Finally, Articles 26-28 provide for various corrections and fines to be imposed in cases where franchisors violate various articles of the Regulations (DLA Piper, 2007). Namely, Article 26 stipulates that a franchisor that violates Articles 16 and/or 19, as noted above, shall be subject to an ordered correction from the Administration of Industry and Commerce which may impose a fine of less than 10,000 yuan. In cases where the agency judges the circumstances to be serious, it may

impose a fine between 10,000 and 50,000 yuan, as well as issue a public reprimand to the offending party(ies). Article 27 provides for penalties for franchisors that violate Article 17 by engaging in fraudulent and misleading claims in the publicizing of franchisees. In less serious violations, the Administration of Industry and Commerce may order a correction and impose a fine between 30,000 and 100,000 yuan. In more serious cases, the Administration issues a fine between 100,000 and 300,000 yuan, in addition to a public reprimand. Further, if the violation constitutes a crime, the offending franchisor is also subject to criminal liability. Article 28 provides remedies for violations of Articles 21-23 relevant to the content and veracity of information provided by franchisors to franchisees. A franchisor confirmed to be in violation of any of all of these Articles is subject to an ordered correction and a fine between 10,000 and 50,000 yuan. For egregious violations, Article 28 sets the fine between 50,000 and 100,000 yuan and requires a public reprimand (FranchiseAsia, 2007). Consequently, while the franchisor-franchisee relationship in regard to retail gasoline operations in China is not specifically addressed as it is in the U.S. (through the Petroleum Marketing Practices Act), both franchisors and franchisees of retail gasoline operations in China are afforded some protections through the country's general franchising regulations. However, as noted above, the protection of franchisees is much more emphasized than that of franchisors in China's Administration of Commercial Franchise Operations.

In addition to the regulation provided by the Administration of Commercial Franchise Operations, the People's Republic of China Contract Law and People's Republic of China Civil Code govern the validity, interpretation, performance, and other areas of the franchisor-franchisee relationship. To the benefit of both parties, both the Civil Code and the Contract Law provide that commercial transactions, inclusive of franchise contracts, should be conducted in good faith. Further, the parties to a franchise are subject to compliance with a number of additional laws, including advertisement law, trademark law, and regulatory requirements such as those prohibiting pyramid selling (Ren, 2011). Most notably, Contract Law governs the circumstances under which both franchisors and franchisees may terminate a franchise relationship (Ren, 2011).

In general, a franchisor may terminate a franchise relationship in accordance with the agreement's provisions relative to termination. In the absence of any express termination provisions in the agreement, the franchisor may terminate the relationship under Contract Law in the following situations: 1) the purpose of the agreement cannot be realized due to any unanticipated or uncontrollable events which release either or both parties from fulfillment of a contractual obligation; 2) the franchisee acknowledges or indicates that it will not honor its principal debt obligations; 3) the franchisee delays the performance of said debt obligations and fails to perform them within a reasonable timeframe provided for it to do so; and 4) the purpose of the franchise agreement cannot be fulfilled because the franchisee either delays in honoring its debt obligations or engages in some other breach of the contract. A franchisee may terminate a franchise relationship based upon contractual stipulations in the agreement. In the absence of such stipulations, the franchisee may terminate under provision of Contract Law during the contract's mutually-agreed upon cooling-off period or, as noted previously, in situations where the franchisor has violated its disclosure obligations (Ren, 2011).

## The Working of the Petroleum Marketing Practices Act

As mentioned above, the previous work had focused on the 1978-1984 period while the present study focuses on the 2001-2010 period. Table 1 below lists the number of cases brought under the PMPA for each of these time periods.

**TABLE 1**  
**CASES BROUGHT UNDER THE PMPA, 1978-1984 AND 2001-2010**

<b>Year</b>	<b>Number of Cases</b>	<b>Percentage of Cases</b>
1978	2	2.1
1979	14	14.6
1980	10	10.4
1981	22	22.9
1982	17	17.7
1983	20	20.8
1984	11	11.5
<b>TOTAL</b>	<b>96</b>	<b>100.0</b>

<b>Year</b>	<b>Number of Cases</b>	<b>Percentage of Cases</b>
2001	6	7.1
2002	13	15.5
2003	7	8.3
2004	6	7.1
2005	9	10.7
2006	5	6.0
2007	14	16.7
2008	9	10.7
2009	7	8.3
2010	8	9.5
<b>TOTAL</b>	<b>84</b>	<b>99.9</b>

Source: United States Code Annotated, 1982 and 1985 Cumulative Annual Pocket Part; *Annual Franchise and Distribution Law Developments, 2001-2010*.

