

Company & Commercial - Ecuador

Court Upholds Choice-of-Law Clause in Distribution Contract

Contributed by **Coronel & Pérez**

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In an action filed by Andina Licores SA, an Ecuadorian corporation, against E&J Gallo Winery, one of the world's largest wineries with headquarters in California, the Guayaquil Second Civil Court found that it lacked jurisdiction to hear the dispute because both parties had agreed in a distribution contract that any disputes should be heard by a California court in accordance with California law. Under the rules of civil procedure governing the type of action initiated by Andina, the decision of the court was not subject to appeal. The ruling is significant because it:

- confirmed that Decree-Law 1038-A/1976,⁽¹⁾ which was repealed by Congress in 1997, does not apply to distribution contracts signed before that year;
- rejected the view entertained by Andina during the proceeding that choice-of-law clauses like those included in the contract at issue are unenforceable because of public order considerations; and
- adopted a favourable approach to choice-of-forum clauses in the context of international contracts, following a trend adopted by the Supreme Court after an amendment to the Civil Code.

Facts

In 1978 Gallo and Andina signed a contract for the distribution of wine in Ecuador on a non-exclusive basis. The contract provided, among other things, that California law would govern the agreement and that disputes should be settled by a court of that jurisdiction. At the time the contract was entered into, the decree-law - which was promulgated by a military junta that ruled Ecuador for many years - was in force. The decree-law contained several provisions which protected Ecuadorian distributors in their dealings with foreign principals. One of the key provisions of the decree-law stated that all disputes arising out of a distribution contract had to be settled in accordance with Ecuadorian law and before the court of the distributor's domicile, even if the parties had agreed otherwise. The decree-law declared that its provisions were "deemed incorporated" into all distribution contracts signed by suppliers and Ecuadorian distributors or agents. In 1997 Congress enacted Law 22, which repealed the decree-law. According to Congress, the provisions of the decree-law violated the equal protection clause of the Constitution and Article 17 of the General Agreement on Trade in Services of the World Trade Organization Treaty, and adversely affected the promotion of foreign investments in Ecuador.

In August 2004 Andina filed a lawsuit against Gallo for breach of contract. Andina alleged that Gallo had adversely affected its business by dealing directly with a local supermarket. Andina stated that it had filed its complaint in Guayaquil (the place of its domicile), and not in California, because the 1978 contract (in particular, its choice-of-law clause) was overruled by the decree-law. Moreover, Andina claimed that because the decree-law was "deemed incorporated" into its distribution contract with Gallo, its provisions had survived the 1997 repealing law. In other words, the provisions of the decree-law had become the *lex contractus* of the parties and were immune to any subsequent legislative change.

Before filing its complaint, Andina had requested that a judge appoint an *ad litem* guardian for Gallo. Andina claimed that Gallo had not appointed an agent with authority to deal with complaints in Ecuador and did not have a known address in the country. The court appointed an inexperienced lawyer.

Author

Hernán Pérez Loose



In answer to the lawsuit, the *ad litem* guardian did not raise the defence of lack of jurisdiction of the Guayaquil court. Gallo became aware of the lawsuit weeks after the proceedings had started, and was able to appoint an attorney only two days before the evidence period was due to end. Gallo argued that its right to defence had been impaired by the appointment of an *ad litem* guardian. According to Gallo, such appointment was illegal since it failed to meet the requirements of the Civil Code (as Andina knew Gallo's address in California). With regard to the court's jurisdiction, Gallo asked the court to halt the proceedings since the choice-of-law clause in the distribution contract was still binding; therefore, the courts of California, not those of Guayaquil, had jurisdiction to hear the case.

During the trial, Andina claimed that the protective provisions of the decree-law were norms of 'public order', since they were intended to control the power of multinational corporations in their dealings with Ecuadorian companies and thus could not be derogated from by private parties. It argued that, according to Article 1505 of the Civil Code in force when the distribution contract was signed, proceedings before a foreign jurisdiction were deemed null and void as "contrary to public order".

