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Protectionism in Puerto Rico: The Impact of the Dealers' Contracts Law on Multinational Companies Planning Operations in Puerto Rico

I. INTRODUCTION

The growing consumer market in Puerto Rico has traditionally attracted many multinational corporations.¹ These companies have expanded their operations to Puerto Rico primarily through the appointment of dealers, distributors, and agents.² To their dismay, however, many of these companies have discovered that once the relationship with the dealer or distributor turns sour, termination of the distributorship is not only lengthy and difficult,³ but also very costly.⁴

¹ Over the years, multinational corporations have viewed Puerto Rico as a very attractive developing market and found that the least costly method of distribution was through local dealers and distributors. Wendell William Colon & Ramiro Luis Colon, Jr., Note, *El Contrato de Distribucion o de Agencia Comercial*, 27 REV. D.P. 225, 226-227 (1968).

² Many of these manufacturers viewed Puerto Rico as an export market. Accordingly, they were appointing distributors on an exclusive basis. *Id.* at 227. The dealer/distributor is one of the most significant players in the Puerto Rican market with its heavy dependency on imports. Arturo Estrella, *El Contrato de Agencia o Representacion Comercial: Naturaleza de la Relacion, la Terminacion del Contrato*, 31 REV. COL. AB. P.R. 241, 241 (1967) (citing GALBRAITH & HOULTON, MARKETING EFFICIENCY IN PUERTO RICO).

³ See *Fornaris v. Ridge Tool Co.*, 400 U.S. 41 (1970) (involving years of litigation, including an appeal to the U.S. Supreme Court); *La Playa Santa Marina, Inc. v. Chris-Craft Corp.*, 597 F.2d 1 (1st Cir. 1979) (evidence sustained an award for goodwill of the Dealer's business as well as a statutory award equal to five times the annual average net profits); *DeMoss v. Kelly Services, Inc.*, 493 F.2d 1012, 1015 (1st Cir. 1974) ("The availability of temporary relief under Article 3A [the Dealers' Contracts Law of Puerto Rico] is not tied to a showing of irreparable injury . . ."). *Tamachi, Inc. v. Chrysler Plymouth of de Ponce*, 651 F. Supp. 1359, 1360 n.1 (D.P.R. 1987) (principals cannot impair dealership contract or refuse renewal without just cause); *Francisco Garraton, Inc. v. Lanman & Kemp-Barclay & Co., Inc.*, 559 F.Supp. 405, 409 (D.P.R. 1983) (public policy requires that temporary relief be granted liberally); *Felix A. Rodriguez, Inc. v. Bristol-Myers Co.*, 281 F.Supp. 643 (D.P.R. 1968); *San Juan Merc. v. Canadian Transport Co.*, 108 P.R. Dec. 211 (1978) (establishing a market and client base legally justifies award of damages to a terminated dealer).

⁴ See *La Playa Santa Marina*, 597 F.2d at 4 (where dealer in the prior two years had a total net profit of \$7,515.90, he is entitled to an award of \$10,000.00 for goodwill plus \$18,789.75 representing five times the average annual profits of dealership for statutory damages); *Compute Systems Corp. v. General Automation, Inc.*, 599 F. Supp. 819, 828-829 (1984) (expenses in training the personnel and sales not yet closed but pending may be included in damages). Due to the length and expense of litigation most Law 75 cases are settled out of court. Estrella, *supra* note 2, at 251. Also large multinational corporations would prefer to settle to avoid the negative publicity caused by an unjust termination action in court. *Id.*

These difficulties result from the application of Law 75, the Dealers' Contracts Act,⁵ which protects Puerto Rican dealers and distributors against termination of their distributorship agreements by U.S. or foreign companies.⁶ The Act reflects the protectionist attitude toward local businesses in Puerto Rico. Successful defenses against wrongful termination actions brought by dealers under the Dealers' Contracts Act are rare because of the Act's narrow definition of "just cause."⁷ Furthermore, Puerto Rican courts liberally construe the Act in favor of local dealers and distributors.⁸ Judicial interpretation and the Act itself, therefore, weigh heavily in favor of the dealer claiming wrongful termination and deprivation of his livelihood by the multinational manufactur-

⁵ Act No. 75 of June 24, 1964, P.R. LAWS ANN. tit. 10, §§ 278-278d (1975 & Supp. 1990) [hereinafter Law 75 or the Act].

⁶ The development and growth of the import and export market in Puerto Rico justified the Act, which not only benefitted distributors within Puerto Rico, but also alerted Puerto Rican manufacturers to the problems that they may encounter in appointing distributors overseas. Estrella, *supra* note 2, at 250. The legislative history of the Act includes the following statement of motives:

The Commonwealth of Puerto Rico cannot remain indifferent to the growing number of cases in which domestic and foreign enterprises, without just cause, eliminate their distributors, dealers, or agents, or without totally eliminating them, gradually reduce and impair the extent of their previously established relationship, as soon as these distributors, dealers or agents have created a favorable market and without taking into account their legitimate interests. The Legislative Assembly of Puerto Rico declares that reasonable stability in distribution relationships in Puerto Rico are vital to the economy of the country, to the public interest, and to the general welfare, and in its exercise of the police powers, considers necessary to regulate those relationships, the abuses caused by certain practices.

1966 P.R. LAWS 332 (translated from Spanish by the author).

⁷ Paul Salamone, *Puerto Rico's Distributor's Law 75: A Primer*, 18 REV. JUR. U.I. 67 (1983) (discussing what constitutes "just cause" for termination under the Act); Carlos A. Rodriguez Vidal, *The Concept of Just Cause for the Lawful Termination of a Dealership Under the Dealers' Contracts Law of Puerto Rico*, 58 REV. JUR. U.P.R. 261, 261-83 (1989) (purpose and meaning of "just cause," history and case law); Salvador Antonetti Zequeira, *A Different Opinion About Just Cause*, 58 REV. JUR. U.P.R. 625, 626-33 (1989) [hereinafter *A Different Opinion*] (urging a narrow interpretation of "just cause" because of possible adverse effects on Puerto Rico's trade resulting from strict construction).

⁸ *La Playa Santa Marina*, 597 F.2d at 4 (alleged distributor's violations did not substantially affect the interests of the principal, and the termination was without just cause); *Whirlpool Corp. v. U.M.C.O. Int'l Corp.*, 748 F. Supp. 1557 (S.D. Fla. 1990) (although allowed by the contract, a manufacturer cannot change the credit terms to the distributor if such a change would result in the demise of the relationship); *See Gemco Latinoamerica, Inc. v. Seiko Time Corp.*, 623 F. Supp. 912, 918 (D.P.R. 1985) (expressed expiration date of the contract is void as against public policy); *Pan American Computer Corp. v. Data General Corp.*, 562 F. Supp. 693, 696 (D.P.R. 1983) (the Act is not unconstitutional where manufacturer knew or should have known that his freedom of contract was limited by the existing law).

er,⁹ and principals, found to have terminated agreements without just cause, will be liable for extensive damages under the Act.¹⁰

⁹ As a result of pressure from local dealers and distributors claiming to have been wrongfully terminated by the manufacturers, the Puerto Rico Chamber of Commerce began a study in March, 1964. Memorandum from Justo Pasto Rivera, President of the Puerto Rico Chamber of Commerce, to All Members Affected by Wrongful Termination (Mar. 4, 1964) (on file with the author). The memorandum instructed the members to complete a questionnaire to be used as the basis of the survey. *Id.* The results of the survey showed that over fifty major distributors and agents claimed to have been wrongfully terminated. See *Camara de Comercio de Puerto Rico, Estudio Sobre la Ley 75 de 24 de Junio de 1964 que Reglamenta los Contratos de Distribucion, Exhibit 20* (1973). The results of the survey presented a negative image of multinational corporations and implied that Puerto Rican dealers and distributors were being terminated by foreign manufacturers in bad faith. In a letter directed to the Senate of Puerto Rico, the President of the Senate's Commission on Industry and Commerce stated:

Recently, the problems created in the distribution system by the untimely actions of domestic and foreign manufacturers who, without just cause, terminate the relationship with their distributors and agents in Puerto Rico, as soon as these distributors and agents have created a favorable market for their products, frustrating the legitimate expectations and interests of those who so efficiently fulfilled their responsibilities [It] is necessary to legislate and insure that the manufacturers will act in good faith and not in an arbitrary manner, and preserve the distributor or agent's justified expectations inherent to the relationship

Letter from Ramon E. Bauza, President of the Commission on Industry and Commerce to the Senate of Puerto Rico (May 14, 1964) *reprinted in* 1964 SERVICIO LEGISLATIVO DE PUERTO RICO, No. 4, at 630 (1964) (translated from Spanish by the author).

¹⁰ The section of the Act dealing with the award of damages states in pertinent part:

If no just cause exists for the termination of the Dealer's contract for detriment to the established relationship, or for the refusal to renew same, the principal shall have executed a tortious act against the dealer and shall indemnify it to the extent of the damages caused him, the amount of such indemnity to be fixed on the basis of the following factors:

- (a) the actual value of the amount expended by the dealer in the acquisition and fitting of premises, equipment, installations, furniture and utensils . . . ;
- (b) the cost of the goods, parts, pieces, accessories and utensils that the dealer may have in stock, and from whose sale or exploitation he is unable to benefit;
- (c) the good will of the business, or such part thereof attributable to the distribution of the merchandise or the rendering of the pertinent services, said good will to be determined by taking into consideration the following factors:
 - (1) number of years the dealer has had charge of the distribution;
 - (2) actual volume of the distribution of the merchandise or the rendering of the pertinent services and the proportion it represents in the dealer's

Many articles have been written on the subject of franchise and dealer protection laws.¹¹ The majority of these articles focus primarily

business;

(3) proportion of the Puerto Rican market said volume represents;

(4) any other factor that may help establish equitably the amount of said good will;

(d) the amount of the profit obtained in the distribution of the merchandise or in the rendering of the services, as the case may be, during the last five years, or if less than five, five times the average of the annual profit obtained during the last years, whatever they may be.

Law 75, *supra* note 5, § 278b.

¹¹ See, e.g., Robert W. Emerson, *Franchising and the Collective Rights of Franchisees*, 43 VAND. L. REV. 1503 (1990) (discussing just cause requirements for termination in franchise agreements); Charles J. Faruki, *The Defense of Terminated Dealer Litigation: A Survey of Legal and Strategic Considerations*, 46 OHIO ST. L.J. 925 (1985) (surveying the most common issues and strategies to defend dealer termination cases); Karl G. Herold & David D. Knoll, *Negotiating and Drafting International Distribution, Agency, and Representative Agreements: The United States Exporter's Perspective*, 21 INT'L LAW. 939 (1987) (discussing the role of the international corporate lawyer in negotiating and drafting international contracts); Michael F. Hoellering, *Arbitrability of Disputes*, 41 BUS. LAW. 125 (1985); Henry T. King, Jr., *Legal Aspects of Appointment and Termination of Foreign Distributors and Representatives*, 17 CASE W. RES. J. INT'L L. 91 (1985) (presenting a practical checklist for those firms contemplating the appointment of agents or distributors overseas); Monroe Leigh, *Federal Arbitration Act — Convention on the Recognition and Enforcement of Federal Arbitral Awards — Arbitrability of Antitrust Claims Arising from an International Transaction*, 80 AM. J. INT'L L. 168 (1986) (examining the enforceability of the Federal Arbitration Act); Barry W. Rashkover, *Title 14, New York Choice of Law Rule for Contractual Disputes: Avoiding the Unreasonable Results*, 71 CORNELL L. REV. 227 (1985) (examining the enforceability of choice of law covenants); Andre M. Saltoun & Barbara C. Spudis, *International Distribution and Sales Agency Agreements: Practical Guidelines for U.S. Exporters*, 38 BUS. LAW. 883 (1983) (providing an overview of laws and regulations affecting international sales and distribution agreements); Myra J. Gaetán & Francisco R. De Jesús Schuck, *En Torno a la Ley Numero 75 del 24 de Junio de 1964: Para Reglamentar la Terminacion de, y la Negativa a Renovar Bajo Determinadas Circunstancias, Ciertos Contratos de Distribucion*, 34 REV. JUR. U.P.R. 497 (1965) (discussing the effects of the Act on termination of dealerships or refusal by the grantor to renew the contract); Lisa Sopata, *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.: International Arbitration and Antitrust Claims*, 7 J. INT'L L. BUS. 595 (1986) (examining the enforceability of arbitration clauses); Rodriguez Vidal, *supra* note 7 (asserting that the interpretation given by the courts to the Act's definition of just cause is broad and encompassing in order to protect the legitimate interests and expectations of dealers and distributors); *A Different Opinion*, *supra* note 7 (urging a narrow interpretation of just cause because of possible adverse effects on Puerto Rico's trade resulting from strict construction); Salvador Antonetti Zequeira, *La Medida de los Daños Bajo la Ley 75*, 58 REV. JUR. U.P.R. 227 (1989) [hereinafter *La Ley 75*] (discussing damages that a terminated dealer may recover from the principal or grantor, and how they are established); Salvador Antonetti Zequeira, *Puerto Rico's Dealer's Act: Fourteen Years Later*, 83 COM. L.J. 453 (1978) [hereinafter *Puerto Rico's Dealer's Act*] (examining major litigation concerning the Act).

on the defense of terminated dealer litigation.¹² Strategies to be followed once a manufacturer has decided to terminate a dealer or distributor have received attention in many other articles.¹³ Articles concerning Puerto Rico's Dealers' Contracts Law in particular have focused primarily on the courts' interpretation of "just cause"¹⁴ and the awarding of damages to the terminated dealer.¹⁵

This Note highlights the issues that a manufacturer must consider prior to establishing a contractual relationship with a dealer, agent, or distributor that will be enforceable under the Act. To avoid the pitfalls of Law 75, the prospective principal or grantor must understand the historical background of the Act, judicial interpretation of Law 75, and their effect on the contractual relationship between the principal or grantor and the prospective dealer/distributor. Section II of this note examines the Puerto Rico Dealers' Contract Act of 1964¹⁶ and subsequent amendments,¹⁷ as well as the legislative history and background of the Act.¹⁸ This discussion illustrates the significance of the protectionist

¹² Kevin Scott Dittmar, *Foerster, Inc. v. Atlas Metal Parts — The Wisconsin Supreme Court Takes a Narrow View of the Dealer's Financial Interest Protected by the Wisconsin Fair Dealership Law*, 1985 WIS. L. REV. 155 (1985) (criticizing the Wisconsin Supreme Court's interpretation of the Wisconsin Fair Dealership Law (WFDL)); Leandra Lederman, *Viva Zapata! Toward a Rational System of Forum-Selection Clause Enforcement in Diversity Cases*, 66 N.Y.U. L. REV. 422 (1991) (discussing the problems encountered when attempting to enforce forum selection clauses); Jill A. Pietrowski, *Enforcing International Commercial Arbitration Agreements — Post-Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 36 AM. U. L. REV. 57 (1986) (explaining how arbitration clauses can override forum selection barriers). An excellent article by Charles Faruki discusses the issues generally in dispute in dealer contractual litigations, the bodies of substantive law that apply to the disputes, and the remedies available. Faruki, *supra* note 11, at 927.