Perhaps the smaller number of cases brought under the PMPA in the second longer period is attributable to the greater familiarity gained by the parties over the years relative to the Act, its enforcement, and its interpretation in the courts.

The disposition of four of the cases identified for the initial 1978-1984 were uncertain. Interestingly, the results of the court dispositions for the remaining set of 92 cases favored the oil companies on a nearly two-to-one basis, i.e. 60 decided for the oil companies (the franchisors) and 32 decided for the franchised dealers. Overall, there were 22 oil companies involved in this case set. The two leading oil companies involved were: Amoco with 18 cases (18.8%) and Mobil with 17 cases (17.7%). Rounding out the top three companies and the only other company with a double-digit number of cases was Exxon with 10 cases (10.4%). Recall that this was before the consolidations of such as Exxon-Mobil and Amoco-BP. Nearly half of the cases decided for the

oil companies (26 of 60 or 43.3%) upheld the company on the basis of Sec. 2802(b)2(c) of the PMPA, i. e. the section permitting a termination or nonrenewal on the basis of an occurrence or event which is relevant to the franchise relationship, the result of which makes said termination or nonrenewal reasonable. Recall that such “occurrences” are provided in Appendix A of this article. The most common of these occurrences cited in the case set decided for the oil companies were: (1) willful adulteration, mislabeling or misbranding of motor fuels or other trademark violations by franchisees; (2) failure of the franchisee to pay to the franchisor in a timely manner when due all sums to which the franchisor is legally entitled; (3) the declaration of bankruptcy or judicial determination of insolvency; and (4) failure by the franchisee to operate the marketing premises for seven consecutive days. Another relatively common occurrence among the cases was the death of the franchisee.

Twelve of the 60 cases decided in favor of the oil companies (20%) turned on the basis of Sec. 2802(b)3(A) of the PMPA, i. e. the section permitting a nonrenewal based upon the failure of the franchisor and the franchisee to agree to changes or additions to the provisions of the franchise agreement. Nearly all of these cases involved higher rental charges proposed by the franchisors, charges which the franchisees in the respective cases refused to pay but which were ruled reasonable by the courts. No other provision of the PMPA claimed a double-digit basis of the decisions rendered in favor of the oil companies.

Nine of the 32 cases decided against the oil companies (28.1%) went against the companies involved because of their failure to comply with notice requirements of the PMPA. Perhaps the companies would have won some, if not all, of these cases had they been more careful relative to the fulfillment of the notice requirement stipulated in the PMPA. In the 32 cases proclaimed as decisions for franchisees, victory is usually interpreted to mean the granting of a preliminary and/or permanent injunction preventing termination or nonrenewal by the franchisor. Only two other bases under the PMPA applied to as many as three of the 32 cases decided in favor of franchisees.

From his examination of the cases brought during the early years of the PMPA, the author surmised that the Act was working reasonably well. He did not believe that the nearly two-to-one margin of decisions favorable to the oil companies was unduly large for, while he realized that the PMPA was enacted to protect gasoline station franchisees from capricious terminations or nonrenewals by franchisor oil companies, he cautioned that there is no inherent reason to expect the balance of court decisions to favor the franchisees. That is, an increased level of fairness or equity to one party (franchisees) is not to be affected by reducing the level of fairness to the other party (franchisors). To wit, franchisors must be protected from frivolous and/or unjustified suits brought by franchisees.

Appeals brought to decisions under a law (as the PMPA) are certainly one way to gauge a law’s effectiveness. Of the 92 determinable decisions in the earlier 1978-1984 period, 26 were appealed, 28.3 percentage of the cases. This did not seem especially large. It is, however, interesting to note that this overall percentage is almost precisely matched by the percentages of lost decisions appealed by the oil companies (franchisors), as well as by the franchise dealers. Indeed, while the oil companies appealed nine of the 32 decisions rendered against them (28.1%), franchise dealers appealed 17 of the 60 cases that they had lost (exactly matching the 28.3% noted for the appeal rate applicable to the entire case set).

For the more recent study period of 2001-2010, there were 33 franchising oil companies involved in the set of the 84 cases. Franchisors won 66 of these court decisions (78.6%) and franchisees won the remaining 18 (21.4%). By contrast, for the earlier period, recall that

franchisors won 60 of the 92 decisions (65.2%) while franchisees won in the remaining 32 cases (34.8%). For the recent 2001-2010 period, the leading oil entity involved in these cases with 15 (17.9%) was BP Oil. Shell Oil itself was involved in 11 of the cases (13.1%). Further, Equilon Enterprises LLC, which conducted business as Shell Oil products, U. S., was involved in 10 cases (11.9%). Therefore, Shell and its affiliate accounted for 21 of the 84 cases (25.0%). However, four of the 84 cases involved Motiva Enterprises, a 50-50 joint venture between Shell Oil and Saudi Refining, a wholly owned subsidiary of Aramco Services Company. Hence lumping this partial-Shell operation with the aforesaid 21 cases involving Shell yields a total of 25 cases involving Shell (29.8% of the total 84 cases).

