THE RISK OF MIXED LAWS: THE EXAMPLE OF INDIRECT AGENCY UNDER CHINESE CONTRACT LAW

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I. INTRODUCTION

In recent years mixed jurisdictions have become a subject of considerable academic discussion.[1] The term mixed jurisdictions is generally used for legal systems which are based on different legal traditions. The analysis of mixed jurisdictions normally refers to the development and operation of mixed legal systems[2]. The mixing of structures and legal institutions from different backgrounds, however, is not only a development of the past. On the contrary, due to the trend towards internationalization all legal systems of the world are mixing in one way or another.[3]

Due diligence now requires legislative bodies to study foreign and international models when creating new laws in order to learn from other countries' experience and to find the most suitable legislative solution.[4] In practice, legislators, especially in emerging legal systems, usually look at legal structures which have already proven successful in other jurisdictions in order to avoid the painful experience of discovering legislative deficiencies only after the enactment of a new law. Sometimes laws which are already in force abroad are taken over in toto. Other times drafters of new legislation decide to adapt various concepts derived from different foreign systems, *i.e.* to 'mix' them, in order to combine their advantages by way of 'legislative cherry picking'. In the latter case, the characteristics of mixed jurisdictions are mirrored on a micro level in the new 'mixed law'.

Laws and single legal instruments, however, are always parts of a larger system. The legislative mix of institutions from different backgrounds, therefore, requires a very careful 'assembling' in order to

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[1] William Tetley, "*Mixed Jurisdictions: Common Law v. Civil Law (Codified and Uncodified)*, 60 LA. L. REV. 677 (2000).

[2] Examples of common law/civil law mixed jurisdictions are Louisiana, *see id.* at 688; Quebec, *see* H. PATRICK GLENN, *Qubec:Mixite and Monism, in* LEGAL SYSTEMS: MIXED AND MIXING 335, 335-352 (Örücü et al. eds., 1996); St. Lucia; Puerto Rico; South Africa, *see* DAVID CAREY MILLER, *South Africa: A Mixed System Subject to Transcending Forces, in* LEGAL SYSTEMS: MIXED AND MIXING 165, 165-192 (Örücü et al. eds., 1996); Zimbabwe; and Scotland, *see* Tetley, *supra* note 3, at 679. Non-occidental mixed legal traditions include Algeria, *see* AHMED AOUED, *Algeria: Reconciling Faith and Modernity, in* LEGAL SYSTEMS: MIXED AND MIXING 193, 193-208 (Örücü et al. eds., 1996); and Sri Lanka, *see* ANTON CORRAY, *Sri Lanka: Oriental and Occidental Laws in Harmony, in* LEGAL SYSTEMS: MIXED AND MIXING 165, 165-192 (Örücü et al. eds., 1996).

[3] ESIN ÖRÜCÜ, *A Theoretical Framework for Transfrontier Mobility of Law*, in TRANSFRONTIER MOBILITY OF LAW 5, 7 (R. Jagtenburg et al. eds., 1995). *See also* KONRAD ZWEIGERT & HEIN KÖTZ, INTRODUCTION TO COMPARATIVE LAW 17 (Tony Weir trans., Oxford 3d ed. 1998) ("The reception of foreign legal institutions is not a matter of nationality, but of usefulness and need. No one bothers to fetch a thing from afar when he has good or better at home, but only a fool would refuse quinine just because it didn't grow in his back garden.").

[4] *See* Örücü, *supra* note 5, at 7.

maintain consistent structures and to avoid systematical confusion. The creation of mixed laws naturally increases the risk of gaps, and it can have fatal consequences if the larger legal context is not taken into account. The provisions of the *Contract Law of the Peoples Republic of China* ("*Contract Law*") on indirect agency exemplify how legal mixing can go wrong.

II. GENERAL

A. Agency

Division of labor is one of the basic preconditions for the success of a modern economic system.[5] Division of labor also implies that sometimes contracts are negotiated and signed by persons who are not parties to the related contract.[6] Consequently any modern legal system has to provide rules on agency which are able to adequately balance the interests of the parties concerned.

Agency can be divided into sub-groups of direct and indirect agency. Indirect agency is also called 'hidden' or 'silent' agency, although these terms are not always interchangeable.[7] Direct agency means that the agent informs the other side that he is acting 'in the name' of another party, *i.e.* in the name of his principal. Legal liability for actions of the direct agent are borne solely by his principal. For example, when an agent concludes a contract in the name of his principal, then only the principal and the third party acting on the other side become parties to the contract.[8] The direct agent himself obtains no rights and incurs no obligations as long as he acted within the scope of his authority.[9]

In the case of indirect agency, the agent does not act in the name of a principal. He acts in his own name, but for the account of the principal. As it is well known, civil law[10] and common law[11] systems have

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5 HEIN KÖTZ & AXEL FLESSNER, EUROPEAN CONTRACT LAW 217 (Oxford, 1997).

6 *Id.*

7 HANS BROX, ALLGEMEINER TEIL DES BÜRGERLICHEN GESETZBUCHS [GENERAL PART OF THE CIVIL CODE] 225 (20th ed., 1996).

8 *Id.* at 232.

9 *Id.*

10 In the context of this article "civil law" shall be understood as the Roman law-influenced continental-European legal systems, *see* GRAF VON BERNSTORFF, EINFÜHRUNG IN DAS ENGLISCHE RECHT 6 n.15 [INTRODUCTION TO ENGLISH LAW] (2d ed., 2000); *see also* Tetley, *supra* note 3, at 683. For the different meanings of the term 'civil law' *see* ALAN WATSON, THE MAKING OF CIVIL LAW 2 (Harvard University Press 1981).

11 The term 'common law' has many meanings, *see* ROSCOE POUND, THE HISTORY AND SYSTEM OF THE COMMON LAW 22-23 (1939). The term is used for all the laws made by judges relating to the whole of the United Kingdom, *see* SHARON HANSON, LEGAL METHOD 34 (1999); For the English law applied in the Commonwealth-countries, *see* Graf von Bernstorff, *supra* note

different answers to the question of what the legal consequences of indirect agency are and whether it is of any importance if the other side has knowledge of an agency relationship.[12]

B. *Agency in China*

It is debatable whether the law of the People's Republic of China ("PRC") belongs to the civil law[13] or to the common law family, or if it has an entirely unique character.[14] Whatever the label, the law of the PRC is not based on a case law system, but on statutory law.[15]

In the PRC, rules regarding agency are set forth first of all in the PRC *General Principles of Civil Law* ("*General Principles*")[16] and in the *PRC Contract Law ("Contract Law").*[17] The *General Principles* entered into force on 1 January 1987. They contain - as the title suggests - basic civil law rules, for example rules on legal capacity, property rights and

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12, at 1-2, 6 n.15; Tetley, *supra* note 3, at 683; . In the context of this article "common law" shall be understood in the latter sense.

