

STATE OF NORTH CAROLINA
LEE COUNTY

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
08 CVS 00692

THE PANTRY, INC.,)
)
Plaintiff,)
)
vs.)
)
CITGO PETROLEUM CORP.,)
)
Defendant.)
_____)

MEMORANDUM OF LAW
IN SUPPORT OF MOTION
TO DISMISS PURSUANT TO
RULE 12(b)(6)

This suit involves a dispute over the price that CITGO Petroleum Corporation (“CITGO”) charges The Pantry, Inc. (“Pantry”) for a type of motor fuel commonly known as “E10,” or “gasohol.” E10 is a mixture of ninety percent gasoline and ten percent ethanol. The parties’ supply agreement contains a “Market Related Pricing” provision that calculates prices for motor fuel sold to Pantry based on the “posted” prices charged by other suppliers in the relevant local markets. CITGO calculates the contract price for E10 based on posted market E10 prices. Pursuant to the contract between the parties, the “posted” prices are obtained from the Oil Price Information Service (“OPIS”), which issues daily price reports for each of the various types of motor fuel sold by each supplier at each gasoline distribution terminal nationwide.

In its Complaint, Pantry asserts that CITGO is required to use the posted market prices for standard, “clear” gasoline (*i.e.*, containing no ethanol) in calculating the contract price for ethanol-based E10 – *an entirely different motor fuel product with different OPIS prices*. Pantry’s interpretation defies common sense and is contrary to the plain language of the parties’ written agreement. For the reasons discussed below, the Complaint should be dismissed.

BACKGROUND

Pantry purchases motor fuel from CITGO for resale under a written contract called the Distributor Franchise Agreement (the “DFA” or the “Contract”).¹ (*See* Cmpl. ¶ 7.) The price term of the DFA was re-negotiated in February 2003 (the “Addendum,” contained in Exhibit A at 10-17) to allow Pantry to purchase motor fuel under a “Market Related Pricing” formula. (*See* Cmpl. ¶ 7; Ex. A at 11.)² The amended pricing term, which remains in effect today, provides in pertinent part:

4. MARKET RELATED PRICING: The purchase price *for the applicable motor fuel that the Company ratably purchases from CITGO* during the term of this Addendum shall be equal to (i) the Base Price set forth herein, plus (ii) an Adder Fee plus applicable taxes, if any.

(i) The Base Price of gasoline shall equal the average of the two lowest net OPIS rack prices *for the applicable grade of motor fuel at the applicable Terminal at the date of lifting*.

In determining the Base Price, CITGO shall not use any OPIS price which was published in error or posted by a supplier that has no motor fuels available for sale at the particular terminal on the applicable date.

. . . .

Ex. A at 11, ¶¶ 4 & 4(i) (emphasis added).

Pantry buys fuel from CITGO at multiple terminals located primarily in the South

¹ The Distributor Franchise Agreement, executed in or about August 2000, as amended, is attached hereto as Exhibit A. Exhibit A has been redacted to protect confidential, competitively sensitive, business information.

The Contract was not attached to the Complaint. The Court, however, may properly consider the Contract because the subject of the Complaint. *See, e.g., Oberlin Capital, L.P. v. Slavin*, 147 N.C. App. 52, 60, 554 S.E. 2d 840, 847 (2001) (“This Court has further held that when ruling on a rule 12(b)(6) motion, a court may properly consider documents which are the subject of a plaintiff’s complaint and to which the complaint specifically refers even though they are presented by the defendant.”).