¹³ Martin D. Fern & Philip Ian Klein, *Restrictions on Termination and Nonrenewal of Franchises: A Policy Analysis*, 36 BUS. LAW. 1041 (1981); Ernest Gellhorn, *Limitations on Contract Termination Rights — Franchise Cancellations*, 1967 DUKE L.J. 465 (1967); King, Jr., *supra* note 11; *La Ley 75*, *supra* note 11; Rashkover, *supra* note 11; For an excellent analysis of "just cause" and its interpretation by the Puerto Rico Supreme Court, see Rodriguez Vidal, *supra* note 7. For a different interpretation, see *A Different Opinion*, *supra* note 7.

¹⁴ See *A Different Opinion*, *supra* note 7, at 626-633 (discussing the leading cases decided by the Supreme Court of Puerto Rico where "just cause" was at issue); Rodriguez Vidal, *supra* note 7, at 261-283 (purpose and meaning of the concept of "just cause," history and case law); Salamone, *supra* note 7, at 70-71 (defining what constitutes just cause for termination under the Act).

¹⁵ *La Ley 75*, *supra* note 11.

¹⁶ Law 75, *supra* note 5.

¹⁷ *Id.*

¹⁸ See 1966 SERVICIO LEGISLATIVO DE PUERTO RICO, No. 4, at 637; 1964 SERVICIO LEGISLATIVO DE PUERTO RICO, No. 4, at 630; 1978 SERVICIO LEGISLATIVO DE PUERTO RICO, No. 3, at 444; Senate Bill 643 of March 12, 1964, 18 DIARIO DE SESIONES, pt. 3, at 1531 (1964); 18 DIARIO DE SESIONES, pt.4, at 1727 (1964) (House version); 1964 P.R. LAWS 231; 1966 P.R. LAWS 332; 1978 P.R. LAWS 341; 1988 P.R. LAWS 425.

environment and legislative attitude affecting the dealer/manufacturer relationships in Puerto Rico. Section III will compare the Puerto Rican legislation with franchise/dealer laws enacted in other United States jurisdictions.¹⁹ The outcome of the cases litigated, both in local and federal courts, will also be explored in Section III, in order to examine the courts' interpretation of the Act, and the impact of those decisions on multinational corporations planning to enter into contractual agreements in Puerto Rico. Section IV discusses the strategies available to principals and manufacturers to overcome the difficulties created by the Act. This section also includes suggestions on some of the key covenants that should be included in a distribution contract to insure that it will be enforceable under Law 75.

II. MANUFACTURER FREEDOM TO CONTRACT UNDER THE DEALERS' CONTRACTS ACT

The Dealers' Contracts Act,²⁰ also known as Law 75,²¹ was enacted to protect dealers²² and distributors²³ from unjust termination of their contracts. Because the Act strongly favors dealers and distributors, it can make the unwary manufacturer's life difficult. Therefore, a manufacturer contemplating the appointment of dealers or distributors in Puerto Rico must be fully aware of the impact of the Act on its contractual relationships.

By 1964, many U.S. manufacturers were terminating their distribution contracts with a large number of established and successful Puerto Rican distributors.²⁴ These actions prompted strong demands for government protection by the business community. The powerful lobbying efforts by influential members of the Puerto Rico Chamber of Com-

¹⁹ Wisconsin Fair Dealership Law, WIS. STAT. §§ 135.01-.07 (1957 & Supp. 1992) [hereinafter WFDL]; California Franchise Relations Act, CAL. BUS. & PROF. CODE § 20025 (West 1985); Automobile Dealers Day in Court Act, 15 U.S.C. §§ 1221-1225 (1982) [hereinafter ADDCA]. The WFDL was selected for comparison purposes because its similarity to Law 75. The ADDCA is selected as an example of a federal law enacted for the purpose of protecting the dealer.

²⁰ Law 75, *supra* note 5.

²¹ Ley 75 is the official name in Puerto Rico.

²² A dealer is "[o]ne who purchases goods or property for resale to final customers; a retailer." BLACK'S LAW DICTIONARY 399 (6th ed. 1990).

²³ A distributor is "[a]ny individual, partnership, corporation, association, or other legal relationship which stands between the manufacturer and the retail seller in purchases, consignments, or contracts for sale of consumer goods. BLACK'S LAW DICTIONARY 475 (6th ed. 1990).

²⁴ Gaetán, *supra* note 11, at 498-500. Some terminated distributors represented large multinational corporations: Luis Ramirez Palmer, Inc., representing Clairol (Bristol-Meyers); C.O. Meso & Co., representing R.J. Reynolds; Colon Bros., Inc., representing American Tobacco; P.R. Supplies Co., representing P. Lorrillard & Co. and Brown & Williamson; Abarca, Inc., representing Standard Transformer; Fernando Pont Flores, representing Ayust Laboratories. *Id.* at 497 n.1.

merce, in addition to the considerable pressures exerted by the local business community,²⁵ the Chamber of Commerce as a body,²⁶ and the Senate's Commission on Industry and Commerce,²⁷ resulted in the enactment of Law 75. The stated purpose of Law 75 is to protect dealers and distributors from unjust termination of their contracts by manufacturers once the dealer/distributor has developed a market for the manufacturer's product through his marketing efforts, advertising and generation of goodwill.²⁸ These concerns are reflected in the Senate's Industry and Commerce Commission Report, released during discussion of Senate Bill 643, incorporating the proposed legislation.²⁹ The Act

²⁵ Many prominent members of Puerto Rico's business community testified in favor of Law 75 at hearings held on August 20-21, 1963 by the Special Committee on Commercial Relations of the Puerto Rico Chamber of Commerce. Gaetán, *supra* note 11, at 497-500. See also Colon, *supra* note 1, at 251.

²⁶ As a result of the hearings, the Puerto Rico Chamber of Commerce presented its recommendations to the legislature. Colon, *supra* note 1, at 251.

²⁷ See *supra* note 9.

²⁸ See Statement of Motives of the Act, *supra* note 6. See also *Informe de las comisiones*, 1966 SERVICIO LEGISLATIVO DE PUERTO RICO, No. 4, at 637, 638. In this report of the amendment to Law 75, the Senate Committee in Industry and Commerce stated:

[O]ne of the proposed amendments has the purpose of establishing with absolute precision that the law covers not only the case of a distributor stripped of the total distribution of a product, without just cause, but also all situations that undermine a distribution line; that is, for example, when a distribution line consists of multiple products, and part of the line is taken away from the distributor, or without affecting his product line, the shipments are drastically reduced. There are many more situations of this nature that could arise, and it must be absolutely clear that they are covered by the law. It would be impossible to list them all.

The other fundamental amendment is contained in Article 4. "This law, by being of a remedial nature, must be liberally interpreted so it will achieve the most efficient protection."

Id. at 638.

²⁹ In its report to the Senate regarding the proposed Senate Bill 643, the Senate's Commission on Industry and Commerce stated:

Recently, the problem created in Puerto Rico's distribution system has worsened due to the abrupt actions of domestic and foreign manufacturing firms that without just cause terminate their relationships with their distributors and agents in Puerto Rico, as soon as these have created a favorable market for their products, frustrating the legitimate expectations and interests of those that have efficiently complied with their responsibilities.

The traditional laws that regulate contracts between particulars have demonstrated to be not efficient in protecting the legitimate interests of the distributor or agent, which makes it necessary to legislate to regulate this relation and guarantee that manufacturers act in good faith, equitably, in a non-arbitrary manner and preserve the distributor or agent in the rights and justified expectations inherent to the relation. In

provides that:

Notwithstanding the existence in a dealer's contract of a clause reserving to the parties the unilateral right to terminate the existing relationship, no principal or grantor may directly or indirectly perform any act detrimental to the established relationship or refuse to renew said contract on its normal expiration, except for just cause.³⁰

In response to the ongoing lobbying efforts from the Puerto Rican business community to expand the scope of the Act,³¹ the Act has been amended many times over the years, narrowing the definition of just cause and expanding dealer/distributor's rights.³²

As a result of the Act's strong bias toward dealers' and distributors' rights, corporations planning to establish contractual relationships with Puerto Rican Dealers and Distributors must be aware that the Act: (1) makes dealer/distributor termination difficult, and (2) often invalidates conditions placed on the relationship.

addition, this will have the consequence of giving stability to the distribution relations.

18 DIARIO DE SESIONES, pt. 3, at 1531 (1964). Salamone, *supra* note 7, at 68. Very little debate preceded the passage of Senate Bill 643, but extensive committee hearings, dominated by prominent members of the Puerto Rico Chamber of Commerce and the Bar, were held. *Id.* n.4. See also Colon, *supra* note 1, at 252-253.

³⁰ Law 75, *supra* note 5, §278a.

³¹ See also *Informe de las Comisiones*, 1966 SERVICIO LEGISLATIVO DE PUERTO RICO, No. 4, *supra* note 28.

³² In 1965, Section 278b of the Act was amended to define, the refusal by the principal to renew the dealer/distributor contract without just cause as a tortious act. Act No. 104 of June 28, 1965. The 1966 amendment expanded the definition of "dealer" and of termination without just cause. The concept of dealer was expanded to include not only the designated party, but also the real interested or affected party. Section 278a was amended to include that "no principal or grantor can . . . directly or indirectly perform any act that undermines the established relationship between grantor and distributor" Additionally, Section 278c was amended with an instruction that the "waiver" clause must be given the most liberal interpretation to protect the interests of the dealer. Act No. 105 of June 23, 1966. By Act No. 75 of June 23, 1978, the law was once again amended to establish that dealer/distributor contracts would only be interpreted in accordance with Puerto Rico law, and any agreement or covenant to the contrary would be null and void. Furthermore, the amendment made void and unenforceable, as against public policy, any contractual covenant that would require a dealer to litigate a Law 75 dispute outside Puerto Rico or under foreign law. *Id.* The most recent amendment, Act No. 81 of July 13, 1988, permits a dealer/distributor to ignore any contractual covenants that restrict financial, managerial, or ownership changes to the business and expanded the type of actions that, if committed by the principal/grantor, would give rise to the presumption of termination without just cause. *Id.* §278a-1.

A. Termination of the Manufacturer/Dealer Relationship

A contractual relationship which falls within the scope of the Act's definition of a dealer contract,³³ may not be terminated or impaired without just cause.³⁴ For instance, if the principal fails to renew the contract upon its expiration or terminates the relationship with the dealer/distributor, he could be liable for extensive damages if it is determined that there was no just cause for termination or non-renewal.³⁵ The definition of just cause is vague at best,³⁶ and has been the subject of extensive litigation.³⁷

³³ Law 75 defines a dealer's contract as,

[the] relationship established between a dealer and a principal or grantor whereby and irrespectively of the manner in which the parties may call, characterize or execute such relationship, the former actually and effectively takes charge of the distribution of a merchandise, or of the rendering of a service, by a concession or franchise, on the market of Puerto Rico.

Law 75, *supra* note 5, § 278(b).

The Supreme Court of Puerto Rico has broadly defined the term "dealer." In *Cordova & Simonpietri Ins. Agency v. Crown American Ins. Co. of Canada*, 112 P.R. Dec. 797 (1982), the court held that an insurance agent fell within the definition of dealer because he promotes and sells insurance contracts as a representative of the Insurance company. *Id.* at 803. *See also San Juan Merc.*, 108 P.R. Dec. 211 (anyone taking the necessary steps to gain new consumers or create a market for a product or service meets the definition of a dealer). *But cf.* *Mario R. Franceschini, Inc. v. Riley Co.*, 591 F.Supp. 414 (D.P.R. 1984) (enterprise cannot be deemed a dealer where it does not purchase equipment sold by the principal, nor is empowered to set sale conditions); *Cruz Ramos v. Brother Int'l Corp.*, 445 F. Supp. 983 (D.P.R. 1978), *aff'd. without op.*, 558 F.2d 817 (1st Cir. 1978) (after lengthy litigation, the court held that a commissioned salesman was not protected by the Act); *See also Sudouest Import Sales v. Union Carbide Corp.*, 732 F.2d 19 (1st Cir. 1984).

³⁴ Law 75 defines "just cause" as:

[N]on performance of any of the essential obligations of the dealer's contract, on the part of the dealer, or any action or omission on his part that adversely and substantially affects the interests of the principal or grantor in promoting the marketing or distribution of the merchandise or service.

Law 75, *supra* note 5, § 278(d).

³⁵ The Act provides damages for termination without just cause which include: goodwill, profits over a specified number of years, reimbursement for the capital investment equipment and fixtures and other expenses. Law 75, *supra* note 5, § 278b. *See also La Ley 75, supra* note 11.

³⁶ The Act does not provide guidance as to the meaning of "essential obligations," or as to what "actions or omissions" adversely and substantially affect the interests of a principal. Law 75, *supra* note 5, § 278(d).

³⁷ The continuing litigation concerning the meaning of just cause is due to the Puerto Rico Supreme Court's failure to totally explore and define the concept. *Rodriguez Vidal, supra* note 7,

The courts have taken a narrow view of what constitutes just cause for termination,³⁸ and have refused to expand the concept.³⁹ Furthermore, there has been considerable pressure on the Puerto Rico courts by the local legal community to maintain a narrow interpretation of just cause.⁴⁰ Under the current judicial⁴¹ interpretation of just cause,⁴² a

at 261. Although, the Act defines what constitutes just cause, it fails to define the acts that could lead to a distributor's claim of unjust termination, such as impairment of the relationship. *Id.* at 265 n. 14.

³⁸ See *infra* note 50. The concept of just cause as stated in the Act and interpreted by the courts protects the interests of the distributors and should not be broadened. Rodriguez Vidal, *supra* note 7, at 297.

³⁹ In *Fornaris v. Ridge Tool Co.*, the court stated that:

To add to "just cause," as was suggested, good faith, or the legitimate interests of the manufacturer, would be to fly in the face both of the unambiguous statutory provisions and the equally unambiguous legislative history. The fact that a dealership has become economically highly disadvantageous is not an excusable impossibility, but is, precisely, a contingency that the legislature sought to guard against.

423 F.2d 463, 568 (1st Cir.), *rev'd*, 400 U.S. 41 (1970) (reversed on other grounds).

⁴⁰ If the courts would broaden the concept of just cause, the results would undermine the intent of the legislature. Rodriguez Vidal, *supra* note 7, at 297. But unless a more flexible interpretation is given to just cause, constitutional challenges can arise in certain cases. *A Different Opinion*, *supra* note 7, at 636. Furthermore, strict construction of just cause could have adverse consequences to the trade in Puerto Rico. *Id.* Inequitable laws may not only trigger constitutional attacks but antitrust challenges as well.

⁴¹ See *supra* note 38.