[12] Zweigert & Kötz, *supra* note 5, at 433.

[13] YASH GHAI, *Hong Kong: Interpretation of the Basic Law of the Special Administrative Region, in* LEGAL SYSTEMS: MIXED AND MIXING 129 (Örücü et al. eds., 1996). *See also* Örücü, *supra* note 5, at 14, 16.

[14] *See* WANG LIMING, HETONGFA YINAN ANLI YANJIU [RESEARCH ON TRICKY CONTRACT LAW CASES] 4 (Beijing 1997)

[15] Wang Liming, *supra* note 16, at 2; SHIYONG FALU ANLI PINGDIAN – MINSHIQUAN [COMMENTARY ON PRACTICAL LAW CASES – CIVIL LAW VOLUME] 1 (Wang Zhaoneng ed., 2001) ; 2000 SHANGHAI FAYUAN ANLI JINXUAN 2 [2000 – SELECTED CASES OF SHANGHAINESE COURTS] 2 (Qiao Xianzhi 2000).

[16] Adopted on 12 April 1986, in force since 1 January 1987, English translation provided *e.g.* by Whitmore Gray & Henry Ruiheng Zheng, 34 AM. J. COMP. L. 715 (1986); CCH Australia Ltd. (publisher), China Law for Foreign Business (looseleaf from 1985), 19-150.

[17] Promulgated on 15 March 1999, in force since 1 October 1999, English translation provided *e.g.* CCH *supra* note 18, 5-650;*ee generally* BING LING, CONTRACT LAW OF CHINA (2001); Wang Limin Xu Chuanxi, *Fundamental Principles of China's Contract Law*, 13 Colum. J. Asian L. 1(1999); WANG SHENGMING ET AL., AN INSIDER'S GUIDE TO THE PRC, CONTRACT LAW (1999); Hugh T. Scogin & Brett D. Braude, *New Contract Basics*, THE CHINA BUS. REV., Jan.-Feb. 1999, at 36; Nan Wang, *The New PRC Contract Law*, CHINA LAW & PRACTICE, Oct. 1998, at 42-46; Lam Ling Wo, *China Unveils Unified Contract Law*, INT'L FIN. L. REV., Jun. 1999, at 17-22; Lam Ling Wo, *Scrutinizing the Contract Law*, CHINA LAW & PRACTICE, May 1999, at 59 - 62; Yunfei Chen, *Interpreting the PRC, Contract Law*, CHINA LAW & PRACTICE Mar. 2000, at40-42; E. Anthony Zaloom & Hongchuan Liu, *China's Contract Law Marks a New Stage of Commercial Law Drafting, China Law & Practice,* May 1999, at 15-18; GUIGUO WANG, WANG'S BUSINESS LAW OF CHINA 56-168 (3d ed., 1999); Frank Münzel & Xiaoqing Zheng , *Chinas neues Vertragsgesetz – ein Überblick, Recht der Internationalen Wirtschaft,* Sep. 1999, at 641-646; Stefanie Tetz, *Neues Vertragsgesetz in China: Was ändert sich für ausländische Vertragspartner*, RECHT DER INTERNATIONALEN WIRTSCHAFT Sep. 1999, at 647-649; Supreme People's Court, *Several Issues Concerning Application of the 'PRC, Contract Law' Interpretation (1)*, promulgated on 19 December 1999, in force since 29 December 1999, English translation in CHINA LAW & PRACTICE, Mar. 2000, at 43-48.

agency.[18] In accordance with the quality of PRC legislation during the eighties, the *General Principles* are partly unclear and incomplete.

The *Contract Law* has been in force since 1 October 1999,[19] and has unified the previously existing rules regarding both contracts that contain foreign elements and those that do not.[20] Its enactment was widely welcomed in the Chinese and foreign legal world.

The Chinese rules on direct agency (provided mainly by the *General Principles*[21]) are very similar to the German rules on agency as set forth in Articles 164 to 181 of the *German Civil Code*.[22] The *Contract Law* also contains interesting regulations on indirect agency. Before discussing these rules, however, we will briefly summarize how some other jurisdictions deal with indirect agency in order to facilitate the comparative analysis of the related Chinese rules.

C. *Indirect Agency from a Comparative Perspective*

1. Germany

German law, like the law of most continental European countries[23], does not recognize the concept of indirect agency.[24] Article 164 of the *German Civil Code* makes it clear that effective agency always requires the agent to act 'in the name'[25] of the principal. Article 164 of the *German Civil Code* reads as follows:

> (1) A declaration of intention which a person makes in the name of a principal within the scope of his agency operates directly both in favor of and against the principal.

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18 General Principles Art. 63-70.

19 Contract Law Art. 428.

20 The *Contract Law* repeals the *PRC Economic Contract Law*, effective since 1 July 1982, the *PRC Foreign Economic Contract Law*, effective since 1 July 1985, and the *PRC Technology Contract Law*, effective since 1 November 1987. *See* Contract Law Art. 428.

21 *See also* Contract Law Art. 9, 48, and 49.

22 The *German Civil Code* entered into force on 1 January 1900. The first translation into the English language was provided by Chung Hui Wang. *See* CHUNG HUI WANG, GERMAN CIVIL CODE–TRANSLATED AND ANNOTATED WITH AN HISTORICAL INTRODUCTION AND APPENDICES (1907). *See also* WALTER LOEWY, GERMAN CIVIL CODE (1909); SIMON L. GOREN, THE GERMAN CIVIL CODE (1994).

23 Zweigert & Kötz *supra* note 5, at 433, 436.

24 *Id.* at 436.

25 The *German Civil Code* fails to explicitly address the case in which the agent informs the third party that he or she acts for a principal whose identity, however, remains undisclosed. According to the prevailing opinion among German scholars, the requirement that the agent acts "in the name of the principal" is met in these cases because the third party knows that he or she is contracting not with the agent, but with somebody else and therefore does not need protection. *Compare* Brox, *supra* note 9), at 230.