² During 2002, Pantry had received competitive bids from a number of major oil companies (*see* Cmpl. ¶¶ 6-7), and the Addendum itself acknowledges that the Market Related Pricing offered by CITGO was to meet these competitive offers. *See* Ex. A at 10 (“WHEREAS, [Pantry] has received offers from other suppliers to purchase motor fuels; and therefore, has requested that CITGO sell branded and unbranded gasoline and low sulfur diesel on a similar basis.”).

and Southeastern United States. (See Cmplt. ¶¶ 7, 14.) At most of these terminals CITGO supplies standard gasoline, sometimes referred to as “clear” gasoline to distinguish it from E10 and the dozens of other unique types of motor fuel sold throughout the country.³ (See Cmplt. ¶¶ 14-15.) At two terminals (Savannah, Georgia and Orlando, Florida), CITGO supplies E10. (See *id.* ¶ 14.) Both E10 and clear gasoline come in three different octane levels (regular, mid-grade and premium). (See *id.*)

In reporting daily market prices, OPIS lists separate prices for E10 and clear gasoline and, in fact, provides separate prices for each of the three different octane levels of E10 and clear gasoline. (See *id.* ¶¶ 15-16.) Thus, for example, OPIS may list the following prices for terminals selling E10 and clear: E10 regular, E10 midgrade, E10 premium, clear regular, clear mid-grade, and clear premium. (See *id.*) When CITGO sells a particular octane level of clear gasoline to Pantry, CITGO charges a net price that is based on the two lowest OPIS posted prices for that octane level of clear gasoline sold at that terminal. (See Ex. A at 11, ¶ 4.) When CITGO sells a particular octane level of E10 to Pantry, CITGO charges a net price that is based on the two lowest OPIS posted prices for that octane level of E10 sold at that terminal. (See Cmplt. ¶ 16.)⁴

³ See generally EPA, Staff White Paper, *Study of Unique Gasoline Fuel Blends (“Boutique Fuels”), Effects on Fuel Supply and Distribution and Potential Improvements* at 46, 99-100 (Oct. 2001) (identifying 15 “Fuel Grades in U.S.” as of 2000 and noting that the “actual number of fuel grades which are distributed would likely be twice the numbers shown” once octane levels, *i.e.* regular and premium versions of each fuel, were counted) (available at <http://yosemite.epa.gov/ee/epa/ria.nsf/vwRef/A.2001.27+B?OpenDocument>).

⁴ Paragraph 15 of the Complaint states that “CITGO raised its posted price on E10 from 4 to 6 cents per gallon over clear gasoline.” But this has nothing to do with the price that Pantry actually pays for E10, which is based on the average of the two lowest OPIS prices for E10 in the relevant market. Thus CITGO’s posted price is only relevant to the price paid by Pantry if it is one of the two lowest prices in the market at issue.

In its Complaint, Pantry takes issue with CITGO's pricing of E10 under the DFA. Count I appears to seek a declaratory judgment that CITGO is required to take the posted price of clear gasoline into account in calculating the price for E10. Count II seeks damages for breach of contract based, presumably, on CITGO's past sales of E10 at the Savannah and Orlando terminals. Both counts fail as a matter of law.

ARGUMENT

On a motion to dismiss pursuant to Rule 12(b)(6), "[t]he trial court must treat allegations in the complaint as true, but the Court is not required to accept as true any conclusions of law or unwarranted deductions of fact." *Oberlin Capital, L.P. v. Slavin*, 147 N.C. App. 52, 56, 554 S.E.2d 840, 844 (2001) (citations omitted). "Thus the Court can reject allegations that are contradicted by the supplementary documents presented to it." *Covenant Equip. Corp. v. Forklift Pro, Inc.*, 2008 WL 1945973, at *8, No. 07 CVS 21932 (N.C.B.C. May 1, 2008). "Similarly, where the complaint alleges facts that defeat the claim, the claim should be dismissed." *Hudson-Cole Devel. Corp. v. Beemer*, 132 N.C. App. 341, 345, 511 S.E.2d 309, 312 (1999).

Oklahoma courts⁵ follow traditional and well-established rules of contract interpretation, particularly with regard to ascertaining the parties' intent:

The courts will read the provisions of a contract in their entirety to give effect to the intention of the parties as ascertained from the four corners of the contract, and where the language is ambiguous, it will be interpreted in a fair and reasonable sense. The courts will read the contract language in its plain and ordinary meaning unless a technical meaning is conveyed. The courts will decide, as a matter of law, whether a contract provision is ambiguous and interpret the contract provision as a matter of law.

