

# Franchising in the Dominican Republic

By

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## Introduction

Home of Merengue and a rich baseball tradition, the Dominican Republic covers 48,730 square kilometers, has a population of approximately 8.8 million people living on the island, and has more than one million nationals living in the United States.

## Economic Overview

Between 1998 and 2000, the country's gross domestic product ("GDP") increased more than 7% per annum. However, in 2003, the economy experienced -1.8% growth, attributed to the collapse of an important local bank, a weak tourism sector, and a weak US export market (the US purchases 87% of its exports). As a result of improved performance of key sectors of the economy and other factors, the Governor of the Central Bank has projected GDP growing 1.8% in 2004.

Despite this recent contraction, many people would be surprised to know that the Dominican Republic is the United States' fourth largest export market in the Western Hemisphere and the twenty-sixth in the world.<sup>2</sup> Annual remittances from the United States totaling over US\$1.5 billion play an important role in bilateral trade. Recently both countries concluded negotiations on a bilateral Free Trade Agreement that, once implemented, will immediately eliminate tariffs on 80% of United States goods exported to the Dominican Republic. Although the country has long been viewed as an exporter of sugar, coffee, and tobacco, in recent years the service sector, led by tourism and export free zones, has overtaken agriculture as the largest employer.

## Franchising

In 2002, there were approximately 250 franchises established in the Dominican market with more than 900 stores in operation providing 10,000 direct jobs. The largest and fastest growing sector is food franchising which represents 35% of the total franchise market in the Dominican Republic. However, as the food service sector of franchising becomes more mature, new franchising sectors such as printing and auto service are expected to grow faster in future years.

The US Commercial Service in the Dominican Republic organizes "*ExpoUSA*," an exhibition of U.S. firms seeking agents, representatives, distributors, licensees, and franchisees in the Dominican Republic. In 2003, sixty-two (62) U.S. based companies participated. *ExpoUSA2004* took place from October 4 to 7, 2004 in Santo Domingo.

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## Franchise Law and Regulations

There are no franchise specific laws that regulate the ongoing relationship between franchisor and franchisee. However, there are other laws impacting the franchise relationship (i.e. the Civil and Commercial Code, Tax Code, Foreign Investment Act, and Dealer Law).

### The Dominican Dealer Law

Law 173 for the Protection of Merchandise and Product Distribution Agents (“Law 173”) was enacted in 1966. The main purpose of Law 173 is to protect agents representing foreign entities in the Dominican Republic from unfair treatment. Dominican courts may impute an agency relationship with the local distributor, regardless of the name of the agreement. Once an “agency relationship” is imputed or established, it can not be terminated without “just cause.” In general, Law 173 is interpreted in favor of the agent, concessionaire, or importer.

A formal written agreement is not required to establish an agency relationship under the law. Law 173 defines agency agreements as “any form of relationship” by virtue of which one party carries out in the Dominican Republic the following activities: the promotion or performance of importation, distribution, sale of products or services, lease or any other form of trade or marketing of foreign merchandise or the services related thereto, whether the party acts as agent, representative, importer, commission agent, licensee or any other form of representation. In addition, per Dominican jurisprudence, the courts have historically reserved the right to review the exclusivity of any such relationship, notwithstanding the stated intention of the parties.

Under Law 173, the agency relationship may not be terminated or non-renewed without “just cause.” Just cause includes (i) breach or non-compliance by any of the parties to any essential obligation under the agreement, and (ii) any action or omission that may adversely and substantially affect the principal’s interest in the promotion or negotiation of the importation, distribution, sale, lease, or any other form of trade of its merchandise, products or services. The compensation for termination without cause includes material losses, investment made by the licensee, and losses of eventual profits calculated on the basis of the last five years of trading.

Law 173 is a “public order” law and hence cannot be waived by choosing a foreign law to govern the agreement. However, Law 173 only protects the agent if the agent has registered the agreement before the International Department of the Central Bank within sixty days of signing the agreement. Although not fully tested in court, there is some legal planning that can be done to mitigate the risks of Law 173.

### Foreign Investment Law

The Foreign Investment Law (Law Number 16) was enacted in 1995. This law, among other things, extended the scope of Law 173 by amending its article 12. Before the enactment of the Foreign Investment Law, foreigners that had resided less than four years in the Dominican Republic and national companies with more than 66% foreign capital did not enjoy the protection of Law 173. Since 1995, all local agents, regardless of their nationality, enjoy the protection of Law 173. The Foreign Investment Law reforms had the perhaps unintended effect of encouraging foreign companies to distribute their products directly in the Dominican Republic, thereby avoiding the Dealer Law.

### US-Dominican Republic Free Trade Agreement/CAFTA

The recently signed Free Trade Agreement between the United States and the Dominican Republic (still pending congressional ratification in both countries) will provide additional protection to US investors

from Law 173 upon entering into effect. Although agency agreements executed prior to the implementation of the treaty will remain subject to Law 173, the US or US controlled entities shall be entitled to additional protection in the form of (a) constitutional protection of “acquired rights,” under Articles 46 and 47 of the Dominican Constitution (b) restrictions on the damages required to be paid so that such payments shall not exceed those otherwise available under general contract law, and (c) the Dominican government shall encourage binding arbitration to resolve any disputes under such agency agreements.

Although the Free Trade Agreement would not repeal Law 173 for those agreements executed after its implementation, it would introduce very important exceptions to the application of such law. The new agreements would be governed by general contract law, and subject to freedom of contract principles, eliminating current requirements of exclusivity, termination, and indemnities. Accordingly, the new agency agreements would: x) terminate on the agreed-upon termination date, and if no termination date is indicated, with six-month prior notice; y) allow the parties to agree upon indemnities to be paid in the event of wrongful termination, or have indemnities be based on actual damages; and z) allow the parties to resolve disputes through binding arbitration, pursuant to mechanisms and at forums agreed to by the parties.

### Conclusion

Given the very strong cultural ties to the US, there are a lot of opportunities for franchise concepts in the Dominican Republic. Moreover, the recent Free Trade Agreement with the Dominican Republic should offer US investors additional opportunities and more legal protection in certain critical areas. As with any offshore investment, careful legal planning is encouraged.