> It makes no difference whether the declaration is made expressly in the name of the principal, or if the circumstances indicate that it was to be made in his name.
> (2) If the intention to act in the name of another is not apparent, the agent's absence of intention to act in his own name is not taken into consideration.
> (3) The provisions of (1) apply *mutatis mutandis* if a declaration of intention required to be made to another is made to his agent.[26]

This means that if the 'agent'[27] acts in his own name and notin the name of a principal, then a legal relationship is only established between the 'agent' and the counterpart.[28] The counterpart, can enforce the 'agent's' rights against the principal only after having obtained the rights by way of assignment and the principal can only claim against the 'agent's' counterpart on the basis of the 'agent's' contractual rights after assignment of these to the principal.[29]

2. Common Law[30]

The common law comes to similar conclusions with regard to direct agency. Where an agent indicates that he is contracting as an agent then contractual relations are only established between his principal and the third party. The agent cannot be made liable on the contract.[31]

The common law[32], however, takes a much broader approach when it comes to undisclosed agency. If a third party concludes a contract with someone who has been appointed as agent and the agent acts within the scope of her authority when concluding the contract, then the principal obtains contractual rights against the third party and vice versa. This holds true even if the agent did not disclose that she was

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[26] *Supra* note 24.

[27] We have put the word 'agent' in brackets because according to German law and the law of most Continental European countries the party acting in his/her own name would not be regarded as agent.

[28] *See* Brox, *supra* note 9), at 232; Zweigert & Kötz, *supra* note 5), at 436.

[29] *See* German Commercial Code Art. 392.

[30] In the following we have only quoted English case law. It must be noted, however, that agency rules of all common law jurisdictions are based on English law, although they may have developed differently in the various jurisdictions.

[31] *Universal Steam Navigation Co. Ltd. v. James McKelvie*, (H.L.), 129 L.T. 395 (1923); *Gadd v. Hougton & Co.*, 35 L.T. 222 (1876); B.S. MARKESINIS & R.J.C. MUNDAY, AN OUTLINE OF THE LAW OF AGENCY, 143 (4th ed.1998).

[32] The rules have almost entirely been developed by the courts. Only a few sporadic rules of statutory law exist, *see* Zweigert & Kötz, *supra* note 5, at 435.

acting on behalf of someone else.[33] Therefore, under common law the principal can have contractual rights and obligations even though she never negotiated or signed the contract and the third party was unaware of the involvement of the principal.[34]

Because in the case of undisclosed agency the agent enters into the contract in her own name, the agent may sue and be sued on the contract until her principal decides to intervene or the third party becomes aware of the agency relationship and elects to sue the principal.[35]

3. Convention on Agency in the International Sale of Goods

The *Convention of Agency in the International Sale of Goods* of 17 February 1983 ("*Geneva Convention*")[36] has turned the above common law principles on indirect agency into black letter law. According to Article 1, the Geneva Convention is applicable regardless of whether the agent has acted in the name of a principal or not.[37] Furthermore, if the agent acts within the scope of his agency and the other party is aware or should be aware of the agency relationship between the agent and his principal, then generally speaking the principal and the third party will be directly bound by the contract concluded between the agent and the third party even if the agent has acted in his own name.[38]

If the third party neither knew, nor ought to have known, about the agency relationship, then the contract is only effective between the

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[33] *E.g., Dyster v. Randall & Sons*, 135 L.T. 596 (1926); *Snee v. Prescott*, 1 AtK 245 (1743); *Nelson v. Powell*, 3 Dog KB 410 (1784); Markesinis & Munday, *supra* note 32, at 154-157.

[34] *See* G.H.L. FRIEDMANN, THE LAW OF AGENCY, 253 (7th ed. 1996): "In contracting with the person physically of metaphorically before him, the third party undertakes the risk that such person has been authorized to act as the agent of another, without revealing the existence of such principal. He may find that instead of contracting with one person he has contracted with another."

[35] Markesinis & Munday, *supra* note 32, at 165-168. The third party may also choose to claim against the agent as his or her contractual counterpart, *see London General Omnibus Co. v. Pope*, 38 L.T.R. 270 (1922); *Clarkson, Booker Ltd. v. Andjel*, 3 All E.R. 260 (1964); *Zweigert & Kötz*, *supra* note 5), at 437. Also, the principal can hold the agent liable for breach of agency duties, *e.g. The "Hermione"*, 126 L.T. 701 (1922); Markesinis & Munday, *supra* note 32, at 92-115.

[36] Pursuant to its Article 33, the *Geneva Convention* will enter into effectiveness on the date on which at least 10 contract states have deposited their instrument of ratification. At the time this article was drafted 6 states (Chile, Holy See, Morocco, Switzerland, Italy, France) had signed the *Geneva Convention*. Italy and France had ratified it. South Africa, Mexico and the Netherlands joined afterwards. For a general discussion of the Geneva Convention *see* Bonell, *The 1983 Geneva Convention on Agency in the International Sale of Goods*, 32 AM. J. COMP. L. 717 (1984).

[37] Article 1 (4) of the *Geneva Convention* reads as follows: "It [the *Geneva Convention*] applies irrespective of whether the agent acts in his own name or in that of the principal."

[38] Article 12 of the *Geneva Convention* reads as follows: "Where an agent acts on behalf of a principal within the scope of his authority and the third party knew or ought to have known that the agent was acting as an agent, the acts of the agent shall directly bind the principal and the third party to each other, unless it follows from the circumstances of the case, for example by a reference to a contract of commission, that the agent undertakes to bind himself only."

agent and the third party.[39] However, if the agent (for whatever reason) fails to fulfill his contractual obligations to the principal then the principal can claim against the third party on the basis of the contractual rights acquired by the agent on his behalf.[40] If the agent does not fulfill his contractual obligations towards the third party then the third party can exercise his contractual rights against either the agent or the principal, subject to any defenses of the agent against him or of the principal against the agent.[41]

III. INDIRECT AGENCY UNDER PRC CONTRACT LAW[42]

A. The Stipulations

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[39] Article13 of the *Geneva Convention* reads as follows:

"(1) Where the agent acts on behalf of a principal within the scope of his authority, his acts shall bind only the agent and the third party if:

(a) the third party neither knew nor ought to have known that the agent was acting as an agent, or

(b) it follows from the circumstances of the case, for example by a reference to a contract of commission, that the agent undertakes to bind himself only.