Of the 84 cases for the 2001-2010 period, 52 represented Federal District Court decisions while 32 represented Circuit Court of Appeals or State Appeals Court decisions. The franchisor companies won 41 of the 52 district court decisions (78.8%) with the franchisee dealers winning 11 (21.2%). The franchisor companies won 25 of the 32 appeal cases (78.1%) with the franchisee dealers prevailing in the remaining 7 appeal cases (21.9%). Eight of the 32 appeal cases were appeals of their eight counterparts in district court. Thus, 15.4% of the district court cases decided in this time span were appealed (8 out of 52). This would seem to be a relatively small amount of appeals thereby suggesting relative satisfaction among parties to franchise agreements with the working of the PMPA in the judicial system.

Table 2 provides a breakdown of the bases of the decisions rendered in favor of the franchising oil companies over the 2001-2010 study period.

**TABLE 2**  
**NUMBER OF PMPA CASES DECIDED IN FAVOR OF OIL COMPANIES,**  
**WITH BASES OF THE DECISIONS, 2001-2010**

<b>Section of Act or Other Basis (es) of Decisions</b>	<b>Number of Cases</b>
Sec. 2802(b) (2) <sup>1</sup>	1
Sec. 2802(b) 2 (A) <sup>2</sup>	11
Sec. 2802(b) 2 (B) <sup>3</sup>	4
Sec. 2802(b) 2 (C) <sup>4</sup>	11
Sec. 2802(b) 2 (E) <sup>5</sup>	5
Sec. 2802(b) 3 (A) <sup>6</sup>	5
Sec. 2802(b) 3 (D) <sup>7</sup>	2
Sec. 2804(a) (2) <sup>8</sup>	1
Sec. 2804 (b) <sup>9</sup>	3
Improper Venue	1
No Valid Claim Under PMPA	16
No Cause of Action Under PMPA	3
No Standing Under PMPA	1
Breach of Contract	1
Prevailing Party Awarded Attorney Fees	1
<b>TOTAL</b>	<b>66</b>

As the reader can see, nearly a third of the cases rendered in favor of the franchisor companies (20 of the 66, for 30.3%) involved essentially illegitimate claims against the

franchisors involved. That is, in 16 of these cases, the courts ruled that there was no cause of action under the PMPA; in three others, that there was no valid claim under the PMPA, and in one case, that the plaintiff had no standing under the PMPA. The two leading groups of cases won by the franchisors related to terminations and nonrenewals permitted for failure by franchisees to comply with any provision of the franchise and to terminations and nonrenewals permitted due to the occurrence of an event which was relevant to the franchise relationship, i.e. such events as enumerated in Appendix A. There were 11 cases (16.7%) decided in favor of franchisors on the basis of each of these two provisions of the PMPA. That is, a full third of the cases won by the franchisors were decided on the basis of these two PMPA provisions.

Interestingly, six of the cases decided in favor of franchising oil companies involved constructive termination claims by franchisees. Generally such claims involve contentions by franchisees that changes in existing franchise arrangements made by franchisors have effectively or constructively terminated the agreement in violation of the PMPA. That is, these constructive terminations represented wrongful terminations under the PMPA. Over the past two and one-half decades, the various Federal Courts of Appeal have been divided over whether a constructive termination claim requires an end to the actual operation of the franchise. That is, can franchisors be guilty of wrongful terminations even when franchisees continue to operate under new conditions imposed by franchisors? The First and Fourth Circuit Courts have maintained that a franchisor can violate the PMPA through constructive terminations even when franchisees continue to exercise all the statutory components of their franchises. However, the Sixth and Ninth Circuit Courts have essentially taken the opposite position that a termination under the PMPA can only occur when a statutory component of the franchise is terminated or discontinued. Further, the Seventh and Eleventh Circuit Courts have indicated agreement with the position of the Sixth and Ninth Circuits without definitively resolving the question. Recently, the U. S. Supreme Court ruled that a franchisor does not terminate a franchise under Section 2802 (a) (1) of the PMPA even constructively or informally, unless it ends at least one of the three statutory elements of the franchise, such elements being the use of the franchisor's trademark, use of the franchise premises, and the receipt of the franchisor's branded motor fuel. (*Mac's Shell Service, Inc., v. Shell Oil Products Co., LLC*, 130 S. Ct. 1251).