⁴² See, e.g., *Jordan K. Rand, Ltd. v. Lazoff Bros. Inc.*, 537 F. Supp. 587 (D.P.R. 1982) (holding that failure by a distributor to pay royalties due, and the unauthorized use of the trademark are just cause for termination). In a leading case, *Marina Industrial, Inc. v. Brown Boveri Corp.*, 114 P.R. Dec. 64 (1983), the Puerto Rico Supreme Court, while holding that there was no just cause for termination, stated, in dicta, several grounds that could constitute just cause for termination. Among them was the manufacturer's decision in good faith to *totally* withdraw from the market. When faced with this same issue, the United States Court of Appeals for the First Circuit, certified the following question to the Supreme Court of Puerto Rico: "[Whether] the lawmakers' intent was to apply Law 75 to a principal who withdraws in good faith from the Puerto Rican market . . . or [whether] the withdrawal in good faith from the market constitute[s] 'just cause' for terminating the relationship." *Medina & Medina v. Country Pride Foods, Ltd.*, 858 F.2d 817, 821 (1st Cir. 1988). In its certification, the Supreme Court of Puerto Rico stated:

Act No. 75 of June 24, 1964, does not bar the principal from totally withdrawing from the Puerto Rican market when his action is not aimed at reaping the good will or clientele established by the dealer, and when such withdrawal—which constitutes just cause for terminating the relationship—is due to the fact that the parties have bargained in good faith but have not been able to reach an agreement as to price, credit, or some other essential element of the dealership. In any case, said withdrawal must be preceded by a previous notice term which shall depend on the nature of the franchise, the characteristics of the dealer, and the nature of the pre-termination negoti-

manufacturer must show that the dealer's breach of an essential obligation of the contract has adversely and substantially affected the manufacturer's interests.⁴³

Since oral agreements are valid in Puerto Rico, the Act applies not only to written contracts, but also to oral agreements.⁴⁴ Furthermore, since the Act's definition of dealer can conceivably include anyone representing a manufacturer,⁴⁵ the Act's mantle of protection extends to dealers,⁴⁶ distributors,⁴⁷ franchisees,⁴⁸ and agents.⁴⁹ Hence, Law 75 will apply to a broad range of relationships not generally thought of as traditional dealership relationships.

B. The Act's Restrictions on Appointments of Additional Distributors or Changes in the Contractual Relationship.

In 1988, Law 75 was amended to add certain actions which create a rebuttable presumption of termination without just cause. This new section⁵⁰ provides, inter alia, that the appointment of additional dealers or distributors by the manufacturer, or the establishment of facilities for

ations.

Id. at 824. See also Salomone, *supra* note 7, at 70 n.10 (concluding that Law 75 is geared at protecting dealers from termination by a principal trying to take over the market, but does not prevent a principal from terminating a distributor as a result of the principal's total withdrawal from the Puerto Rican market).

⁴³ For a comprehensive discussion of the court's interpretation of just cause, see *infra* notes 107-111.

⁴⁴ The courts in Puerto Rico have upheld the validity of oral agreements. See P.R. LAWS ANN. tit. 31, §§3541-3453. See also, Puerto Rico's Dealer's Act, *supra* note 11, at 454. Following the lead from Spanish commentators, the courts in Puerto Rico have held that oral contracts will be upheld as to the original parties and their successors, regardless of the sums involved. *Id.* at 454 n.6.

⁴⁵ Law 75 defines a dealer as: "[A] person actually interested in a dealer's contract because of his having effectively in his charge in Puerto Rico the distribution, agency, concession or representation of a given merchandise or service." Law 75, *supra* note 5, § 278(a).

⁴⁶ See *supra* note 23.

⁴⁷ See *supra* note 23.

⁴⁸ A Franchisee is a "[p]erson or company that is granted franchise by a franchisor." BLACK'S LAW DICTIONARY 659 (6th ed. 1990). A franchise is "[a] privilege granted or sold, such as to use a name or to sell products or services. The right given by a manufacturer or supplier to a retailer to use his products and name on terms and conditions mutually agreed upon." *Id.* at 658.

⁴⁹ An agent is "[a] person authorized by another (principal) to act for or in place of him; one entrusted with another's business One who undertakes to transact some business, or to manage some affair, for another, by the authority and on account of the latter, and to render an account of it." *Id.* at 63.

⁵⁰ Law 75, *supra* note 5, § 278a-1.

direct sales or services anywhere in Puerto Rico is a breach of the contractual obligation toward the dealer or distributor,⁵¹ and thus constitutes termination without just cause. If it is determined that the principal has undermined the contractual relationship by establishing parallel dealerships or selling directly,⁵² the manufacturer or principal may be liable for damages in an amount equivalent to the reduction in profits to the distributor caused by the principal's actions.⁵³

⁵¹ Section 278a-1 states:

(a) It will not be considered just cause for a violation, by the distributor, of any covenant included in the distribution contract that impairs or restricts changes in the capital structure of the distributor, or management changes, or means of financing the operation, or is designed to impair or restrict the sale, transfer, or encumbrance of any corporate action, participative share, rights or interests owned by any person in said distribution business, unless the principal or grantor demonstrates that the violation may affect or has already affected adversely and substantially the interests of the principal or grantor in the development of the market, distribution or delivery of services;

(b) a rebuttable presumption that the principal or grantor has impaired or damaged the established relationship [with a dealer/distributor] will be triggered by any of the following events:

(1) when the principal or grantor establishes in Puerto Rico, facilities for the direct distribution of merchandise or for the delivery of services, previously handled by the distributor;

(2) when the principal or grantor establishes a distribution relationship with one or more additional distributors for Puerto Rico, or an area of Puerto Rico in contravention with the existing contract between the parties;

(3) when the principal or grantor unjustifiably refuses or neglects to service the merchandise orders sent by the distributor, in a reasonable manner and quantities;

(4) when the principal or grantor unilaterally and unreasonably changes, to the detriment of the distributor, the shipping methods, or terms and conditions for payment for the merchandise ordered;

Id.

⁵² *Id.* §278a-1(b).

⁵³ This would be the case where the manufacturer appoints an additional distributor without terminating the original distributor's contract. In this situation, assuming the original distributor was exclusive, the original distributor would find itself with reduced profits due to the competition from the additional distributor. *La Ley 75*, *supra* note 11, at 256-57. Section 278a-1(b)(2) of the Act provides for recovery of damages in this situation. *Law 75*, *supra* note 5. See also *Draft-Line Corp., v. The Hon Company*, *aff'd* 1993 U.S. App. Lexis 101 (1st Cir. P.R. 1993). (the Act extends to those cases where, without terminating the dealer, the principal establishes parallel dealerships).

C. *The Costs of Dealer Termination*

The narrow statutory definition of just cause⁵⁴ and the restrictions placed by the Act on choice of law⁵⁵ and forum,⁵⁶ place a manufacturer in the difficult position of having to litigate under adverse conditions in a foreign forum under foreign law.⁵⁷ The Act makes termination of a contract without just cause a tort giving rise to tort damages.⁵⁸ It is not coincidental that four days after the approval of the amendment, the Puerto Rico Legislature approved Law No. 105 extending the reach of the Long Arm Statute⁵⁹ to include non-resident principals. As a result, Puerto Rican distributors can file their claims in the local courts, greatly simplifying the process of personal jurisdiction over foreign manufacturers.⁶⁰

Tort remedies are also available when third parties interfere with the contractual relationship between dealer and principal. For instance, if a manufacturer conspires with a prospective distributor to terminate the present distributor's contract, and as a result, the contract with the aggrieved distributor is terminated, not only can the manufacturer be held liable for tortious interference of contractual relations, but the conspiring successor distributor can be liable for tort damages as well.⁶¹ Court

⁵⁴ See *supra* note 34.

⁵⁵ See Law 75, *supra* note 5, § 278b-2.

⁵⁶ *Id.*

⁵⁷ Because Puerto Rico is a civil law jurisdiction, the principal will need to hire local counsel experienced in civil law litigation and in a foreign language (Spanish).

⁵⁸ Act No. 104 of June 28, 1965.

⁵⁹ On June 28, 1965 the Puerto Rican Legislature promulgated a companion statute, Act No. 105 of June 28, 1965. Act 105 amends Rule 4.7 of the Puerto Rico Rules of Civil Procedure, simplifying the process to obtain *in personam* jurisdiction over the manufacturers. This amendment clearly places the breach of contract actions within the scope of Puerto Rico's long-arm statute, allowing service by certified mail. *Puerto Rico's Dealer's Contracts*, *supra* note 11, at 454 n. 10. This amendment is consistent with Article 1802 of Puerto Rico's Civil Code, which includes in its definition of tort actions "an[y] act or omission caus[ing] damage to another through fault or negligence . . ." P.R. LAWS ANN. tit. 31, § 5141 (1990).

⁶⁰ The reach of the amended Long Arm Statute in a Law 75 action was successfully tested in *Executive Air Services, Inc. v. Beech Aircraft Corp.*, 254 F. Supp. 415 (D.P.R. 1966). The court held that in a dispute over a distribution contract, a non-resident corporation with a distributor in Puerto Rico was subject to the Puerto Rico Rules of Civil Procedure, therefore amenable to personal jurisdiction. *Id.* at 417. The relationship in that case was one of manufacturer/distributor. The contract specified that the manufacturer give discounts and payment terms to the distributor and supply all of the promotional and administrative materials. Although the distributor could appoint sub-agents, it could do so only with approval from the principal. Given the nature of the relationship, there was no question that the manufacturer was subject to the Puerto Rico Rules of Civil Procedures. Colon, *supra* note 1, at 288.

⁶¹ If conspiracy between the manufacturer and the successor distributor results in the unjust

cases indicate that the aggrieved party must demonstrate that the conspiring successor distributor acted intentionally with knowledge of the existence of a contract.⁶² In addition, interference by a third party could cause loss of diversity jurisdiction since the aggrieved distributor will join the local conspirator/prospective distributor with the manufacturer, destroying diversity.⁶³ Loss of diversity would result in losing federal court jurisdiction. Without federal court jurisdiction the case would be tried in the local courts in Puerto Rico, subjecting the principal to a foreign forum. Few cases have been decided on the issue of tortious interference with distributors' contracts.⁶⁴ Given the pro-distributor interpretation of the Act by the Puerto Rico courts, however, it is likely that in future cases, the courts will continue to hold a successor distributor jointly liable with the principal.

III. PROTECTIVE RESTRICTIONS IMPOSED BY THE ACT

Law 75 is the result of on-going successful lobbying efforts of the Commission on Industry and Commerce and the Puerto Rico Chamber of Commerce on behalf of local dealers, distributors, and agents.⁶⁵ These lobbying efforts did not stop after the advocates of the Act obtained its passage in the Legislature. Anytime an unfavorable decision came down from the courts, the lobbying efforts resumed, attempting to close the loopholes and make the Act more restrictive.⁶⁶ These efforts

termination of the previous distributor's contract, the successor distributor could be held liable for damages and/or injunctive relief to the former distributor, under Article 1802 of the Puerto Rico Civil Code. P.R. LAWS ANN. tit. 31, § 5141 (1990). See also Salamone, *supra* note 7, at 83. Furthermore, the liability may extend to all persons participating in the conspiracy. *Id.*

⁶² General Office Prods. v. A.M. Capen's Sons, 115 P.R. Dec. 553 (1984). In *Gen. Office Prods.*, the court held that the third party was jointly and severally liable with the principal and defined various elements that must be present for a finding of tortious interference with a contractual obligation. Those factors are: (1) there must be a contract with which the third party interferes; (2) the victim must introduce facts or prove that the third party acted intentionally with knowledge of the existence of a contract; (3) the plaintiff must have suffered damages; and (4) a causal relationship between damages to the victim and the actions of the third party. *Id.*

⁶³ See *El Gran Video Club Corp. v. E.T.D., Inc.*, 757 F. Supp. 151 (D.P.R. 1991) (remand to Commonwealth court granted. Joinder of non-diverse dealer was proper where defendant dealer had intentionally contributed to principal's refusal to honor exclusive dealership agreement).

⁶⁴ See *Lexington Ins. Co. v. Abarca Warehouses Corp.*, 476 F.2d 44 (1st Cir. 1973) (if fault or negligence of one party causes injury to a party to a contract, the aggrieved party's right to recovery lies in tort). Cf. *Dolphin Int'l of Puerto Rico, Inc. v. Ryder Truck Lines, Inc.*, 91 J.T.S. 13 (1991) (in answering the certified question, the Puerto Rico Supreme Court suggested that recognition of a tortious interference claim would require an underlying contractual obligation); *Panamerican Pharmaceutical v. Sherman Lab.*, 293 F. Supp. 713, 715 (D.P.R. 1986); *Romero v. ITE Imperial Corp.*, 332 F. Supp. 523, 525 (D.P.R. 1971)]. In both, *Panamerican* and *Romero* the court carefully avoided ruling on this issue. Salamone, *supra* note 7, at 82-83.

⁶⁵ See *supra* notes 22-23 & 49.

⁶⁶ On May 9, 1973, the Puerto Rico Supreme Court declared the retrospective application of

were assisted by the on-going use of the local press.⁶⁷ This pro-distributor and anti-manufacturer environment is best exemplified in a letter sent in 1963 by the most influential members of the Chamber of Commerce⁶⁸ to the then Governor of Puerto Rico, the Hon. Luis Muñoz Marín.⁶⁹ In their letter, these members stated that, for U.S. corporations, it is a "privilege" to be able to do business in Puerto Rico, and that they should be viewed not as bringing employment, but as displacing the local entrepreneurs.⁷⁰ The potentially adverse consequences to contractual relationships, such as manufacturers establishing their own distribution in Puerto Rico in order to avoid the pitfalls of the Act, as well as the potentially adverse economic consequences such as increased prices to the consumer,⁷¹ were not a priority in the minds of the sponsors of the Act.⁷² Nor were the negative effects of similar legislation

Law 75 unconstitutional. *See generally*, Warner Lambert Co. v. Tribunal Superior, 101 P.R. Dec. 378 (1973). Three days later, the president of the Chamber of Commerce sent a letter to the legislature requesting the amendment to the Act. Letter From Herminio Fernandez Torrecillas, President, Chamber of Commerce of Puerto Rico, Letter to Lic. Alberto Ferrer (May 12, 1973) (on file with the author). *See also*, Letter From Rafael Pico, President, Commission of Commerce and Industry, et. al. Letter to the Senate of Puerto Rico (May 24, 1965) (on file with the author). In their letter the authors, members of the various commissions of the Senate of Puerto Rico urged the Senate body to amend the Act and also the Rules of Civil Procedure, so that violation of the Act would be considered a tort, and the distributor would have personal jurisdiction over the foreign principal or manufacturer, regardless of the principal's contacts in Puerto Rico. *Id.*

⁶⁷ *See* Ramon M. Diaz, *Commercial Firms Denounce U.S. Manufacturers*, EL IMPARCIAL, June 14, 1963; Ramon M. Diaz, *Complaints About U.S. Manufacturers Will be Investigated*, EL IMPARCIAL, August 13, 1963; Dario Cario, *Agency and Distributorship Cancellations by U.S. Manufacturers Causes Panic in Puerto Rico*, EL MUNDO, Aug. 13, 1963; *Law is amended to protect Agents and Distributors from Foreign Manufacturers*, EL IMPARCIAL, Apr. 9, 1966; Enrique Grau Esteban, *Amendment to Protect Distributors when their Contract is Cancelled*, EL IMPARCIAL, June 10, 1967; Editorial, *Chamber of Commerce Signals That the Puerto Rican Economy is in Danger Because of the Termination of Distributor's Contracts by Foreign Firms*, EL MUNDO, Sep. 12, 1970. (translation from Spanish by the author).