(2) Nevertheless:

(a) where the agent, whether by reason of the third party's failure of performance or for any other reason, fails to fulfill or is not in a position to fulfil his obligations to the principal, the principal may exercise against the third party the rights acquired on the principal's behalf by the agent, subject to any defenses which the third party may set up against the agent;

(b) where the agent fails to fulfil or is not in a position to fulfil his obligations to the third party, the third party may exercise against the principal the rights which the third party has against the agent, subject to any defenses which the agent may set up against the third party and which the principal may set up against the agent.

(3) The rights under paragraph 2 may be exercised only if notice of intention to exercise them is given to the agent and the third party or principal, as the case may be. As soon as the third party or principal has received such notice, he/she may no longer free himself from his obligations by dealing with the agent.

(4) Where the agent fails to fulfill or is not in a position to fulfill his obligations to the third party because of the principal's failure of performance, the agent shall communicate the name of the principal to the third party.

(5) Where the third party fails to fulfill his obligations under the contract to the agent, the agent shall communicate the name of the third party to the principal.

(6) The principal may not exercise against the third party the rights acquired on his behalf by the agent if it appears from the circumstances of the case that the third party, had he/she known the principal's identity, would not have entered into the contract.

(7) An agent may, in accordance with the express or implied instructions of the principal, agree with the third party to derogate from or vary the effect of paragraph 2."

[40] Geneva Convention Art. 13 (2) (a).

[41] Geneva Convention Art. 13 (2) (b); Zweigert & Kötz, *supra* note 5, at 441: "... so that in the result, contrary to the position in the Common Law, the principal who has paid the agent is not liable to pay again."

[42] For Chinese law of indirect agency *see generally* Bing Ling, *supra* note 19, at § 4.3.4.

The *Contract Law* addresses questions regarding indirect agency[43] within the Chapter on so-called mandate contracts ("weituo hetong"). Article 396 *Contract Law* defines mandate contracts as "a contract by which a mandator and a mandatary agree that the mandatary will handle a matter of the mandator."[44] The rules on indirect agency are set forth in Articles 402 and 403 of the *Contract Law*. Both Articles address two different situations. Article 402 of the *Contract Law* reads as follows:

> "If the mandatary concludes a contract with a third party in his own name and within the scope of authority delegated by the mandator, and, at the time of concluding the contract, the third party is aware of the agency relationship between the mandatary and the mandator, the contract directly binds the mandator and the third party, unless there is conclusive evidence that the said contract binds only the mandatary and the third party."

Article 402 therefore refers to a situation where a mandatary concludes a contract in his own name[45] but within his power of authority and the third party knows about the agency relationship between the mandator and the mandatary. In this case, generally speaking, the mandator and the third party are directly bound by the contract.

As far as the contractual situation of the agent himself is concerned, the wording of Article 402 is ambiguous. On the one hand one could argue that the word "only"[46] (in the last line) of this Article indicates that the agent remains bound by the contract which he has signed in his own name, i.e., that the third party can elect to hold the mandator or the agent contractually liable.[47] On the other hand, the word "directly"[48] (in the third last line) could support the argument that only the

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[43] The term indirect agency is not used by the *Contract Law*. YIAN SHUOFA – HETONGFA BIAN [EXPLAINING THE LAW THROUGH CASES – CONTRACT LAW], 342(Li Yanfang ed. 2001), uses the phrase 'yiming daili', which, however, corresponds with 'undisclosed agency'.

[44] Mandate contracts can be against payment or gratituous, *see* Contract Law\Art. 405, 406; HETONGFA XIANGGUAN SHUYU CIYU XINJIE [DETAILED EXPLANATION OF RELATED CONTRACT LAW TERMS] 345 (Zhao Xudong 1999); LI JIANGUO & MIN WEIGUO, HETONGFA LIJIE YU YINGYONG [UNDERSTANDING AND USING THE CONTRACT LAW] 504 (1999).

[45] The conclusion of a mandate contract does not require the mandatary to act in his own name. He/she can also act in the name of the mandator, *see* HETONGFA XINSHI YU LIJIE - SHANG [NEW EXPLANATION OF THE CONTRACT LAW AND CASE SOLUTIONS I] 966 (Xie Liangquan ed. 2000); Li Yanfang, *supra* note 44, at 341. Articles 402 and 403 of the *Contract Law* would not be applicable if the mandatary acted in the name of the mandator.

[46] Chinese: "zhi".

[47] This is suggested by TANG DEHUA, HETONGFA SHENPAN SHIWU [CONTRACT LAW TRIAL PRACTICE] 1169 (2000); Xie Liangquan, *supra* note 46, at 967.

[48] Chinese: "zhijie".

principal and the third party are contractually bound. Further, while Article 403 provides an explicit rule regarding elective rights of the third party, Article 402 does not. This could be seen as additional evidence that in situations addressed by Article 402 contractual relations shall only exist between the third party and the principal. Again, however, it must be emphasized that the wording of Article 402 is not totally clear.

Article 403 addresses the situation where the mandatary concludes a contract in his own name and the third party does not know about the agency relationship. Here, the contract is generally binding only upon the third party and the mandatary. If the mandatary, however, fails to fulfill his contractual obligations because of reasons for which the third party is responsible, then the mandatary has to disclose the third party's identity and the mandator can claim against the third party.[49] The third party can claim against the mandator in the same way if the mandatary does not fulfill his obligations towards the third party due to the mandator's responsibility.[50] Article 403 of the *Contract Law* reads as follows:

> "When the mandatary concludes a contract with a third party in his own name and, at the time of concluding the contract, the third party is not aware of the agency relationship between mandatary and mandator, if the mandatary fails to perform his obligation toward the mandator due to reasons attributable to the third party, the mandatary shall disclose the third party to the mandator and the mandator may on those grounds exercise the rights of the mandatary against the third party, unless the third party would not have entered into the contract with the mandatary if at the time of its conclusion he/she had known that the mandatary's principal was the mandator in question.
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> "If the mandatary fails to perform his obligation toward the third party due to reasons attributable to the mandator, the mandatary shall disclose the mandator to the third party and the third party has an option on those grounds to claim against either the mandatary or the mandator. However, once selected, the third party may not change the person against whom he/she claims.

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49 Contract Law Art. 403 paragraph 1. *See also* Münzel & Zheng, *supra* note 19, at 543.