⁵ The parties have agreed that their contract be interpreted in accordance with Oklahoma law. (See Ex. A at 9, ¶ 18.) "North Carolina will give effect to a contractual provision agreeing to a different jurisdiction's substantive law." *Covenant Equip.*, 2008 WL 1945973, at *8 (citing *Tanglewood Land Co. v. Byrd*, 299 N.C. 260, 262, 261 S.E.2d 655, 656 (1980)).

Oklahoma Oncology & Hematology P.C. v. US Oncology, Inc., 160 P.3d 936, 946 (Okla. 2007).

Here, the parties' clear, unambiguous intent – as ascertained from the four corners of the Contract – is that CITGO should calculate the price for E10 exactly as it has been doing: by using the two lowest net OPIS rack prices for E10 at a given terminal on the date of lifting by Pantry. The Contract's pricing provision is explicitly based on "[t]he purchase price for the applicable motor fuel that the Company ratably purchases from CITGO." (Ex. A at 11, ¶ 4) (emphasis added). It is undisputed that the "applicable motor fuel that the Company ratably purchases from CITGO" is indeed E10. *See* Cmplt. ¶¶ 14-16 (admitting that the product Pantry "ratably purchases from CITGO" is E10).

Moreover, the Contract states that E10 sold to Pantry should be based on "the average of the two lowest net OPIS rack prices for *the applicable grade of motor fuel* at the applicable Terminal at the date of lifting." (Ex. A at 11, ¶ 4(i).) The plain reading of this provision, and the Contract as a whole, is that when E10 is the motor fuel being purchased, "applicable grade of motor fuel" refers to the particular type of E10 – either regular E10, mid-grade E10 or premium E10 – being purchased by Pantry. *See Pierce Couch Hendrickson Baysinger & Green v. Freede*, 936 P.2d 906, 911-12 (Okla. 1997) ("A contract must be considered as a whole so as to give effect to all it [sic] provisions without narrowly concentrating upon some clause or language taken out of context.") (internal quotes and citation omitted); *see also Oklahoma Oncology*, 160 P.3d at 946 ("The Court will read the provisions of a contract in their entirety.").

Pantry has no logical basis for its assertion that for purposes of calculating its price, "applicable grade of motor fuel" should refer not to the particular type of motor fuel purchased (here, E10), but to other motor fuels that have the same octane rating (such as clear

gasoline). Specifically, in its Complaint, Pantry alleges that “[t]he ‘grade’ of motor fuel, as set out in Paragraph 4, refers to the octane rating: regular, unleaded, mid-grade, or premium,” and that “Paragraph 4(i) therefore calls for the price of gasoline to be set by the lowest prices for the same octane rating of motor fuel posted by any supplier in the city where The Pantry takes delivery.” (Cmplt. ¶ 8.) However, nothing in the Contract’s use of the phrase “applicable grade of motor fuel” suggests that *different* motor fuels with the same octane levels should be used in calculating Pantry’s price.⁶ To the contrary, the Contract’s use of the phrase “applicable motor fuel that the Company ratably purchases” in Paragraph 4 of the Addendum to preface the “applicable grade of motor fuel” language in Paragraph 4(i) suggests just the opposite – that only the OPIS listings for the “applicable motor fuel” that was purchased by Pantry should be taken into account.

Paragraph 4(i) must be read in conjunction with the prior statement in Paragraph 4 that defines the purchase price “for the applicable motor fuel.” Plaintiff’s construction would render Paragraph 4’s reference to the “applicable motor fuel” superfluous. *See U.S. Fidelity & Guaranty Co. v. Walker*, 329 P.2d 852, 856 (Okla. 1958) (“[A] cardinal rule of interpretation of contracts followed by this court, is that such construction must be placed thereon, if possible, as to give meaning to every provision contained in the contract.”).⁷ Read together, the Contract’s

⁶ Under Pantry’s position, in calculating Pantry’s price for premium E10 gasoline, CITGO should look to all of the market prices for any premium motor fuels regardless of whether they are for E10 or clear gasoline. If, as Pantry contends, octane level were the only pertinent characteristic for pricing purposes, it would lead to the absurd result that every product with a common octane rating must be priced identically, including not only clear gasoline and E10 but also federally mandated reformulated gasoline (“RFG”), and gasoline designed to meet area-specific Reid Vapor Pressure regulations (“Low-RVP” fuels). Nothing in the Contract or the parties’ past dealings supports such a result.

