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Opinion No. 09-62

Conflicts Between Senate Bill SB1931/HB1517 and State and Federal Petroleum Practices Laws

QUESTIONS

1. Does Senate Bill SB1931/HB1517, as proposed, improperly interfere with or abrogate the rights of a franchisor to protect the quality of fuel sold under its franchise agreements when read in conjunction with the existing state and federal petroleum practices acts, the Tennessee Petroleum Trade Practices Act, Tenn. Code Ann. §§ 47-25-601, *et seq*., the Federal Petroleum Marketing Practices Act, 15 U.S.C. §§ 2801, *et seq*., and the Tennessee Constitution?

2. Does SB1931/HB1517 abrogate the rights of a franchisor to select its own customers under existing state and federal petroleum practices acts?

OPINIONS

1. No. Neither the Tennessee Petroleum Trade Practices nor the Federal Petroleum Marketing Practices Act provides a franchisor with a substantive right to protect the quality of fuel sold under its franchise agreements.

2. No. State and federal petroleum practices laws do not specifically provide a franchisor with the right to select its own customers. In addition federal petroleum practices laws do not preempt a state's ability to regulate a franchisor's sale of petroleum.

3. The above analysis notwithstanding, SB1931/HB1517 is constitutionally suspect on other grounds outside of the scope of the questions posed.

ANALYSIS

Senate Bill SB1931/HB1517 ("SB1931") proposes to amend Tennessee Code Annotated, Title 47, Chapter 25 by adding a new part entitled "Tennessee Renewable Fuels Blending Act of 2009." The stated purpose of SB1931 is to encourage and foster the use of biofuels, like ethanol, and thus reduce reliance on out-of-state imported petroleum products. Although not directly stated in the text of SB1931, a Tennessee General Assembly Fiscal Review Note also indicates

that SB1931 was developed in response to the recent refusal by some petroleum suppliers to provide unblended petroleum to Tennessee wholesalers. Instead, suppliers have begun requiring wholesalers to purchase pre-blended ethanol, thereby raising local wholesalers' costs and depriving the State of at least $100,000 in tax revenues. *See* TENNESSEE GENERAL ASSEMBLY FISCAL REVIEW COMMITTEE, CORRECTED FISCAL NOTE SB 1931 - HB 1517 (March 17, 2009). SB1931 attempts to preserve revenues for Tennessee wholesalers who produce income through cost-savings by blending ethanol themselves.

In order to achieve these purposes, SB1931 requires the following:

> All refiners, suppliers and permissive suppliers in this state shall make available to any wholesaler all grades of gasoline, including regular, premium and midgrade, and all grades of diesel available at the terminal in such condition that such wholesaler may blend ethanol or other biological products to create those grades of petroleum products generally available for sale by retailers in this state. In addition, gasoline products must be made available with detergent additives in sufficient concentrations such that after the addition of ethanol, the final product meets or exceeds the Lowest Additive Concentrations as required by the United States environmental protection agency (EPA).

Senate Bill SB1931, § 47-25-2003. In short, SB1931 requires petroleum suppliers to make unblended petroleum available to wholesalers.

SB1931 also states that "[a]ny contract between a wholesaler and a refiner, supplier, or permissive supplier executed or renewed on or after the effective date of this act, which forbids, limits or restricts a wholesaler's ability to blend petroleum products, shall be void as against public policy." Senate Bill SB1931, § 47-25-2004. This provision, in effect, prevents suppliers from contractually prohibiting or limiting wholesalers' ability to blend their own ethanol.

1. If enacted, Section 47-25-2004 of SB1931 will void contracts that "forbid[], limit[] or restrict[]" wholesalers from blending petroleum on their own.[1] *Id*. This provision applies, however, only to contracts executed or renewed after the enactment of SB1931. Without having been provided with or reviewing any actual contracts, the Attorney General's Office cannot state whether any existing franchise agreements would, if renewed, be voided by SB1931. If, however, a supplier and wholesaler execute or renew a franchise agreement which contains fuel quality control provisions that act to place conditions on a wholesaler's ability to blend petroleum products, the franchise agreement would be void under SB1931.