50 Contract Law Art. 403 paragraph 2.

> "If the mandator exercises the rights of the mandatary against the third party, the third party may set up against the mandator the defences which he/she has against the mandatary. If the third party opts to claim against the mandator, the mandator may set up against the third party the defenses which he/she has against the mandatary as well as the defenses which the mandatary has against the third party."

Articles 402 and 403 of the *Contract Law* raise interesting questions[51] which shall be discussed in the following.

B. Open Questions

1. Location of Articles 402 and 403

First, it must be asked why the *Contract Law* rules on indirect agency form part of the chapter on mandate contracts. The substantive content of Article 402 refers to the preconditions of agency as such.[52] The strict requirement of Article 63 paragraph 2 of the *General Principles*,[53] according to which an agent always has to act in the name of the principal in order to create a contractual liability of the principal, is given up by Articles 402 and 403 of the *Contract Law*. It is for this reason that one would assume that this provision should be found among the general rules on agency.

Further, Article 402 seems to take the agency relationship between mandator and mandatary 'for granted' without further explanation or regulation. Does that mean that under Chinese law the appointment of agents always requires the conclusion of a mandate contract?[54] As a matter of fact, Article 64 paragraph 1 of the *General Principles*[55] also uses the Chinese term for mandate agency ("weituo daili") in order to describe 'appointed agency'. Nevertheless, it is common practice in China to appoint agents on the basis of a labor contract, which implies that mandate contracts cannot be essential for the appointment of an agent. Does Article 402 perhaps mean that the

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51 *Compare*, e.g., Xie Liangquan, *supra* note 46, at 958.

52 *Compare* Zhonghua Rnmin Gongheguo HETONGFA JINGJIE [ESSENTIAL EXPLANATION OF THE PRC CONTRACT LAW], 345 (Jiang Ping ed. 1999).

53 Article 63 paragraph 2 of the *General Principles* reads as follows: "An agent shall, within the scope of his agency, perform civil legal acts in the name of the principal. The principal shall assume civil liability for the representing acts of the agent."

54 This seems to be suggested by Lam Wing Wo, *supra* note 19, at 61.

55 Article 64 paragraph 1of the *General Principles* reads as follows: "Agency includes appointed agency, statutory agency and designated agency."

conclusion of a mandate contract always requires the appointment of a mandatary as agent? This conclusion is not compelling.

The aforementioned problems seem to be caused by the fact that under Chinese law (like under common law) it is not yet widely accepted that drawing a distinction between the appointment of an agent on the one hand, and the underlying contractual relationship between the appointing party (principal) and the appointed party (agent)[56] on the other hand facilitates the analysis of the legal relationships and the solution of agency-related problems.[57] If the agency system of the *Contract Law* was based on this distinction, then Articles 402 and 403 of the *Contract Law* should have been placed within the set of general rules on agency as such. The inclusion of Articles 402 and 403 as part of the mandate contract rules seems to indicate that the Chinese legislators have at least not paid attention to the difference between an agent's appointment and underlying legal relationships.

2. Applicability of other Agency Rules?

The above leads to a further question that cannot be directly answered on the basis of the wording of Articles 402 and 403: Are other regulations of the *Contract Law* or the *General Principles* regarding agency to be applied in the situations addressed by Articles 402 and 403? One example: Article 402 requires that the agent act in his own name and within the scope of his authority. What would be the consequence if the agent acts outside the scope of his authority? Could a third party claim that Article 49 of the *Contract Law* must be applied? Article 49 reads as follows:

> "If a contract is concluded in the name of a principal by a person who has no power of agency, who exceeds his power of agency, or whose power of agency has expired, and the opposite party has reason to believe that the person with whom he/she concludes the contract has power of agency, then such act of agency is valid."

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[56] *See generally* Wolfram Müller-Freienfels, *Legal Relations in the Law of Agency: Power of Agency and Commercial Certainty*, 13 Am. J. Comp. L. 193, 198 (1965).

[57] *See* Li Yanfang, *supra* note 44, at342; YANG ZENSHAN & LIANG SHUWEN, XINHETONGFA YUANLI YU SHIYONG QUANSHU [COMPENDIUM OF PRINCIPLES AND USE OF THE NEW CONTRACT LAW] 1550, 1567 (1999); WANG WENJIANG, HETONG SHIWU SHOUCE [PRACTICAL CONTRACT LAW HANDBOOK] 89 (1999); (discussing the difference between the appointment of an agent and a mandate contract). *See* Zweigert & Kötz, *supra* note 5, at 434-435.

Our understanding is that this regulation and other rules on direct agency should be applied *mutatis mutandis* at least in situations covered by Article 402 of the *Contract Law* in order to have a consistent and complete set of rules.[58]

3. Common Law Influence

Articles 402 and 403 of the *Contract Law* basically follow the structure of the *Geneva Convention*.[59] The following major differences, however, should be noted:

(i) Unlike Article 402 and 403, the *Geneva Convention* only deals with agency as such and not with the underlying contractual relationship between agent and principal.

(ii) The Geneva Convention does not distinguish between acts of the agent carried out in the name of the principal and acts carried out in the agent's own name, whereas the *Contract Law* (in connection with the *General Principles*) provides rules on direct agency and also addresses indirect agency within the chapter on mandate contracts.

(iii) A strict reading of Article 402 requires the third party to have positive knowledge[60] of the agency relationship for the establishment of direct contractual rights between the principal and the third party based on indirect agency. Under Article 13(1) of the *Geneva Convention*[61] contractual rights are established when the third party "ought to know" of the agency relationship.

(iv) Article 403 limits the ability of the mandator and the third party to claim against each other in those situations where the agent's non-performance has been caused by the other side. Article 13(2)(a) and (b) of the *Geneva Convention*[62] allows such a claim notwithstanding the reason of the agent's failure to perform.

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58 For example, the *Geneva Convention* does not cause similar problems, since pursuant to its Article 1 (4), *supra* note 24, the related Article 14 is applicable regardless of whether the agent acted in the name of the principal or in his own name, and notwithstanding of any underlying contractual relationship. Article 14 of the *Geneva Convention* reads as follows:

"(1) Where an agent acts without authority or acts outside the scope of his authority, his acts do not bind the principal and the third party to each other.