⁷ *See also* Richard A. Lord, *Williston on Contracts* § 32:5 (“To the extent possible, . . . every word, phrase or term of a contract must be given effect. An interpretation which gives effect to all provisions of the contract is preferred to one which renders a portion of the writing superfluous, useless or inexplicable. A court will interpret a contract in a manner that gives reasonable meaning to all of its provisions, if possible.”) (citing 15 Okl. St. Ann. §§ 155, 157; *Oklahoma Oncology & Hematology P.C. v. US*

references to “applicable motor fuel” and “applicable grade” require that CITGO price the motor fuels it sells to Pantry based on the market prices for the comparable product *and* octane grade from other sellers in the same geographic market, as reported by OPIS. Thus, if Pantry purchases premium E10, CITGO’s price is based on the two lowest net OPIS rack prices for premium E10, not, as Pantry suggests, the two lowest net OPIS rack prices for premium E10 *or* premium clear.

Pantry’s interpretation would also disregard the parties’ express purpose in creating the pricing provision – entitled “Market Related Pricing” – which was, by its very terms, to create a negotiated pricing mechanism tied to *prevailing market prices for the relevant product*. (See Ex. A at 10-11). Market Related Pricing, as defined in Paragraphs 4 and 4(i) of the Addendum, plainly means that Pantry should pay prices based on the OPIS postings for the comparable product and octane level from the various sellers in the particular market.

Pantry’s allegation that the market prices (as reported by OPIS) for E10 and clear gasoline consistently differ (*see* Cmplt. ¶ 16) shows that they are distinct products with distinct market prices. Moreover, the fact that federal and state regulations treat E10 and clear gasoline differently also demonstrates that E10 and clear gasoline are separate and distinct motor fuels.

For example:

- Federal law taxes sales of E10 and of clear gasoline at different rates. *See* 26 U.S.C. § 40(b), (h);⁸
- Federal and state laws impose different volatility requirements on E10 than on clear gasoline. *See, e.g.*, 40 C.F.R. § 80.27(d); Fla. Admin. Code § 5F-2.001(1)(a)(1); Ga. Comp. R. & Regs. § 391-3-1-.02(2)(bbb)(2); Ga. Comp. R.

Oncology, Inc., 160 P.3d 936 (Okla. 2007); *Pierce Couch Hendrickson Baysinger & Green v. Freede*, 936 P.2d 906 (Okla. 1997)).

⁸ Federal law provides a tax incentive to encourage ethanol blending, amounting to a 5.1 cent subsidy per gallon of E10. *See* 26 U.S.C. § 40(b), (h); *see also* Cmplt. ¶ 15.

& Regs. § 40-20-1-.01(b);

- In many states, pumps at retail stations delivering E10 must bear labels indicating the ethanol content of the fuel, thereby informing the consumer that the product is not clear gasoline. *See, e.g.*, Fla. Admin. Code 5F-2.003(7); S.C. Code of Regs. 5-446(2)(F); 2 Va. Admin. Code 5-420-40(A);
- Federal law requires that refiners sell a certain volume of “renewable fuels.” The ethanol portion of E10 qualifies as a “renewable fuel,” while clear gasoline does not. Therefore, CITGO’s sales of E10 contribute towards satisfaction of its obligations under federal renewable fuels requirements, whereas sales of clear gasoline do not. *See generally* 40 U.S.C. § 7545(o); 40 C.F.R. § 80.1100, *et seq.*;
- Oklahoma law, which governs the contract here, defines E10 as a distinct product from gasoline. Specifically, E10 (also known as “gasohol”) is “*an unleaded motor fuel containing 9 parts gasoline to 1 part denatured ethyl alcohol (ethanol) by volume.*” *See* Okla. Admin. Code § 165:15-1-2 (emphasis added); *see also* Ga. Comp. R. & Regs. § 391-3-1-.02(2)(bbb)(7)(ii) (“‘Ethanol blend’ means gasoline which contains at least 9 percent and no more than 10 percent (by volume) ethanol, excluding denaturants.”); if E10 is a combination of gasoline and ethanol, then by definition it is not, in and of itself, gasoline.

