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Federal Watch

RULING HURTS DISTRIBUTORS IN PUERTO RICO

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Florida manufacturers and franchisers that do business in Puerto Rico are welcoming a federal appeals court decision that makes it easier for companies in certain situations to terminate contracts with product distributors on the island.

The 1st U.S. Circuit Court of Appeals in Boston ruled this summer that Dow Brands could not be held liable for unfairly terminating without notice a contract with San Juan-based V. Suarez & Co. because Dow sold its entire product line in good faith to another manufacturer. Dow Brands, now known as Dow AgroSciences, is an Indianapolis-based subsidiary of Dow Chemical Co., which is based in Midland, Mich.

V. Suarez had sued Dow Brands in a Puerto Rican court citing Act 75, also known as the Puerto Rico Dealers' Act. That law protects distributors on the island by prohibiting acts "detrimental to the established relationship ... except for just cause." The case later was transferred to federal court.

In April 2002, U.S. District Judge Jay A. Garcia-Gregory in San Juan summarily dismissed the lawsuit. On July 21, a three-judge panel of the 1st Circuit, which handles federal appeals from Puerto Rico, unanimously affirmed Garcia-Gregory's decision, holding that Dow's withdrawal from the Puerto Rican market constituted just cause.

"From a plain reading of the statute, it may appear that only action or inaction on the part of the dealer would provide just cause to allow a principal to terminate the relationship," the order said. "But a plain reading of Act 75 would produce, in some situations, absurd and constitutionally suspect results. As a consequence, the courts have filled in other readings."

Protectionist measures like Act 75 are common throughout the Caribbean and Latin America. Ronald P. Weil, a partner at Aragon Burlington Weil Schwiep Kaplan & Blonsky in Coconut Grove, who handled Dow's appeal with fellow partner Daniel F. Blonsky, said the ruling could reduce the business obstacles posed by such laws.

"It's unfair to saddle companies that close their doors or leave a particular market with additional compensation to the local supplier for having made that business decision," Weil said. "This kind of a decision tends to have a ripple effect, and while it's not binding precedent in Central American countries, it will certainly have some leading edge impact."

But San Juan solo practitioner Horacio R. Subira, who represented V. Suarez, called the ruling "very unfair," and said no appeal is possible because the case does not involve constitutional issues.

"Law 75 was designed to establish fair standards for the termination of distributor contractors," Subira said. "In this case, it was a bona fide sale by a billion-dollar multi-national where they just ignored the distributors." He said some of the more obvious potential beneficiaries of the ruling in Florida are large orange juice companies that market in Puerto Rico.

Subira was co-counsel with Federico Calaf-Legrand and Alejandro J. Cacho of San Juan's Reichard & Calaf.

True market withdrawal?

V. Suarez, a household products distributor with more than \$312 million in annual sales, distributed Dow Brands products for more than a decade. The products included well-known names like Fantastik, Glass Plus and Spray 'N Wash. But by August 1996, those products were only a small part of V. Suarez's business -- just \$1.1 million.

In January 1998, after months of secret negotiations, Dow sold its product line to Racine, Wis.,-based S.C. Johnson & Son and walked away from its longstanding distributor contract with V. Suarez. In 1999, V. Suarez sued Dow Brands in a court of the commonwealth. The case was later transferred to U.S. District Court in San Juan.

Prior rulings by the Supreme Court of Puerto Rico established that market withdrawal constituted good cause.

But V. Suarez argued that what had happened with Dow Brands was not a true market withdrawal because the products continued to be sold in Puerto Rico. It also argued that the sale wasn't negotiated in good faith, and Suarez wasn't properly notified. In addition, V. Suarez claimed Dow profited from its hard work in distributing the products.

None of those arguments proved persuasive to the 1st Circuit panel.

"The district court correctly found that Suarez had not presented evidence that Dow was attempting to take advantage of or profited from the good will and clientele Suarez had developed," the order said. "Importantly, Suarez does not allege that Dow at any time acted in bad faith."

Dow Brands, known since the sale as Dow AgroSciences, was awarded legal fees and costs. A hearing to determine the amount is pending.

Judge Sandra L. Lynch wrote the opinion. Concurring were Judge Jeffrey R. Howard and 8th U.S. Circuit Court of Appeals Senior Judge Richard S. Arnold of Little Rock, Ark.

Weil said the ruling "could affect every local businessperson in Puerto Rico who has a foreign supply connection, and anyone doing business in Puerto Rico who is an offshore supplier."

The ruling, however, does not directly impact franchise agreements in Puerto Rico because Act 75 does not address franchise arrangements. Still, the commonwealth does have a similar law that protects local franchise operators from arbitrary termination.

"With this decision, conceivably, if there is a consolidation and Burger King sells out to someone else, you could end up with the same thing," Subira said. "You'd have the same local shop selling the same product, but now with a different owner free to do whatever they wanted."

The sudden loss of business with Dow Brands was not catastrophic for V. Suarez because Dow represented only a fraction of its business. "But this decision could be catastrophic for a distributor who has a big line or a product that dominates his business," Subira said.

Puerto Rico is not alone in having a law to protect local distributors from predatory business practices by foreign distributors, according to University of Miami professor Jerry Haar. The laws themselves are "like herpes -- easy to contract and impossible to get rid of," said Haar, director of the Dante B. Fascell North-South Center's Inter-

American Business and Labor Program. "The Dominican Republic is notorious for this, and so is Venezuela."

"Anyone doing business in Latin America needs to be concerned about these protectionist laws," Weil said. He said that the 1st Circuit's ruling could aid American companies that do business in foreign countries with laws similar to Puerto Rico's Act 75.

But Haar said U.S. companies need to be even more vigilant before entering into deals outside the U.S.

"One of the benefits of doing business in Puerto Rico is that it's governed by U.S. law," he said. "When you start talking about other countries that's quite different."

"Companies need to be very astute about the form in which they enter a foreign market. They need to make sure they have really good local legal counsel."

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