(2) Nevertheless, where the conduct of the principal causes the third party reasonably and in good faith to believe that the agent has authority to act on behalf of the principal and that the agent is acting within the scope of that authority, the principal may not invoke against the third party the lack of authority of the agent."

59 Tang Dehua, *supra* note 48, at 1169.

60 The Chinese term "zhidao", however, is sometimes also used in legal texts for "ought to know".

61 *See supra* note 40.

62 *See supra* note 40.

In Articles 402 and 403 of the *Contract Law* the PRC legislators have adopted a common law institution,[63] *i.e.* indirect agency.[64] This could explain why the relationship between indirect agency and mandate contract remains rather unclear under the regime of the *Contract Law*[65]. As already explained,[66] common law lawyers do not stress the importance of a clear differentiation.[67]

In light of the analysis above, it must be pointed out, however, that the *Contract Law* as such is obviously very much civil law oriented and exhibits a clearly civilian style.[68] Many of the principles and rules are expressed by using such civil law concepts as declaration of intention, obligation, claim and defense. The principle of good faith[69] plays a predominant role in the regulation of contractual rights which is evidenced by the fact that products of the good faith principle such as precontractual liability[70], postcontractual liability[71] and ancillary duties in the performance of a contract[72] are explicitly set forth by the *Contract Law. In addition, u*nlike the common law, under the *Contract Law* consideration is not essential for the enforceability of a contract.[73] Furthermore, the receipt doctrine is adopted in regard to the acceptance of an offer,[74] and defenses of non-performance[75] and insecurity[76] are provided

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63 *Compare* Li Yanfang, *supra* note 44, at 342; Jiang Ping, *supra* note 53, at 344.

64 Common law lawyers use the term 'undisclosed agency'.

65 *See* Section 3.1 (1) above.

66 *Id.*

67 *See* Zweigert & Kötz, *supra* note 5, at 435.

68 For general aspects of the relationship of PRC law towards the civil law world *see* Yash Ghai, *supra* note 15, at 130 b*ut see* UGO MATTEI, COMPARATIVE LAW AND ECONOMICS 226 (1997) (holding that American leadership is clear in the process of privatization in China, "where American advisors play a major role").

69 *See* Contract Law Art. 6: "When exercising their rights and performing their obligations the parties shall abide by the principle of good faith."

70 *See* Contract Law Art. 42:

"A party that during the process of concluding a contract causes losses on the other party's side is liable for damages if he/she:

(1) negotiated in bad faith under the pretext of concluding a contract;

(2) deliberately concealed an important fact relevant to the conclusion of the contract or provided false information; or

(3) engaged in another act contrary to the principle of good faith."

71 *See* Contract Law Article 92: "After the rights and obligations under the contract have been discharged, the parties shall perform such obligations as giving notice and providing assistance and maintaining confidentiality etc. in accordance with trade usage and in line with the principle of good faith."

72 *See* Contract Law Article 60 paragraph 2: "The parties shall perform such obligations as giving notice, providing assistance and maintaining confidentiality, etc. in accordance with the nature and the objective of the contract and trade usage and in line with the principle of good faith."

73 *See* Contract Law Art. 185-195 (on Gift Contracts).

74 *See* Contract Law Art. 26 sentence 1: "An acceptance notice becomes effective when it reaches the offeror."

75 *See* Contract Law Art. 66 sentence 2: "A party may refuse the other party's demand for performance, if the other party has not yet performed his/her obligation."

for with regard to the performance of bilateral contracts. The creditor's rights of subrogation[77] and revocation[78] under the *Contract Law* are borrowed from civil law jurisdictions such as France, Italy and Taiwan. Last but not least, specific performance is treated as a legal right of the parties to the contract rather than being within the equitable discretion of a court.[79]

It seems to be worthwhile to pursue the question why the civil law-inspired *Contract Law* has adopted the common law institution of indirect agency. For this question, legal writers[80] have traditionally pointed to the Chinese foreign trade system, which shall therefore briefly be discussed in the following.

IV. INDIRECT AGENCY AND THE PRC FOREIGN TRADE SYSTEM

A. State Monopoly

The Chinese state has traditionally monopolized China's foreign trade. In the past this foreign trade monopoly was used in order to implement planned economy structures. In particular it was used to

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[76] *See* Contract Law Art. 68:

"The party which is to perform his obligation first may suspend performance if he/she has conclusive evidence that

(1) the other party's business circumstances have significantly deteriorated;

(2) the other party has transferred assets and/or surreptitiously withdrawn funds in order to evade his/her obligation;

(3) the other party has lost his/her goodwill; or

(4) there are other circumstances which have caused or may cause the other party losing his/her ability to perform his/her obligation. ..."

[77] *See* Contract Law Art. 73 paragraph 1: "If the obligor neglects to exercise his own matured claims, thereby causing injury to the obligee, the obligee may apply with the people's court to be subrogated in his own name to the claim of the obligor, unless such claim is a personal claim of the obligor."

[78] *See* Contract Law Art. 74 paragraph 1: "If the obligor waives his own matured claim or assigns property without consideration and thereby causes damages to the obligee, the obligee may apply with a people's court to annul such act of the obligor. If the obligor assigns property at a price which obviously is unreasonably low, thereby causing damages to the obligee, and the assignee is aware of such circumstances, the obligee may also apply with a people's court to annul such act of the obligor."

[79] *See* Contract Law Art. 110:

"If a party fails to perform a non-monetary obligation or performs a non-monetary obligation in a way other than that is agreed upon, the other party can demand performance unless:

(1) performance is impossible in law or in fact;

(2) the subject matter of the obligation is not suited for specific performance or the cost of performance would be excessively high; or

(3) the obligee has failed to demand performance within a reasonable period of time."