The central purposes of the Tennessee Petroleum Trade Practices Act, Tenn. Code Ann. §§ 47-25-601, *et seq*. (the "TPTPA") are (1) to regulate vertical integration of the petroleum industry in Tennessee in order to protect free trade, full competition and to reduce the price of petroleum, and (2) to protect independent and small distributors and dealers from subsidized

[1] The Senate Finance, Ways and Means Committee voted to amend Section 47-25-2004 of SB1931 on April 8, 2009, to void only the offending contract provision and not the entire contract. The amendment does not change the analysis which follows.

pricing by vertically integrated retailers.[2] Tenn. Code Ann. § 47-25-603. In order to achieve these purposes, the TPTPA contains provisions regulating below-cost sales of petroleum. In addition, the TPTPA governs the creation and termination of franchises between suppliers and wholesalers. For example, TPTPA § 47-25-621 obligates suppliers to provide wholesalers with certain information before entering into a franchise agreement. Likewise, TPTPA § 47-25-622 mandates certain non-waivable provisions in the franchise agreement concerning pricing and contract termination. The TPTPA, however, does not discuss a supplier's right to protect the quality of petroleum it sells by contract. Accordingly, the TPTPA does not create any substantive right for a supplier to protect the quality of fuel sold under its franchise agreements.

The Federal Petroleum Marketing Practices Act, 15 U.S.C. §2801, *et seq*. (the "FPMPA") also governs franchise agreements between suppliers and wholesalers. The purpose of the FPMPA is "to create a uniform set of rules covering the grounds for termination and non-renewal of motor fuel marketing franchises, and 'to protect franchisees from arbitrary or discriminatory termination or non-renewal of their franchises.'" *Massey v. Exxon Corp.*, 942 F.2d 340, 342 (6th Cir. Ky. 1991) (citing *Brach v. Amoco Oil Co.*, 677 F.2d 1213, 1216 (7th Cir. 1982)). The FPMPA "is intended to remedy the extreme disparity of bargaining power between refiners and dealers and to …. remedy the historic disadvantage gasoline dealers have experienced by preventing arbitrary terminations and nonrenewals." *Gruber v. Mobil Oil Corp.*, 570 F. Supp. 1088, 1091 (E.D. Mich. 1983). Thus the FPMPA's provisions are designed primarily to protect franchisees, not franchisors. Accordingly, like the TPTA, the FPMPA does not create a substantive right for a franchisor to protect the quality of the fuel sold under its franchise agreement. Thus, SB1931 cannot be said to interfere improperly with or abrogate such a right pursuant to the FPMPA.

Article 1, § 20 of the Tennessee Constitution, often referred to as the "Contracts Clause," protects existing contracts from retroactive impairment by legislative action. Specifically, § 20 provides "[t]hat no retrospective law, or law impairing the obligations of contracts, shall be made." Tenn. Const. Art. I, § 20. SB1931 however, does not apply retroactively, but only to agreements "…executed or renewed on or after the effective date of this act…." SB1931, § 47-25-2004. Thus, SB1931 does not violate the Contracts Clause of the Tennessee Constitution.

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[2] (a) The purpose of this part is to regulate vertical integration of the petroleum industry in Tennessee, it being the conclusion of the general assembly hereby expressed that vertical integration tends to operate in restraint of free trade and inhibits full and free competition and, therefore, tends to increase the price of petroleum and related products and services as prohibited under part 1 of this chapter.

(b) Independent and small dealers and distributors of petroleum and related products are vital to a healthy, competitive marketplace, but are unable to survive subsidized below-cost pricing at the retail level by others who have other sources of income. Below-cost selling laws have been effective in preserving independent and small retailers and wholesalers in other trades and businesses from subsidized pricing. Subsidized pricing is inherently unfair and destructive to, and reduces competition in, the motor fuel marketing industry, and is a form of predatory pricing. An additional purpose of this part is to prevent and eliminate subsidized pricing of petroleum and related products.

Tenn. Code Ann. § 47-25-603.

2. SB1931 requires that "[a]ll refiners, suppliers and permissive suppliers in this state shall make available to *any* wholesaler" petroleum in a non-blended state. SB1931, § 47-25-2003 (emphasis added). Currently, suppliers can select (subject to antitrust laws) the wholesalers to whom they will sell petroleum. If SB1931 is enacted as currently drafted, however, suppliers will no longer be able to decide whether and to which wholesalers they will make non-blended petroleum available.

