

Dispute Resolution

Does an Arbitration Agreement bind the Undisclosed Principal to a Contract?

Introduction

In June 2020, the Beijing No. 4 Intermediate People's Court ("**Court**") granted a civil ruling ("**Beijing Ruling**") which dismissed the application to set aside an arbitral award issued by the China International Economic and Trade Arbitration Commission ("**CIETAC**"). In the Beijing Ruling, the Court held that in the situation of an undisclosed agency, although the relevant contract was signed by the agent, the arbitration agreement therein would nonetheless bind the undisclosed principal to the contract. This is one of the few cases where a court has extended the effect of the arbitration agreement to a party who did not sign the relevant contract.

Key Points

Factual Background

On 28 April 2015, the applicant ("**Ivatherm**") and a third party ("**High Hope**") signed a distribution contract for the sale and purchase of certain goods ("**Distribution Contract**"). Thereafter, the respondent ("**Xia Shi**") was incorporated. On 8 May 2015, Xia Shi and High Hope signed an import agency contract, authorising High Hope to conclude and execute the Distribution Contract as an agent of Xia Shi ("**Agency Contract**"). Clause 14.3 of the Distribution Contract provided that any dispute arising out of or in connection with the Distribution Contract was to be resolved by arbitration administered by the CIETAC Shanghai Branch.

Due to disputes in connection with the quality of the goods, Xia Shi commenced arbitral proceedings against Ivatherm in accordance with Clause 14.3 of the Distribution Contract. In May 2020, CIETAC issued an arbitral award in favour of Xia Shi.

Ivatherm applied to the Court to set aside the arbitral award on the ground that there was no arbitration agreement between Ivatherm and Xia Shi. Xia Shi argued that the arbitration agreement in the Distribution Contract (signed by Ivatherm and High Hope) should be deemed as an arbitration agreement between Ivatherm and Xia Shi, and the arbitral award should therefore not be set aside.



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The Court's Decision

Article 402 of the Contract Law of the People's Republic of China ("**Contract Law**") states that:

"If the agent, within the scope of the power delegated by the principal, concludes a contract with a third party in its own name, and the third party is aware of the agency relationship between the agent and the principal at the time of concluding the contract, the contract shall be directly binding on the principal and the third party, unless there is conclusive evidence proving that the said contract is only binding on the agent and the third party."

Accordingly, the Court found in favour of Xia Shi for the following reasons:

1. There was an undisclosed agency relationship between Xia Shi and High Hope.
 - a. Although Xia Shi had not been incorporated at the time the Distribution Contract was signed, Ivatherm had already been informed that Xia Shi would soon be incorporated. As Xia Shi was eventually incorporated, High Hope's actions before the incorporation of Xia Shi were binding on Xia Shi.
 - b. The Court also found that Luxandra, the actual controller of Ivatherm, had attended Xia Shi's distributor conference in Shanghai. This strengthened the Court's impression that the *de facto* counterpart to Ivatherm was Xia Shi.
2. Ivatherm was aware of this relationship at the time the Distribution Contract was signed.
 - a. From the very beginning, the actual controller and beneficial shareholder of Xia Shi (an individual named Cheng Wei) had been involved in the precontractual negotiations relating to the terms of the Distribution Contract.
 - b. After disputes arose between the parties, Xia Shi communicated directly with Ivatherm on the quality issue. Ivatherm did not question Xia Shi's standing. Therefore, the Court found that Ivatherm had known and acknowledged that Xia Shi was the principal of High Hope in the Distribution Contract.
3. High Hope's signing of the Distribution Contract was within the scope of the authority granted by Xia Shi.

It is worth mentioning that Clause 14.10 of the Distribution Contract provided that the clauses therein were made solely for the benefit of the contracting parties, their respective successors or permitted assignees, and shall not be construed as conferring any rights, including any rights of a third party

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beneficiary, on any third party. However, the Court held that this clause did not affect or nullify the undisclosed principal's rights under Article 402 of the Contract Law.

Influence of the Beijing Ruling

This is the first time that a Chinese court has applied the doctrine of undisclosed agency relationship to an arbitration agreement. This is also the first time a Chinese court clearly held that an arbitration agreement binds the undisclosed principal.

The Beijing Ruling shows that the doctrine of privity of contract can be "overridden" in special circumstances, e.g. undisclosed agency. This is, however, not inconsistent with the spirit behind the doctrines, as the undisclosed agent signs the contract merely for and on behalf of the undisclosed principal. In other words, the undisclosed principal can be regarded as the *de facto* contracting party.

There is no doubt that the Beijing Ruling is a landmark ruling. However, it is arguable that the court had placed too much emphasis on the intimate participation of Xia Shi in negotiating and performing the Distribution Contract. According to the wording of Article 402 of the Contract Law, as long as the contracting party has knowledge of the undisclosed agency relationship, the contract shall bind the undisclosed principal. The undisclosed principal's involvement in the negotiation and performance of the Distribution Agreement should only be deemed as evidence of such knowledge; it should not be considered as a condition precedent for the arbitration agreement to bind the undisclosed principal.

Additionally, the Beijing Ruling suggested that the arbitration agreement shall "*bind*" the undisclosed principal. This likely means that the contracting party could in turn commence arbitration against an undisclosed principal. We look forward to this issue being clarified in future cases.

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