⁶⁸ The letter was signed by the members of the Special Committee on Commercial Relations represented by the president of the Chamber of Commerce, the Vice-president and six prominent members of the business community. Letter From Bird, President of the Chamber of Commerce of Puerto Rico, et. al., Letter to the Hon. Luis Muñoz Marín, Governor of Puerto Rico, (Aug. 1963) (on file with the author).

⁶⁹ *Id.*

⁷⁰ The letter states in pertinent part that "[t]he giant foreign corporations do not realize that it is a privilege to operate under the corporate umbrella in Puerto Rico and, in the absence of state regulation, do and undo, destroying the private initiative of the Puertorican people." (translation from Spanish by the author). *Id.*

⁷¹ Middlemen such as distributors usually increase the cost of the product to the end user. Eliminating one layer in the distribution chain would lower distribution costs. *See* GALBRAITH, *supra* note 2.

⁷² *See* Gaetán, *supra* note 11, at 497-500. *See also* Colon, *supra* note 1, at 250-53. In the

on foreign commerce evaluated.⁷³ The proponents of the Act were only concerned with the protection of dealers/distributors, not with the cost of the legislation to the consumer nor the effect on the interests of manufacturers or the economy.⁷⁴

All dealer protection legislation, however, is not as restrictive or harmful to commerce. The Federal Automobile Dealer's Day in Court Act⁷⁵ was enacted by the United States Congress in an effort to protect exclusive automobile dealers from unscrupulous automobile manufacturers making unjustifiable demands under the threat of cancellation of the dealership.⁷⁶ Although the supporters of Puerto Rico's statute compare

first few years following the enactment of Law 75, the Puerto Rico Supreme Court was skeptical about the statement of motives in Law 75's legislative history. *A Different Opinion*, *supra* note 7, at 626. In *Warner Lambert*,¹⁰¹ P.R. Dec. 378, the Supreme Court of Puerto Rico stated:

Neither the statement of motives nor the legislative committee reports, adduce a single fact in support of such statement. No public hearings were held to argue the situation presented by Act No. 75. There was not even a debate on the floor of the legislative bodies when the Act was enacted. We have no basis to take judicial notice of the effect that the termination of the distribution contracts may have on the economy of Puerto Rico or on our society.

On the contrary, in the absence of facts which justify the legislative declaration on the need of Act No. 75, we find that the operation of the exclusive dealer in the distribution of food products has been protested because its commission constitutes an additional cost assumed by the consumer.

Id. at 627 (quoting from *Warner Lambert*). Furthermore, the *Warner Lambert* opinion contains a study by John Kenneth Galbraith, a world renowned economist, who recommends the elimination of middlemen or dealers in order to improve the distribution efficiency of food products. *Id.* at 627 n.8 (quoting from n.10 of the *Warner Lambert* opinion).

⁷³ The source for Law 75 is a statute from the Dominican Republic, a country not generally regarded as committed to freedom of commerce. *A Different Opinion*, *supra* note 7, at 626 (1989). It has not been uncommon for the Dominican Republic to enact legislation making it difficult for foreign firms to establish relationships within its borders. *Id.* at n.5. The analogous Dominican statute is Law No. 173 of April 6, 1966, as amended by Law 263 of December 31, 1971 and Law No. 622 of December 28, 1973. *Id.* See also Colon, *supra* note 1, at 262-264. Article 12 of Law No. 622 places serious obstacles in the path of any foreign entity wishing to engage in distribution in the Dominican Republic. In fact, while both, Law 75 and its Dominican Republic counterpart have similar restrictions, there is one difference. The Dominican Republic statute, Law 173 does not apply to principals located within the Dominican Republic. It only applies if the manufacturer is a foreign entity. *Id.* A similar statute exists in Cuba. See Gaetán, *supra* note 11, at 500 n.15 (citing Decreto 4504 promulgado en la *Gaceta Oficial* el 22 de Diciembre de 1947).

⁷⁴ See excerpts of the *Warner Lambert* opinion, *supra* note 72.

⁷⁵ Automobile Dealers Day in Court Act, 15 U.S.C. §§ 1221-1225 (1982).

⁷⁶ Many automobile dealers were being subjected to coercion and intimidation by manufacturers. Under the threat of cancellation of their dealerships, dealers were required to acquire unnecessarily large showrooms, or purchase undesired parts or models of cars. These unreasonable

Law 75 to the Automobile Dealer's Day in Court Act,⁷⁷ this comparison is unfounded. In fact, Law 75 is a major departure from the provisions of the Automobile Dealer's Day in Court Act.

The Puerto Rico Act applies to anyone within the statutory definition of "dealer"⁷⁸ and prohibits termination without just cause or the non-renewal of a contract upon its normal expiration.⁷⁹ In contrast, the Automobile Dealer's Day in Court Act only addresses "exclusive" dealers and does not convert terminable dealer contracts into non-terminable ones.⁸⁰ The intent of the Automobile Dealer's Day in Court Act is to prevent improper or coercive behavior on the part of the manufacturer and insure that the manufacturer acts in good faith.

In comparison, good faith is irrelevant in the enforcement of the Puerto Rico statute. Law 75 was enacted to prevent the termination of dealers or distributors by principals, irrespective of whether the principal acted in good faith.⁸¹ Furthermore, while Law 75 declares unenforceable many covenants unfavorable to the dealer, the Automobile Dealer's Day in Court Act permits any action within the terms of the contract, including termination.⁸² In addition, many states within the U.S. have also enacted legislation for the protection of distributors, dealers and franchises against wrongful termination.⁸³ None are as restrictive in their interpretation of just cause as Law 75,⁸⁴ and none contain the ab-

requirements placed undue financial burdens on the dealers. See generally Kessler, *Automobile Dealer Franchise: Vertical Integration by Contract*, 66 YALE L.J. 1135 (1957).

⁷⁷ See Colon, *supra* note 1, at 260 (Suggesting that the Puerto Rico Legislature developed Law 75 from the Automobile Dealer's Day in Court). See also Gaetán, *supra* note 11, at 527-28.

⁷⁸ See *supra* note 33.

⁷⁹ See *supra* notes 32, 34.

⁸⁰ See *Automobile Dealer's Day in Court Act*, *supra* note 76. See also Colon, *supra* note 1, at 260.

⁸¹ See *supra* note 6.

⁸² *Fornaris*, 423 F.2d at 568, (citing *Berry Bros. Buick, Inc. v. General Motors Corp.*, 257 F. Supp. 542, 546 (E.D.Pa. 1966), *aff'd mem.*, 377 F.2d 552 (3d Cir. 1967)).

⁸³ WFDL, *supra* note 19. California Franchise Relations Act, *supra* note 19. In total, sixteen states, including the Virgin Islands and the District of Columbia, have enacted some type of legislation requiring good cause for termination of contracts. Emerson, *supra* note 11, at 1509-13 (explaining types of legislation in this area).

⁸⁴ The Wisconsin Fair Dealership Law is a good example of such legislation. In 1974, Wisconsin enacted legislation to protect gas station operators, chain-restaurant owners, and small business operators from unjust termination or other unfair actions by the principal. Dittmar, *supra* note 12, at 155. In *Foerster, Inc. v. Atlas Metal Parts*, 105 Wis. 2d 19, 313 N.W.2d 61 (1981), the Wisconsin Supreme Court held that an agreement between a manufacturer and his representative did not constitute a dealership under the Wisconsin Fair Dealership Law. *Id.* at 157. The court reasoned that a narrow interpretation should be given to the definition of dealership. *Id.* But *c.f. supra* note 33. Puerto Rico Law 75's all encompassing definition of dealership. In con-

solute restrictions that Law 75 places on choice of law and forum.⁸⁵

A. *Scope of the Dealers' Contracts Act*

Although, the terms dealer⁸⁶, distributor⁸⁷, franchisee,⁸⁸ and agent⁸⁹ describe different relationships and responsibilities, Law 75 may extend its mantle of protection to all of them, provided that their activities fall within those contemplated in the Act.⁹⁰ The threshold question of whether certain activities and responsibilities fall within the Act's definition of "dealer" has been extensively litigated.⁹¹ The Puerto Rico

trast to the Wisconsin Supreme Court's interpretation of dealership, the Puerto Rico Supreme Court defines "dealer" as anyone rendering services to a principal or anyone taking the necessary steps to gain new consumers or create a market. *See Cordova & Simonpietri*, 112 P.R. Dec. at 797. *See also San Juan Merc.*, 108 P.R. Dec. 211. In contrast, "good cause" is defined by the WFDL as:

- (a) Failure by a dealer to comply substantially with essential and reasonable requirements imposed upon him by the grantor, or sought to be imposed by the grantor, which requirements are not discriminatory as compared with requirements imposed on other similarly situated dealers either by their terms or in the manner of their enforcement; or
- (b) Bad faith by the dealer in carrying out the terms of the dealership.

WFDL, *supra* note 19, § 135.02(4). In contrast, under Law 75, very few acts by the dealer give rise to just cause for termination. *See supra* notes 34 & 42.

⁸⁵ *See* Law 75, *supra* note 5, § 278b-2. The Act states that any covenant requiring a dealer/distributor to litigate outside Puerto Rico is null and void because it violates public policy. *Id.* In contrast similar laws enacted by various states within the United States enforce choice of law and forum selection clauses. *See* *Smith, Valentino & Smith, Inc. v. Superior Court*, 17 Cal. 3d 491, 551 P.2d 1206, 131 Cal. Rptr. 374 (1976). In upholding a forum selection clause requiring action to be brought in Philadelphia, the California Supreme Court stated that California courts enforce contractual choice of law provisions. *Id.* at 494. *See also* *Medtronic, Inc. v. Gibbons*, 684 F.2d 565, 567-8 (8th Cir. 1982) (refusing to apply California substantive law in restrictive covenants because the agreement contained a Minnesota choice of law clause); *33 Flavors of Greater Delaware Valley, Inc. v. Bresler's 33 Flavors, Inc.*, 475 F. Supp. 217, 226-228 (D. Del. 1979) (holding that a Delaware franchisee was subject to the Illinois choice of law provision in the distributor's contract).

⁸⁶ *See* BLACK'S LAW DICTIONARY, *supra* note 22, at 399.

⁸⁷ *Id.* at 475.

⁸⁸ *Id.* at 659.

⁸⁹ *Id.* at 63.

⁹⁰ The Act defines a "dealer" as one who is "actually interested in a dealer's contract because of his having effectively in his charge in Puerto Rico the distribution, agency, concession or representation of a given merchandise or service." Law 75, *supra* note 5 § 278(a).

⁹¹ *See Cordova*, 112 P.R. Dec. at 803 (promoting and selling insurance contracts, constitutes a franchise relationship under Law 75); *San Juan Merc.*, 108 P.R. Dec. at 211 (exclusivity not a requirement to be considered a dealer); *J. Soler Motors*, 108 D.P.R. 134 (non-exclusivity or re-

Supreme Court, in an attempt to provide some guidance to the lower courts, outlined factors that must be considered to determine if the relationship is protected under the Act.⁹² The court decisions define a dealer as an independent entrepreneur engaged in an on-going relationship with a principal/grantor for the distribution of products and services designed to develop or expand a market for the products of the principal/grantor.⁹³ This entrepreneur must be able to show that he actively promotes the products, has authority to conclude contracts, purchases and keeps his own inventory, has discretion in fixing prices and sales terms, has invoicing and delivery responsibilities for the products or services, and has the facilities to offer product-related services to clients.⁹⁴

These same decisions also indicate, however, that a salesperson or commissioned representative would not be considered a dealer for the purposes of the Act.⁹⁵ The courts reason that a salesperson or commissioned representative is not an independent business entrepreneur,⁹⁶ does

served rights by the principal to sell directly does not remove the relationship from the Act's protection). *But see Sudouest Import Sales Corp.*, 732 F.2d at 15 (finding that representative was not a dealer because it did not handle product billings and receipts and had limited involvement in sales and promotions); *Mario R. Franceschini, Inc. v. Riley Co.*, 591 F. Supp. 414 (D.P.R. 1984) (not a dealer because it did not buy the equipment nor had the authority to fix sales terms or perform billing). *But see Computec Systems Corp.*, 599 F. Supp. at 823, n.7 (being in charge of the dealership is a key requirement).

⁹² At the end of its 1988 term, the Puerto Rico Supreme Court discussed the circumstances under which a grantee would be considered a dealer. *Rodríguez Vidal, supra* note 7, at 264. In *Roberto Colon, Inc. v. Oxford Industries, Inc.*, 88 J.T.S. 102 (1988), the court stated:

To determine whether one is before a "dealer," various factors must be taken into account, among them: whether the dealer conducts an active promotion and/or closing of contracts; whether it acquires inventory; whether it exercises control over prices; whether it has discretion in reaching agreement over the terms of the sales; whether it is responsible for the delivery and collection of merchandise and authority to grant credit To these, others may be added, lest it be understood or intended that this be a complete listing.

Rodríguez Vidal, supra note 7, at 265.

⁹³ *Roberto Colon, Inc.* In *Colon*, the court defined various factors, that while not individually dispositive, when considered as a whole classify the grantee as a dealer entitled to protection under the Act. Some of the factors defined by the court were: (1) being an independent business person with an ongoing relationship with the principal; (2) active promotion and marketing of the product; (3) keeping one's own inventory; (4) discretion to establish sales prices; (5) responsibility for extending credit, billing and product delivery; and (6) the assumption of business risks associated with the activities undertaken. *Id.*

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ *See William B. Topp v. Narrow Fabrics of America*, No. 87-0703 GG, 1989 U.S. Dist. LEXIS 1390, at *6-*8 (D.P.R. Feb. 2, 1989) (soliciting orders for new business, maintenance of

not assume the normal business risks associated with business operations,⁹⁷ and does not have the discretion to establish sales prices nor to make decisions on extension of credit or product deliveries.⁹⁸ In contrast, under certain circumstances, an agent for the principal can be considered a dealer if his contractual relationship with the principal shows that the agent has the duties, responsibilities, and liabilities normally associated with owning and operating a business.⁹⁹ Hence, it is not the label placed on the relationship that controls whether it is protected under the Act, but the responsibilities and acts that the agent performs.¹⁰⁰

B. *The Narrow Interpretation of "Just Cause"*

The Act defines "just cause" in terms of acts committed by the dealer that adversely and substantially affect the interests of the principal,¹⁰¹ but does not address the effects of changes in the marketplace,¹⁰² total non-discriminatory withdrawal from the market,¹⁰³ or

existing accounts and performing limited advertising are not necessarily dealer activities, but may also be activities of a commissioned salesperson not protected by the Act).

