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National Mandatory Rules and International Public Policy: The Status of the Agent's Goodwill Compensation in Portugal

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I. The Court of Appeal of Lisbon recently granted recognition of an arbitral award made in Paris, under the Rules of Arbitration of the ICC, holding that the Portuguese law applicable to the Agency Agreement, in spite of being of mandatory nature, do not constitute part of the international public policy of the Portuguese state and, therefore, do not constitute grounds to refuse the recognition of a foreign arbitral award.

This decision, made on 16 January 2014, is available [online](#) and full translation will be published in the 2014 Yearbook Commercial Arbitration (out in January 2015).

In the meantime, it will be interesting to read the following particulars of the case and discuss the decision.

II. Company S sought the recognition and enforcement in Portugal of an arbitral award made in Paris, under the auspices of the ICC. The underlying legal relationship related to a series of distribution agreements (“Importer Agreements”) entered into between Company S (agent) and Company SE (principal) for the distribution in Portugal of vehicles of the “S” brand, manufactured in Spain. This commercial distribution relationship lasted for nearly 20 years and was covered by several written agreements, the last of which was entered into between the parties on 1 October 1996. This “Importer Agreement” was subject to the Spanish Law and contained an arbitration clause providing for the resolution of the disputes under the Rules of the ICC, having Spanish as the language of the procedure.

On 27 September 2002, under the grounds of the EU Regulation no. 1400/2002 of 31 July 2002, Company SE declared to Company S that the “Importer Agreement” would not be renewed as of the date of the agreed term. On 14 March 2003, Company S started arbitration in Paris against Company SE, under the ICC rules, making several claims, including for goodwill compensation (Company SE also made a counter-claim but, for the purpose of this post, it will not be considered).

The arbitral tribunal awarded Company S a substantial portion of its claims, namely compensation for loss of future revenue, but denied Company S the requested relief for goodwill compensation.

In 2005, Company S and Company SE entered into a “Mutual Acquittance Agreement”. According to such agreement, each of the parties declared that it had received all that it was entitled to receive

pursuant to the arbitral award. Each of the parties declared that it had nothing to claim from the other, thus acquitting the other.

Notwithstanding the “Mutual Acquittance Agreement”, Company S and one of its subsidiaries filed with the Lisbon Court of First Instance a lawsuit against Company SE and its Portuguese subsidiary, claiming goodwill compensation (that had been denied in the arbitral proceedings).

Among other pleas, Company SE contested the lawsuit invoking the effect of *res judicata* of the arbitral award. Company S objected to that contention, arguing that the arbitral award could not have the effect of *res judicata* within the Portuguese jurisdiction and that the award could not be recognized or enforced in Portugal simply because the denial of goodwill compensation would be in breach of the public policy of the Portuguese Republic.

Following an appeal that reached the Supreme Court of Justice, the Lisbon Court of First Instance decided that the recognition and enforcement of the arbitral award was a preliminary issue and, therefore, decided to suspend the lawsuit until the award was recognized and enforced. Company SE then brought the recognition procedure of the ICC arbitral award before the Lisbon Court of Appeal. Company S contested these proceedings, alleging inter alia that the ICC award could not be recognized, as the recognition and enforcement of that award would be in breach of the public policy of the Portuguese Republic.

III. The Court of Appeal of Lisbon considered the contention raised by Company S, according to which the arbitral award could not be recognized because it had denied goodwill compensation, which was contrary to the public policy of the Portuguese Republic. Indeed, Company S pleaded that Art. 33(1) of Decree Law no. 178/86 of 3 July 1986 (Commercial Agency Contract Act), under its mandatory provisions, grants the agent goodwill compensation in the case of termination of the agency contract. It further provides that the contractual relationships that have been “exclusively or predominantly” performed within the Portuguese territory shall only be subject to a law different to the Portuguese if it is more advantageous to the agent. This legal framework, contended Company S, is applicable by analogy to all commercial distribution contracts, and such was the case of the “Importer Agreements”. Thus, an arbitral award that has applied a foreign law that does not provide for goodwill compensation payable to the agent may not be recognized in Portugal for being intolerably contrary to the public policy of Portugal.

Addressing this issue, the Court of Appeal of Lisbon considered that the grounds to refuse the recognition of a foreign arbitral award are listed in Art. 56 of the new Portuguese Arbitration Act (Law No. 63/2011, of December 14, 2011) and are in line with the New York Convention of 1958. According to this legal provision, the recognition of an arbitral award may only be refused if the recognition or enforcement of the award would lead to a result blatantly incompatible with the international public policy of the Portuguese State – Art. 56(1)(b)(ii) of the Portuguese Arbitration Act.