The Contract as a whole must “be interpreted in a fair and reasonable sense.”

Oklahoma Oncology, 160 P.3d at 946.⁹ Nothing in the Contract supports the result sought by Pantry. Under the Contract, Pantry already negotiated a price for E10 based on the lowest prices for E10 offered by any seller in a given area, whether or not that was the price posted by CITGO. (*See* Ex. A at 11, ¶ 4(i).) There is no dispute that CITGO is selling E10 to Pantry based on the

⁹ *See also Fairbanks, Morse & Co. v. Miller*, 195 P. 1083, 1091 (Okla. 1921) (“If one construction would make a contract unreasonable while another would do justice to both parties, the latter will be adopted.”); *Skimbo v. Eastern Okla. State College*, 1996 WL 822817, at *4 (Okla. App. Aug. 20, 1996) (finding defendants’ interpretation of professor’s employment contract “patently unreasonable when they favor nontenured faculty over tenured faculty”); *Eureka Water Co. v. Nestle Waters N. Am., Inc.*, 2008 WL 281559, at *3 (W.D. Okla. Jan. 31, 2008) (rejecting plaintiff’s assertion that it had an exclusive license to market defendant’s product because it “can not be reasonably construed as consistent with the express terms of the License Agreement”); *Continental Resource, Inc. v. PXP Gulf Coast, Inc.*, 2006 WL 2865509, at *11 (W.D. Okla. Oct. 5, 2006) (finding plaintiff’s proffered “interpretation of the parties’ agreements would render portions of . . . the joint operating agreement meaningless” and would “render unreasonable or absurd results”); *Tipton v. Pike*, 550 F. Supp. 191, 195 (W.D. Okla. 1982) (finding “that the interpretation which the Plaintiff puts forward is unnatural and unreasonable and should not be followed”).

lowest prices for E10 offered by any seller in a given area. Pantry is now attempting, through litigation, to obtain a better price than it negotiated in the Contract, seeking to have the lowest posted prices for *clear* gasoline apply to its purchases of *E10*. As explained above, a plain reading of the Contract does not support this position. Therefore, as a matter of law, CITGO's pricing of E10 based on posted OPIS prices for E10 is entirely consistent with and not in breach of its written agreement with Pantry. Accordingly, Pantry's breach of contract claim set forth in Count II, and its related declaratory judgment action in Count I,¹⁰ should be dismissed.

CONCLUSION

For the foregoing reasons, CITGO respectfully requests that this Court grant its motion to dismiss for failure to state a claim on which relief can be granted.

Respectfully submitted, this 15th day of August 2008,

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¹⁰ A declaratory judgment action that is related to an underlying a breach of contract claim is properly dismissed when the breach of contract claim is dismissed. *See, e.g., Shelton v. Duke Univ. Health Sys. Inc.*, 179 N.C. App. 120, 125, 633 S.E.2d 113, 117 (2006) (dismissing a declaratory judgment action to determine what plaintiff should pay under an ambiguous price term in the contract where the court had already held that the price term was not ambiguous); *Accretive Commerce, Inc. v. Kenco Group, Inc.*, 2008 WL 413856, *12 (W.D.N.C. Feb. 13, 2008) (dismissing a declaratory judgment claim that was dependant upon the existence of the dismissed breach of contract claim).

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing **Memorandum of Law in Support of Motion to Dismiss Pursuant to Rule 12(b)(6)** was served on the following by filing the foregoing through Electronic Filing, which, pursuant to Rule 6.5 of the General Rules of Practice and Procedure for the North Carolina Business Court, caused notice of the foregoing to be served by email addressed as follows:

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This the 15th day of August, 2008.

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