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Legal Update

Sales Representation and Merchandising Under Puerto Rico Law

Increasingly, principals in Puerto Rico (particularly of food and beverages) are using merchandisers or promotion agents to improve the volume of their distribution in Puerto Rico and their corresponding market share. This tendency has moved many of these merchandisers and promoters to seek coverage under Puerto Rico's stern and one-sided Sales Representative Act, commonly known as Law 21. This position is based on a mistaken interpretation of the Act.

In 1964 Puerto Rico created the Puerto Rico Dealers Act, known as Law 75. Law 75 gives distributors protection against unilateral termination, refusal to renew the contract or undermining by the principal of the distribution terms without just cause. Regardless of contractual language to the contrary, just cause is defined by the statute as a breach by the distributor of a substantial term of the agreement or any act or omission on its part that seriously impairs the distribution of the product in Puerto Rico. With certain limited exceptions, just cause is always something related to what the distributor did or failed to do and not to the commercial interest of the principal.

Law 75 is drafted in very vague terms. For example, in essence, the law defines a distributor as someone in charge of the distribution of a product or service in Puerto Rico. This is a circular definition that says very little. In 1988, the Supreme Court of Puerto Rico tried to provide content to this definition indicating that generally a distributor would have to acquire title over the products, keep inventory of the same, be responsible for promoting the product and closing sales contracts, assume the credit risk, be obligated to pay regardless of payment by the clients, etc. Although those elements are not a closed list and not all of them need to be present in all cases, it is clear that commission sales representatives who place orders that are served under terms determined by the principal exclusively, do not fall under this definition.

As a reaction to this decision, the sales representatives pushed for the approval of a similar law covering their situation. This resulted in the enactment of the Puerto Rico Dealers Act, commonly known as Law 21. This statute gives the sales representatives very similar protection to that afforded by Law 75 to distributors. Law 21 is as a one-way-street in favor of the sales representative as much as Law 75 is in favor of the distributor.

But one essential difference between the two statutes is that Law 75 protects both exclusive and non-exclusive distributors while Law 21 protects only exclusive sales representatives. The Supreme Court of Puerto Rico has not provided a full and detailed definition of exclusivity but the weight of authority seems to be that said exclusivity does not have to cover the whole territory of



For more information on this Legal Update, please contact:

Rafael Escalera

escalera@reichardescalera.com
787.777.8877

Amelia Caicedo

caicedo@reichardescalera.com
787.777.8824

Puerto Rico nor all channels of trade. But within some geographical area or channel of trade, exclusivity has to be granted in order for the relationship to be protected by Law 21.

One thing that is clear, is that exclusivity is defined in negative terms. The Supreme Court of Puerto Rico and the Court of Appeals for the First Circuit have ruled that exclusivity precludes the principal from doing, directly or indirectly, what he has assigned the representative to do in the territory.

Additionally, the case-law has provided some content to the definition of what a sales representative is. Although the totality of said figure has not been drawn, at least the sales representative has to secure purchase orders for the products and place them with the principal. These orders should be the basis for the sales that the sales representative is supposed to secure for the principal on an exclusive basis.

As we said at the beginning, it is not uncommon for principals in certain lines of trade to have an exclusive distributor who buys inventory and resells the same under the distributor's terms and at the same time a promoter or merchandiser who organizes promotion activities, supervises product placement at the retailer level, and otherwise promotes brand recognition and acceptance. However, these promoters do not take orders for products and much less place them with the principal. The commercial transaction for the sale of the products occurs between the principal and the distributor who then resells to the client in Puerto Rico. For the same reason, the promoter cannot make an argument of exclusivity since the distributor participates in the selling activity within the same territory.

Any attempt by such a merchandiser to seek protection under Law 21 for reasons of termination, refusal to renew or undermining on the part of the principal should be rejected. The Supreme Court of Puerto Rico has repeatedly indicated that not all intermediaries that participate in the chain of commerce between the principal and the end consumer are protected by either Law 21 or Law 75. In the same way that sales representatives were left out of Law 75 protection by the decision of the court, something similar has occurred with merchandisers when it comes to protection under Law 21.

Despite all of the above, a principal would do well in taking precautions before retaining the services of a merchandiser or promoter. A contract with these intermediaries should be in writing and the same should contain the provisions that at the inception of the relationship are effective in displacing this protective statute.

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