Decision

The Guayaquil Second Civil Court ruled in favour of Gallo. The court found that the appointment of an *ad litem* guardian was improper since Andina had failed to disclose the fact that it knew the whereabouts of Gallo in California. The court noted that in a similar case⁽²⁾ the Supreme Court had ruled that the appointment of an *ad litem* guardian is improper where the plaintiff knows the address of the defendant. The court ruled that the presence of the *ad litem* guardian constituted a violation of Gallo's right to due process.

The court then found that it lacked jurisdiction to hear the case since both parties were still bound by the 1978 contract, including its choice-of-law clause. The court noted that the plaintiff's request that the court declare the choice-of-law clause null and void was unattainable in this type of action. In any case Andina's request was barred by the statute of limitations and by Article 1726 of the Civil Code, which precludes anyone who has executed or performed a contract, or knew or should have known that the contract was null, from seeking a declaration of nullity thereafter.

The court noted that the decree-law - under which Andina brought the action - was repealed by virtue of Law 22. Moreover, the court underlined the fact that in 1997 Congress also repealed the provision of the Civil Code that declared null and void clauses under which parties which had signed a contract in Ecuador submitted themselves to the courts of a foreign jurisdiction. The court stressed the importance of the will and freedom of the parties in contractual relations and rejected Andina's view that public order is threatened by the choice of a foreign law and forum in a private contract. According to the court, clauses like the choice-of-law clause in the contract at issue are common in international commercial relations, especially in the context of increasing globalization.

Even though all persons have the right to stand trial before the judge of their domicile, Article 29 of the Code of Civil Procedure establishes the freedom of the parties to select a conventional forum. The court added that the freedom to select a forum was also recognized by Article 318 of the Code of Private International Law.

Finally, the court pointed out - with no comment - the fact that Gallo had commenced an action against Andina before the Modesto Court in California.

Comment

For years the decree-law has been a source of concern in the international commercial distribution sector in Ecuador. During the 1990s there was a flurry of litigation involving the provisions of the decree-law in the face of contracts duly executed by local distributors and foreign corporations. The more favourable attitude of successive governments towards international economy, as well as abuses encountered in certain cases brought under the decree-law, led Congress to repeal it in 1997. However, as the case at hand demonstrates, there have been attempts to resurrect the decree-law even after its abrogation. The argument that the choice of foreign forums to settle contractual disputes is contrary to public policy has been weakened significantly. As noted by the court, in 1997 Congress repealed an old provision of the Civil Code that declared such agreements null. Following this legislative change, in 2000 the Supreme Court issued an important decision in a case involving an international contract. The court ruled that under Ecuadorian civil and commercial law, parties are free to select the forum and law applicable to the settlement of contract disputes.⁽³⁾ The only exceptions are agreements signed by public entities within the Ecuadorian territory. A similar trend has been observed with regard to the contention that the provisions of the decree-law were based on public order considerations. In a case initiated before the decree-law was repealed, the Supreme Court rejected such characterization as the decree-law regulated only business activities.⁽⁴⁾

Finally, the Guayaquil Second Civil Court ruling confirmed that the Supreme Court opposes the appointments of an *ad litem* guardian to answer a complaint on behalf of a foreign corporation doing business in Ecuador without the presence of an agent in the country, where the plaintiff knows the address of the corporation abroad. In such cases the local plaintiff must serve the foreign defendant with a letter rogatory in order to guarantee the foreign corporation's right to a due process.

These developments are welcomed and should help local distributors and foreign suppliers to create long-term relations with more certainty.

For further information on this topic please contact [Hernán Pérez Loose](#) at Coronel & Pérez by telephone (+593 4 2519 900) or by fax (+593 4 2320 657) or by email (hperez@coronelyperez.com).

Endnotes

- (1) Law for the Protection of Representatives, Agents and Distributors of Foreign Enterprises, Official Register 245, December 31 1976.
- (2) *Grace v Delta Steamship Lines Inc*, *Judicial Gazette* Series XV No 9, page 2570.
- (3) *Società Italiana Per Condotte d' Acqua Spa v Teresa Garcia*, Official Register 109, June 29 2000.
- (4) Sentence 205-2003, September 25 2003, Official Register 259, January 26 2004.

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