⁹⁷ See *E.B.I., Inc. v. Gator Industries, Inc.*, 807 F.2d 1 (1st Cir. 1986) (commissioned sales people are not protected by Law 75 because they do not take substantial business risks nor are they authorized to close sales).

⁹⁸ See *Morales v. Gregg Shirt Makers, Inc.*, 682 F. Supp. 142, 144-145 (D.P.R. 1988) (exclusive sales representative who sold \$880,000.00 in merchandise over a period of eight years is not a dealer as defined by the Act when he does not maintain inventory nor take any credit risk since the credit checks and collections were made by the principal).

⁹⁹ See *Lineas Aereas Costarricenses, S.A. (LASCA) v. Caribbean*, 682 F. Supp. 117 (D.P.R. 1988). In *Lineas Aereas Costarricenses, S.A.*, the court found that Caribbean's relationship with LACSA was covered under Law 75. The contract between LASCA and Caribbean stated that Caribbean was solely responsible for employing personnel at its own expense, purchasing the necessary licenses, all business losses or credit risks, and conducting all marketing and sales campaigns at its own expense. *Id.* The court reasoned that Caribbean's duties and responsibilities as well as the great business risk assumed by the contract, placed Caribbean within the intended meaning of Law 75. *Id.*

¹⁰⁰ See *Roberto Colon, Inc.*, 88 J.T.S. 102.

¹⁰¹ Law 75, *supra* note 5, § 278(d). For the definition of just cause see *supra* note 34.

¹⁰² The courts have stated that just cause does not include good faith termination of the contract by the principal nor the right of the manufacturer to adjust its distribution system to expand the market. *Salamone, supra* note 7, at 105 (citing *Warner Lambert Co.*, 101 P.R. Dec. at 400). Furthermore, the need to implement changes in the principal's worldwide operations does not constitute just cause. *Id.* at n.131.

¹⁰³ Just cause does not include termination of the distributor as a result of the principal's bona-fide or partial withdrawal from the market due to unprofitability. *Id.* at 70 n.10. *But see Medina & Medina*, 858 F.2d 817 (Law 75 does not bar principal from good faith total withdrawal from the market). The tough limitations and conditions precedent outlined by the court for a total withdrawal defense to prevail make it highly unlikely that it will be used often. *Rodriguez Vidal, supra* note 7, at 280.

other causes affecting the grantor, such as raising a defense of impossibility of performance.¹⁰⁴ Accordingly, under a literal reading, just cause does not include dealer termination due to bona-fide market reasons. These gaps in the statutory definition have left the interpretation of what constitutes just cause to the courts,¹⁰⁵ which have interpreted the Act as giving broad protection to the dealer.¹⁰⁶ The decisions show that the courts' interpretation of "just cause" is very restrictive.¹⁰⁷

A principal/grantor may terminate a dealer with just cause only as a result of two types of conduct. The first encompasses cases where the dealer/distributor breaches any essential contractual obligation, or where an act or omission by the dealer/distributor substantially and materially affects the interests of the principal or grantor with regards to its marketing efforts in Puerto Rico.¹⁰⁸ An essential obligation would be one negotiated and agreed upon by the parties and included in the contract. Breach by the dealer or distributor of any covenant containing such agreed upon obligations is likely to fall under the statutory definition of just cause,¹⁰⁹ giving the principal a valid defense against an action for termination initiated by a dealer/distributor.

¹⁰⁴ Law 75 also seems to preclude the principal from raising the defenses of impossibility of performance or *rebus sic stantibus*. *Id.*

¹⁰⁵ See *supra* note 37. Although there has been considerable litigation on the question of just cause, there is very little consistency in the construction of the term. Rodriguez Vidal, *supra* note 7, at 269. Courts have had to apply their own interpretation of the term. *Id.*

¹⁰⁶ The interpretation given to just cause by the courts supports the view that the mantle of protection afforded to the dealer/distributor is broad and inclusive. Rodriguez Vidal, *supra* note 7, at 297.

¹⁰⁷ See *General Office Products Corp. v. Gusco Mfg., Inc.*, 666 328, 331, (D.P.R. 1987) (inactivity by a manufacturer, after being notified of third party interferences with the distributor's exclusive contract constitute termination without just cause). *Tamachi, Inc.*, 651 F. Supp. at 1360, n.1 (principal cannot undermine contractual relationship with distributor nor refuse to renew the contract without just cause); See also *Biomedical Instrument & Equip. v. Cordis Corp.*, 797 F.2d 16 (1st Cir. 1986) (reversing a summary judgment granted for the manufacturer on the issue of termination with just cause for lack of payments); *Jordan K. Rand, Ltd. v. Lazoff Bros., Inc.*, 537 F. Supp. 587 (D.P.R. 1982) (non payment of royalties and unauthorized use of trademark constitute just cause for termination).

¹⁰⁸ Rodriguez Vidal, *supra* note 7, at 266. See also *Jordan K. Rand, Ltd.*, 537 F. Supp. at 587; *An-Port, Inc. v. M.B.R. Indus.*, 772 F. Supp. 1301 (P.R. Dec. 1991). In *An-Port* the court stated that distribution of competing products by a dealer in violation of a contract clause, adversely and substantially affected the interests of the principal in marketing its products. Therefore, the principal had just cause for termination. *Id.*

¹⁰⁹ A dealer that assigned maintenance duties to a third party was in violation of his distribution agreement because the maintenance duty was an "essential obligation" under the contract. Accordingly the principal had just cause for termination. *Pan American Computer Corp.*, 562 F. Supp. 693. See also *Luis Rosario, Inc.*, 733 F.2d 172. In *Luis Rosario, Inc.*, a dealer violated an essential obligation of the contract by not keeping adequate inventory and operating his own service organization. Therefore, the principal had just cause for termination. *Id.*

The second type of conduct is that which involves a dealer/distributor committing a business tort such as trademark infringements, non-payment of royalties or for merchandise, or unfair competition.¹¹⁰ This behavior constitutes dealer misconduct which adversely affects the principal. Hence, termination of a dealer with just cause would occur only in instances of substantial breach or dealer misconduct that substantially and adversely affects the principal's or grantor's marketing efforts.

1. Interpretation of "Just Cause"

In most non-renewal or contract termination cases the principal or grantor claims either dishonest practices, material breaches, or poor performance on the part of the dealer as the reason for termination.¹¹¹ An analysis of litigated cases under the Act indicates that Law 75 focuses only on *substantial* breaches that *adversely and substantially* affect the principal or grantor. Court decisions make a broad distinction between substantial and minor breaches.¹¹² The following actions by a dealer/distributor have been found to be substantial breaches giving rise to termination with just cause: (1) unfair competition by the unauthorized use of a trademark;¹¹³ (2) dealer assigning his contractual rights to a competitor of the principal without authorization;¹¹⁴ (3) dealer failing to maintain adequate inventory and failing to operate his own service organization;¹¹⁵ (4) consistent violation of payment terms;¹¹⁶ and (5) fail-

¹¹⁰ See *De Moss* 493 F.2d 1012 (granting principal's request to enjoin agent from continuing another business relationship in violation of the agreement); *John K. Rand, Ltd.*, 537 F. Supp. 587 (failure by distributor to pay royalties and unauthorized use of a trademark are reasons for termination with just cause). For additional discussion on the concept's interpretation by the courts, see also Rodriguez Vidal, *supra* note 7, at 269.

¹¹¹ See *P.P.M. Chemical Corp. v. Saskatoon Chemicals, Ltd.*, 931 F.2d 138 (1st Cir. 1991) (dealer's continual violation of payment terms constitutes a material breach of the contract); *Bio-medical Instrument & Equip. v. Cordis Corp.*, 797 F.2d 16 (D.P.R. 1986) (dealer's failure to pay on time the amounts due constitutes a violation of one of the essential obligations of the contract); *Luis Rosario, Inc.*, 733 F.2d 172 (failure to keep adequate inventory and operate own service organization in addition to poor sales is a material breach of the contract); *Pan American Computer Corp.*, 652 F.2d 215 (dealer assignment of his contractual rights to a competitor of the principal violated the dealer's essential obligations under the contract) *De Moss*, 493 F.2d 1012 (distributor's violation of covenant on ownership of competing business constitutes unfair competition); *Jordan K Rand, Ltd.*, 537 F. Supp. 587 (dealer's use of trademark for unfair competition was a substantial breach of the contract).

¹¹² See *La Playa Santa Marina*, 597 F.2d 1. In *La Playa Santa Marina*, the court deemed dealer's declining sales and performance problems as minor breaches and not enough to constitute just cause. *Id.* at 3.

¹¹³ *Jordan K. Rand, Ltd.*, 537 F. Supp. 587.

¹¹⁴ *Pan American Computer Corp.*, 652 F.2d. 215.

¹¹⁵ *Luis Rosario, Inc.*, 733 F.2d 172.

ure to pay royalties when due.¹¹⁷ In contrast, declining sales and performance problems have been deemed minor breaches and not just cause for termination.¹¹⁸ Because allegations of poor performance are usually related to performance objectives agreed upon by the parties, principals should be aware that dealers/distributors are not bound by contract provisions establishing standards of conduct, sales and performance quotas, or distribution objectives.¹¹⁹ Therefore, in an action contesting the termination of the contract, the principal can expect that the distributor is likely to *allege* that those standards, quotas, etc. do not conform to the realities of the market in Puerto Rico, and therefore he cannot be held responsible for non-compliance.¹²⁰

2. Duration of the Agreement

The Act protects the dealer/distributor from contract covenants restricting the length of the relationship.¹²¹ Furthermore, the Act establishes that a manufacturer cannot refuse to renew a distribution contract if the dealer/distributor desires to continue the relationship.¹²² Nevertheless, in recent cases the courts have stated that the freedom of contract is limited by Puerto Rico law only in those circumstances that violate

¹¹⁶ *P.P.M. Chemical Corp.*, 931 F.2d 938.

¹¹⁷ *Biomedical Instrument & Equip.*, 797 F.2d 16.

¹¹⁸ See *La Playa Santa Marina*, 597 F.2d 1.

¹¹⁹ On July 13, 1988, the Puerto Rico Legislature approved an amendment to Law 75. See *supra* note 5. This amendment added § 278a-1 which states in pertinent parts:

(e) it will not be deemed to be just cause any violation or non-performance, by the distributor, of any covenant included in the distribution contract that establishes canons of conduct, quotes or performance objectives that do not reflect the market realities in Puerto Rico at the time of the violation or non-performance by the distributor. The burden of proof to demonstrate the reasonability of the canon of conduct, quota or objective lies with the principal or grantor.

Law 75, *supra* note 5, § 278a-1 (translated from Spanish by the author).

¹²⁰ *Id.*

¹²¹ The Act provides:

Notwithstanding the existence in a dealer's contract of a clause reserving to the parties the unilateral right to terminate the existing relationship, no principal or grantor may directly or indirectly perform any act detrimental to the established relationship or refuse to renew said contract on its normal expiration, except for just cause.

Law 75, *supra* note 5, § 278a.

¹²² *Id.*

public policy.¹²³ These rulings do not grant the principal a blanket right to terminate the contract. In fact, the courts have upheld termination or non-renewal of a dealership agreement in those cases where the market conditions were such that the principal wanted to completely withdraw from the market.¹²⁴ The principal/grantor must be aware that while total withdrawal from the Puerto Rican marketplace may constitute just cause,¹²⁵ withdrawal from the market in order to either sell or service directly or through other sources will most likely not be considered just cause for termination.¹²⁶ It is important that this option and reservation of rights by the principal be covered in the agreement by the inclusion of a covenant. The covenant should state that the principal and the dealer/distributor agree that the contract may be terminated in the event that the distributor totally withdraws from the marketplace.

3. Notice Requirements

Notice of termination or non-renewal is not only legally necessary,¹²⁷ but is also necessary for fairness to the parties. Termination or non-renewal notice gives dealers and distributors the opportunity to mitigate the financial impact that the discontinuance of the relationship will have by planning for alternate sources of income or adjusting inventories.¹²⁸

¹²³ Contracts must be performed "pursuant to the codified doctrine of *pacta sunt servanta* (agreements must be respected). P.R. LAWS ANN., tit. 31, § 2994. *Cassera Foods, Inc. v. E.L.A.*, 108 P.R. Dec. 850 (1979) (emphasis added). See also *Grisson v. Colotti*, 644 F. Supp. 903, 905 (D.P.R. 1986) (stating that the freedom of contract is limited by Puerto Rico Law only in those circumstances that violate public policy, morals or the law).

¹²⁴ Law 75 does not bar the principal from withdrawing from the market provided that his action is not aimed at capitalizing on the good will or customer base created by the dealer. *Medina & Medina*, 858 F.2d at 824. (citing the Supreme Court of Puerto Rico). Cf. *Warner Lambert Co.*, 101 P.R. Dec. at 400 (need to implement worldwide marketing changes does not justify termination of the dealer/distributor).

¹²⁵ In *Medina & Medina*, 858 F.2d at 824, the court stated that the Act applied where the principal terminates the dealer/distributor with the purpose of either selling directly or appointing other dealers/distributors. *Id.* The Act did not apply in the cases of good faith total withdrawal from the market. *Id.*

¹²⁶ See *id.*

¹²⁷ Reasonable notice must be given to afford the dealer an opportunity to explore alternative sources of income. See generally *id.* Courts will examine all the conditions surrounding the contract termination and renewal negotiations, including duration and extent of negotiations, in determining the reasonableness of the notice term. *Id.* at 823.

¹²⁸ *Id.* See also, Faruki, *supra* note 11, at 931. In discussing the requirement for notice of termination, Faruki states that notice of termination is fair because it gives the distributor the opportunity to adjust his inventory, seek alternate suppliers, and adjust his business plan. *Id.* Furthermore, the notice of termination will trigger a duty on the part of the distributor to mitigate damages. *Id.*

C. Unenforceable Contractual Clauses Under the Dealers' Contracts Act

Standard distribution contracts commonly used in the U.S. between manufacturers and dealers/distributors have been labeled adhesion contracts in Puerto Rico,¹²⁹ and hence, many of the clauses contained in them have been held to be unenforceable.

1. Customary or Boiler-Plate Distribution Agreements

Because the manufacturer usually develops the contract and the general covenants, they have been considered by Spanish scholars as giving unequal bargaining power to the manufacturer.¹³⁰ This argument was used by the proponents of Law 75 to justify legislative protection for Puerto Rican dealers and distributors against the use of boiler-plate language.¹³¹ The supporters of the Act justify the restrictions placed by Law 75 on the freedom of contract, as a way to restore equal bargaining power between the manufacturers and the dealer/distributors.¹³²

Many of the standard clauses found in most distribution contracts such as the principal's right to terminate or not renew the contract¹³³ and the right to establish performance covenants¹³⁴ are invalid or unenforceable under the Act.¹³⁵ In contrast, in other U.S. jurisdictions with comparable legislation, the parties are free to include in a contract any

¹²⁹ In an adhesion contract the contractual covenants are usually established and imposed by the more powerful economic entity. Colon, *supra* note 1, at 228. The parties are in total disequilibrium. Accordingly, the principles of contractual autonomy are broken. *Id.* (translation from Spanish by the author).