As noted above, the TPTPA governs the creation and regulation of franchises and the sale of petroleum below cost. The TPTPA expressly states that "that nothing in this section shall prevent … [d]ealers engaged in selling petroleum products in commerce within the state of Tennessee from selecting their own customers in bona fide transactions and not in restraint of trade." Tenn. Code Ann. § 47-25-623(a)(1)(B). A dealer is defined as "…any person, firm, corporation, or partnership engaged in the sale of petroleum products to the public at retail." Tenn. Code Ann. § 47-25-602(2). SB1931, which does not use the same definitions as the TPTPA, defines two entities which might meet the definition of dealer: "retailer" and "wholesaler." A retailer is defined as "a person who engages in the business of selling or distributing petroleum products to the end user within this state through a retailer station." SB1931, § 47-25-2002(7). A wholesaler is defined as "an entity which acquires petroleum products from a supplier, importer, or from another wholesaler, for subsequent sale and distribution at wholesale by tank cars, transport trucks or vessels, and subsequently resells to retailers, other wholesalers or to consumers from its own or its wholly owned affiliated retail locations." SB1931, § 47-25-2002(12). Thus, to the extent that persons defined as retailers or wholesalers under SB1931 sell petroleum products to the public at retail, the TPTPA will not prevent them from selecting their customers. There is, however, no corresponding provision in the TPTPA with respect to a supplier's right to decide to whom it will sell petroleum. Thus SB1931 does not abrogate the rights of a supplier to choose its own customers under the TPTPA, because such a right does not exist under the TPTPA.

The FPMPA, like the TPTPA, has no provision that expressly states that a supplier can select to whom it sells petroleum. In addition, courts have recognized that the FPMPA only preempts state law concerning the renewal, termination and notice of franchise agreements. "Beyond those limits, state regulation may claim full approbation." *Exxon Corp. v. Georgia Assn of Petroleum Retailers*, 484 F. Supp. 1008, 1017 (N.D. Ga. 1979). SB1931, § 47-25-2300's requirement that suppliers make non-blended petroleum available to any wholesaler does not concern the renewal or termination of, or notice required in, franchise agreements. The FPMPA, therefore, does not create a right for suppliers to provide petroleum to customers of their choice, nor does it preempt a state's ability to regulate sales of non-blended petroleum products. Accordingly, SB1931 does not improperly abrogate a supplier's right to select customers under the FPMPA.

3. Although the Attorney General's Office was not requested to consider other infirmities with SB1931, certain aspects of the bill may be constitutionally suspect. For example, if enacted, § 47-25-2004 will void any new contract or contract renewal that contains any provision prohibiting or placing conditions on a wholesaler's ability to blend petroleum products. As drafted, § 47-25-2004 can reach and void contracts between parties not involved in selling petroleum in Tennessee. The terms "retailer" and "wholesaler", as defined in SB1931, §

47-25-2002, are not clearly defined to limit their scope to Tennessee-based activities and could be construed to refer to parties located anywhere in the United States. For example, a retailer located in Kentucky contracts with a wholesaler located in Arkansas, who only resells to other wholesalers or through its own retail stations in Arkansas, and the contract contains a provision prohibiting the wholesaler from blending ethanol. Pursuant to SB1931, § 47-25-2004, this contract would be void as against public policy. This result likely implicates the Commerce Clause, U.S. CONST. art. 1, § 8, cl. 3, which grants to Congress the exclusive power "[t]o regulate Commerce … among the several States…."

Furthermore, according to the General Assembly Fiscal Note, SB1931 is a response to the refusal by out-of-state suppliers to sell non-blended petroleum to Tennessee wholesalers which "effectively shifted income and/or profits away from certain Tennessee petroleum wholesalers and to out-of-state suppliers." CORRECTED FISCAL NOTE SB 1931 - HB 1517. SB1931 attempts to rectify this by requiring refiners to offer non-blended fuel to Tennessee wholesalers, shifting blending revenues from out-of-state refiners back to in-state wholesalers. This, too, likely implicates the Commerce Clause:

> The U.S. Supreme Court has held that the Commerce Clause "directly limits the power of the States to discriminate against interstate commerce." The restraint is referred to as the "dormant" Commerce Clause. To evaluate a state's regulatory measures under the dormant Commerce Clause, the first step is to determine whether it "regulates evenhandedly with only incidental effects on interstate commerce, or discriminates against interstate commerce." The term, "discrimination" means "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter. If a restriction on commerce is discriminatory, it is virtually per se invalid."

Free the Fathers, Inc. v. State, 2008 Tenn. App. LEXIS 67, fn. 3 (Tenn. Ct. App. Feb. 7, 2008) (citations omitted). To the extent that SB1931 attempts to promote in-state wholesaler interests at the expense of out-of-state suppliers or refiners, it is constitutionally suspect under the dormant Commerce Clause doctrine.

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