The Court of Appeal of Lisbon considered that defining “public policy” is a hard and complicated task. It also considered that the “public policy” that may bar the application of a foreign law shall be understood as the “international public policy” and that no one, until now, has been able to suggest a definition of “international public policy” that could enable a judge to solve any given dispute without hesitation. The status of the legal science, the Court of Appeal cited, allows us only to establish “general guidance principles serving as a criterion and a compass in the floating and uncertain sea of the realities of legal life.”

In order to ascertain the existence of such principles of public policy, it was necessary to find the “general characteristics” of the rules “d’orde publique” and the reasons that would lead those rules to prevail over a foreign law. The Court of Appeal of Lisbon reasoned that, although not decisive, the “general characteristics” of the principles of international public policy would be those related to the preservation of superior interests of the state or of the national community, or rather those which would prevent a flagrant contradiction between these domestic rules and the rules of the foreign law. The very circumstance that the rules in question are deemed to be absolutely mandatory would also have the “general characteristic” of the international public policy.

As for the reasons of the prevalence of a national law rule over a foreign law, the Court of Appeal of Lisbon recognized that it was impossible to require precision and certainty when pointing out the political, moral or economic reasons underlying such prevalence, thus leaving to local courts the task of filling this “blank rule” and determining whether the application of a foreign law would amount to an unbearable outcome, not only from the view point of the common legal sentiments (“good morals”) but also from the view point of the fundamental principles of the Portuguese legal system. It would have to be something irreconcilable with the legal concepts that underpin the legal system.

Analyzing the particular circumstances of the case, the Court of Appeal of Lisbon started by considering that the recognition of the arbitral award would not amount to a blatant breach of fundamental principles and rules of the domestic legal order, notwithstanding the fact that the foreign law did not grant a claim (goodwill compensation) that is accorded under the national law. The recognition of the arbitral award would not amount to a severe and essential contradiction to the principles of the international public policy of Portugal.

The Court of Appeal did not reject the conclusion that the goodwill compensation is grounded in a national mandatory legal provision that aims to protect the agent. However, the Court reasoned, the mandatory nature of the rule is not decisive to ascertain that such rule is part of the international public policy of the Portuguese State. The rules of Articles 33 and 38 of the Commercial Agency Contract Act have the characteristics of the domestic public policy but not of the international public policy, the latter being more restrictive than the former.

The Court of Appeal of Lisbon, therefore, recognized and ordered the enforcement of the ICC arbitral award.

IV. As seen earlier, the Lisbon Court of Appeal has not considered an arbitral award that did not apply a national mandatory rule (goodwill compensation right under the Portuguese Commercial Agency Contract Act) to be in violation of the international public policy of Portugal.

In my opinion, it is a righteous decision but nevertheless may not be seen as the reflection of a pacific understanding in the context of international commercial arbitration. Some have already concluded in quite the opposite direction.

In any event, let us think a little further and assume that the Court of Appeal found the refusal to apply a national mandatory rule to be contrary to the international public policy of Portugal.

Two questions might then follow.

V. Firstly, in the event the Court of Appeal would have found that the international public policy of Portugal consisted – among others – of national mandatory rules. Yet, it would have also

disregarded the principle of *res judicata*. If so, it would have then followed a balancing between the weight of national mandatory rules and the weight of the principle of *res judicata* in the context of international public policy. Which principle then should prevail?

VI. Secondly and more importantly, considering the fact specifics of this case (more precisely the “Mutual Acquittance Agreement” aforementioned), what would be the relevance of the principle of good faith – or the other side of the coin, the prohibition of acts in bad faith – in the context of international public policy of Portugal? Is the principle of good faith part of the international public policy of any given state and should it also be of the Portuguese Republic?

Indeed, bringing a lawsuit in contradiction to a prior agreement that settled all disputes that had arisen in the arbitral proceedings – including the dispute related to the goodwill compensation claim – might well be seen as contradicting a past act with a concluding meaning, thus being contrary to the principles of good faith.

Disregarding the arbitral award and, more importantly, the “Mutual Acquittance Agreement”, would necessarily entail the question of whether the national mandatory rules would prevail over the principles of good faith.

If I may suggest that the answer to the first question should be negative (that is, mandatory legal provisions should prevail over *res judicata*), the second question remains to be discussed here.

Simply put: do good faith principles prevail over mandatory rules in the context of ascertaining the international public policy as a ground to refuse the recognition of an arbitral award?

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