¹³⁰ LUIS RIERA AISA, *Contrato in 5 NUEVA ENCICLOPEDIA JURIDICA*, 317, 321 as cited in Colon, *supra* note 1, at 228. This type of contract should not be allowed in Puerto Rico. It should be restricted to certain type of activities only, such as insurance and ban loan agreements. *Id.*

¹³¹ It is necessary for the legislature to provide protection to the dealers and distributors because they are in an inferior bargaining position. Colon, *supra* note 1, at 229. Distributors have to accept whatever is established by the principal, who is always in position to dictate the contract terms. *Id.* Most contracts drafted by the principal include the right to terminate by either party. But it is usually the principal, who in bad faith, terminates the dealer. Hence, these distributors need the protection of the legislation. *Id.* at 232.

¹³² *Id.* at 229.

¹³³ Except under narrowly defined circumstances the principal cannot unilaterally terminate the contract. *See supra* notes 34, 103-104, 110-113.

¹³⁴ The Act states that violation by the dealer of performance objectives, quotas or any other covenant restricting the dealer's course of conduct, will not be grounds for termination with just cause. The principal has the burden of proof to demonstrate that the performance objectives were reasonable for the market conditions at the time of breach. Law 75, *supra* note 5, § 278a-1c.

¹³⁵ *See supra* note 51.

agreed upon covenants, including performance quotas and termination clauses. Furthermore, the courts will enforce agreed upon covenants as representative of the intent of the parties.¹³⁶

Because Law 75 was enacted to protect the dealer,¹³⁷ prior to entering into negotiations for a distribution or dealership contract in Puerto Rico, the principal must clearly understand: (1) what constitutes a protected "dealer" under Law 75; and (2) what restrictions the Act imposes on the enforcement of certain distribution contracts' covenants.

2. Changes in Ownership, Management and Financing

The distributor is not forced to comply with contractual clauses restricting changes in ownership, management or business structure of his operation.¹³⁸ These contract clauses, commonly found in franchise agreements, are not enforceable under Law 75 unless it is proven by the principal that the violation of any such clause has adversely and substantially affected the interests of the principal in the development of the market place.¹³⁹

3. Changes in the Course of Dealing

The Act establishes a presumption of termination without just cause whenever the distributor appoints additional dealers/distributors, or unjustifiably withholds or delays merchandise deliveries, or changes, prejudicing the distributor, shipping methods or payment terms and condi-

¹³⁶ See *Automobile Dealer's Day in Court*, *supra* note 19 (any action within the terms of the contract is permissible including termination); *WFDL*, *supra* note 19 (choice of law will be respected). See also Kessler, *Automobile Dealer Franchises: Vertical Integration by Contract*, 66 *YALE L.J.* 1135 (1956) (comparison of the statutes enacted by various states protecting the distributor's contract rights).

¹³⁷ 1966 P.R. LAWS 332, *supra* note 6, Statement of Motives of the Act.

¹³⁸ § 278a-1 states in pertinent parts:

(a) It will not be considered just cause any violation, by the distributor, of any covenant included in the distribution contract that impairs or restricts changes in the capital structure of the distributor, or management changes, or means of financing the operation, or is designed to impair or restrict the sale, transfer, or encumbrance of any corporate action, participative share, rights or interests owned by any person in said distribution business, unless the principal or grantor demonstrates that the violation may affect or has already affected adversely and substantially the interests of the principal or grantor in the development of the market, distribution or delivery of services.

Law 75, *supra* note 5, § 278a-1.

¹³⁹ *Id.*

tions.¹⁴⁰ Nevertheless, in limited circumstances courts have allowed changes in the course of dealing, provided that they did not have a detrimental effect on the operation of the dealer/distributor.¹⁴¹ In evaluating whether a change in the course of dealing constitutes termination without just cause, the court will also inquire as to whether the change was contemplated in the original agreement, reflecting the original intention of the parties.¹⁴² It is clear that subsequent intentions, once the relationship has gone sour, are not likely to prevail in an unjust termination action under Law 75.¹⁴³

D. Non Waivable Dealers' Rights

The rights and remedies of Law 75 are conferred as a matter of public policy and cannot be waived.¹⁴⁴ The courts, in enforcing this clause, have often invalidated contractual provisions, implied or explicit, between distributors and manufacturers.¹⁴⁵ The covenants most frequently invalidated are the choice of law or forum selection clauses,¹⁴⁶ and renewal/non-renewal clauses.¹⁴⁷ Additionally, in many

¹⁴⁰ See *supra* note 51.

¹⁴¹ The principal has the right to establish a distributor and require the dealer to do business through such distributor, provided that at the inception of the contract between the principal and the dealer, the principal had reserved the right to appoint distributors. *J. Soler Motors*, 108 P.R. Dec. at 135. Requiring the dealer to conduct his business through a newly appointed distributor did not constitute "undermining of the relationship" because there was no detrimental effect on the dealer operations and was contemplated in the original contract. *Id.* at 144.

¹⁴² *Id.*

¹⁴³ *La Playa Santa Marina*, 597 F.2d 1; *J. Soler Motors*, 108 P.R. Dec. 134.

¹⁴⁴ The Act states:

The provisions of this chapter are of a public order and therefore the rights determined by such provisions cannot be waived. This chapter being of a remedial character, should, for the most effective protection of such rights, be liberally interpreted; in the adjudgment of the claims that may arise hereunder, the courts of justice shall recognize the right in favor of whom may, effectively, have at his charge the distribution of activities, notwithstanding the corporate or contractual structures or mechanisms that the principal or grantor may have created or imposed to conceal the real nature of the relationship established.

Law 75, *supra* note 5, § 278c.

¹⁴⁵ See *Pan American Computer Corp.* 467 F. Supp. at 970 (any covenant implying the intention by the parties to place a distribution contract outside the reach of the statute is null and void); *Walborg Corp. v. Tribunal Superior*, 104 P.R. Dec. 184, 189 (1975) (the rights of the distributor to select Puerto Rico as the forum cannot be waived).

¹⁴⁶ The decisions of the Supreme Court of Puerto Rico are the Law in Puerto Rico, and binding on both Commonwealth and the federal district court of Puerto Rico. *King Seely Thermos Co. v. Ernesto F. Rodriguez, Inc.*, 385 F. Supp. 894 (D.P.R. 1974). See also *Gemco Latinoamerica, Inc.*, 623 F. Supp. at 918 (Commonwealth law applies notwithstanding a covenant

instances, the courts have precluded the principal from enforcing certain contract covenants, such as the reservation of rights to change distributor's credit terms or course of dealing because they may be detrimental to the legitimate expectations of the dealer.¹⁴⁸ The Act will also preclude the principal from enforcing sales quotas and performance objectives necessary for viable operation, even if agreed upon by the dealer at inception of the agreement.¹⁴⁹ In fact, courts have ruled that termination of a dealer/distributor by the principal, for failure to meet performance objectives is considered unjust termination and makes the principal liable for damages under Law 75.¹⁵⁰ This is not to imply that a manufacturer has no right to set performance quotas. In fact, most distributor contracts contain some type of performance covenant since the effective marketing of his products is at stake. The court's decisions in this area seem simply to imply that sales quotas cannot be enforced without first demonstrating that they are reasonable, at the time of enforcement, in light of prevailing market conditions, the state of the economy, and competition.¹⁵¹

stating that contract should be interpreted pursuant to the laws of New York); *Pan American Computer Corp.*, 467 F. Supp. 969 (the non-waiver provision of the Act forecloses any doubt about the invalidity of any consensual choice of jurisdiction); *Southern Int'l Sales v. Potter & Brumfield Div.*, 410 F. Supp. 1339 (S.D.N.Y. 1976) (applying Indiana law would frustrate the fundamental policy expressed by the Act, notwithstanding the fact that Indiana law was chosen by both parties).

¹⁴⁷ A provision in a distribution contract stating that the contract could only be extended by a formal writing signed by the parties and that a continuation of the business dealings could not be interpreted as the intent of the parties to renew the contract is void because it violates the Act. *Gemco Latinoamerica, Inc.*, 623 F. Supp. at 918.

¹⁴⁸ In *Whirlpool Corp. v. U.M.C.O. Int'l Corp.*, 748 F. Supp. 1557 (S.D.Fla. 1990), the court ruled that a contract covenant allowing the principal to alter the credit terms unilaterally was not free from scrutiny under the Act. The court reasoned that the Act was not limited to protecting the established relationship, but rather to protect the legitimate expectations of the dealer/distributor. *Id.*

¹⁴⁹ See §278a-1(c), *supra* note 119.

¹⁵⁰ See *La Playa Santa Marina, Inc.*, 597 F.2d at 4. In *La Playa Santa Marina*, the court held that the manufacturer did not have just cause for terminating its dealer in Puerto Rico. Here, the defendant, Chris-Craft, terminated its Puerto Rican dealership contract because of dissatisfaction with the dealer's performance and declining sales. The court did not find enough evidence for the allegations and deemed the breaches as minor, hence, outside the court's interpretation of just cause. *Id.* Cf. *Francisco Garraton, Inc. v. Lan Man & Kemp-Barclay*, 559 F. Supp. 405 (D.P.R. 1983). In *Garraton*, the distributorship contract was terminated by the manufacturer for failure to properly service the manufacturer's product line. The court reasoned that the distributor's failure to perform was not due to the principal's actions but was due to the distributor's own financial problems. Distributor's request for injunctive relief was denied, implying that the principal had just cause for termination. *Id.*

¹⁵¹ See *Salamone*, *supra* note 7, at 106-107.

E. Choice of Laws and Forum Selection Clauses

While the courts of most states respect choice of law and forum selection contract clauses,¹⁵² Law 75 clearly regards these clauses in contracts with Puerto Rican dealers and distributors as unenforceable.¹⁵³ In fact, in diversity cases litigated in federal court, choice of forum clauses that select forums outside Puerto Rico are always challenged, and the courts insist that Puerto Rico law be applied.¹⁵⁴ Law 75 invalidates as against public policy, any contractual provisions or stipulations

¹⁵² See *Smith, Valentino & Smith, Inc.*, 17 Cal. 3d at 493. In upholding a forum selection clause requiring action to be brought in Philadelphia, the California Supreme Court stated that California courts enforced contractual choice of law provisions. *Id. see also Medtronic, Inc. v. Gibbons*, 684 F.2d 565, 567-68 (8th Cir. 1982) (refusing to apply California substantive law in restrictive covenants because the agreement contained a Minnesota choice of law clause). 33 *Flavors of Greater Delaware Valley, Inc.*, 475 F. Supp. at 226-228 (holding that a Delaware franchisee was subject to the Illinois choice of law provision in the distributor's contract). *But see Southern Int'l Sales*, 410 F. Supp. 1339 (1976). In *Southern Int'l Sales*, the Puerto Rican distributor brought his action in a New York court. The principal tried to enforce a choice of law clause designating that the contract would be governed by Indiana law. In holding that Puerto Rico law applied, the Court stated:

[T]he significance of the parties choice of Indiana law would pale when viewed against the fact that almost all of the equipment sold by Southern on defendant's behalf was sold in Puerto Rico, for Puerto Rican accounts and for its use in Puerto Rico; the solicitation of customers occurred in Puerto Rico; and plaintiff signed the contract there. More to the point, the application of Indiana law would frustrate the fundamental policy expressed in the Puerto Rican Dealer's Contract Act.

Id. at 1341.

¹⁵³ See Law 75, *supra* note 5, § 278b-2. The Act states:

The dealer's contracts referred to in this chapter shall be interpreted pursuant to and ruled by the laws of the Commonwealth of Puerto Rico, and any other stipulation to the contrary shall be void.

Any stipulation that obligates a dealer to adjust, arbitrate or litigate any controversy that comes up regarding his dealer's contract outside of Puerto Rico, or under foreign law or rule of law, shall be likewise considered as violating the public policy set forth by this chapter and is therefore null and void.

Law 75, *supra* note 1, § 278b-2 as amended by Act. No. 75 of June 23, 1978.

¹⁵⁴ See *Pan American Computer Corp.*, 467 F. Supp. 969. The United States District Court, citing the 1978 amendment to Law 75 and stressing the strong public policy behind Law 75, held that a contract clause designating Massachusetts law as controlling was unenforceable. *Id. See also Gemco Latinoamerica*, 623 F. Supp. at 918, n.2. (setting aside a New York choice of law covenant and applied Puerto Rico law where the contract had been partially negotiated and executed in Puerto Rico). *Compare with Southern Int'l Sales*, 410 F. Supp. 1339 (Puerto Rico law applies because applying Indiana law would frustrate the fundamental purpose of Law 75).

that require the dealer/distributor to litigate a Law 75 dispute outside Puerto Rico.¹⁵⁵ The provision was incorporated in an amendment enacted in 1978.¹⁵⁶ Proponents of the amendment¹⁵⁷ argued that public policy required that distribution contracts be interpreted under Puerto Rico's laws. Their main concern was that dealers/distributors forced to litigate in foreign forums and under foreign law would frequently be at a disadvantage.¹⁵⁸ Nevertheless, recent court cases show that where forum-non-conveniens becomes a relevant issue, the courts may uphold choice of forum and choice of law clauses.¹⁵⁹

In spite of the restrictions on choice of law and forum, litigants desiring to enforce these clauses may succeed through arbitration clauses. While the courts in Law 75 actions have, as a matter of public policy, refused to enforce choice of law and choice of forum covenants,¹⁶⁰ arbitration clauses are routinely enforced.¹⁶¹ The U.S. Supreme Court

¹⁵⁵ See *supra* note 153.

¹⁵⁶ 1978 P.R. LAW 341; Act No. 75 of June 23, 1978, 1978 *SERVICIO LEGISLATIVO DE PUERTO RICO*, No. 3, at 444.

¹⁵⁷ This provision of the law is the result of the lobbying efforts by the Commission on Industry, Commerce and Industrial Development on behalf of Puerto Rican dealers and distributors. In a letter to the Senate of Puerto Rico dated May 16, 1978, Danny Lopez Soto, President of the Commission on Industry, Commerce and Industrial Developments, recommends the adoption of this amendment. See 1978 *SERVICIO LEGISLATIVO DE PUERTO RICO*, No. 3, at 444.

¹⁵⁸ In a report rendered to the Senate of Puerto Rico, Danny Lopez Soto, states:

[T]his project attends to the situation of great disadvantage in which a distributor is frequently placed because of the inclusion in distribution contracts of certain covenants forcing him to resolve his controversies or claim his rights in foreign forums and under foreign laws. The P. of the C. 175 declares these covenants null and void incorporating the doctrine established by our Supreme Court in *Walborg Corporation v. Tribunal Superior* decided on the 30 of September of 1975 (104 D.P.R. 184).

