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Petroleum Marketing Practice Group:

This Alert has been prepared by Shipman & Goodwin's Petroleum Marketing Practice Group for the use of its clients and friends. For further information, please contact one of the following attorneys:

Paul D. Sanson
(860) 251-5721
psanson@goodwin.com

Vaughan Finn
(860) 251-5505
vfinn@goodwin.com

Karen T. Staib
(860) 251-5612
kstaib@goodwin.com

Laurie A. Sullivan
(860) 251-5589
lsullivan@goodwin.com

www.shipmangoodwin.com

First Circuit Appears to Affirm Principle That Terminations Based on PMPA §2802(c) Are Per Se Reasonable

The Shell Company (Puerto Rico) Ltd. v. Los Frailes Service Station, Inc.,

605 F.3d 10 (1st Cir. 2010)

Shell terminated a franchisee based on the occurrence of events specifically identified in § 2802(c) of the PMPA as justifying termination. The franchisee challenged the termination, claiming that these events (such as its failure to purchase gasoline) were caused by unlawful acts of Shell, and that the district court was required to consider whether termination based on these events was objectively reasonable, not just whether they had occurred. The First Circuit affirmed the ruling in Shell's favor, reiterating that it is the law of the Circuit that, if an event specified in §2802(c) of the PMPA occurs, "termination is conclusively presumed to be reasonable as a matter of law." Somewhat curiously, however, the Court went on to say "[w]e need not evaluate the wisdom of [that] *per se* rule" because the result would be the same even if Shell's termination were reviewed on an objectively reasonable basis. 605 F.3d 10 at 21 & n.7. The Court then noted that the Fourth Circuit also has a *per se* rule but that the Third and Sixth Circuits do not and instead conduct some inquiry into the events giving rise to the termination to determine if the termination was objectively reasonable.

It is unclear whether the Court undertook this additional analysis out of concern over the viability of a *per se* approach or simply to make its decision appeal proof in light of the conflict among the circuits. To be on the safe side, franchisors basing terminations on §2802(c) grounds should consider seeking a finding by the trial court that the termination was also objectively reasonable.

Los Frailes, the franchisee, owned the property and leased it to Shell under a long term ground lease. Shell then subleased the property back to the franchisee. 605 F. 3d at 14. Due to cash flow



problems, which Los Frailes claimed were caused by unlawful actions by Shell, Los Frailes failed to make fuel payments on time and then temporarily closed the premises when Shell refused to deliver more gas. The franchisee thereafter took down most (but not all) Shell trade dress and signage, and began selling non-branded gas. *Id.* at 17. Shell terminated the franchise under § 2802(b)(2)(C), for failure to pay the franchisor in a timely manner, failure to operate the marketing premises for an unreasonable period of time, and willful adulteration and misbranding of fuels/ other trademark violations. *Id.* at 17, 20.

The district court found that termination was proper; awarded a permanent injunction ordering the franchisee to refrain from using Shell's trademarks, trade dress or color patterns; and ordered the franchisee to comply with certain post-termination contractual obligations. *Id.* at 26. The First Circuit upheld the district court's decision in all respects, except as to a portion of the injunctive relief that gave Shell particular rights under the ground lease, as opposed to those derived from the PMPA. *Id.*

The franchisee argued in the district court that the PMPA requires courts to determine whether a termination is objectively reasonable, not just whether an event listed under § 2802(c) technically occurred. The district court rejected this argument, holding as a matter of law that Shell's termination was per se reasonable because it was based on three explicitly listed grounds for termination. While acknowledging that the district court's interpretation of the PMPA "reflects the law of this circuit," *id.* at 21 n.7 (citing Defosses v. Wallace Energy, Inc., 836 F.2d 22, 26 (1st Cir. 1987)), the First Circuit stated that it "need not evaluate the wisdom of a per se rule" because the franchisee could not prevail even under an objectively reasonable standard. Although the First Circuit noted that the district court had not actually found that the termination was objectively reasonable, it concluded that the lower court's reasoning "suggested" the termination was valid under this standard and held that various fact findings in that regard were not clearly erroneous. The First Circuit also noted that, while the Fourth Circuit has also adopted a per se rule, the Third and Sixth Circuits have applied an objective reasonableness test. Compare Hinkleman v. Shell Oil Co., 962 F.2d 372, 377 (4th Cir. 1992) (per curiam) with Patel v. Sun Co., 141 F.3d 447, 456-57 (3d Cir. 1998) and Marathon Petroleum Co. v. Pendleton, 889 F.2d 1509, 1512 (6th Cir. 1989).

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One Constitution Plaza
Hartford, CT 06103-1919
860-251-5000

300 Atlantic Street
Stamford, CT 06901-3522
203-324-8100

1133 Connecticut Avenue NW
Washington, DC 20036-4305
202-469-7750

289 Greenwich Avenue
Greenwich, CT 06830-6595
203-869-5600

12 Porter Street
Lakeville, CT 06039-1809
860-435-2539

www.shipmangoodwin.com



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