Table 3 shows the bases of the eighteen decisions rendered in favor of the franchisees over the 2001-2010 study period.

**TABLE 3**  
**NUMBER OF PMPA CASES DECIDED IN FAVOR OF FRANCHISEES, WITH BASES**  
**OF THE DECISIONS, 2001-2010**

Section of Acts or Other Basis (es) of Decisions	Number of Cases
Section 2802(a) (1): Wrongful termination or nonrenewal	10
Section 2802(b) (E)iii: Proper Right of First Refusal not provided	1
Section 2804(a) (2): Insufficient Number of Days Notice of Termination Provided	1
Section 2804(b): Failure to meet Sufficient Notification Requirements	1
Breach of Contract: Breach of Contract Claims of Franchisee Not Preempted by PMPA	2
Constructive Termination	1
No Valid Claim Under PMPA: Tortious Business Interference with Prospective Business Relations Claim not Preempted by PMPA	1
Continuation of a Prior Case: Awarding of Attorney's Fees to Franchisee in an earlier decision for the Franchisee	1
<b>TOTAL</b>	<b>18</b>

Although listed separately for emphasis and specificity, the case above involving constructive termination actually comes under wrongful termination under Section 2802 (a) (1) of the PMPA. Hence, eleven of the eighteen (61.1%) decisions favoring the franchisees involved wrongful termination by franchisors.

### **The Two Study Periods**

The above findings relative to the number and disposition of the PMPA cases decided during the two study periods of 1978-1984 and 2001-2010 suggest that PMPA enforcement worked reasonably well in both of the study periods. In the earlier, shorter span of study, 92 cases were decided through the judiciary process. However, a smaller number of cases (84) were adjudicated in the second, longer period of study. This tends to suggest improved acceptability of and adaptability to the PMPA over time. The leading basis for decisions favorable to franchisors in the earlier student period, the reader will recall, was Section 2802(b)(2)(c) of the PMPA which permits termination or nonrenewal due to an event under which such action is held to be reasonable. Recall that the specific events included under this provision of the Act are listed in Appendix A. In fact, these event-driven terminations or nonrenewals provided the basis for 26 of the 60 decisions rendered for the franchise (43.3%). An additional 12 of the decision favorable to franchisors in the earlier study period (20%) were based on Section 2802 b (3)(A) of the PMPA, the section permitting termination or nonrenewal due to the failure of the franchisor and franchisee to agree to changes or additions to the provisions of the franchise.

In contrast, the leading basis for the cases favoring franchisors in the later study period was simply a lack of a valid claim rendered by franchisees under the PMPA against franchisors. Recall that this applied to 16 of the 66 cases (24.3%) of the cases decided in favor of franchisors. Only eleven of the 66 cases (16.7%) were decided on the basis of Section 2802(b)(2)(c) dealing with event-driven terminations or nonrenewals. An equal number of decisions favorable to

franchisors (again 16.7%) were decided on the basis of Section 2802(b)(2)(A) of the PMPA, i. e. the section dealing with a franchisee's failure to comply with provisions of the franchise agreement. Only five of the 66 decisions (7.6%) favorable to franchisors in the second study period were decided on the basis of Section 2802(b) (3)(A) of the PMPA relative to the parties failing to agree on changes to the franchise agreement (lower than the 20% of cases favorable to franchisors in the earlier study period. Though their percentages varied widely, the leading basis for decisions rendered in favor of franchisees in both study periods related to, perhaps not surprisingly, to the failure of franchisors to comply with appropriate notice requirements, hence, to wrongful termination on the part of franchisors. For the earlier study period, 9 of the 32 cases (28.1%) favorable to franchisees were related to wrongful termination, while ten of the 18 cases (55.6%) favorable to franchisees dealt with this issue in the later study period. Overall, it would seem that familiarity with the implementation of the PMPA has moderated the instances of reckless terminations and nonrenewals on the part of franchisors over time and has served as a check on invalid claims against the franchising oil companies.

## RESULTS

The following results are taken directly from the prior study by the first author, Greco (1988), and are listed here for comparison purposes:

*“An attempt was made to measure the influence of the Petroleum Marketing Practices Act on the number of franchisee-owned gasoline service stations. Since a number of other factors would also influence this amount, a linear multiple regression model was set up regressing the number of annual franchises on the following independent variables: (1) gasoline sales (as an indicator of demand), (2) the number of company-owned franchises, (3) U. S. average retail price of regular unleaded gasoline, (4) U. S. average wholesale price for motor gasoline, (5) U. S. resident population, (6) the presence or absence of the Petroleum Marketing Practices Act for the years covered in the regression model, and (7) total annual supply of finished motor gasoline (inclusive of imports).*