Although this case held that by express disposition of Article 4, the rights conferred by Law 75 to distributors cannot be waived and that the covenants forcing a distributor to resolve its controversies outside Puerto Rico are unenforceable, this project to incorporate in the text of Law 75 the referred jurisprudence doctrine must be approved.

Id.

¹⁵⁹ Although a forum selection clause will not be a dispositive factor, the convenience of the forum, given the parties expressed preference for that venue, must be considered in the balancing test. *Royal Bed & Spring Co., v. Famosul Industria e Comercio de Moveis, Ltd.*, 906 F.2d 45, 52 (1st Cir. 1990). In ruling that Brazil was the most convenient forum, the court considered, *inter alia*, the following factors: (1) both parties selected Brazil as their choice of law and forum; (2) the furniture was manufactured in Brazil; (3) the distributor had previously litigated in Brazil; (4) the contract was drafted in Portuguese, was signed in Brazil *Id.* at 52-53.

¹⁶⁰ See *Gemco Latinoamerica, Inc.*, 623 F. Supp. 912; *Pan Am. Computer Corp.*, 467 F. Supp. 969; *Southern Int'l Sales* 410 F. Supp. 1339

¹⁶¹ The U.S. Supreme Court held in *Mitsubishi Motors Corporation v. Soler Chrysler-Plym-*

has held that the Federal Arbitration Act¹⁶² cannot be preempted by Puerto Rico laws.¹⁶³ By holding that an arbitration covenant containing a choice of forum is enforceable in a Law 75 action, the U.S. Supreme Court has given manufacturers and grantors in diversity cases the opportunity to enforce their arbitration clauses and the choice of forum clauses for arbitration.¹⁶⁴

Arbitration may be commenced by either party provided that there is a contract provision to arbitrate.¹⁶⁵ In addition, the conduct of the

outh, Inc., 473 U.S. 614 (1985), that arbitration agreements were enforceable "as a matter of federal law." *Id.* at 626.

¹⁶² 9 U.S.C.A. §§ 1 et. seq. (1970). Federal policy, deriving from the Federal Arbitration Act, favor arbitration. Faruki, *supra* note 11, at 940. The United States Supreme Court has given arbitration agreements a liberal interpretation, consistent with the federal policy of discouraging court litigation over arbitrability of issues when there is an agreement to arbitrate. *Id.*

¹⁶³ Law 75 provides that any covenant requiring a dealer to arbitrate a controversy under foreign law or in a foreign forum is invalid as violating public policy. *See supra* note 153. The Puerto Rico Supreme Court has upheld this section of the act. *See Walborg Corp.*, 104 P.R. Dec. 184. In light of the diversity jurisdiction of the federal courts, the vitality of *Walborg* and this provision of the Act is questionable. Salamone, *supra* note 7, at 96. Many of the Law 75 actions filed by distributors in Puerto Rico courts could be removed to federal court by reason of diversity, since in most cases they involve U.S. or foreign companies. *Id.* In a landmark case, the U.S. Supreme Court reaffirmed the validity of arbitration agreements and their enforceability "as a matter of federal law." *Mitsubishi Motors Corp.*, 417 U.S. 614. In *Mitsubishi*, the Court held that "concerns of international comity, respect for the capacities of foreign and transnational tribunals, and sensitivity to the need of the international commercial system for predictability in the resolution of disputes require [enforcement of] the parties' agreement, even assuming that a contrary result would be forthcoming in a domestic context." *Id.* at 617. *See also* *Sea-Land Service, Inc. v. Sea-Land of Puerto Rico, Inc.*, 636 F. Supp. 750 (D.P.R. 1986) (plaintiff must submit his Law 75 claim to a Miami arbitration panel); *Propane Gas Co. of P.R., Inc. v. Sony Consumer Products Co.*, 613 F. Supp. 215 (D.P.R. 1985) (plaintiff ordered to arbitrate in New York). In a recent case, the U.S. District Court in Puerto Rico held that the United States Arbitration Act and Convention on Recognition and Enforcement of Foreign Arbitral Awards, 9 U.S.C.A. §§ 1 et. seq. 3, 21 U.S.T. § 2517 (1970), T.I.A.S. No. 6997, *reprinted following* 9 U.S.C. § 201 (1981), governed the distribution agreement containing an arbitration covenant. In fact, in a recent case the court held as valid a covenant to arbitrate in accordance with the laws of Ontario, Canada, and ordered arbitration before the London Court of Arbitration. *McCain Foods, Ltd. v. Puerto Rico Supplies, Inc.*, 766 F. Supp. 58, 61 (D.P.R. 1991).

¹⁶⁴ In *Propane Gas Co.*, 613 F. Supp. 215, the court held that the arbitration clause in the agreement requiring arbitration of controversies in New York was enforceable. The court reasoned that the Puerto Rico statute voiding any covenants providing for arbitration outside Puerto Rico or under foreign laws violated the Supremacy clause and the Federal Arbitration Act and was therefore unenforceable. *Id.* *See also McCain Foods Ltd.*, 766 F. Supp. at 60 (forum selection clauses in arbitration agreements must be strictly enforced, unless it is shown that enforcement would be unreasonable or that there are compelling reasons against its enforcement); *Michael v. N.A.P. Consumer Electronics Corp.*, 574 F. Supp. 68 (D.P.R. 1984) (plaintiff ordered to arbitrate Law 75 claim in Tennessee).

¹⁶⁵ *See* Stephen B. Goldberg, et. al. *Arbitration*, in DISPUTE RESOLUTION 189, 190-191 (1985) (citing the American Arbitration Association (AAA) Commercial Arbitration Rules). The Federal

principal must be consistent with his intentions to arbitrate. Where actions by the principal have been inconsistent with his intentions to arbitrate, courts have ruled that the principal had constructively waived his rights to arbitration.¹⁶⁶

F. Constitutional Challenges

Due to the restrictive interpretation of the concept of just cause, numerous challenges to the constitutionality of Law 75 have been mounted both in the Puerto Rico Supreme Court as well as the U.S. Supreme Court.¹⁶⁷ All such challenges have failed.¹⁶⁸ Finally, in 1983 the Puerto Rico Supreme Court upheld the constitutionality of the statute, placing the issue to rest.¹⁶⁹

Arbitration Act, *supra* note 163, makes contract covenants requiring arbitration specifically enforceable. *Id.* at 190. And such agreements have been routinely upheld even in jurisdictions with conflicting state laws. *Id.*

¹⁶⁶ Salamone, *supra* note 7, at 100. (citing *Caribbean Ins. Serv., Inc. v. American Life Assurance Co. of Florida*, No. 83-1032, slip op. (1st Cir. Aug. 24, 1983)). In *Caribbean Ins. Serv.*, the defendant-principal answered a complaint for unjust termination. At no time in the pleadings did the defendant seek arbitration. The court held that the right to arbitration had been constructively waived. *Id.* at 101.

¹⁶⁷ In *Marina Indus., Inc. v. Brown Boveri Corp.*, 114 P.R. Dec. 64 (1983), the Puerto Rico Supreme Court rejected a constitutional challenge grounded on Due Process, Equal Protection, and illegal taking of property. Cases challenging retrospective application of the Act have been successful. Rodriguez Vidal, *supra* note 7, at 280. In *Fornaris* 423 F.2d at 567-68, the First Circuit held that the statute could not be applied retrospectively. *See also, Puerto Rico's Dealer's Act*, *supra* note 11, at 455. The Supreme Court in *Fornaris* indicated that a narrow interpretation of the meaning of just cause might help to avoid constitutional questions. The Supreme Court reversed and directed the lower court to instruct the District Court to wait until the Puerto Rico Supreme Court had ruled on the "local law question." *Id.* (emphasis added). The Puerto Rico Supreme Court refused to address the issue, and a decade passed before the Court finally upheld the constitutionality of the law. Rodriguez Vidal, *supra* note 7, at 282.

¹⁶⁸ *See, e.g., Warner-Lambert Co.*, 101 P.R. Dec. 378; *Merle v. West Bend Co.*, 97 P.R. Dec. 403 (1969); *Pan American Computer Corp.*, 562 F. Supp. at 701 (the Act does not violate due process because it is public policy to maintain the stability of the manufacturer/distributor contractual relationship and prevent certain abuses); *Ruiz v. Economics Laboratory, Inc.*, 274 F. Supp. 14 (D.P.R. 1967) (the Act did not violate equal protection or due process).

¹⁶⁹ A constitutional challenge based on due process, equal protection and taking clauses of the Puerto Rico Constitution was mounted in *Marina Indus.*, 114 P.R. Dec. 64. The constitutionality of the statute was upheld on each ground. *Id.* at 80-86. In rejecting the constitutional attacks, the Court held that the Act was not an arbitrary use of legislative powers, but was intended to balance the bargaining power between the principal and the distributor. Salamone, *supra* note 7, at 74. The court also rejected the unconstitutional taking of property arguments and stated that the damages computation formula was a guideline and not a rigid equation. *Id.* Although not all constitutional issues have been addressed by the courts, the major constitutional questions clouding Law 75 seem to have been finally resolved. *Id.* at 75.

IV. DRAFTING A DISTRIBUTION CONTRACT IN ACCORDANCE WITH THE REQUIREMENTS AND RESTRICTIONS OF THE DEALERS' CONTRACTS ACT

As shown in the preceding discussion, companies planning to expand their operations to Puerto Rico cannot successfully enforce standard distributor agreements customarily used in the U.S because of the restrictions on freedom of contract imposed by Law 75.¹⁷⁰ To draft a contract that will be enforceable under the Law 75, the principal must understand the intent of the Act as well as its interpretation by the courts. Once the scope of the Act is understood, the principal can draft a distribution contract whose operative language complies with the requirements of the law and will be enforceable in Puerto Rico.

A. *Defining the Relationship*

From the analysis of Puerto Rico Supreme Court cases, it is evident that the trend in the Puerto Rico Supreme Court is toward expanding the scope of protection to relationships that would not normally fit the standard definition of dealer or distributor.¹⁷¹ A determination that the grantee's activities fall under the Act's definition of a dealer has major impact on the principal's course of action. Once a dealer relationship is found, it cannot be impaired or terminated without just cause.¹⁷² Also, the provisional and injunctive relief remedies available under the Act¹⁷³ can vary depending on the type of relationship.¹⁷⁴

¹⁷⁰ Some of this restrictions are: (1) broad definition of a "dealer," (2) restrictive definition of "just cause", (3) restriction on enforcement of performance clauses, *supra* note 120; and (4) restriction on forum selection and choice of law, *supra* note 156.

¹⁷¹ Salamone, *supra* note 7, at 81. See also *Lineas Aereas Costarricenses, S.A.*, 682 F. Supp. 117 (an agent is covered under Law 75 when he is responsible for employing personnel at its own expense, responsible for purchasing the necessary licenses, and where all business losses or credit risks are the agent's sole responsibility); *Cordova*, 112 P.R. Dec. 797 (promoting and selling insurance contracts, constitutes a franchise relationship under Law 75); *San Juan Merc.*, 108 P.R. Dec. 211 (exclusivity not a requirement to be considered a dealer); *J. Soler Motors* 108 P.R. Dec. 134 (non-exclusivity or reserved rights by the principal to sell directly does not remove the relationship from the Act's protection). But see *Sudouest Import Sales Corp.*, 732 F.2d 14 (finding that representative was not a dealer because it did not handle product billings and receipts and had limited involvement in sales and promotions); *Mario R. Franceschini, Inc.*, 591 F. Supp. 414 (not a dealer because it did not buy the equipment nor had the authority to fix sales terms or perform billing). But see *Compute Systems Corp.* 599 F. Supp. at 828 n.7 (being in charge of the dealership is a key requirement).

¹⁷² Law 75, *supra* note 5, § 278a. See also *Rodriguez Vidal*, *supra* note 7, at 263. If the principal/grantor terminates the dealer without just cause or impairs the contractual relationship, he may be found liable for damages to the dealer. Law 75, *supra* note 5, § 278b.

¹⁷³ The Act states:

In resolving Law 75 disputes, the Puerto Rico courts apply the principle of "substance over form."¹⁷⁵ Thus, labels such as dealer, distributor, agent, etc., are not enough to distinguish the relationship because the courts will go beyond the definitions or written terms used to describe the relationship and will examine the grantee's actual activities and responsibilities.¹⁷⁶ Accordingly, when drafting a distributor/dealer's contract, the duties of the grantee must be described with clarity and precision so that the substantive responsibilities and activities of the grantee will fit the label that describes the relationship.

B. *Non-Renewal and Contract Termination Provisions*

1. Duration of the Agreement

As previously discussed, the Act not only invalidates contractual restrictions on the length of the relationship,¹⁷⁷ but also establishes that a manufacturer cannot refuse to renew a distribution contract if the

In any litigation involving the termination of a distribution contract or any act that undermines the established relationship between the principal or grantor and the distributor, the court may, during the pendency of the litigation, grant any provisional remedy or injunctive measure to order either or both parties to continue within the terms, the relationship established by the contract, and or restrain from any act or omission that undermines the relationship

Id. § 278b-1

¹⁷⁴ See *DeMoss*, 493 F.2d 1012 (availability of temporary remedies or injunction is not subject to a showing of possibility of irreparable damage); *Lineas Aereas Costarricenses, S.A.*, 682 F. Supp. 117 (neither the General Agent or the principal are entitled to a preliminary injunction. In this manner, the parties may reach an agreement to arbitrate); *Francisco Garraton, Inc.*, 559 F. Supp. at 408 (the temporary remedies established by the Act are to be given liberally in accordance with the public policy considerations of the Act); *Aybar v. F. & B. Manufacturing Co., Inc.*, 498 F. Supp. 1184, 1185 (D.P.R. 1980) (the court is authorized to grant a preliminary injunction while the litigation is pending in order to compel the parties to maintain and abide by their contractual obligations).

¹⁷⁵ See *Roberto Colon*, 88 J.T.S. 102 (defining the factors that would be considered to classify the relationship as a "dealership" protected by the Act). See also *Cordova & Simonpietri*, 112 P.R. Dec. 797 (an insurance agent fell within the definition of dealer because of his promoting and selling insurance contracts as a representative of the Insurance company); *Lineas Aereas Costarricenses, S.A.*, 682 F. Supp. 117 (a sales agent responsible for creating and promoting the market, and selling and closing sales contracts, is covered by Law 75); *San Juan Merc.*, 108 P.R. Dec. 211 (taking the necessary steps to gain new consumers or create a market for a product or service are activities within the scope of a dealer); *But cf. Mario R. Franceschini, Inc.*, 591 F. Supp. 414 (enterprise cannot be deemed a dealer where it does not purchase equipment sold by the principal, nor is empowered to set sale conditions).