[80] *See* Tang Dehua , *supra* note 48, at 1169; Zaloom & Liu, *supra* note 19, at 18; Münzel & Zheng, *supra* note 19, at 643.

control the import and export of products, and the spending and income of foreign currency. As part of this policy, only specially designated foreign trade companies[81] and to a limited extent enterprises with foreign investment ("*FIEs*")[82] were allowed to engage in foreign trade. In 1978 about 7000 foreign trade companies existed.[83] Chinese companies without foreign trade rights were, and are still, not allowed to conclude contracts with foreign partners directly. Contracts concluded between Chinese parties without foreign trade rights and foreign parties were regarded as void.[84] Therefore, until today foreign companies wishing to conduct trade with China must always carefully check that their direct Chinese partners have the necessary foreign trade rights. In the case where a Chinese enterprise without foreign trade rights wants to enter into trade relationships with foreign partners, a foreign trade company must be used as an agent.[85] Foreign trade companies generally charge fees equal to about 1-3% of the product value for these agency services.[86]

The legal framework of the Chinese foreign trade system is set forth by the *Foreign Trade Law of the People's Republic of China*, in force since 1 July 1994 ("*Foreign Trade Law*").[87] The relationship between Chinese enterprises without foreign trade rights and foreign trade companies is governed by the *Tentative Regulations Regarding the*

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[81] Zaloom & Liu, *supra* note 19, at 18. Foreign trade companies were normally bigger state-owned enterprises subordinated to the Ministry of Foreign Trade and Economic Cooperation ("MOFTEC") or other Ministries or local governments, Robert Heuser, *Die VerGATTung des chinesischen Außenhandelsrechts*, RECHT DER INTERNATIONALEN WIRTSCHAFT 1994, at 1010-1011 (1010). *See also* Tetz, *supra* note 19, at 648.

[82] FIEs are Equity Joint Ventures, Cooperative Joint Ventures and Wholly Foreign Owned Enterprises. The right of these enterprises to export their own products and import their own raw material and equipment is set forth by the related FIE-legislation, *see* Equity Joint Venture Law Art. 9 (July 1, 1979, last revised on March 15, 2001), English/Chinese version provided by *CCH* 1, 6-500; Co-operative Joint Venture Law Art. 19 (April 13, 1988, last revised on October 31, 2000), English/Chinese version provided by *CCH* 1, 6-105, Wholly Foreign Owned Enterprise Law Art. 15 (April 12, 1986, revised on October 31, 2000), English/Chinese version provided by *CCH* 2, 13-506; Rules for the Implementation of the Wholly Foreign Owned Enterprise Law Art. 46 (December 12, 1990), English/Chinese version provided by *CCH* 2, 13-507.

[83] Dietz, *supra* note 82, at 1011; Helen K. Ho, *Foreign Trade Firsts*, THE CHINA BUSINESS REVIEW 45, 47 (1995).

[84] Article 7 paragraph 2 and Article 9 paragraph 1 of the former *Foreign Economic Contract Law*, effective from July 1, 1985 to October 1, 1999, English/Chinese available in CHINA LAW & PRACTICE Mar. 1987 at 379; *See also* Tetz, *supra* note 19, at 648: "without doubts ... void". The *Foreign Economic Contract Law*, however, has been repealed by the *Contract Law, see supra* note 22. A case where an arbitration organ has declared a contract void because of the Chinese party's lack of foreign trade rights is reported by China's 19 FOREIGN TRADE 36(1997).

[85] Foreign Trade Law of the People's Republic of China Art. 13; English translation provided by *CCH* 4, 19-568.

[86] Tang Dehua, *supra* note 48, at 1169; Zaloom & Liu, *supra* note 19, at 18; 2 LUNGERSHAUSEN GBAKTUELL 15, 16 (1995).

[87] *See supra* note 86; *see generally* Lungershausen, *supra* note 87, at 15-17; Helen K. Ho, *supra* note 84, at 45-47.

Foreign Trade Agency System, effective since 29 August 1991[88] ("*Foreign Trade Agency Regulations*"). However, until the promulgation of the *Contract Law* no explicit rules existed governing the relationship between foreign trade companies and foreign parties.[89] It was generally assumed that when a Chinese company without foreign trade rights engaged in foreign trade via a foreign trade company, contractual relationships existed only between the foreign party and the foreign trade company on the one hand and the foreign trade company and its Chinese principal on the other. When problems arose with regard to contractual performance, the majority opinion held that the foreign party could only make claims against the foreign trade company. Likewise, only the foreign trade company (but not its Chinese principal) could make claims against the foreign party.[90] However, the statutory situation, was not totally clear, and judicial practice in China before 1999 was inconsistent.[91]

With the liberalization of the Chinese economy since the late 1970s, the restrictions imposed on the Chinese foreign trade system have been loosened. The opportunity to obtain foreign trade rights is now open to any company of a reasonable size provided that certain preconditions set forth by the *Foreign Trade Law* are met.[92] It is reported that more than 20,000 enterprises have obtained foreign trade rights since the

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[88] English translation provided by *CCH* 2, 13-566; *see also* Münzel & Zheng, *supra* note 19, at 643.

[89] *But see* Münzel & Zheng, *supra* note 19, at 643, who assume that the relationship between the domestic Chinese company, appointed foreign trade company and foreign partner is governed by Article 8 and 9 of the *Tentative Regulations regarding the Foreign Trade Agency System.* However, the recitals and Article 1 of these *Tentative Regulations* strongly indicate that they only govern the relationship between the mentioned Chinese parties.

[90] Zaloom & Liu, *supra* note 19, at 18.

[91] *In Voest-Alpine Trading (USA) Corp. v. Jiangsu Jiangyin Foreign Trade Co.*, Supreme People's Court Gazette 142 (Jiangsu High People's Court and Supreme People's Court 1998), the plaintiff, a foreign party, sued the defendant, a foreign trade company, for payment of a purchase price under an import contract which the defendant had concluded on behalf of a domestic principal. The Supreme People's Court, on appeal, rejected the defendant's argument that it was the domestic principal that had taken possession of the goods and the defendant should not be liable for that reason. The Supreme People's Court held that the domestic principal had "no legal or factual connection" with the foreign party and the defendant was "the sole obligor" under the contract. However, in *Newco Commodities AG of Switzerland v. China Construction Bank*, Jilin Huichun Branch Supreme People's Court Gazette 71 (Jilin High People's Court and Supreme People's Court 1999), the Court approved a statement by the trial court (Jilin High People's Court) that the foreign trade agent in the related case "was not the buyer in the contract of international sale of goods", implying that it was the domestic principal that was the buyer under the contract, even though the foreign trade agent had signed the contract in its own name. The two cases may be somewhat reconcilable because in Voest-Alpine the foreign party did not know of the existence of the domestic principal at the time of the conclusion of the contract and chose to sue the foreign trade agent only, whereas in Newco the foreign party did know of the undisclosed principal.

[92] Foreign Trade Law Art. 9; *see also* Heuser, *supra* note 82, at 1010.

liberalization took effect.[93] According to a circular issued by the Ministry of Foreign Trade and Economic Co-operation ("*MOFTEC*") in July 2001, related restrictions have further been lifted.[94] China's WTO-membership since 11 December 2001 will cause another 'wave' of liberalization.