*Complete data were available for this set of variables only for the ten-year period, 1976-1985, and only on an annual basis. The resulting regression equation for this time span was of the form:*

$$Y = a + b_1X_1 + b_2X_2 + b_3X_3 + b_4X_4 + b_5X_5 + b_6X_6 + b_7D$$

Where:

*Y = the Number of Franchises*

*a = the constant term*

*X<sub>1</sub> = Annual Gasoline Sales*

*X<sub>2</sub> = Company Owned Franchises*

*X<sub>3</sub> = Average U. S. Retail Price of Regular Unleaded Gasoline*

*X<sub>4</sub> = Average U. S. Wholesale Price of Motor Gasoline*

*X<sub>5</sub> = Annual U. S. Resident Population*

*X<sub>6</sub> = Annual Total Supply of Finished Motor Gasoline*

*D = Regulation (PMPA),*

*D = 1 if PMPA was in effect,*

*= 0 if PMPA was not in effect,*

*b<sub>1</sub> ... b<sub>7</sub> = coefficients of the respective independent variables.*

Specifically, the estimated regression equation was:

$$Y = 461,169 - 0.0544509X_1 + 0.964611X_2 - 301.671X_3 + 371.73X_4 \\ \quad \quad \quad (-0.165) \quad \quad (1.1035) \quad \quad (-1.045) \quad \quad (0.909) \\ -1.50314X_5 - .00472294X_6 + 2052.22D \\ \quad \quad \quad (-2.341) \quad \quad (-0.246) \quad \quad (1.102)$$

Computed *t* values are given in parentheses below the coefficient of each of the independent variables. The critical *t*-value for a ninety-five percent confidence level or five percent level of significance with two degrees of freedom is 2.92 (one-tailed test). It is obvious from the above that none of the independent variables proved to be a significant predictor at the five percent level of significance. In fact, only population proved to be significant at the ten percent level of significance or ninety percent confidence level. Hence, regulation through the Petroleum Marketing Practices Act did not appear to be a significant influence on the number of franchised gasoline service station outlets.

However, the entire regression equation did show a statistically significant relationship between the dependent variable, the number of franchises, and the set of independent variables which it includes. The coefficient of determination had a value of 0.999, and the adjusted coefficient of determination was 0.997. This, therefore, suggests that virtually all of the variation in the number of franchises is explained by the set of independent variables contained in the multiple regression equation used. As further evidence of the equation, the computed *F*-statistic of 237.78 far exceeded the critical *F*-value of 193.6 for degrees of freedom 7 and 2 of the ninety-five percent confidence level.

The author had hoped to incorporate more observations in this analysis, but the data were unavailable. Further, data on cost factors, such as the initial cost of obtaining a franchise, as well as, the cost of operating such a franchise, were unavailable for use as independent variables in the regression analysis.”

A similar multiple regression model was sought to analyze the influence of the Petroleum Marketing Practices Act and other relevant factors on the number of franchisee-owned gasoline service stations in the more recent study period. This interest in such an analysis was generated by the two amendments to the PMPA, which were completed in 1994 and 1997, subsequent to the original research on the effects of the PMPA. Therefore, the intention was to estimate via regression the number of annual gasoline franchises using the same set of independent variables. However, data for the number of company-owned franchises and the number of non-company franchisees were not available for the entire 1995-2010 proposed study period. However, annual data were available for the number of convenience stores selling gasoline. Since nearly all gasoline is sold in conjunction with a convenience store arrangement and since a continuously large percentage of convenience stores sell gasoline, the number of convenience stores selling gasoline was used as a proxy dependent variable and the number of convenience stores was used as one of the independent variables.

Since annual data were also available for the period 1995-2010 for annual gasoline sales, the average U.S. retail price of gasoline, the average U.S. wholesale price of motor gasoline, annual U.S. population, and the annual total supply of finished motor gasoline, as well as, for the convenience store fuel margin as a percentage of sales and for the average margin per gallon of gasoline (cents per gallon), this sixteen-year period was chosen as the period of analysis in the more recent study period. The PMPA was in effect for every year of this 1995-2010 study

period. Hence, no dummy variable was needed to reflect the annual presence or absence of the regulation.

The resulting multiple linear regression equation for the 1995-2010 study period is of the form:

$$\hat{Y} = a + b_1X_1 + b_2X_2 + b_3X_3 + b_4X_4 + b_5X_5 + b_6X_6 + b_7X_7 + b_8X_8$$

where:

$\hat{Y}$  = the number of convenience stores selling gasoline

a = the constant term

$X_1$  = annual gasoline sales

$X_2$  = the number of convenience stores

$X_3$  = the annual retail price of motor gasoline

$X_4$  = the average US wholesale price of motor gasoline

$X_5$  = annual US resident population

$X_6$  = annual total supply of finished motor gasoline

$X_7$  = convenience store fuel margin as a percentage of sales

$X_8$  = the average margin per gallon of gasoline (cents per gallon)

$b_1, \dots, b_8$  = coefficients of the perspective independent variables.