¹⁷⁶ See *id.*

¹⁷⁷ See Law 75, *supra* note 5, § 278a.

dealer/distributor desires to continue the relationship.¹⁷⁸ Nevertheless, good drafting practices can avoid a contract of indefinite duration.¹⁷⁹

The distribution contract should be drafted for a definite fixed term with an automatic termination upon expiration of such term. Also, because the courts have upheld the termination or non-renewal of a contract in those cases where the principal wanted to completely withdraw from the market,¹⁸⁰ the option to rely on market conditions as a justification for non-renewal or termination and the attendant reservation of rights by the principal must be expressly covered in the agreement. The covenant should state that the principal and the dealer/distributor agree that the contract may be terminated in the event that the distributor *completely* withdraws from the marketplace.

2. Notice Requirements

The dealership or distribution contract should impose affirmative duties on the dealer/distributor desiring to continue the relationship upon normal expiration of the term. These affirmative duties will shift the burden of initiating the renewal process to the dealer/distributor, and failure by the dealer/distributor to do so may enable the principal to refuse to renew the contract.¹⁸¹ The method of termination, the time period and method for giving notice of termination or non-renewal, should be discussed. Also, the contract must explicitly require the

¹⁷⁸ See *supra* note 121.

¹⁷⁹ Contracts of indefinite duration are unpredictable and not favored by the courts. Herold, *supra* note 11. See also King, *supra* note 11, at 101.

¹⁸⁰ See *Medina & Medina*, 858 F.2d at 824 (citing the Supreme Court of Puerto Rico), (Law 75 does not bar the principal from withdrawing from the market provided that his action is not aimed at capitalizing on the good will or customer base created by the dealer).

¹⁸¹ In Law 75 actions, the courts have upheld the validity and enforceability of affirmative requirements placed on dealers/distributors as a pre-condition for renewal of a distribution contract. *Nike International, Ltd., v. Athletic Sales, Inc.*, 689 F. Supp. 1235 (D.P.R. 1988). In *Nike*, the manufacturer asserted that the distribution contract had expired because of the distributor's failure to give notice of his desire to renew the term of the contract, as required in the contract terms. *Id.* The distributor claimed that the renewal clause was void because it violated public policy. The court held that a clause requiring the distributor to give written notice to the principal of his desire to renew the contract was enforceable. *Id.* at 1239. The court reasoned that although Law 75 prohibits the principal from refusing to renew a distribution contract without just cause, the provision does not apply where the dealer/distributor, after having agreed to comply with pre-renewal notice requirements, fails to do so. *Id.* at 1247. Accordingly, the court held that the principal could not be liable for the distributor's acts or omissions. *Id.* See also *Castillo v. Smart Products*, 289 F. Supp. 138 (D.P.R. 1968) (dealers/distributors have the right to rescind a distributorship agreement. Accordingly, Law 75 cannot invalidate contractual covenants that establish procedures for the distributor to extend the contract beyond a given date, if it so desires).

dealer/distributor to notify the principal within a fixed period of time prior to expiration of the contract of his desire to continue the relationship.¹⁸² The initial intentions of the parties regarding duration of the contract must be clear from the writing, not left to interpretation at the time of a termination or non-renewal dispute.¹⁸³

C. *Defining Grounds for Termination*

In finding just cause for termination, the courts focus only on *substantial* breaches that *adversely and substantially* affect the principal or grantor. Accordingly, it is important not only to define the dealer/distributor actions which would give rise to termination or non-renewal of the contract, but also to thoroughly and immediately document dealer/distributor conduct which violates any of the contract provisions.

1. Performance Objectives and Quotas

As discussed, termination for poor performance is not a justifiable defense for the principal/grantor to employ in unjust contract termination actions. In its defense against termination for failure to meet performance quotas or objectives, the dealer will most likely argue that diminished performance is not a substantial breach or in the alternative that the quotas are unreasonable for the marketplace as it existed at the time of the alleged non-performance.¹⁸⁴ The Act specifies, and the courts have affirmed, that the burden of proof to demonstrate that those con-

¹⁸² In *Nike Int'l Ltd.*, 689 F. Supp. at 1235, the court upheld the enforceability of the following contract clause:

Should *distributor* wish to extend the term of this Agreement, *distributor* shall notify NIKE in writing of such desire not later than . . . whereupon the parties shall commence, within a reasonable time thereafter, good faith negotiations regarding the extension of the agreement. If the parties fail to reach an agreement by . . . , there shall be no further obligation to negotiate and this agreement shall expire in its normal termination date.

Id. at 1239.

¹⁸³ Contracts must be performed according to their covenants "pursuant to the codified doctrine of *pacta sunt servanta* (agreements must be respected). P.R. LAWS ANN. tit. 31, § 2994. *Cassera Foods, Inc. v. E.L.A.*, 108 P.R. Dec. 850 (1979) (emphasis added). The freedom of contract is limited by Puerto Rico Law only in those circumstances that violate public policy, morals or the law. *Grisson v. Colotti*, 644 F. Supp. 903, 905 (D.P.R. 1986). For a detailed discussion on the various jurisdiction's interpretation of non-renewal and termination provisions, see *Faruki*, *supra* note 11, at 933.

¹⁸⁴ See *supra* note 119.

tract clauses are reasonable is on the manufacturer or principal.¹⁸⁵ Thus, it is essential that poor dealer performance be routinely documented from the outset to establish that it is not being used by the principal as a pretext for contract termination¹⁸⁶ since the courts are not likely to accept allegations of poor performance that arise at the time when the relationship starts to go sour.¹⁸⁷

Sales quotas are essential elements of a dealer/distributor contract. The principal or grantor must be prepared to show that quotas were established in good faith and reflect the existing market conditions, competition, ability of the principal to deliver and ability of the dealer to meet his commitment, as relied on at the time of the contract.¹⁸⁸ To establish poor performance by the dealer, the principal or grantor must demonstrate that: (1) the requirements, quotas, performance objectives, etc, were clearly established and agreed upon by the dealer/distributor at the time of execution of the contract; (2) the quotas or performance objectives were computed in good faith and are reasonable for the market conditions *at the time of the alleged non-performance*;¹⁸⁹ and (3) the dealer/distributor had been receiving adequate and timely written notifications regarding his performance and warnings regarding the consequences for failure to improve.

The Puerto Rico courts have not accepted allegations of poor performance where the duties of the dealer/distributor were not clearly spelled out and agreed to by him, and where the above conditions had not been met.¹⁹⁰ Therefore, if renewal of the contract is dependent on dealer performance, meeting objectives, or compliance with any other requirements, it must be made clear in the writing. Failure to renew, or the termination of the contract due to the dealer not performing as required by the principal will be deemed "termination without just

¹⁸⁵ *Id.*

¹⁸⁶ Claim of just cause for termination cannot be supported by alleging unsatisfactory performance at the time of answering the complaint and without the evidence to support the claim. *La Playa Santa Marina*, 597 F.2d at 4.

¹⁸⁷ *Id.* at 3 (holding that there was no just cause for termination despite the principal's claims of poor performance).

¹⁸⁸ *Id.* Performance objectives and quotas should be established at the outset of the contract and in good faith. Salamone, *supra* note 7, at 106. The contract should also include some method for revising the quota to reflect the changing market conditions. *Id.*

¹⁸⁹ See Salamone, *supra* note 7, at 106. Failure to meet the quota does not establish a *prima facie* case. The principal or grantor must show that the contract was reasonable and that it included provisions for ongoing revision and adjustment of quotas to reflect changing market conditions. *Id.* See also *La Playa Santa Marina, Inc.*, 597 F.2d at 1.

¹⁹⁰ In *La Playa Santa Marina*, 597 F.2d at 3, the court noted that prior to issuing the notice of termination to the dealer, the distributor had at no time expressed its dissatisfaction with the dealer performance.

cause¹⁹¹ unless it is clear from the writings at the inception of the contract that the intention of the parties was to terminate or not renew the contract for failure to perform as agreed, and the agreed upon objectives reflected the intention of the parties.

The above standard, as many unfortunate principals have found, is not easy to meet. Therefore, a better alternative to setting quotas or performance objectives is to require that the dealer purchase and prepay, or guarantee payment for, a specified amount of product as a condition for maintaining the distributorship contract. In the alternative, a clause could be included providing for remedies in the form of quantity pricing¹⁹² and bill-backs¹⁹³ when the distributor fails to purchase the minimum amount of product required by the contract. If the dealer/distributor fails to purchase the required amounts at the higher prices, or fails to pay for the bill-backs when invoiced, the principal would have a valid cause for termination.¹⁹⁴

2. Reservation of Rights to Make Changes in the Course of Dealing

It is critical to discuss within the contract the *non-exclusivity* of the relationship and to state clearly that the grantor reserves the right to appoint additional dealers/distributors/agents, and that the grantee recognizes this principal's right and has planned its business strategy accordingly. The writing of this section must clearly indicate the intention of the parties as they existed at the time of execution of the contract.

D. Arbitration Clauses, Choice of Law and Forum Selection

As discussed above, arbitration clauses are routinely enforced and cannot be preempted by Puerto Rico law.¹⁹⁵ Accordingly, a covenant

¹⁹¹ *Id.* at 1-3. *Tamachi, Inc.*, 651 F. Supp. at 1360, n.1 (principal cannot undermine contractual relationship with distributor); *General Office Products Corp.*, 666 F. Supp. at 331 (inactivity by a manufacturer, after being notified of third party interferences with the distributor's exclusive contract constitute impairment of the relationship).

¹⁹² In quantity pricing arrangements the dealer/distributor discounts are low initially and increase as purchase volume increases.

¹⁹³ In the bill-back arrangement, the dealer/distributor receives the dealer discount based on a predetermined purchase level. If the purchase level is not met, the discount level changes to that of a lower quantity level and the dealer/distributor is invoiced (billed-back) for the excess discounts received.

¹⁹⁴ See *P.P.M. Chemical Corp.*, 931 F.2d 138 (dealer's continual violation of payment terms constitutes a material breach of the contract); *Biomedical Instrument & Equip.*, 797 F.2d 16 (dealer's failure to pay on time the amounts due constitutes a violation of one of the essential obligations of the contract).

¹⁹⁵ Arbitration agreements are enforceable "as a matter of federal law." *Mitsubishi*, 473 U.S.

stating that all disputes arising from the contract must be resolved by arbitration should be included. This covenant must also specify the choice of law and forum for arbitration.¹⁹⁶ Parties wishing to arbitrate usually turn to the American Arbitration Association for assistance in administering the hearing, providing procedural rules, and selecting an arbitrator.¹⁹⁷ Therefore, for guidance in drafting the arbitration clause, the drafter should refer to the "Standard Broad Form Clause" of the American Arbitration Association.¹⁹⁸ Even if this arbitration clause is included in the agreement,¹⁹⁹ the principal must reaffirm by his actions his intent to arbitrate so as not to waive his right to arbitration.²⁰⁰ Conduct or stipulations incompatible with the pursuance of arbitration remedies may be considered a constructive waiver of arbitration.²⁰¹

CONCLUSION

The appointment of a dealer/distributor in Puerto Rico by a U.S. or foreign principal/grantor may trigger the application of Law 75. This law has created a protectionist environment that benefits dealers, distributors, franchisees and agents to the detriment of the unwary principal or grantor. As the law has evolved, Puerto Rican distributors, through strong lobbying activities, have obtained amendments to the Act which have closed off loopholes and further strengthened their position. Although these restrictions seriously impair the principal's freedom of contract, they have been upheld by both the Puerto Rico courts and the U.S. federal courts applying Puerto Rico law.²⁰² Foreign or U.S. mainland manufacturers are usually not aware of the on-going changes in

at 626.

¹⁹⁶ This clause must clearly reflect the intention of the parties to submit all their disputes to arbitration. The strong federal policy towards arbitration will enforce these covenants and will not attempt to second guess or rewrite the contract. See *Luis Rosario*, 733 F.2d 172.

¹⁹⁷ Goldberg, *supra* note 165, at 190.

¹⁹⁸ Some of the items that should be included in the arbitration clause are: (1) procedure for initiating the arbitration process; (2) selection of arbitrators; (3) rules of decision (majority or concurrence by all); (4) form, scope and time of award; and (5) fees. *Id.* at 192-195. In addition, a clause must be included stating that "[p]arties to these Rules shall be deemed to have consented that judgment upon the arbitration award may be entered in any Federal or State Court having jurisdiction thereof." *Id.* at 190.

¹⁹⁹ Under American Arbitration Rules, the party initiating the arbitration process must give notice to the other party of its intention to arbitrate. *Id.* at 192. The initiating party must file with the Regional Office of the American Arbitration Association three copies of the notice and three copies of the agreement to arbitrate. *Id.*

²⁰⁰ See *supra* note 166.

²⁰¹ See *Caribbean Insurance Serv., Inc. Assurance Company of Florida*, 715 F.2d 17 (a principal or grantor can constructively waive his right to arbitrate with his actions). Salamone, *supra* note 7, at 100.

²⁰² *Pan American Computer Corp.*, 562 F. Supp. at 696.

Law 75 until it is too late.²⁰³ Therefore, an understanding of the current state of Law 75 and its effect on the contemplated relationship can reduce the principal's exposure to unnecessary and expensive litigation. The inclusion of the clauses discussed above will also provide the principal with some added measure of protection under Law 75.

As shown, Law 75 has been a source of extensive litigation and a great deal of controversy.²⁰⁴ Most of the litigation has centered around three key areas: (1) what relationships fall under Law 75's definition of "dealership"; (2) what reasons for termination of a distribution relationship fall within the meaning of "just cause"; and (3) what contract covenants are *not enforceable* under Law 75. These issues must be addressed in the drafting of any distribution, dealership, franchise or agency contract aimed at the Puerto Rico market if the contract is to survive scrutiny under Law 75. The goal of the contract should be to structure the relationship so as to reflect the original intention and expectations of the parties and to facilitate the termination of the relationship without running afoul of the Act if those expectations are not met.

This note has attempted to provide background and analysis of Law 75 as well as a set of recommendations on the areas that need additional attention when drafting a distributorship, dealership or agency contract under Law 75. These recommendations are intended to highlight areas that need special attention when drafting a distributorship, dealership or agency contract, to insure that it will be enforceable under the Puerto Rico Dealers' Contract's Act. They should supplement the covenants and business considerations usually included in most sound distributorship agreements. If implemented, these recommendations should assist a principal or grantor in avoiding the pitfalls of Puerto Rico's Dealer's Contract Act.

Richard M. Krumbein

²⁰³ *A Different Opinion*, *supra* note 11, at 632.

²⁰⁴ Commentators believe that the Act will continue to generate more lawsuits and more controversy unless the law is amended in the near future to resolve the potential constitutional issues and more clearly define who is a protected dealer. Salamone, *supra* note 7, at 111-112. In fact, prominent experts in Law 75 litigation have warned that the Act could have serious adverse consequences to Puerto Rico consumers and distributors. *A Different Opinion*, *supra* note 7, at 632. Furthermore, multinational corporations, once they become aware of the effects of the Act on the cost of doing business in Puerto Rico, may have second thoughts before embarking on a distribution venture with a Puerto Rican distributor. *Id.*

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