B. Foreign Trade Agency and Articles 402 and 403 of the Contract Law

During the discussions of different drafts of the Contract Law it was claimed to be unfair that Chinese foreign trade companies have to bear the whole contract risk in the event that they are engaged as a foreign agent by a domestic company without foreign trade rights against receipt of only 1-3% of the contract value.[95] It was requested that the Contract Law should provide a regulation which would release the foreign trade companies from their liability in these cases. It is generally assumed that Articles 402 and 403 of the Contract Law carry out this function.[96]

However, as explained above[97], the pure wording of Article 402 and 403 does not, as far as the 'foreign trade triangle' is concerned, unambiguously support the release of foreign trade companies from their contractual liability. On the contrary, in addition to the foreign trade company's contractual liability, the foreign company may also be able to make claims against the principal.

Furthermore, it is questionable whether Articles 402 and 403 are applicable at all when a Chinese enterprise enters into contractual relationships with a foreign party via a foreign trade company acting as an agent. This is because the Contract Law also provides rules for commission agency contracts ("hangji hetong"). Article 414 of the Contract Law defines commission agency contracts as " contract[s] by which a commission agent agrees to engage in trading activities in his

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[93] *But see* Randle Peerenboom, *Missed Opportunity? China's New Contract Law Fails to Address Foreign Technology Providers' Concerns*, CHINA LAW & PRACTICE, May 1999, at 83, 86 (argues that since the *Contract Law* entered into force it is no longer to acquire foreign trade rights).

[94] *See* Bei Hu, *Beijing Levels Playing Field on Export Rights* South China Morning Post-Business 3 August 2001, p. 6. At the time this article was written we had not yet seen the official version of the *MOFTEC*-circular. It is reported, however, that enterprises with a minimum capital of three million RMB may register with provincial authorities for the right to import their own equipment and raw materials, and export their products. The minimum capital requirement is relaxed to two million RMB in less developed areas, and one million RMB for high-technology firms. Registered capital of at least five million RMB and certification by the *MOFTEC* are required for other kinds of trading activities. Here, the minimum capital requirement is reduced to three million RMB in central and western China.

[95] Tang Dehua, *supra* note 48, at 1169 (who points out that it was disputed how and if this problem should be addressed by the *Contract Law*).

[96] *Id.*; Zaloom & Liu, *supra* note 19, at 18; Münzel & Zheng, *supra* note 19, at 643.

[97] *See* Section 3.1 above.

own name for a principal, and the principal agrees to pay remuneration therefor."[98]

The main differences between mandate contracts and commission agency agreements are threefold: (i) a commission agency contract always requires payment of a commission agency fee, i.e. unlike a mandate contract it cannot be gratuitous; (ii) commission agency contracts are always related to trade activities while mandate contracts can also cover other activities; (iii) a commission agent must always act in his own name, whereas a mandatary can also act in the name of her principal and thus become a direct agent.[99]

Consequently, commission agency contracts must be regarded as a special type of mandate contract for trade operations.[100] This conclusion is supported by the wording of Article 423 of the Contract Law,[101] according to which the rules on mandate contracts are applicable where the commission agency rules do not provide for special regulations. Contracts concluded between foreign trade companies on behalf of their 'mandators' with foreign partners are trade-related and are carried out by foreign trade companies against a fee. Therefore, the related contracts must be regarded as commission agency agreements.[102]

The commission agency rules of the Contract Law, however, do not acknowledge the concept of indirect agency. On the contrary, Article 421 of the Contract Law clearly states:

> "If the commission agent concludes a contract with a third party, he/she directly acquires rights and incurs obligations thereunder.
>
> "If the third party fails to perform his obligations, thereby causing injury to the principal, the commission agent is liable for damages, unless the agent and the principal have agreed otherwise."[103]

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98 PRC Contract Law, *supra* note 19.

99 *See* Li Yanfang, *supra* note 44, at 352; Yang Zhenshan & Liang Shuwen, *supra* note 58, at 1570; Li Jianguo & Min Weiguo, *supra* note 45, at 514.

100 Xie Liangquan, *supra* note 46, at 986; *but see*Jiang Ping, *supra* note 53, at 35; WU JINBIAO, HETONGFA YUANLI YU SHIYONG [(BASIC PRINCIPLES AND APPLICATION OF THE CONTRACT LAW] 405 (1999).

101 Article 423 of the *Contract Law* reads as follows: "Matters not provided for in this chapter are governed by the relevant provisions for mandate contracts."

102 *Compare* Li Yanfang, *supra* note 44, at 352-353.

103 *See also* Xie Liangquan, *supra* note 46, at 997-998; Li Yanfang, *supra* note 44, at 351.

This leads to an awkward situation with regard to the interpretation of Articles 402 and 403. Articles 402 and 403 are based on the original intention to transfer the contractual liability of foreign trade companies when concluding contracts with foreign partners to their principals/mandators. However, Articles 402 and 403 *Contract Law* are not applicable in these situations due to the more special regulations on commission agency agreements.

One could argue that because of their legislative background, Articles 402 and 403 must be applied if a Chinese company without foreign trade rights engages a foreign trade company for trade activities with foreign partners despite the rules on commission agency agreements. The future will show whether the Chinese judicial practice will share this opinion and ignore the clear wording[104] of the *Contract Law.*

In any event the described uncertainties could have been avoided if Articles 402 and 403 were included in a general part of the *Contract Law and* thus were made applicable to all types of contracts covered by the *Contract Law.* This, however, would have required the acknowledgement of the necessity to distinguish between the appointment of an agent and the underlying contractual relationship between agent and principal.

V. FINAL REMARKS

It was demonstrated that the rules on indirect agency contained in the PRC *Contract Law* raise many questions. The related uncertainties and problems may be caused by the fact that indirect agency is a common law institution whereas the PRC *Contract Law* is mainly civil law-inspired. One could say that indirect agency under the PRC *Contract Law* is like a common law animal under a civil law roof. Unfortunately, this common law animal has used the wrong entrance and ended up in the wrong room. Nevertheless, it must be fed (first of all by the Chinese legal profession) and it will be very interesting to watch this feeding process in the future.

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[104] *See* Li Yanfang, *supra* note 44, at 351.