Before finalizing the regression coefficients, the cases were examined for outliers. An outlier is any case that has a residual more than 3 standard deviations from the regression line (IBM, 2010). By this criterion, data for the year 2002 produced a standardized residual of 3.26, and so this case was removed from further analysis. Repeating the regression analysis without year 2002, the case for year 2001 revealed a standardized residual of 3.221. Consequently, this case was also removed. Subsequent analyses identified no additional outliers, and so the final regression equation is specified as in Table 4. The final data utilized in the analysis are listed in Appendix B.

**TABLE 4  
REGRESSION MODEL**

Model	Beta	Standard Error	t	Sig.	Collinearity Statistics VIF
Constant	-227605.725	7321.842	-31.086		0.000
$X_5$ , population	.001	.000	10.178	0.000	6.338
$X_6$ , gas supply	4.544E-5	.000	9.750	0.000	6.338

$$\hat{Y} = -227,605.725 + 0.001X_5 - .00004544X_6$$

Only two independent variables, the annual U.S. resident population (“population”) and Annual Total Supply of Finished Motor Gasoline (“gas supply”) were found to be significant (i.e. non-zero) at the .05 significance level. Recall that in the previous work, the regression equation was listed using all independent variables, but none of those variables had coefficients that were statistically different from zero. In the present study period, population and gas supply are statistically significant.

**TABLE 5**  
**REGRESSION MODEL STATISTICS**

Statistic	Value
Adjusted R-Square	.995
Std. Error of Estimate	1287.334
Durbin-Watson	2.401
F-statistic	1206.626
Significance of F	.000

From Table 5 it is clear that virtually all variation, 99.5%, in the number of convenience stores selling gasoline is explained by variation in the U.S. population and in the finished supply of gasoline. The overall test of model significance (at least one coefficient is not zero) has a value of 1206.62, which is highly significant at the .05 level of significance for F with 2 and 11 degrees of freedom, respectively. In addition, the individual t-tests for significance of the individual variables in Table 4 are also significant for each of  $X_5$  and  $X_6$  with significance levels of 0.000 for both. The significance levels of 0.000 indicate the practical impossibility of obtaining the t statistics obtained for these variables if the true coefficients for these variables were, in fact, equal to zero.

The Durbin-Watson statistic is also provided, which indicates the desired lack of autocorrelation in the residuals, since the critical values for a sample of size  $n = 14$  and 2 independent variables are (.91, 1.55). In this case, the obtained statistic of 2.41 indicates that we fail to reject the null hypothesis of no residual correlation (Lind, Marchal, & Wathen, 2012). Finally, the variance inflation factor (VIF) is reported, which indicates no problems of multicollinearity between the two independent variables, since their VIF values fall within the acceptable range of values less than 10.0 (Lind et. al, 2012). These criteria collectively indicate a very strong linear model for predicting the number of convenience stores selling gasoline based on the U.S. population and the supply of gasoline.

The strength of this linear model is further indicated by the magnitude of the correlations between the 3 variables in the regression equation (see Table 6). The significance level for each pair of variables in Table 6 is 0.000, indicating that there is extremely strong evidence that the correlation values are not due to chance. The values of the correlations indicate a very strong (and near perfect direct) linear relationship between Y and each of  $X_5$  and  $X_6$ .

**TABLE 6**  
**CORRELATION COEFFICIENTS**

	Y	$X_5$	$X_6$
Y, # convenience stores	1.0		
$X_5$ , population	.978	1.0	
$X_6$ , gas supply	.976	.918	1.0

The practical interpretation of the values of the regression coefficients indicates the following:

- For each additional person in the U.S. population, the number of convenience stores selling gasoline increases by .001. Equivalently, for every 1000 additional people in the population, the number of convenience stores selling gasoline increases by one.
- For each additional barrel of gasoline available, the number of convenience stores selling gasoline increases by 0.00004544. Equivalently, for every additional 100,000 barrels of gasoline produced, the number of convenience stores selling gasoline increases by 4.544.

For comparison purposes, the geometric mean percent changes per year in each of the 3 variables was computed as .929% growth per year for the population, 3.467% growth per year in the number of convenience stores selling gasoline, and .932% growth per year in the total supply of finished motor gasoline. Interestingly, the growths of the U.S. population and of the supply of gasoline are almost identical. Given these facts, it is not surprising that the number of convenience stores selling gasoline can be very well predicted using the values of population and gas supply.

## **DISCUSSION**

This paper has reviewed the provisions of the Petroleum Marketing Practices Act, (PMPA), originally passed in 1978 and amended in 1994 and 2007, which was designed to protect gasoline franchisees from arbitrary and capricious termination by gasoline franchisors. Further, the paper reviewed the judicial cases brought under the PMPA during 1978-1984 (the earlier time period initially examined by the first author), as well as, over the recent 2001-2010 time span. An examination was made relative to the basis(es) for the cases brought during these two time periods. It was found that 92 cases were decided through the judicial process during the earlier time period; and 84, in the second. This lower number of cases in the second, longer time period suggests improved acceptability of and adaptability to the PMPA over time. The leading basis for the legal decisions rendered favorably to franchisors in the earlier period was essentially the section of the PMPA which permits terminations or nonrenewal due to a specific event under which such action is held to be reasonable. In contrast, the leading reason for decisions favoring franchisors in the later period was simply a lack of a valid claim rendered by franchisees under the PMPA against franchisors. The leading basis for decisions rendered in favor of franchisees in both study periods related to the failure of franchisors to comply with appropriate notice requirements, hence, to wrongful termination on the part of franchisors. Overall, the authors concluded that familiarity with the implementation of the PMPA has seemingly moderated the instances of reckless terminations and nonrenewal by franchisors over time and has served as a check on invalid claims under the Act against the franchising oil companies.

Multiple regression models were run over each time period to analyze the influence of the PMPA and other relevant factors on the number of franchisee-owned gasoline stations. Regulation through the PMPA did not appear to be a significant influence on the number of franchised gasoline service station outlets in either time period. In the first study period (which included years in which PMPA was in effect, as well as years in which it was not), none of the independent variables proved to be statistically significant. For the more recent time period, two independent variables were statistically significant: Annual U. S. Resident Population, and Annual Total Supply of Finished Motor Gasoline. Moreover, variation in these two independent

variables explained 99.5% of the variation in the number of convenience stores selling gasoline (the dependent variable). Further, the correlation coefficients suggested a very strong linear relationship between the dependent variable and each of the two independent variables.

From the second study period, virtually all variation (99.5%) in the number of convenience stores selling gasoline is explained by the two independent variables, U.S. population and supply of finished gasoline. It is therefore reasonable to conclude that no other variables, including any effects from the PMPA or its amendments are significant contributors to this variation (since only .5% of variation remains unexplained). One exception to this logic is the scenario in which the true effects of the PMPA and its amendments can be implicitly modeled as a linear combination of the U.S. population and/or the supply of finished motor gasoline. In general, such claims are not possible in linear regression because there is generally significant variability (20% or more) that is not explained by the independent variables in the regression equation. Based on this result, the passage of the PMPA in 1978, together with its amendments in 1994 and 2007 has not explicitly influenced the number of franchises selling gasoline in the United States.

## NOTES

1. No withdrawal by the company.
2. Permits termination or nonrenewal of franchise for failure by the franchisee to comply with any provision of the franchise which is both reasonable and of material significance to the franchise relationship.
3. Permits termination or nonrenewal for failure by franchisee to exert good faith efforts to carry out franchise provisions.
4. Permits termination or nonrenewal due to the occurrence of an event which is relevant to the franchise relationship the result of which makes said termination or nonrenewal reasonable.
5. Permits termination or nonrenewal of a franchise when a determination is made by a franchisor in good faith and in the normal course of business to withdraw from the marketing of motor fuel through retail outlets in the relevant geographic market area in which the marketing premises is located provided that the termination or nonrenewal is not for the purpose of converting the relevant premises to operation by employees or agents of the franchisor for such franchisor's own account.
6. Permits termination or nonrenewal due to the failure of the franchisor and franchisee to agree to changes or additions to the provisions of the franchise.
7. Permits termination or nonrenewal if a franchisor determines in good faith and in the normal course of business to convert a leased marketing premises to a use other than the sale of a distribution of motor fuel, or to materially alter, add to, or replace such premises, or to sell such premises.
8. Permits termination or nonrenewal if notification of such termination or nonrenewal is provided by the franchisor to the franchisee not less than 90 days prior to the effective date of such termination or nonrenewal.
9. Permits termination or nonrenewal provided additional notification requirements are satisfied by the franchisor.

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### **Legislation**

15 U. S. C. §§ 1221-1225 (1982).

15 U. S. C. §§ 2801-2841 (1982).

### **Appendix A: Termination or Nonrenewal of Franchise Relationship**

As used in subsection (b)(2)(C) of this section, the term “an event which is relevant to the franchise relationship and as a result of which termination of the franchise or nonrenewal of the franchise relationship is reasonable” includes events such as –

- (1) fraud or criminal misconduct by the franchisee relevant to the operation of the marketing premises;
- (2) declaration of bankruptcy or judicial determination of insolvency of the franchisee;
- (3) continuing severe physical or mental disability of the franchisee of at least 3 months duration which renders the franchisee unable to provide for the continued proper operation of the marketing premises;

- (4) loss of the franchisor's right to grant possession of the leased marketing premises through expiration of an underlying lease, if
  - (A) the franchise was notified in writing, prior to the commencement of the term of the then existing franchise—
    - (i) of the duration of the underlying lease; and
    - (ii) of the fact that such underlying lease might expire and not be renewed during the term of such franchise (in the case of termination) or at the end of such term (in case of nonrenewal);
  - (B) during the 90-day period after notification was given pursuant to section 2804 of this title, the franchisor offers to assign to the franchisee any option to extend the underlying lease or option to purchase the marketing premises that is held by the franchisor, except that the franchisor may condition the assignment upon receipt by the franchisor of—
    - (i) an unconditional release executed by both the landowner and the franchisee releasing the franchisor from any and all liability accruing after the date of the assignment for--
      - (I) financial obligations under the option (or the resulting extended lease or purchase agreement);
      - (II) environment contamination to (or originating from) the marketing premises; or
      - (III) the operation or condition of the marketing premises; and
    - (ii) an instrument executed by both the landowner and the franchisee that ensures the franchisor and the contractors of the franchisor reasonable access to the marketing premises for the purpose of testing for and remediating any environmental contamination that may be present at the premises; and
  - (C) in the situation in which the franchisee acquires possession of the leased marketing premises effective immediately after the loss of the right of the franchisor to grant possession (through an assignment pursuant to subparagraph (B) or by obtaining a new lease or purchasing the marketing premises from the landowner), the franchisor (if requested in writing by the franchisee not later than 30 days after notification was given pursuant to section 2804), during the 90-day period after notification was given pursuant to section 2804 of this title—
    - (i) made a bona fide offer to sell, transfer, or assign to the franchisee the interest of the franchisor in any improvements or equipment located on the premises; or
    - (ii) if applicable, offered the franchisee a right of first refusal (for at least 45 days) of an offer, made by another person, to purchase the interest of the franchisor in the improvements and equipment.
- (5) condemnation or other taking, in whole or in part, of the marketing premises pursuant to the power of eminent domain;
- (6) loss of the franchisor's right to grant the right to use the trademark which is the subject of the franchise, unless such loss was due to trademark abuse, violation of Federal or State law, or other fault or negligence of the franchisor, which such

- abuse, violation, or other fault or negligence is related to action taken in bad faith by the franchisor;
- (7) destruction (other than by the franchisor) of all or a substantial part of the marketing premises;
- (8) failure by the franchisee to pay to the franchisor in a timely manner when due all sums to which the franchisor is legally entitled;
- (9) failure by the franchisee to operate the marketing premises for-
  - (A) 7 consecutive days, or
  - (B) such lesser period which under the facts and circumstances constitutes an unreasonable period of time;
- (10) willful adulteration, mislabeling or misbranding of motor fuels or other trademark violations by the franchisee;
- (11) knowing failure of the franchisee to comply with Federal, State, or local laws or regulations relevant to the operation of the marketing premises; and
- (12) conviction of the franchisee of any felony involving moral turpitude.
- (d) Compensation, etc., for franchisee upon condemnation or destruction of marketing premises

**Appendix B: Final Regression Data for 1995 – 2010**

<b>Year *</b>	<b># of Convenience Stores selling Gas</b>	<b>Annual US Resident Population</b>	<b>Annual Total Supply of Finished Motor Gasoline</b>
1995	68,036	266,278,000	2,842,855,000
1996	75,482	269,394,000	2,887,954,000
1997	76,358	272,647,000	2,926,148,000
1998	83,001	275,854,000	3,012,497,000
1999	89,550	279,040,000	3,077,242,000
2000	93,444	282,172,000	3,100,774,000
2003	104,560	290,211,000	3,261,237,000
2004	109,182	292,892,000	3,332,579,000
2005	109,711	295,561,000	3,343,131,000
2006	114,974	298,363,000	3,377,174,000
2007	115,133	301,290,000	3,389,269,000
2008	114,741	304,060,000	3,290,057,000
2009	115,344	307,007,000	3,283,730,000
2010	117,365	308,745,538	3,297,564,000

*\* Cases for 2002 and 2001 were removed as outliers*